

JOBS TAX CREDIT

JOINT HEARINGS
BEFORE THE
SUBCOMMITTEE ON ADMINISTRATION OF
THE INTERNAL REVENUE CODE
OF THE
COMMITTEE ON FINANCE
AND THE
SELECT COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE
NINETY-FIFTH CONGRESS
SECOND SESSION

—————
JULY 18 AND 26, 1978
—————

Printed for the use of the
Committee on Finance and the Select Committee on Small Business



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JOB TAX CREDIT

TUESDAY, JULY 18, 1978

U.S. SENATE,
SELECT COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON ADMINISTRATION OF THE
INTERNAL REVENUE CODE OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The joint committees met, pursuant to notice, at 9:35 a.m., in room 221, Dirksen Senate Office Building, Hon. Floyd K. Haskell (chairman of the subcommittee) presiding.

Present: Senators Haskell, Long, Dole, and Packwood.

[The committee press release announcing these hearings follows:]

[Press release]

SUBCOMMITTEE ON ADMINISTRATION OF THE INTERNAL REVENUE CODE ANNOUNCES JOINT HEARINGS WITH SENATE SELECT COMMITTEE ON SMALL BUSINESS ON JOB TAX CREDIT—ADMINISTRATIVE PROBLEMS AND PROPOSED CHANGES

Senator Floyd K. Haskell (D-Colo.), Chairman of the Subcommittee on Administration of the Internal Revenue Code, today announced that the Subcommittee, together with the Senate Select Committee on Small Business, will hold hearings on July 18, 1978 and July 26, 1978. The hearings will begin at 9:30 a.m. in room 2221, Dirksen Senate Office Building.

The purpose of the hearings is to look at any administrative problems arising from the existing jobs tax credit (which was signed into law in May 1977 and expires in 1980), possible improvements to the existing provisions, and the Administration's proposals for a new jobs tax credit.

Senator Haskell stated that "Congress needs to investigate whatever problems may have arisen under the existing jobs tax credit before it turns to the President's proposals for a new 'targeted' credit—which is part of his Urban Program. This subject, because of the mixture of tax, urban policy and welfare issues, is a complex one, and it should not be considered hastily."

Requests to testify.—Persons who desire to testify at the hearings should submit a written request to Michael Stern, Staff Director, Committee on Finance, room 2227, Dirksen Senate Office Building, Washington, D.C. 20510, by no later than close of business on Thursday, July 13, 1978.

Legislative Reorganization Act.—Senator Haskell stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify must comply with the following rules:

- (1) A copy of the statement must be filed by the close of business two days before the day the witness is scheduled to testify.
- (2) All witnesses must include with their written statement a summary of the principal points included in the statement.
- (3) The written statements must be types on letter-size paper (not legal size) and at least 75 copies must be submitted by the close of business the day before the witness is scheduled to testify.

(4) Witnesses are not to read their written statements to the Committee, but are to confine their ten-minute oral presentations to a summary of the points included in the statement.

(5) Not more than ten minutes will be allowed for oral presentation.

Written testimony.—Senator Haskell stated that the Subcommittee would be pleased to receive written testimony from those persons or organizations who wish to submit statements for the record. Statements submitted for inclusion in the record should be typewritten, not more than 25 double-spaced pages in length and mailed with five (5) copies by Thursday, August 3, 1978, to Michael Stern, Staff Director, Committee on Finance, room 2227, Dirksen Senate Office Building, Washington, D.C. 20510.

Senator HASKELL. The joint hearing of the Select Committee on Small Business and the Committee on Finance Subcommittee on the Administration of the Internal Revenue Code will commence.

I have a brief statement, ladies and gentlemen, that I would like to make. First, let me say it is a delight to have the administration on my side for a change. They did not seem to think very much of the jobs credit a year ago and now it seems the light has dawned.

When we convened a similar hearing last year on February 22, the circumstances surrounding jobs and the related credit were very different from those faced today. At that time, we had something around 8 percent unemployment. We had a rather poor use of industrial capacity, and we were looking at an entirely different economic picture.

Today, for example, today the unemployment rate is 5.7. Since that hearing a year ago, the civilian employment has increased by 4.6 million persons. This is a staggering increase.

Civilian unemployment has decreased by 1.5 million, while the people who are active participants in the labor force has increased substantially.

I think that we all would agree that a 1 percent increase in unemployment costs the Federal Treasury between \$16 billion and \$18 billion in unemployment insurance, welfare, and other social benefits and lost tax revenue. That means that, today, the Federal Treasury is saving somewhere between \$32 billion and \$36 billion because of the decrease in unemployment.

Ever since I have been in the Senate, we have faced high unemployment that necessitated Federal deficit spending to stimulate job creation. As these conditions of unemployment change, our dependence on stimulative fiscal policy should also change.

Therefore, today we are considering several proposals that would target such a job credit to certain populations as opposed to the existing credit which is available to any employer who increases his or her employment over a base period.

Finally, the players have changed. As I mentioned previously, in February of 1977, the only persons interested in the jobs credit were a few Congresspersons and the Small Business Committee.

The purpose of this hearing is to examine this problem; particularly the administrative problems of the existing jobs credit, and to consider the merits of other job credits approaches, especially targeting. We want to consider whether targeting will work and the simplest way to do it.

We also want to inquire as to the administration's willingness to publicize and support any revised or extended credit in contrast to the notable lack of support for the present program.

These hearings have a particular urgency, in that the existing credit is scheduled to expire at the end of 1978. This day of discussion, together with the hearings scheduled for July 26, should prepare the Finance Committee to address the extension or revision of the existing program.

This committee is obviously interested in achieving the most efficient use of its tax expenditures for the creation of jobs. It is highly desirable to use the private enterprise system to decrease unemployment. The administration's proposal seeks to aid employment through private enterprise in the area where it is astronomically high—that is in the late teens and early twenties.

I am not wedded to the existing proposal or to any proposal. We are here today to see what is going to work, and what will work best.

So we look very much forward to hearing from you, Mr. Packer.

Maybe Senator Packwood has a statement.

Senator PACKWOOD. I have no statement.

STATEMENT OF HON. ARNOLD H. PACKER, ASSISTANT SECRETARY FOR POLICY, EVALUATION, AND RESEARCH, DEPARTMENT OF LABOR

Mr. PACKER. Thank you, Mr. Chairman. With me on my left is Bob Lerman and on my right, Hugh Pitcher, from our staff. We are very happy to be here today to discuss employment tax credits, especially at a time when the administration and yourself are in some agreement.

Expanding employment has been an urgent goal throughout the seventies. With unemployment rates averaging 6.5 percent during that period, no one can doubt that the economy has generated too few jobs for the Nation's expanding work force.

Although employment rose a healthy 15 percent between 1970 and 1977, the labor force increased by nearly 18 percent.

Part of the employment problem has been due to recessions and economic slowdowns. Since we have not been able to eliminate the business cycle, we face long periods when large numbers of able workers cannot find jobs. In fact, over the entire post-World War II period, the United States has had an unemployment rate of 4 percent or less in only 1 out of every 3 years. I think it is very important, when looking at targeted credits, to recognize that usually there is not full employment. So, to some extent, targeted credits will give the advantage to one group at the expense of some other.

A second part of the employment problem, one that we have with us today, is the structurally unemployed workers who cannot find jobs, or decent jobs, during times of economic prosperity. Workers with low skills or education, young workers, low-income heads of families, welfare recipients, black workers, and workers living in depressed areas are heavily represented among the structurally unemployed.

The administration and the Congress have worked together to deal with these two problems of cyclical and structural unemployment. We have tried to reach a balance between public and private employment and the stimulus package included the expansion of direct public job creation, as well as you have mentioned, the jobs tax credit aimed at the private sector.

Today, although aggregate unemployment still remains well above the full employment level, the problem we face is increasingly structural. In response to the changing nature of the problem, we have proposed a targeted program focused on disadvantaged youth.

We are still aiming at a mixed public-private approach. We are calling for a continuation of a substantial public service employment program of 725,000 persons, increases in training, and a special, private-sector initiate program with industry counselors to move our public programs more toward the private sectors.

But we are also calling for the employment tax credit.

The question we must address today is how employment tax credits can expand private employment opportunities for disadvantaged workers. My testimony discusses some of the experience with the existing credit—the jobs tax credit. I will just briefly note some of the findings on an initial survey.

We found that large firms learn quickly about the credit, and perhaps 90 percent know about it. Small firms have been slower to learn. That is, by February of this year, 90 percent of the firms with over 500 employees but only 30 percent of the firms with less than 10 employees knew about the credit. Only 6 percent of the firms which knew about the credit claimed that they changed their employment behavior as a result of that credit.

The other existing employment tax credits are the WIN and welfare tax credits, which are structural tax credits and have not been as successful as we had hoped. In a typical year, employers have claimed WIN credits on behalf of about 30,000 workers. That is less than 1 percent of all heads of AFDC families and only about 5 to 6 percent of employed AFDC families.

In other words, we could spend almost 20 times as much without increasing employment among those groups at all, if everyone who was eligible for such a credit would have a credit claimed for them.

I now would like to turn to the proposals for changing the existing employment tax credit that the administration has proposed.

The purpose of the new targeted credit is to reduce structural unemployment and to provide better private-sector opportunities to disadvantaged young workers. We believe that the targeted credit will compensate employers for the lack of prior work experience of disadvantaged youth; in that sense, it will be fair and not a windfall to employers.

By reducing the unemployment of disadvantaged youth, we hope to be able to achieve our 4-percent unemployment goal without encountering bottleneck shortages.

Under the proposal, employers could claim credits for hiring disadvantaged youths, aged 18 to 24, as well as handicapped workers of any age. The credit would equal 33 percent of the youth's wages, up to \$6,000 in the first year, and 25 percent in the second year. Up to \$6,000 would be the base in both cases.

Since firms would have to reduce the wages deductible as business expenses, the amount of the credit will be much less. If they are in the 50-percent tax bracket, of course, the savings would only be \$1,500. Since some of the youth will earn less than \$6,000, we expect the cost to the Treasury to be \$1,050 for the average worker in the first year and \$850 in the second.

The youths would have to work full time—over 30 hours per week—and would have to be employed a minimum of 75 days to qualify. To prevent wholesale substitution of workers who are already onboard by new workers and to limit the windfalls, no firm could claim the credit for more than 20 percent of its workers.

To qualify as disadvantaged, a youth would have to meet the criteria of the Comprehensive Employment and Training Act, the CETA program—that is, their incomes would have to be less than 70 percent of the Bureau of Labor Statistics lower living standard.

Senator HASKELL. Who finds out about that income? Is that a simple certification, or do you have to go through some process of filling out forms and having inspectors?

Mr. PACKER. No, it is a simple certification now. It is used now for entry into the CETA program. The Employment Service does it, in general, for the CETA program and it works rather smoothly.

Senator HASKELL. Would I be able to go—assuming I was lucky enough to be 18 years old—could I just go to an employer and certify that my income was zero, or would I have to go to some agency and get them to fill out a form and give me a certificate and then go to the employer?

Mr. PACKER. You would have to go to the Employment Service first. And we think the program will be more effective because it is tied to the CETA system. That is, the CETA system's purpose is to have these young people employed. They have a representative selling the young person to a firm. They would have this credit to make it more advantageous. So that the publicity would be on a one on one basis for a particular individual.

The unemployment rates of these young people, disadvantaged youth, were over 30 percent in March 1977 and are most likely only slightly under 30 percent now. We estimate that the revenue loss associated with the targeted tax credit will be about \$350 million in the next fiscal year. It will rise to \$1½ billion by fiscal 1983 in order to pay for 1.8 million person-years of employment in that year.

If the experience is as limited for the WIN and welfare credits, of course, the loss to the Treasury will be much less. But if our assumption is correct, we expect additional youth employment of 160,000—that is, of the 1.8 million, only 160,000 will be new jobs, because employers are likely to claim the credit for those whom they would have hired anyway.

These assumptions imply a cost per job of \$9,375. The accuracy is spurious. It could be substantially different from that, but our best estimates are on the order of \$9,000 to \$10,000.

In addition to stimulating new jobs, we think the subsidy will allow the youth to bargain for better jobs.

The idea of the targeted approach is to relieve the structural unemployment problem that is the barrier to full employment. In order to increase the total number of jobs, we need macroeconomic policy to sop up the extra labor that becomes available if those who are structurally unemployed can become employed. One is able to do that without creating the inflationary pressures which general macroeconomic policies, or untargeted approaches, would create if we tried to get to 4 percent unemployment.

I would like to finally turn to the congressional proposal, in particular, that was put forth by Senators Moynihan, Long, and Cranston, who recommend several important changes in the current WIN and welfare credit.

They propose raising the rate of subsidy from 20 percent to 50 percent during the first year of employment; providing subsidies for the second and third years of employment with the same firm at rates of 33 and 25 percent; limiting the wage over which the subsidy applies to \$6,000 in 1979 and have it increase at the same rate as the minimum wage increases; and finally, allowing nonprofit employees to receive tax credits similar to those received by for-profit employers.

The administration opposes this proposal. We oppose first the size of the credit. The new credit would permit firms to claim the credit, as well as the full wage deduction. If the firm hired a welfare recipient at a \$6,000 salary and was in a 50-percent tax bracket, they would gain \$3,000 in reduced tax liability and another \$3,000 as a tax credit, which would make hiring the welfare recipient essentially free, except for social security taxes.

Senator HASKELL. The present job credit prevents double dipping. Does Senator Moynihan's tax credit prevent double dipping?

Mr. PACKER. As I understand it, the current welfare tax credit, not—

Senator HASKELL. Oh, I am talking about the current credit that I proposed.

Mr. PACKER. Yours does not. The Senator Long-Moynihan proposal would allow double dipping, and the current welfare tax credit allows double dipping.

We do not believe such subsidies of that size are correct.

Second, we oppose extending eligibility to individuals in nonprofit organizations, especially in the household sector. We do not believe Federal tax expenditures should subsidize dead end jobs in the household sector, especially since persons in above 50 percent tax brackets could actually make a profit by hiring somebody if they got the tax credit and a 60 or 70 percent deduction.

Finally, and perhaps most importantly from my point of view, we believe that any major change in the welfare system should be considered in the broader context of welfare reform. It is true that the enhanced credits could stimulate new jobs for welfare recipients. If, however, such success were achieved, it could create a serious danger. As jobs became easier to obtain for AFDC mothers heading families, unemployment could increase among low-income heads of two-parent families.

In States that provide AFDC-UF, such family heads might be pushed onto welfare. In States that do not, displaced heads of two-parent families might face severe poverty, and could only turn to food stamps.

A vastly expanded credit could contribute to the breakup of low-income families by increasing unemployment within those families.

The danger is not entirely the fault of the credit proposed by Senators Moynihan and Long. It is largely the fault of a welfare system that excludes very low-income two-parent families.

If the President's welfare reform proposal were enacted, employment opportunities for poor two-parent families would be equal to, or symmetrical to, one-parent families.

In summary, the administration believes that any employment tax credit should be only one element in a larger, overall structural employment strategy, and tax credits should be targeted especially in this time of increased danger of inflation.

In this environment, it is best to proceed with caution. The administration is moving cautiously by limiting employment tax credits to a target group that clearly faces substantial structural unemployment.

We view the credit as one of several tools for relieving the severity of unemployment among disadvantaged youth. We will follow the impact of the credit, the youth credit, carefully, and we believe though that it will improve the position of those least able to compete in the labor market today.

Thank you, and I will try to answer your questions.

Senator HASKELL. Thank you, Mr. Secretary.

I was distressed to hear that the majority of people employing 10 or less people had no knowledge of the existing job credit. Can you explain briefly what efforts your Department might have made to publicize the existence of that credit?

Mr. PACKER. The Department has made little effort. The Department primarily works with low-income people who are disadvantaged and the credit applied broadly. The Treasury, I believe, took the lead in promoting the idea of the credit.

Senator HASKELL. I do not think they did a very good job—at least, that is my impression. I would hope that if we do extend the existing job credit that your Department, as the Department that is charged, in effect, with seeing that people have work opportunity, does its best. Possibly you could submit for the record a suggested information program that you could indulge in, both in the existing credit, if it is extended, and in the administration program.

Would you submit that for the record?

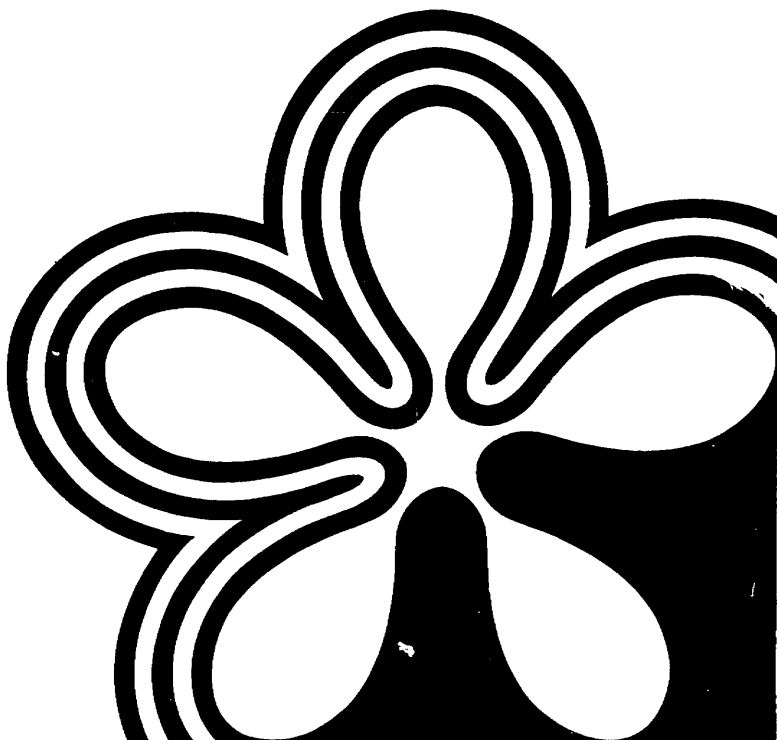
Mr. PACKER. Yes, we will.

[The following was subsequently supplied for the record:]

Employer's Reference Guide



U.S. Department of Labor
U.S. Department of Health, Education and Welfare
1978



This guide contains the relevant sections of the statute which established the Work Incentive (WIN) tax credit, namely, the Revenue Act of 1971. This statute was amended in 1975, 1976, and 1977. The amendments are noted in the margins, so that the current status, as of February, 1978, is presented.

There is also a brief explanation of the more significant terms used in the statutes.

This guide is not a complete exposition of the statutes. For further information, contact the United States Internal Revenue Service or a tax specialist.

85 Stat.] PUBLIC LAW 92-178—DEC. 10, 1971

PUBLIC LAW 92-178

An Act

December 10, 1971

H. R. 10947

To provide a job development investment credit, to reduce individual income taxes, to reduce certain excise taxes, and for other purposes.

As it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE, ETC.

Revenue Act
of 1971.

(a) SHORT TITLE.—This Act may be cited as the "Revenue Act of 1971".

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- TITLE III— STRUCTURAL IMPROVEMENTS
- TITLE IV— EXCISE TAX
- TITLE V— DOMESTIC INTERNATIONAL SALES CORPORATIONS
- TITLE VI— JOB DEVELOPMENT RELATED TO WORK INCENTIVE PROGRAM
(Only Title VI amendments are traced here)
- Sec. 601. Tax credit for certain expenses incurred
 in work incentive program.
- TITLE VII— TAX INCENTIVES FOR CONTRIBUTIONS TO CANDIDATES FOR PUBLIC OFFICE
- TITLE VIII—FINANCING OF PRESIDENTIAL ELECTION CAMPAIGNS



TITLE VI—JOB DEVELOPMENT RELATED TO WORK INCENTIVE PROGRAM

SEC. 601. TAX CREDIT FOR CERTAIN EXPENSES INCURRED IN WORK INCENTIVE PROGRAM.

(a) ALLOWANCE OF CREDIT.—Subpart A of part IV of subchapter A of chapter 1 (relating to credits allowable) is amended by renumbering section 40 as section 42, and by inserting after section 39 the following new section:

68A Stat. 12;
79 Stat. 167.

“SEC. 60. EXPENSES OF WORK INCENTIVE PROGRAMS.

“(a) GENERAL RULE.—There shall be allowed, as a credit against the tax imposed by this chapter, the amount determined under subpart C of this part.

infra.

“(b) REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section and subpart C.”

“(b) COMPUTATION OF CREDIT.—Part IV of subchapter A of chapter 1 (relating to credits against tax) is amended by adding at the end thereof the following new subpart:

“Subpart C—Rules for Computing Credit for Expenses of Work Incentive Programs

“Sec. 50A. Amount of credit.

“Sec. 50B. Definitions; special rules.

“SEC. 50A. AMOUNT OF CREDIT.

“(a) DETERMINATION OF AMOUNT.—

“(1) GENERAL RULE.—The amount of the credit allowed by section 40 for the taxable year shall be equal to 20 percent of the work incentive program expenses (as defined in section 50B(a)).

“(2) LIMITATION BASED ON AMOUNT OF TAX.—Notwithstanding paragraph (1), the credit allowed by section 40 for the taxable year shall not exceed—

“(A) so much of the liability for tax for the taxable year as does not exceed _____ plus

“(B) 50 percent of so much of the liability for tax for the taxable year as exceeds _____

“(3) LIABILITY FOR TAX.—For purposes of paragraph (2), the liability for tax for the taxable year shall be the tax imposed by this chapter for such year, reduced by the sum of the credits allowable under—

“(A) section 33 (relating to foreign tax credit),

“(B) section 35 (relating to partially tax exempt interest),

“(C) section 37 (relating to retirement income),

“(D) section 38 (relating to investment in certain depreciable property), and

“(E) section 41 (relating to contributions to candidates for public office).

For purposes of this paragraph, any tax imposed for the taxable year by section 56 (relating to minimum tax for tax preferences), section 531 (relating to accumulated earnings tax), section 541 (relating to personal holding company tax), or section 1378 (relating to tax on certain capital gains of subchapter S corporations), and any additional tax imposed for the taxable year by section 1351(d)(1) (relating to recoveries of foreign expropriation losses), shall not be considered tax imposed by this chapter for such year.

“(4) MARRIED INDIVIDUALS.—In the case of a husband or wife who files a separate return, the amount specified under subparagraphs (A) and (B) of paragraph (2) shall be _____ in lieu of _____. This paragraph shall not apply if the spouse of the taxpayer has no work incentive program expenses for, and no unused credit carryback or carryover to, the taxable year of such spouse which ends within or with the taxpayer's taxable year.

Amended to:
\$50,000
by P.L. 94-455
Sec 2107 (a)
[1] 10-4-76

Amended to:
\$25,000 by
P.L. 94-455
Sec 2107 (a)
[2] (A); amended to:
\$50,000
by P.L. 94-455
Sec 2107 (a)
[2] (B) 10-4-76

Ante, p. 553.
Post, p. 556.

68A Stat. 13.
26 USC 33.
76 Stat. 24, 33.
76 Stat. 962.

Post, p. 560.

83 Stat. 580.
68A Stat. 179,
182.
80 Stat. 113.
80 Stat. 99.

PUBLIC LAW 92-178—DEC. 10, 1971 [85 Stat.

"(5) CONTROLLED GROUPS.—In the case of a controlled group, the \$50,000 amount specified under paragraph (2) shall be reduced for each component member of such group by apportioning \$50,000 among the component members of such group in such manner as the Secretary or his delegate shall by regulations prescribe. For purposes of the preceding sentence, the term 'controlled group' has the meaning assigned to such term by section 1563(a).

75 Stat. 120.
83 Stat. 602.

Amended to:
\$50,000 by
P.L. 94-455
Sec 2107 (a)
[3] 10-4-76

"(6) LIMITATION WITH RESPECT TO NONBUSINESS ELIGIBLE EMPLOYEES.—Notwithstanding paragraph (1), the credit allowed by section 40 with respect to Federal welfare recipient employment incentive expenses paid or incurred by the taxpayer during the taxable year to an eligible employee whose services are not performed in connection with a trade or business of the taxpayer shall not exceed \$1,000."

New inclusion:
P.L. 94-12
Title IV
Sec 401 (a) [1]
3-29-75

"(b) CARRYBACK AND CARRYOVER OF UNUSED CREDIT.—

"(1) ALLOWANCE OF CREDIT.—If the amount of the credit determined under subsection (a) (1) for any taxable year exceeds the limitation provided by subsection (a) (2) for such taxable year (hereinafter in this subsection referred to as 'unused credit year'), such excess shall be—

"(A) a work incentive program credit carryback to each of the 3 taxable years preceding the unused credit year, and

"(B) a work incentive program credit carryover to each of the 7 taxable years following the unused credit year, and shall be added to the amount allowable as a credit by section 40 for such years, except that such excess may be a carryback only to a taxable year beginning after December 31, 1971. The entire amount of the unused credit for an unused credit year shall be

Ante, p. 553.

86 Stat.] PUBLIC LAW 92-178—DEC. 10, 1971

carried to the earliest of the 10 taxable years to which (by reason of subparagraphs (A) and (B)) such credit may be carried, and then to each of the other 9 taxable years to the extent that, because of the limitation contained in paragraph (2), such unused credit may not be added for a prior taxable year to which such unused credit may be carried.

"(2) LIMITATION.—The amount of the unused credit which may be added under paragraph (1) for any preceding or succeeding taxable year shall not exceed the amount by which the limitation provided by subsection (a) (2) for such taxable year exceeds the sum of—

"(A) the credit allowable under subsection (a) (1) for such taxable year, and

"(B) the amounts which, by reason of this subsection, are added to the amount allowable for such taxable year and attributable to taxable years preceding the unused credit year.

"(c) EARLY TERMINATION OF EMPLOYMENT BY EMPLOYER, ETC.—

"(1) GENERAL RULE.—Under regulations prescribed by the Secretary or his delegate—

"(A) WORK INCENTIVE PROGRAM EXPENSES.—If the employment of any employee with respect to whom work incentive program expenses are taken into account under subsection (a) is terminated by the taxpayer at any time during the first ~~12 months~~ of such employment (whether or not consecutive) or before the close of the ~~12th calendar month~~ after the calendar ~~month~~ in which such employee completes ~~12 months~~ of employment with the taxpayer, the tax under this chapter for the taxable year in which such employment is terminated shall be increased by an amount (determined under such regulations) equal to the credits allowed under section 40 for such taxable year and all prior taxable years attributable to work incentive program expenses paid or incurred with respect to such employee.

"(B) CARRYBACKS AND CARRYOVERS ADJUSTED.—In the case of any termination of employment to which subparagraph (A) applies, the carrybacks and carryovers under subsection (b) shall be properly adjusted.

"(2) SUBSECTION NOT TO APPLY IN CERTAIN CASES.—

"(A) IN GENERAL.—Paragraph (1) shall not apply to—

"(i) a termination of employment of an employee who voluntarily leaves the employment of the taxpayer,

"(ii) a termination of employment of an individual who, before the close of the period referred to in paragraph (1) (A), becomes disabled to perform the services of such employment, unless such disability is removed before the close of such period and the taxpayer fails to offer reemployment to such individual, ~~or~~

"(iii) a termination of employment of an individual, if it is determined under the applicable State unemployment compensation law that the termination was due to the misconduct of such individual.

Amended to:

1. "90 days"
2. "90th calendar day"
3. "the day" by P.L. 94-455 Sec 2107 (b) [1], [2], and [3] 10-4-76

Ints. p. 553.

Deleted by:

P.L. 94-12
Title IV
Sec 401 (a) [2] [A]
3-29-75

Amended to:

“, or” by P.L. 94-12
Title IV Sec 401
(a) [2] [B] 3-29-75

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(iv) a termination of employment of an individual with respect to whom Federal welfare recipient employment incentive expenses (as described in section 501) (a)(2)) are taken into account under subsection (a), or

(v) a termination of employment of an individual due to a substantial reduction in the trade or business operations of the taxpayer.

New Inclusion:
P.L. 94-12
Title IV
Sec 401 (a) [2]
[C] 3-29-76

New Inclusion:
P.L. 94-455
Sec 2107 (c) [3]
10-4-76

“(B) CHANGES IN FORM OF BUSINESS, ETC.—For purposes of paragraph (1), the employment relationship between the taxpayer and an employee shall not be treated as terminated—

“(1) by a transaction to which section 381(a) applies, if the employee continues to be employed by the acquiring corporation, or

“(2) by reason of a mere change in the form of conducting the trade or business of the taxpayer, if the employee continues to be employed in such trade or business and the taxpayer retains a substantial interest in such trade or business.

“(3) SPECIAL RULE.—Any increase in tax under paragraph (1) shall not be treated as tax imposed by this chapter for purposes of determining the amount of any credit allowable under subpart A.

“(d) FAILURE TO PAY COMPARABLE WAGES.—

“(1) GENERAL RULE.—Under regulations prescribed by the Secretary or his delegate, if during the period described in subsection (c)(1)(A), the taxpayer pays wages (as defined in section 50B (b)) to an employee with respect to whom work incentive program expenses are taken into account under subsection (a) which are less than the wages paid to other employees who perform comparable services, the tax under this chapter for the taxable year in which such wages are so paid shall be increased by an amount (determined under such regulations) equal to the credits allowed under section 40 for such taxable year and all prior taxable years attributable to work incentive program expenses paid or incurred with respect to such employee, and the carrybacks and carryovers under subsection (b) shall be properly adjusted.

“(2) SPECIAL RULE.—Any increase in tax under paragraph (1) shall not be treated as tax imposed by this chapter for purposes of determining the amount of any credit allowable under subpart A.

58A Stat. 124,
26 USC 381.

Infra.

Ante., p. 553.

26 USC 32.

85 Stat.] PUBLIC LAW 92-178—DEC. 10, 1971

- Ante*, p. 553.
- "(24) CREDIT UNDER SECTION 40 FOR WORK INCENTIVE PROGRAM EXPENSES.—The acquiring corporation shall take into account (to the extent proper to carry out the purposes of this section and section 40, and under such regulations as may be prescribed by the Secretary or his delegate) the items required to be taken into account for purposes of section 40 in respect of the distributor or transferor corporation."
- 84 Stat. 1846. (4) Section 56(a)(2) (relating to imposition of minimum tax for tax preferences) is amended—
- (A) by striking out "and" at the end of clause (ii),
- (B) by striking out "; and" at the end of clause (iii) and inserting in lieu thereof a comma, and
- (C) by inserting after clause (iii) the following new clauses:
- "(iv) section 40 (relating to expenses of work incentive program), and
- "(v) section 41 (relating to contributions to candidates for public office); and".
- (5) Section 56(c)(1) (relating to tax carryovers) is amended—
- (A) by striking out "and" at the end of subparagraph (B),
- (B) by striking out "exceed" at the end of subparagraph (C), and
- (C) by inserting after subparagraph (C) the following new subparagraphs:
- "(D) section 40 (relating to expenses of work incentive program), and
- "(E) section 41 (relating to contributions to candidates for public office), exceed".
- Post*, p. 560.
- (d) STATUTES OF LIMITATIONS AND INTEREST RELATING TO WORK INCENTIVE CREDIT CARRYBACKS.—
- (1) ASSESSMENT AND COLLECTION.—Section 6501 (relating to limitation on assessment and collection) is amended by adding at the end thereof the following new subsection:
- "(o) WORK INCENTIVE PROGRAM CREDIT CARRYBACKS.—In the case of a deficiency attributable to the application to the taxpayer of a work incentive program credit carryback (including deficiencies which may be assessed pursuant to the provisions of section 6213(b)(2)), such deficiency may be assessed at any time before the expiration of the period within which a deficiency for the taxable year of the unused work incentive program credit which results in such carryback may be assessed, or, with respect to any portion of a work incentive program credit carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, at any time before the expiration of the period within which a deficiency for such subsequent taxable year may be assessed."
- 68A Stat. 803;
83 Stat. 525.
- 68A Stat. 771.
- (2) CREDIT OR REFUND.—Section 6511(d) (relating to limitations on credit or refund) is amended by adding at the end thereof the following new paragraph:
- "(7) SPECIAL PERIOD OF LIMITATION WITH RESPECT TO WORK INCENTIVE PROGRAM CREDIT CARRYBACKS.—
- "(A) PERIOD OF LIMITATION.—If the claim for credit or refund relates to an overpayment attributable to a work incentive program credit carryback, in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be that period which ends with the expiration of the 15th day of the 40th month (or 30th month, in the case of a corporation) following the end of the taxable year of the unused work incentive program credit which results in such carry-
- 78 Stat. 858.

"SEC. 50B. DEFINITIONS; SPECIAL RULES.

"(a) **WORK INCENTIVE PROGRAM EXPENSES.**—For purposes of this subpart, the term 'work incentive program expenses' means the wages paid or incurred by the taxpayer for services rendered during the first 12 months of employment (whether or not consecutive) of employees who are certified by the Secretary of Labor as—

"(1) having been placed in employment under a work incentive program established under section 432(b)(1) of the Social Security Act, and

"(2) not having displaced any individual from employment.

81 Stat. 894.
47 USC 632.

Deleted by:
P.L. 94-12
Title IV
Sec 401 (a) (3)
3-29-75 and
substituted as
follows—

(a) WORK INCENTIVE PROGRAM EXPENSE.—

(1) **IN GENERAL.**—For purposes of this subpart, the term 'work incentive program expenses' means the sum of—

(A) the amount of wages paid or incurred by the taxpayer for services rendered during the first 12 months of employment (whether or not consecutive) of employees who are certified by the Secretary of Labor as—

(i) having been placed in employment under a work incentive program established under section 432(b)(1) of the Social Security Act, and

(ii) not having displaced any individual from employment, plus

(B) the amount of Federal welfare recipient employment incentive expenses paid or incurred by the taxpayer during the taxable year.

(2) **DEFINITION.**—For purposes of this section, the term 'Federal welfare recipient employment incentive expenses' means the amount of wages paid or incurred by the taxpayer for services rendered to the taxpayer before July 1, 1976, by an eligible employee.

(3) **EXCLUSIONS.**—No item taken into account under paragraph (1)(A) shall be taken into account under paragraph (1)(B). No item taken into account under paragraph (1)(B) shall be taken into account under paragraph 1(A).

New Inclusion:
P.L. 94-12
Title IV
Sec 401 (a) (3)
3-29-75

Amended to:
"for services rendered during the first 12 months of employment (whether or not consecutive)"
by: P.L. 94-455
Sec 2107 (e)
10-4-76

Amended to:
"before January 1, 1980"
by: P.L. 94-455
Sec 2107 (d)
10-4-76

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"(b) **WAGES.**—For purposes of subsection (a), the term 'wages' means only cash remuneration (including amounts deducted and withheld).

"(c) **LIMITATIONS.**—

"(1) **TRADE OR BUSINESS EXPENSES.**—No item shall be taken into account under subsection (a) unless such item is incurred in a trade or business of the taxpayer.

"(2) **REIMBURSED EXPENSES.**—No item shall be taken into account under subsection (a) to the extent that the taxpayer is reimbursed for such item.

"(3) **GEOGRAPHICAL LIMITATION.**—No item shall be taken into account under subsection (a) with respect to any expense paid or incurred by the taxpayer with respect to employment outside the United States.

"(4) **MAXIMUM PERIOD OF TRAINING OR INSTRUCTION.**—No item with respect to any employee shall be taken into account under subsection (a) after the end of the 24-month period beginning with the date of initial employment of such employee by the taxpayer.

"(5) **INELIGIBLE INDIVIDUALS.**—No item shall be taken into account under subsection (a) with respect to an individual who—

"(A) bears any of the relationships described in paragraphs (1) through (8) of section 152(a) to the taxpayer, or, if the taxpayer is a corporation, to an individual who owns, directly or indirectly, more than 50 percent in value of the outstanding stock of the corporation (determined with the application of section 267(c)),

"(B) if the taxpayer is an estate or trust, is a grantor, beneficiary, or fiduciary of the estate or trust, or is an individual who bears any of the relationships described in paragraphs (1) through (8) of section 152(a) to a grantor, beneficiary, or fiduciary of the estate or trust, or

"(C) is a dependent (described in section 152(a)(9)) of the taxpayer, or, if the taxpayer is a corporation, of an individual described in subparagraph (A), or, if the taxpayer is an estate or trust, of a grantor, beneficiary, or fiduciary of the estate or trust.

"(d) **SUBCHAPTER S CORPORATIONS.**—In case of an electing small business corporation (as defined in section 1371)—

"(1) the work incentive program expenses for each taxable year shall be apportioned pro rata among the persons who are shareholders of such corporation on the last day of such taxable year, and

"(2) any person to whom any expenses have been apportioned under paragraph (1) shall be treated (for purposes of this subpart) as the taxpayer with respect to such expenses.

"(e) **ESTATES AND TRUSTS.**—In the case of an estate or trust—

"(1) the work incentive program expenses for any taxable year shall be apportioned between the estate or trust and the beneficiaries on the basis of the income of the estate or trust allocable to each,

"(2) any beneficiary to whom any expenses have been apportioned under paragraph (1) shall be treated (for purposes of this subpart) as the taxpayer with respect to such expenses, and

"(3) the \$25,000 amount specified under subparagraphs (A) and (B) of section 50A (a) (2) applicable to such estate or trust shall be reduced to an amount which bears the same ratio to \$25,000 as the amount of the expenses allocated to the trust under paragraph (1) bears to the entire amount of such expenses.

"(f) **LIMITATIONS WITH RESPECT TO CERTAIN PERSONS.**—In the case of—

"(1) an organization to which section 593 applies,

"(2) a regulated investment company or a real estate investment trust subject to taxation under subchapter M (section 851 and following), and

"(3) a cooperative organization described in section 1381 (a),

rules similar to the rules provided in section 48(d) shall apply under regulations prescribed by the Secretary or his delegate.

Amended to:
"subsection
[a] [1] [A]" by
P.L. 94-12
Title IV
Sec 401 [a] [4]
[A] 3-29-75

Amended to:
"subsection
[a] [1] [A]" by
P.L. 94-12
Title IV
Sec 401 [a] [4]
[B] 3-29-75

6-A Stat. 43.
26 USC 152.

6-A Stat. 43.
26 USC 152.
72 Stat. 1607.

72 Stat. 1650;
78 Stat. 112.

Ante, p. 554.

76 Stat. 977;
83 Stat. 620.
68A Stat. 268;
83 Stat. 717.

76 Stat. 1045.
Ante, p. 507.

(g) ELIGIBLE EMPLOYEE.—

- (1) **ELIGIBLE EMPLOYEE.**—For purposes of subsection (a)(1) the term 'eligible employee' means an individual—
- (B) the term 'eligible employee' means an individual—
- (A) who has been certified by the ~~Secretary of Labor~~ by the appropriate agency of State or local government as being eligible for financial assistance under part A of title IV of the Social Security Act and as having continuously received such financial assistance during the 90 day period which immediately precedes the date on which such individual is hired by the taxpayer.
- (B) who has been employed by the taxpayer for a period in excess of 30 consecutive days on a substantially full-time basis.
- (C) who has not displaced any other individual from employment by the taxpayer, and
- (D) who is not a migrant worker.

The term 'eligible employee' includes an employee of the taxpayer whose services are not performed in connection with a trade or business of the taxpayer.

- (2) **MIGRANT WORKER.**—For purposes of paragraph (1), the term 'migrant worker' means an individual who is employed for services for which the customary period of employment by one employer is less than 30 days if the nature of such services requires that such individual travel from place to place over a short period of time.

(b) **EFFECTIVE DATE.**—The amendments made by this section with respect to federal welfare recipient employment incentive expenses shall apply to such expenses paid or incurred by a taxpayer to an eligible employee whom such taxpayer hires after the date of the enactment of this Act.

New Inclusion:
P.L. 94-12
Title IV
Sec 401 (a) (5)
[g] 3-29-76

inserted by:
P.L. 94-455
Sec 2107 (f)
10-4-76

(6) LIMITATION WITH RESPECT TO NONQUALIFYING ELIGIBLE EMPLOYEES.—Notwithstanding paragraph (1), the credit allowed by section 40 with respect to Federal welfare recipient employment incentive expenses paid or incurred by the taxpayer during the taxable year to an eligible employee whose services are not performed in connection with a trade or business of the taxpayer shall not exceed \$1,000."

Included by:
P.L. 94-12
Title IV
Sec 401 [a] [1]
3-29-75

(iv) a termination of employment of an individual with respect to whom Federal welfare recipient employment incentive expenses (as described in section 503 (a)(2)) are taken into account under subsection (a), or
(v) a termination of employment of an individual due to a substantial reduction in the trade or business operations of the taxpayer.

Included by:
P.L. 94-12
Title IV
Sec 401 [a] [2]
[C] 3-29-75

(a) WORK INCENTIVE PROGRAM EXPENSES.—

(1) IN GENERAL.—For purposes of this subpart, the term 'work incentive program expenses' means the sum of—

Included by:
P.L. 94-455
Sec 2107 [c] [3]

(A) the amount of wages paid or incurred by the taxpayer for services rendered during the first 12 months of employment (whether or not consecutive) of employees who are certified by the Secretary of Labor as—

Included by:
P.L. 94-12
Title IV
Sec 401 [a] [3]
3-29-75

(i) having been placed in employment under a work incentive program established under section 432(b)(1) of the Social Security Act, and

(ii) not having displaced any individual from employment, plus

(B) the amount of Federal welfare recipient employment incentive expenses paid or incurred by the taxpayer ~~during the taxable year~~

Amended to:
"for services rendered during the first 12 months of employment [whether or not consecutive]"
by: P.L. 94-455
Sec 2107 [e]
10-4-76

(2) DEFINITION.—For purposes of this section, the term 'Federal welfare recipient employment incentive expenses' means the amount of wages paid or incurred by the taxpayer for services rendered to the taxpayer ~~by an eligible employee~~ by an eligible employee.

Amended to:
"before January 1, 1967"
by: P.L. 94-455
Sec 2107 [d]
10-4-76

(3) EXCLUSION.—No item taken into account under paragraph (1)(A) shall be taken into account under paragraph (1)(B). No item taken into account under paragraph (1)(B) shall be taken into account under paragraph 1(A).

(g) **ELIGIBLE EMPLOYEE.**—

(1) **ELIGIBLE EMPLOYEE.**—For purposes of subsection (a)(1), the term "eligible employee" means an individual—

(A) who has been certified by the Secretary of Labor or by the appropriate agency of State or local government as being eligible for financial assistance under part A of title IV of the Social Security Act and as having continuously received such financial assistance during the 90-day period which immediately precedes the date on which such individual is hired by the taxpayer.

(B) who has been employed by the taxpayer for a period in excess of 30 consecutive days on a substantially full-time basis.

(C) who has not displaced any other individual from employment by the taxpayer, and

(D) who is not a migrant worker.

The term "eligible employee" includes an employee of the taxpayer whose services are not performed in connection with a trade or business of the taxpayer.

"(2) **MIGRANT WORKER.**—For purposes of paragraph (1), the term "migrant worker" means an individual who is employed for services for which the customary period of employment by one employer is less than 30 days if the nature of such services requires that such individual travel from place to place over a short period of time."

(b) **EFFECTIVE DATE.**—The amendments made by this section with respect to federal welfare recipient employment incentive expenses shall apply to such expenses paid or incurred by a taxpayer to an eligible employee whom such taxpayer hires after the date of the enactment of this Act.

Included by:
P.L. 94-12
Title IV
Sec 401 (a) (5)
(g) 3-29-75

Inserted by:
P.L. 94-455
Sec 2107 (f)
10-4-76

"SEC. 188. AMORTIZATION OF CERTAIN EXPENDITURES FOR ON-THE-JOB TRAINING AND CHILD CARE FACILITIES.

"(a) Allowance of Deduction.—At the election of the taxpayer, made in accordance with regulations prescribed by the Secretary or his delegate, any expenditure chargeable to capital account made by an employer to acquire, construct, reconstruct, or rehabilitate section 188 property (as defined in subsection (b)) shall be allowable as a deduction ratably over a period of 60 months, beginning with the month in which the property is placed in service. The deduction provided by this section with respect to such expenditure shall be in lieu of any depreciation deduction otherwise allowable on account of such expenditure.

"(b) Section 188 Property.—For purposes of this section, the term 'section 188 property' means tangible property which qualifies under regulations prescribed by the Secretary or his delegate as a facility for on-the-job training of employees (or prospective employees) of the taxpayer, or as a child care center facility primarily for the children of employees of the taxpayer; except that such term shall not include

"(1) any property which is not of a character subject to depreciation; or

"(2) property located outside the United States.

"(c) Application of Section.—This section shall apply only with respect to expenditures made after December 31, 1971, and before January 1, 1977."

Deleted by:
P.L. 95-30, Sec 402,
(a), (3), 5-23-77

Deleted by:
P.L. 95-30, Sec 402
(a), (2), 5-23-77

Amended to:
January 1, 1982
by P.L. 95-30,
Sec 402 (a), (1)
5-23-77

Definition of Terms

- * Applies to WIN Tax Credit
- ** Applies to Welfare Tax Credit

Work Incentive Program Expenses

[WINWAGES] - The term "work incentive program expenses" means the sum of . . .

- * A. . . the amount of wages paid or incurred by the taxpayer for services rendered during the first 12 months of employment (whether or not consecutive) of employees who are certified by the Secretary of Labor as,
 - having been placed in employment under a work incentive (WIN) program, and
 - not having displaced any individual from employment, plus
- ** B. . . the amount of Federal welfare recipient employment incentive expenses paid or incurred by the taxpayer for services rendered during the first 12 months of employment (whether or not consecutive).

No expenses taken into account under A may be considered under B. Likewise, no expenses claimed under B may be claimed under A.

- ** **Eligible Employee** - For purposes of the welfare tax credit, an 'eligible employee' means an individual

- A. who has been certified by the Secretary of Labor or by the appropriate agency of State or local government as being eligible for financial assistance under part A of Title IV of the Social Security Act and as having continuously received such financial assistance during the 90-day period which immediately precedes the date on which such individual is hired by the taxpayer,
- B. who has been employed by the taxpayer for a period in excess of 30 consecutive days on a substantially full-time basis,
- C. who has not displaced any other individual from employment by the taxpayer, and
- D. who is not a migrant worker.

The term 'eligible employee' includes an employee of the taxpayer whose services are not performed in connection with a trade or business of the taxpayer.

- ** **Federal Welfare Recipient Employment Incentive Expenses** - The amount of wages paid or incurred by the taxpayer for services rendered the taxpayer before January 1, 1980, by an eligible employee.
- ** **Wages** - The term 'wages' means only cash remuneration (including amounts deducted and withheld).

- ** **Amount of Tax Credit** - The amount of the tax credit allowed for the taxable year equal to 20 percent of the work incentive program expenses.
- ** **Limitation Based on the Amount of the Tax Credit** - The credit allowed for the taxable year shall not exceed \$50,000 plus 50 percent of the remaining tax liability for the year which exceeds \$50,000.
- ** **Unused Credit** - The amount of the credit for a tax year which exceeds \$50,000 plus 50 percent of the remaining tax liability for the year which exceeds \$50,000.
- ** **Unused Credit Year** - The taxable year in which there is an unused credit.
- * **Credit Carryback and Carryover** - Any unused credit may be carried back to each of the 3 taxable years preceding the unused credit year and each of the 7 taxable years following the unused credit year and may be added to the amount allowable as a credit for such years. Such excess may be a carryback only to December 31, 1971. The entire amount of the unused credit for an unused credit year shall be carried to the earliest of the 10 taxable years described above to which such credit may be carried and then to each of the other 9 taxable years. The credit may not be added for a taxable year prior to which any unused credit may have been applied.
- ** **Credit Carryback and Carryover** - Same as above, except carryback is allowed only to April 1, 1975.
- ** **Limitation on Carryover and Carryback** - The amount of the unused credit which may be added for any preceding or succeeding taxable year shall not exceed the amount by which the limitation on the amount of the tax credit (\$50,000) plus 50 percent of the remaining tax liability for the year in excess of \$50,000) exceeds the sum of 20 percent of work incentive program expenses for the taxable year added to the amount of unused credits which are attributable to taxable years preceding the unused credit year.
- * **Recapture** - If the employment of any employee with respect to whom work incentive program expenses are taken into account is terminated by the taxpayer at any time during the first 90 days of such employment (whether or not consecutive) or before the close of the 90th

calendar day after the day in which such employee completes 90 days of employment with the taxpayer, the tax for the taxable year in which such employment is terminated shall be increased by an amount equal to the credit allowed for such taxable year and all prior taxable years attributable to work incentive program expenses paid or incurred with respect to such employee.

In this case, carrybacks and carryovers will be properly adjusted.

- • **Failure to Pay Comparable Wages** - If during the period of employment, the taxpayer pays wages to an employee with respect to whom work incentive program expenses are taken into account, which are less than the wages paid to other employees who perform comparable services, the tax for the taxable year in which such wages are so paid shall be increased by an amount equal to the credits allowed for such taxable years attributable to work incentive program expenses paid or incurred with respect to such employee and the carrybacks and carryovers shall be adjusted properly.
- **Exceptions to Recapture Provisions** - Recapture provisions shall not apply to the following:
 - A. a termination of employment of an employee who voluntarily leaves employment of the taxpayer,
 - B. a termination of employment of an individual who before the close of the period of 90 days of employment becomes disabled to perform the services of such employment, unless such disability is removed before the close of such period and the taxpayer fails to offer re-employment to such individual,
 - C. a termination of employment of an individual, if it is determined under applicable state unemployment compensation law that the termination was due to misconduct of such individual,
 - D. a termination of employment of an individual due to substantial reduction in the trade or business operations of the taxpayer.
- • **Change in Form of Business** - The employment relationship between the taxpayer and an employee shall not be treated as terminated by a transaction, if the employee continues to be employed by the acquiring corporation or by reason of a mere change in the form of conducting the trade or business of the taxpayer, if the employee continues to be employed in such trade or business and the taxpayer retains a substantial interest in such trade or business.

Limitations on Expenses -

- **Trade or Business Expenses** - No item shall be taken into account as work incentive program expenses unless such item is incurred in a trade or business of the taxpayer.
- • **Reimbursed Expenses** - No item shall be taken into account as work incentive program expenses to the extent the taxpayer is reimbursed for such item.
- • **Geographical Limitation** - No item shall be taken into account as work incentive program expenses with respect to any expense paid or incurred by a taxpayer with respect to employment outside of the United States.
- **Maximum Period of Training or Instruction** - No item with respect to any employee shall be taken into account under work incentive program expenses (wages) after the end of the 24-month period beginning with the date of initial employment of such employee by the taxpayer.
- • **Ineligible Individuals** - No item shall be taken into account as work incentive program expenses with respect to an individual who:
 - A. bears any relationship to the taxpayer or if the taxpayer is a corporation to an individual who owns directly or indirectly more than 50 percent in the value of outstanding stock of the corporation,
 - B. if the taxpayer is an estate, trust, is a grantor, beneficiary or fiduciary of the estate or trust or is an individual who bears any relationship to a grantor beneficiary, or fiduciary of the estate or trust, or
 - C. is a dependent of the taxpayer or, if the taxpayer is a corporation or an individual who owns directly or indirectly more than 50 percent in the value of outstanding stock of the corporation.

Amortization for Child Care Facilities - A taxpayer may elect to amortize expenditures for child care facilities over a five year period instead of using other depreciation methods.

Eligible Expenditures for Amortization - Capital expenditures made to acquire, construct, reconstruct or rehabilitate child care facilities.

Eligible Facilities - Five year amortization is applicable only to facilities or portions of facilities that could be constructed, renovated, or remodeled specifically for use as child care facilities. This means buildings and equipment, or portions of them, actually used for the provision of child care services in which children receive such personal care, protection and supervision as would be required to meet their needs in the absence of their parents.

This includes a room or rooms, or play equipment and materials particularly suited to the needs of children being cared for during the day. Special facilities such as kitchen facilities connected to the child care center or area or special children's toilet facilities could also be included.

Ineligible Facilities - Facilities not eligible for five year amortization would include general purpose rooms used for many purposes, for example, a room used as an employee recreation center during the evening or a room or part of a room which is simply screened off for use by children during the day. Also, property located outside of the United States is not eligible.

Recapture - The gain realized on the disposition of property eligible for amortization as a child care facility is subject to recapture or disposition as ordinary income to the extent of these amortization deductions.

Eligibility for Five Year Amortization and the Investment Tax Credit - Property for which an election is made to take five year ratable amortization cannot be treated as eligible for the investment credit.

Effective Dates - Five year amortization of child care facilities applies to expenditures made after December 31, 1971 and before January 1, 1982.

Four Steps to a Tax Credit



U.S. Department of Labor
U.S. Department of Health, Education and Welfare
1978

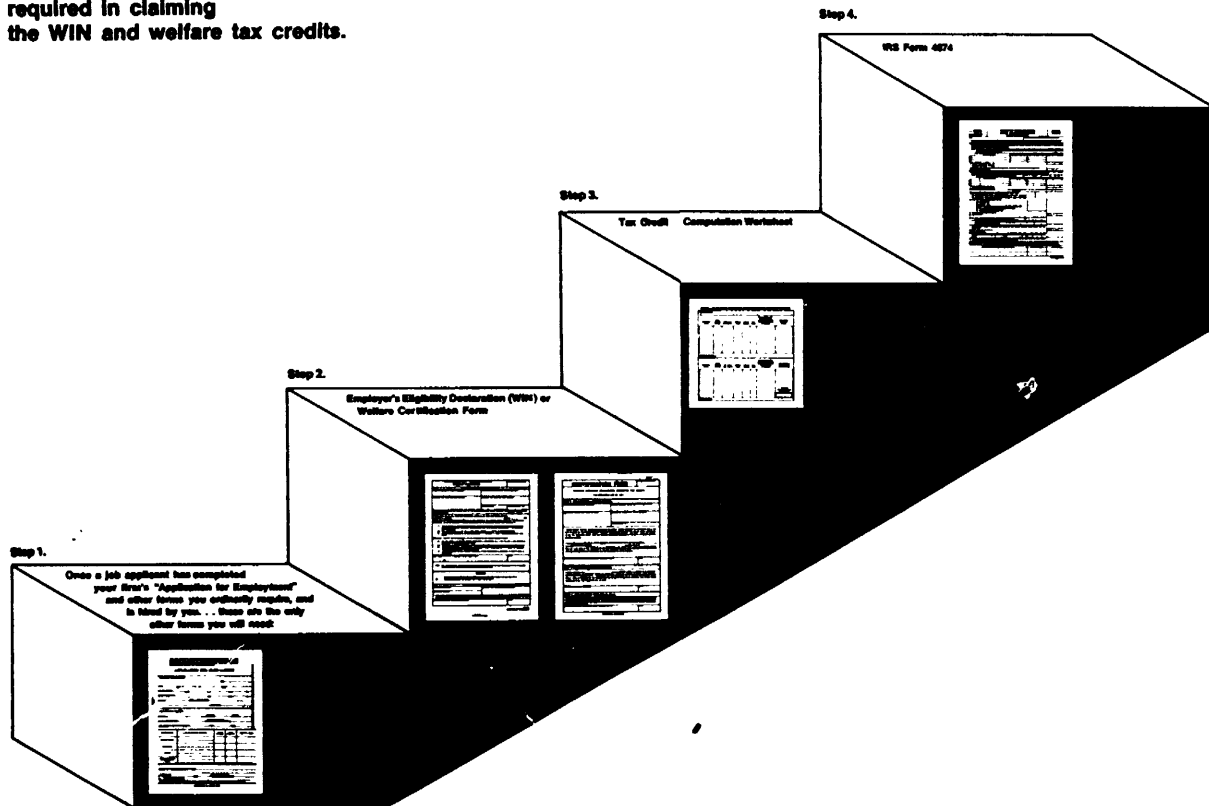


Introduction

Employers are sometimes reluctant to claim a tax credit because they think that the process will be long and arduous. This is certainly not the case for the Work Incentive (WIN) Program or welfare tax credits.

In this short booklet, the entire process for claiming the WIN and welfare tax credits is summarized in four basic steps. Each step is described for you in straightforward terms, and samples of any forms associated with each step are provided. In general, these forms are self-explanatory, but hints to assist you in completing them are included where necessary.

**Employers are often surprised
by the small amount of paperwork
required in claiming
the WIN and welfare tax credits.**



Step 1. The Hire

The first step in claiming either the WIN or welfare tax credit is the hire. Job applicants who make you eligible for either tax credit may be hired through the standard personnel procedures of your firm. Such prospective employees may reach your personnel department in any of three ways.

Your Firm Places a Job Order with the WIN Program

When your company has a new or vacant position available, you are encouraged to contact your local WIN office. You will find it listed in your local telephone directory under your State Employment Services listing. It is well to become acquainted with one job developer or counselor who can become familiar with your company's hiring needs. This will permit a more careful selection of job applicants to be sent to you for job interviews.

The WIN staff person who receives your call will ask you to provide certain basic information about the positions(s) you wish to fill, including job title, starting wage, job description, and requirements. This job will then be listed on the job bank system used by the WIN Program. Once the job has been listed, WIN counselors will review the records of individuals available for work, in order to select those with the backgrounds and skills the position requires. Those WIN participants identified as qualified will be referred directly to your firm. The final hiring decision is, of course, yours. You are under no obligation to hire persons referred to you by WIN.

Remember: When you hire a job applicant referred by WIN, you may be certain the applicant is eligible for the WIN tax credit.

Or: The WIN Job Development Specialist Contacts Your Firm

When WIN counselors identify the various skills of their clients, the WIN job development specialists go into action. They begin by contacting companies that are generally in need of employees with these skills. If they discover an available position, the WIN Program will begin referring qualified applicants.

In some instances, WIN clients referred meet most of the basic skill requirements for the vacant position, but may need some additional training. In many of these cases, WIN may be able to provide some reimbursement for on-the-job training expenses incurred by the firm in upgrading the skills of these individuals to the level that the job demands. Such reimbursement is contingent on many factors, including availability of funds, type of job, duration of required training, and skill level of the applicant.

If it has been some time since you last wrote an on-the-job training (OJT) contract, you may be surprised to learn that this contract has been greatly simplified. The new contracts have been reduced to a few pages, and there is increased flexibility in their provisions. Your WIN job developer will have full details regarding the OJT contracts. If you write one, you may be reimbursed for up to 50 percent of the wages paid trainees during the period of training. You can take this reimbursement in addition to the tax credit.

Remember: When you hire an applicant referred by a WIN job development specialist, you can be certain the applicant will make your firm eligible for the tax credit.

Also: Walk-In Applicants

Although a number of job applicants who can qualify you for the tax credit will reach your firm through WIN, many others will simply walk in, either in response to an advertised opening or job listing or to investigate opportunities available through your personnel office.

In the past, employers have had no way of knowing these persons could qualify them for the tax credit. For this reason, the Department of Labor is now encouraging everyone who makes an employer

eligible for either credit to carry the brochure "Employer Tax Credits Can Reduce Your Income Taxes" and to present it during their employment interviews. This will be your way of knowing the individual presenting the brochure can qualify you for the tax credit.

Remember: Individuals who carry and present the brochure "Employer Tax Credits Can Reduce Your Income Taxes" can make you eligible for the tax credit.

Step 2. Certification

Once you have hired an individual who qualifies you for either the WIN or welfare tax credit, it is necessary for your local WIN or welfare office to certify both the employee's and the firm's eligibility for the tax credit. Regardless of which credit you wish to claim, you can start this process by contacting your local WIN office and requesting an Employer's Eligibility Declaration or Welfare Certification Form.

Within a few days, the WIN or welfare office (depending on which credit you request and the individual makes you eligible for) will mail an Employer's Eligibility Declaration to you. You should complete this form and send it back to the office that issued it.

The local WIN or welfare office will mail an Employer's Eligibility Declaration and, upon finding all eligibility criteria have been met, will send you a copy of the form for your files. You do not file the form with your tax return; simply retain it in your files.

This process must be completed for each individual hired for whom your firm wishes to claim a tax credit. There is no limit on the time between the date of hire and your completion of the Employer's Eligibility Declaration. All employers are, however, strongly encouraged to request and complete the Eligibility Declaration as soon as possible. In this manner, you will be certain to have your form on file at tax time.

It is important to note that your firm is eligible for the tax credit even if the employee remains on welfare. The wages that you pay such an employee serve to reduce his or her welfare payments. Therefore, you should request certification for all of those employees who qualify you for the tax credits.

Remember: The Employer's Eligibility Declaration is an important document. It is your record that both your firm and the employees have hired qualify for the tax credit.

The following forms are samples of the Eligibility Declarations used in claiming the WIN and welfare tax credits. You will notice that the WIN Eligibility Declaration is a two-part form, with Part A to be completed by the employer and Part B to be completed by the WIN office. The Welfare Certification is a three-part form, with Part A to be completed by the employer, Part B by the employee, and Part C by the local welfare office.

Remember: When claiming the welfare tax credit, the employee-recipient must complete Part B of the Certification form or your request for certification will not be processed.

CERTIFICATION FORM		IRS IDENTIFICATION NO.
WELFARE RECIPIENT EMPLOYMENT INCENTIVE TAX CREDIT TAX REDUCTION ACT OF 1975		
PART A (TO BE COMPLETED BY EMPLOYER-APPLICANT)		
NAME OF EMPLOYER (FIRM OR INDIVIDUAL)		NAME OF RECIPIENT-EMPLOYEE (FIRST, MIDDLE, LAST)
ADDRESS (NO., STREET, CITY, STATE, ZIP CODE)		ADDRESS (NO., STREET, CITY, STATE, ZIP CODE)
		SOCIAL SECURITY NO.
<p>I hereby declare that the information concerning the above-named employee is required by me or my firm to apply for the Federal Welfare Recipient Employment Incentive Tax Credit under provisions of the Tax Reduction Act of 1975 and that the information requested on this form will not be used for any other purpose.</p> <p>I further declare that the above-named employee was employed by me or my firm on (date) _____ as a (Job Title or Occupation) _____ at (Wage Rate) \$ _____, that the wage paid to this employee is not less than wages paid to other employees for similar work, and that the employment of this person has not displaced any other employee.</p>		
SIGNATURE AND TITLE (AUTHORIZED EMPLOYER REPRESENTATIVE)		DATE
PART B (TO BE COMPLETED BY RECIPIENT-EMPLOYEE)		
<p>I hereby authorize the _____ County Welfare Agency to release to my employer the information requested below. I understand that this information will be used by my employer for the sole purpose of applying for the Federal Welfare Recipient Employment Incentive Tax Credit under provisions of the Tax Reduction Act of 1975.</p>		
SIGNATURE (RECIPIENT-EMPLOYEE)		DATE
PART C (TO BE COMPLETED BY COUNTY WELFARE AGENCY)		
<p>The above-named individual is hereby <input type="checkbox"/> certified <input type="checkbox"/> not certified as having been eligible for Aid to Families with Dependent Children (AFDC) under Title IV A of the Social Security Act immediately preceding the date of hire as well as having continuously received such financial assistance during the 90 days immediately preceding this date of hire.</p>		
SIGNATURE AND TITLE (AUTHORIZED AGENCY REPRESENTATIVE)		DATE

EMPLOYER - APPLICANT

U.S. DEPARTMENT OF LABOR * MANPOWER ADMINISTRATION		IRS IDENTIFICATION NO.
ELIGIBILITY DECLARATION		
PART A. (To be completed by Employer/Applicant)		
NAME OF EMPLOYER (Firm or Individual)		NAME OF WIN PARTICIPANT (First, Middle, Last)
ADDRESS (No., Street, City, State, ZIP Code)		ADDRESS (No., Street, City, State, ZIP Code)
		PHONE NUMBER
		SOCIAL SECURITY NO.
Has the above establishment been relocated within two years immediately preceding this date resulting in unemployment in the original area of the establishment? <input type="checkbox"/> yes <input checked="" type="checkbox"/> no		
I hereby declare that the above named WIN PARTICIPANT was hired by the above named employer on (date) at (job title or occupation) at (wage rate) \$ and that the wage paid to this WIN PARTICIPANT is not less than wages paid to other employees of this employer for similar jobs in this establishment, and that the employment of this WIN PARTICIPANT was not displaced any individual from employment, i.e.,		
<ol style="list-style-type: none"> (1) That no reduction in non-overtime hours, wages or employment benefits has occurred or is expected to occur for workers currently employed by the above-named employer-applicant which can be related to the employment of the above named WIN PARTICIPANT; (2) That no employees are in layoff status awaiting recall for positions to be filled by the WIN PARTICIPANTS; (3) That the vacancy to be filled by the WIN PARTICIPANT is not the result of a strike or lockout in the course of a labor dispute 		
Furthermore, I CERTIFY that this employment meets and will continue to meet minimum standards as follows		
<ol style="list-style-type: none"> (1) The wage paid is no less than any applicable Federal, State or local minimum wage, or the wage paid to other employees of the employer for similar jobs, whichever is higher; (2) All provisions of applicable Federal, State and local health, safety, child labor and work hours laws and regulations are met; (3) The WIN PARTICIPANT will be afforded the same employee benefits including opportunities for training and advancement as others similarly employed in the same establishment; (4) All applicable Federal and State workmen's compensation or other laws pertaining to compensation for illness or injury are complied with. 		
SIGNATURE AND TITLE (Authorized Employer Representative)		DATE
NOTE: It is a criminal offense, punishable by a penalty of not more than \$10,000 or five years imprisonment, or both, to knowingly and willfully falsify a material fact in this application for Certification Form.		
INSTRUCTION		
One signed copy of ELIGIBILITY DECLARATION FORM is to be returned to Employer, one copy is to be sent to CRU's in the usual manner, and one copy is to be retained in the WIN project.		
PART B. (To be completed by WIN Project)		
WIN PROJECT NUMBER	ADDRESS (No., Street, City, State, ZIP Code)	
TELEPHONE NUMBER		
I hereby declare that the above named individual was placed in the above described employment under a War Incentive Program established under Section 432(b)(1) of the Social Security Act, and that this employment has not displaced any individual from employment.		
SIGNATURE AND TITLE (WIN Certification Officer)		DATE

MA 6-72
Revised February 1974 (SN-24055)

EMPLOYER FILE

Step 3. Computing the Credit

A sample worksheet for calculating wages to welfare recipients is shown on the next page. It may be used by the personnel officer of your firm to compute the total wages to which the 20-percent tax credit may be applied. The worksheet may be used for calculating either the WIN or the welfare tax credits, or both.

When completed by the personnel officer, the worksheet performs two important functions:

- 1) It is useful in assisting the accounting or tax department in completing IRS form 4874.
- 2) It provides the personnel officer with a means of measuring the corporate savings accrued by hiring welfare recipients. Substantial savings along with acceptable job performances have encouraged many employers to hire more WIN and welfare clients each year.

The worksheet itself is very simple to complete. It requires entering the name, social security number, date hired, starting wage, new wages and date of increase (if applicable), and total wages for the period being recorded.

The time limitations on wages to which the WIN and welfare tax credits are applicable are listed under the column headings and are explained in the "Employer's Reference Guide."

Step 4. Claiming the Credit

When tax time approaches it is most important to have your Tax Credit Computation Worksheet reviewed and updated, if necessary, to insure that it is current. It should then be forwarded to the person who prepares the income tax return for your company.

Most of the information needed by your tax preparer in completing IRS Form 4874 "Credit for Work Incentive Program (WIN) Expenses" may be taken directly from this worksheet.

After completing the 4874, your tax preparer will enter your company's total allowable credit on the firm's income tax return, IRS Form 1120, under the item title "Work Incentive (WIN) credit."

Please note the IRS Form 4874 is used for claiming *both* the WIN and welfare tax credits. Correspondingly, the total tax credit earned, whether WIN or welfare or both, is entered on your firm's 1120 under Work Incentive (WIN) credit. There is no separate item on your company's return for the welfare tax credit.

The following page provides a sample IRS Form 4874.

If your tax preparer desires further information on carry-over or carry-back procedures, this information is available in the "Employer's Reference Guide."

Information on fast writeoff provisions for day-care facilities, which your tax preparer may also desire, is also discussed in the "Employer's Reference Guide."

Be sure to remind your tax preparer of the availability of the New Jobs and Vocational Rehabilitation Tax Credits to see if your firm qualifies

Form **4874**

Department of the Treasury
Internal Revenue Service

**Credit for Work Incentive
(WIN) Program Expenses**

▶ Attach to your tax return.

1976

Name _____ Identifying number as shown on page 1 of your tax return _____

Qualified Work Incentive Program Salaries and Wages and Federal Welfare Recipient Employment Incentive Expenses

1 WIN wages (including Federal welfare recipient employment incentive expenses other than expenses paid or incurred to employees hired after September 7, 1976 in connection with a child day care services program for the period of September 8, 1976 through September 30, 1977) paid or incurred to employees:

Note: Nonbusiness Federal welfare recipient employment incentive expenses incurred by the taxpayer are limited to \$5,000 per employee for the taxable year. Include your share of WIN wages paid or incurred to employees by a partnership, estate, trust, or small business corporation.

Name of employee	Social security number	Date employment began	Current year's WIN wages
(a)			
(b)			
(c)			
2 Total of lines 1(a) through (c)			
3 Tentative credit (20% of line 2)			
4 Carryback and carryover of unused WIN credits (see instruction for line 4—attach computation)			
5 Total—Add lines 3 and 4			

6 Federal welfare recipient employment incentive expenses paid or incurred to employees hired after September 7, 1976 in connection with a child day care services program for the period of September 8, 1976 through September 30, 1977.

Note: Federal welfare recipient employment incentive expenses paid or incurred to employees in connection with a child day care services program is limited to \$5,000 for each employee.

Name of employee	Social security number	Date employment began	Current year's WIN wages
(a)			
(b)			
(c)			
7 Total of lines 6(a) through (c)			
8 Tentative credit (20% of line 7)			

Limitation

9 (a) Individuals—Enter amount from line 18, page 1, Form 1040	
(b) Estates and trusts—Enter amount from line 24 or 25, page 1, Form 1041	
(c) Corporations—Enter amount from line 9, Schedule J, page 3, Form 1120	
10 Less: (a) Credit for the elderly (individuals only)	
(b) Foreign tax credit	
(c) Investment credit	
(d) Credit for contributions to candidates for public office (individuals only)	
(e) Tax on lump-sum distribution (see instruction for line 10(a))	
(f) Possession tax credit (corporations only)	
11 Total—Add lines 10(a) through (f)	
12 Line 9 less line 11	
13 (a) If line 12 is \$25,000 or less, enter line 12. (Married persons filing separately, controlled corporate groups, estates, and trusts, see instruction for line 13.)	
(b) If line 12 is more than \$25,000, enter the amount computed in accordance with the formula in instruction for line 13. (Married persons filing separately, controlled corporate groups, estates, and trusts, see instruction for line 13.)	
14 WIN credit limitation for WIN wages other than Federal welfare recipient employment incentive employee wages paid or incurred in connection with a child day care services program—Enter amount from line 13(a) or (b)	
15 Enter lesser of line 5 or line 14	
16 Line 12 less line 15	
17 WIN credit limitation for Federal welfare recipient employment incentive employee wages paid or incurred in connection with a child day care services program—Enter amount from line 8 or line 16, whichever is lesser.	
18 Total allowable WIN credit—Add lines 15 and 17 (enter here and on line 53, Form 1040; line 10(c), Schedule J, page 3, Form 1120; or the appropriate line on other returns)	

Supplement A If any part of the above WIN wages (including Federal welfare recipient employment incentive expenses) was paid or incurred by a partnership, estate, trust, or small business corporation, complete the following:

Name and address (partnership, estate, trust, etc.)	Name of employee	Amount

Senator HASKELL. One thing that concerns me on the administration program is churning. In other words, you say that churning might be prevented by having only 20 percent of the labor force involved in this credit, that is those between 18 and 24. Do you have any mechanism that would prevent the firing of people 25, 26, and 27?

I think it is a very serious problem.

Mr. PACKER. It is a serious problem. There are no easy solutions to it. The 20 percent was our estimate of the turnover in firms hiring persons of this sort. It was thought that with the 20 percent limit there would be no problem, there would be no need to do as you suggest. I am sure it could happen in some situations.

The problems inherent in restricting substitution would make the tax credit more awkward to use. It is not that there is nothing to be said for trying to attempt to prevent what you are talking about, but there is no easy way.

Senator HASKELL. Perhaps other witnesses will address that problem.

Two further questions I have for you. I am somewhat concerned about eligibility determinations. If this is going to work it ought to be as simple as possible. I do not know how complicated it is to get a certificate. Take for example the tax system. It is one of self-assessment: Is it like taking a statement under oath? If I were lucky enough to be between 18 and 24 and I made a statement under oath that my income is not in excess of a certain amount and couldn't the employer rely on that?

If I misstated my income, I would be subject to the penalties of perjury.

It seems to me that in order to be effective, the system must be as simple as possible. Now, maybe it cannot be made that simple.

Mr. PACKER. Well, Senator, I think there is an attempt to keep things simple. If the employer thought he was liable, then he would be reluctant to hire.

This way, if some Government agency certifies that the person passes the income test, the employer's liability is ended.

Senator HASKELL. Well, what if the employer were allowed to rely upon a sworn statement of the applicant?

Mr. PACKER. I do not think we would want to be put in a situation of putting the young person in jail for perjury, and since the tax advantage would accrue to the employer—

Senator HASKELL. Well, the young person gets the job. If he wants to lie and take the risk of going to jail, then that is a risk he takes.

I am just looking for simplicity.

Mr. PACKER. I think the penalty would be too severe to be a meaningful threat. It would seem like, in my judgment, overkill. The employee would not be terribly concerned.

Senator HASKELL. Where does a young person have to go to get this certification?

Mr. PACKER. To the Employment Service.

Senator HASKELL. Is this in every city in the Nation?

Mr. PACKER. That is right. The Employment Service, or CETA.

Senator HASKELL. And how long is the form the young person has to fill out?

Mr. PACKER. Well, the forms have not been developed, but it would be quite simple. He just claims that; in fact, he has that income and there might be some further questioning of the last time he had worked.

Senator HASKELL. What type of income? Cash income?

Mr. PACKER. Yes.

Senator HASKELL. And then what do you do? Do you have folks who go out and investigate to see if he is telling the truth?

Mr. PACKER. No. There is some checking of his social security number to see if social security taxes or unemployment taxes have been paid for him. If that has been the case and the wages seem so high as to make his statement seem untrue, then further checking is done.

Senator HASKELL. Do you happen to have any comments on the other bills before the committee.

Mr. PACKER. That is a complex proposal which, in its present form, the administration opposes, though there are certain things about it that we would not oppose.

Senator HASKELL. Would you submit for the record your analysis of that proposal and your position?

Mr. PACKER. I guess we—

Senator HASKELL. In a week could you submit your analysis of that proposal and why you like it or why you do not like it?

Mr. PACKER. Yes. I might mention, Senator, I understand that the Labor Department, the Employment and Training Administration is in the process of preparing advisory materials on both the jobs tax credit and the WIN tax credit right now.

Senator HASKELL. If we could have that within a week, I think it would be very helpful to us. Do you think that is possible?

Mr. PACKER. Yes. I do not know what State—

Senator HASKELL. The man on your left is nodding yes. So I hope that means it is available.

Mr. PACKER. If he says so, it must be so.

[The following was subsequently supplied for the record:]

AN EXAMINATION OF THE BAKER-BELLMON-RIBICOFF-DANFORTH PROPOSAL FOR A
JOB CREATION TAX CREDIT

I. GENERAL DESCRIPTION AND PURPOSE

The purpose of the Job Creation Tax Credit (JCTC) is to increase employment of disadvantaged workers who are AFDC recipients, long-term unemployed, and/or unemployed CETA graduates. JCTC would provide per hour credits to firms that hire these workers, but only to the extent that the firm's total hours of employment exceeded 102% of hours of employment in the previous year. For example, a firm that increased total hours by 6% could receive a subsidy for up to 4% of its employees hours (106%-102%); the firm would qualify for the full 4% if at least 4% of its hours were worked by credit-eligible employees. In limiting the credit only to firms that expand employment, the JCTC is similar to the existing Jobs Credit. Among the other features of the existing Jobs Tax Credit adopted by JCTC are provisions requiring an increase of 5% in the firm's total wage base, limiting the credits per firm to \$100,000 and allowing the credit only for reductions in tax liability. Apparently, the authors of the JCTC would continue the existing credit's provisions that reduce wage deductions for tax purposes by the amount of the credit.

Unlike the existing credit's subsidy of 50% of the first \$4,200 in earnings, the JCTC would pay \$1 per hour of qualifying employment. A second important difference is that the JCTC would operate alongside a voucher program which

appears to dominate the credit for every employer, including those eligible for the tax credit. In this initial analysis, the assumption is that the JCTC becomes law but the voucher program does not. If both passed, an examination of the CTC would serve no purpose.

II. INCENTIVES TO HIRE ADDITIONAL DISADVANTAGED WORKERS

The nature of the incentives JCTC offers to firms to hire disadvantaged workers depends on the expected growth of the firm and the normal number of disadvantaged workers hired by the firm. To see how different firms might be affected by JCTC, consider several cases.

Case 1. Firm does not normally employ credit-eligible workers

Firms in this category will face an incentive to expand employment of credit-eligible workers if they expect to increase total labor hours by at least 2%. The credit of \$1 per hour will apply to the first 50 person-years of employment of credit eligibles for all such firms increasing other hours by at least 2%. However, even for expanding firms, the incentive the credit offers in the initial year will be reduced somewhat by the fact that increases in the labor hours base will make it more difficult to take advantage of the credit during the following year. For firms not expected to grow, the JCTC will offer some incentive to expand labor hours. But, if the firm does not expand labor hours, the credit will offer no incentive to employ disadvantaged workers.

Case 2. Firm normally employs disadvantaged workers

Firms in this category may find the JCTC provides no incentive to hire additional disadvantaged workers. Consider a firm which normally uses credit-eligible workers for 15% of its labor hours. Such a firm will see a gain by expanding total labor hours, but unless the expansion exceeds 17%, the firm will have no new incentive to hire more credit-eligibles. Expansions more than 2% but less than 17% will permit the firm to claim credits for workers it would have hired without the subsidy. On the other hand, firms who normally employ credit-eligible workers and who do not expand total hours would receive no credits. In this way, the increased hours criteria would reduce the subsidies going to pay for workers who would have been hired in the absence of the credit.

The credit's incentive effect will also depend on the firm's expectations about its profits. Firms which may not earn profits will see the credit as an uncertain advantage. Although firms will be able to carry forward or carry back the credits, many firms do not survive long enough to claim credits in these ways. Treasury estimates that 20% of firms who qualify for investment credits never end up claiming such credits.

III. INCENTIVES FOR WORKERS TO BECOME CREDIT-ELIGIBLE

One problem in estimating the number of workers who would be credit-eligible is that the existence of the credit may increase the number in categories specified as eligible for the credit. Because of the credit, firms who expect to hire graduates of the CETA program may delay hiring them until such graduates have experienced 30 days of unemployment. The long term unemployment criteria (90 days for youth and 26 weeks for others) would not influence workers to become unemployed; however, it might cause some increases in unemployment at the margin. Youth unemployed for 8 or 9 weeks might be asked to take two or three more weeks off in order to become eligible for the credit. Other youth might register as unemployed while in school and not actively seeking jobs so that upon leaving school, they will qualify for the credit. These kinds of perverse incentives are likely to operate, only if the credit is effective in making eligibility an important advantage in seeking a job.

IV. ESTIMATING THE COSTS, JOBS SUBSIDIZED, AND NEW JOBS FOR THE DISADVANTAGED

To estimate the costs, one must determine how many credit-eligible workers would be employed by firms able to claim the credit even in the absence of the credit and how many new credit-eligible workers firms would hire because of the credit. The first task is to estimate total labor hours by credit-eligible workers before the credit. The next task is to subtract the number of credit-eligible workers employed by firms unable to claim the credit. Among those firms claiming the

credit, some but not all would see an incentive to expand employment of credit-eligibles. To determine the extent of the increase requires a calculation of the average labor cost reduction due to the credit and the employer's response to such cost reductions. With these numbers, it is possible to project the jobs induced by the credit. Adding existing plus induced jobs yields total jobs and total costs.

In a typical year after the credit becomes law, the number of hours subsidized will depend on the hours worked by those who become eligible during the current and preceding years. For example, youth who are subsidized in 1981 might have become unemployed in 1980 or in 1981. Similarly, those subsidized in 1981 because of AFDC status might have spent time in 1980 or in 1981 on the welfare rolls.

The first set of estimates are for the pool of workers for whom employers could claim credits at some time during the year. These estimates are for those eligibles who are likely to work if jobs are available. The numbers are approximations, subject to a wide margin of error.

Potential pool of workers :

AFDC-UF recipients.....		300,000
Other AFDC recipients.....		700,000
Total		1,000,000
Disadvantaged youth unemployed 90 days.....	800,000-1,000,000	
Disadvantaged adults unemployed 26 weeks.....	400,000	
CETA graduates, not placed after 30 days, not in other categories	500,000- 800,000	
Total	2,700,000-3,200,000	

The next step is to determine how many hours are worked by the eligible pool over a full year. To stay in similar units, we have converted total hours into person-years by dividing total hours by 2080. The approximate figures on person-years of employment are :

AFDC-UF recipients.....	180,000	
Other AFDC recipients.....	400,000	
Total AFDC	580,000	
Disadvantaged youth unemployed 90 days or more.....	400,000- 500,000	
Disadvantaged adults unemployed 26 weeks or more.....	150,000	
CETA graduates not placed after 30 days.....	300,000- 400,000	
Total	1,430,000-1,630,000	

Of these person-years of employment we expect about 30%-40% are worked for employers not eligible to claim the credit. Employers would not be eligible if they were in the public or nonprofit sectors, if they were unable to make a profit, or if they did not expand total hours worked by at least 2%. This leaves 850,000-1,140,000 person-years of existing employment qualifying for the subsidy.

To complete the estimates, we must determine how many new jobs the credit stimulates. If the average wage paid to potential eligibles is about \$3.50-\$4.00 per hour, the JCTC would represent a reduction in labor costs of about 25%. Assuming that those firms eligible respond by increasing demand by .5% for each 1% reduction in labor costs, the percentage increase in employment could run as high as 15%. However, the cap of \$100,000 will reduce this number substantially. For firms with about 30% of the eligible employment, the credit will offer no subsidy whatever to increases in employment because the firm already receives the maximum subsidy. A second element keeping the response to the subsidy low is the fact that firms realize that expanding employment this year will reduce opportunities to claim a subsidy the following year. Given all these complications, a reasonable estimate for the increase in job is 85,000-115,000 person-years of employment.

Adding the induced number of person-years to the existing number yields a total of about 930,000-1,255,000 person-years qualifying for a subsidy. Not all of the qualifying hours would actually be claimed simply because firms and individuals do not apply for benefits for which they qualify. It is difficult to predict the share of firms claiming the credit. If the response is similar to responses to the WIN tax credit, participation rates may run as low as 5%. However, with adequate publicity and broader worker coverage, we expect higher participation rates. The table below shows costs, new jobs, and costs per job under alternative

participation assumptions. Because the credit would be taxable, net budget costs would average 62 cents per hour rather than \$1 per hour.

EFFECTS OF BAKER-BELLMON CREDIT UNDER ALTERNATIVE PARTICIPATION ASSUMPTION

	Assumed participation rate		
	25 percent	50 percent	75 percent
Treasury cost (billions).....	\$0.3-\$0.4	\$0.6-\$0.8	\$0.9-\$1.22
Hours subsidized (billions).....	0.48-0.65	0.97-1.3	1.45-1.96
Increase in person-years of employment of disadvantaged induced by the jobs credit (billions).....	21,000-29,000	42,000-58,000	64,000-86,000
Cost per new job for disadvantaged.....	12,800-73,800	12,800-13,800	12,800-13,800

Senator HASKELL. Perhaps you could also give us some analysis for the record on how large the group is of individuals which your credit is targeted to help. Break it down by employed and unemployed, by race and sex, by marital status, and by presence and absence of children.

If I am asking an impossible thing, tell me what is impossible, and I will strike it from the record. But we want to try and see what kind of group we are looking at.

Mr. PACKER. No, I do not think so. We know that the total population of disadvantaged youth are close to 5 million, of which 1.1 million are in school and the remainder are not.

We have some breakdowns—

Senator HASKELL. Could you submit that for the record?

Mr. PACKER. We could submit that for the record.

Senator HASKELL. And then submit for the record how many persons and what type you expect your proposal to put to work.

Mr. PACKER. OK.

[The following was subsequently supplied for the record:]

TABLE 1.—EMPLOYMENT AND SCHOOL ACTIVITY STATUS OF DISADVANTAGED YOUTH,¹ BY AGE AND RACE, MARCH 1977

	18 to 24		18 to 19		20 to 21		22 to 24	
	White	Non-white	White	Non-white	White	Non-white	White	Non-white
Population.....	3,442	1,508	1,087	546	1,015	456	1,340	506
In school.....	711	460	352	268	217	113	143	79
Not in school.....	2,731	1,048	735	277	799	343	1,198	427
Percent of population:								
In school.....	21	31	32	49	21	25	11	16
Not in school.....	79	69	68	51	79	75	89	84
In school: ²								
E/P.....	25	6	21	6	26	6	33	5
UR.....	26	68	23	64	31	67	25	78
LFPR.....	34	19	28	17	38	19	43	25
Not in school: ²								
E/P.....	54	37	54	34	53	30	55	44
UR.....	22	39	24	43	22	49	21	29
LFPR.....	69	60	72	60	68	58	69	61
Total: ²								
E/P.....	48	27	44	20	47	24	52	38
UR.....	23	42	24	47	23	51	21	32
LFPR.....	62	48	58	39	61	49	66	56

¹ Disadvantaged youth are those in families whose 1976 incomes fell below 70 percent of the BLS lower living level during 6-mo period.

² E/P is employment-population ratio; UR is unemployment rate and LFPR is labor force participation rate.

Source: Unpublished tabulations from the March 1977 current population survey.

TABLE 2.—EMPLOYMENT AND SCHOOL ACTIVITY STATUS OF DISADVANTAGED MALE YOUTH,¹ BY AGE AND RACE, MARCH 1977

	18 to 24		18 to 19		20 to 21		22 to 24	
	White	Non-white	White	Non-white	White	Non-white	White	Non-white
Population.....	1,437	578	463	245	397	156	577	177
In school.....	335	195	163	126	95	41	77	28
Not in school.....	1,102	383	300	119	303	115	500	149
Percent of population:								
In school.....	23	34	35	51	24	26	13	16
Not in school.....	77	66	65	49	76	74	87	84
In school: ²								
E/P.....	24	7	20	7	23	5	35	12
UR.....	32	64	31	60	38	72	29	67
LFPR.....	36	20	29	18	36	18	50	36
Not in school: ²								
E/P.....	71	51	70	38	71	44	71	67
UR.....	22	39	22	50	20	47	23	26
LFPR.....	91	84	90	76	90	82	92	91
Total: ²								
E/P.....	60	36	52	22	60	33	67	59
UR.....	23	42	23	52	22	49	23	29
LFPR.....	78	62	68	46	77	65	87	83

¹ Disadvantaged youth are those in families whose 1976 incomes fell below 70 percent of the BLS lower living level during a 6-mo period.

² E/P is employment-population ratio; UR is unemployment rate; and LFPR is labor force participation rate.

Source: Unpublished tabulations from the March 1977 current population survey.

TABLE 3.—EMPLOYMENT AND SCHOOL ACTIVITY STATUS OF DISADVANTAGED FEMALE YOUTH,¹ BY AGE AND RACE, MARCH 1977

	18 to 24		18 to 19		20 to 21		22 to 24	
	White	Non-white	White	Non-white	White	Non-white	White	Non-white
Population.....	2,005	930	624	300	618	301	763	329
In school.....	376	265	189	142	122	72	65	51
Not in school.....	1,628	665	435	158	496	229	698	278
Percent of population:								
In school.....	19	28	30	47	20	24	9	16
Not in school.....	81	72	70	53	80	76	91	84
In school: ²								
E/P.....	26	5	23	5	29	7	30	2
UR.....	20	71	15	67	25	64	19	89
LFPR.....	32	18	27	16	39	20	36	19
Not in school: ²								
E/P.....	42	28	44	32	41	23	42	31
UR.....	23	39	27	35	24	50	19	31
LFPR.....	55	46	60	48	54	47	52	45
Total: ²								
E/P.....	39	22	37	19	39	19	41	27
UR.....	22	43	25	42	24	52	19	35
LFPR.....	51	38	50	33	51	40	51	41

¹ Disadvantaged youth are those in families whose 1976 incomes fell below 70 percent of the BLS lower living level during a 6-mo period.

² E/P is employment-population ratio; UR is unemployment rate; and LFPR is labor force participation rate.

Source: Unpublished tabulations from the March 1977 current population survey.

TABLE 4.—CHARACTERISTICS OF DISADVANTAGED YOUTH, 18 TO 24, BY EMPLOYMENT STATUS IN MARCH 1977

	Population	Employment	Unemployment
Family status and sex:			
In families with children under 18:			
Males:			
Family head.....	401	284	62
Relative of head.....	713	231	107
Females:			
Family head.....	494	96	29
Relative of head.....	1,465	351	101
In other units:			
Males:			
Family head.....	158	110	35
Relative of head.....	542	220	71
Individual.....	238	145	35
Female:			
Family head.....	769	301	86
Relative of head.....	213	108	24
Individual.....			
Race and sex:			
Males:			
White.....	1,460	866	265
Nonwhite.....	591	215	120
Females:			
White.....	2,009	780	153
Nonwhite.....	1,107	205	156

Source: Unpublished tabulations from March 1977 current population survey.

Mr. PACKER. The figure was 160,000 and we do not know how many of those will be male, female, black or white.

Senator HASKELL. All right, sir.

Well, Mr. Secretary, we do have other witnesses. Senator Nelson has a series of questions which I would merely hand you rather than ask you here. Could you possibly give your answers for the record, because I do not want to unduly prolong your stay or keep other witnesses waiting.¹

Thank you very much, Mr. Secretary.

[The prepared statement of Mr. Packer follows:]

STATEMENT OF ARNOLD H. PACKER, ASSISTANT SECRETARY FOR POLICY, EVALUATION, AND RESEARCH, U.S. DEPARTMENT OF LABOR

Mr. Chairman and Members, I am happy to be here today to discuss employment tax credits. First, however, I would like to address briefly the overall employment situation.

Expanding employment has been an urgent goal throughout the 1970s. With unemployment rates averaging 6.5% during the 1970-77 period, no one can doubt that the economy has generated too few jobs for the Nation's expanding work force. Employment rose 15% between 1970 and 1977, but the labor force increased by nearly 18%.

One part of the employment problem has been due to recessions and economic slowdowns. Since we have not been able to eliminate the business cycle, we have faced long periods when large numbers of able workers cannot find jobs. In fact, over the entire post-World War II era, the United States has operated at 4% for only one out of every three years.

A second part of the employment problem has been the inability of disadvantaged workers to find jobs even during times of economic prosperity for the country as a whole. We can classify these workers in a variety of ways. They are workers with low skill or education, young workers, low income heads of families, welfare recipients, black workers, and workers living in depressed areas.

Regardless of how we classify these workers, the problem before us is to increase substantially their employment opportunities. If we cannot find jobs for such structurally unemployed workers at a faster rate than the increase in total employment, we will be unable to meet our target of a 4% unemployment rate by 1983.

¹ See p. 195.

The Administration and the Congress have worked together to deal with the cyclical and structural barriers to reaching full employment. In this effort, we have attempted to achieve a balance between expanded public and private employment. The economic stimulus package that emerged last year from Administration proposals and Congressional actions included an expansion of direct public job creation programs, as well as the Jobs Tax Credit and other components aimed at stimulating private employment.

Today, although aggregate unemployment still remains well above full employment levels, the problem we face is increasingly a structural one. In response to the changing nature of this problem, we have proposed targeted programs for disadvantaged youth, low income heads of families with children, and other disadvantaged workers. We are targeting our efforts on these groups because, while the overall unemployment rate continues to fall, they continue to have extreme difficulty finding employment. For example, during the past 12 months while the unemployment rate for white males over the age of 20 has fallen from 4.5% to 3.4%, the unemployment rate for black teenagers has remained at slightly less than 40%.

In dealing with these continuing problems, we are again aiming at a mixed public-private approach. We are calling for a continuation of a substantial public service employment program; we are calling for increases in training programs; we are calling for a special private sector initiatives program, with industry councils and more on-the-job training; and we are calling for an employment tax credit to encourage private employers to hire disadvantaged youth.

The PSE program has the dual purpose of providing a job now and of improving private sector employment prospects of disadvantaged workers. We are attempting to speed the transition to private employment by enhancing work experience and placement services under CETA and by limiting wages and duration on PSE jobs.

The Administration, as you can see, is committed to expanding private employment opportunities for disadvantaged workers. The question we must address today is how employment tax credits can be a good vehicle for achieving this goal. First, I would like to review the experience with the existing tax credits. Next, I shall discuss the Administration's proposal for replacing the Jobs Tax Credit with a targeted tax credit, and then the proposals for expanding tax credits for welfare recipients. In analyzing these proposals, I shall try to point out the advantages and disadvantages of various employment tax credit features. My basic conclusion is that while general tax credits may be useful, the current environment dictates that such credits must be targeted on the disadvantaged.

THE EXISTING EMPLOYMENT TAX CREDITS

The Jobs Tax Credit was added by Congress last year to the Administration's economic stimulus program. The purposes of the credit were to induce a temporary boost in total employment and to offer a special incentive to hire low wage workers. The program, which expires at the end of this year, pays tax credits to firms which expand their employment in 1977 and 1978. The program provides employers with credits equal to 50% of the increase in their Federal unemployment tax (FUTA) wage base over 102% of the previous year's base. Thus, a firm which hires an additional worker could receive 50% of the worker's first \$4200 of earnings as a tax credit. However, since the firm must reduce wages charged as business expenses by the amount of the credit, the revenue loss and gain to the firm is 25-30% of the first \$4200, or about \$1,100-\$1,200. Limiting the credits to the first \$4200 means that the percentage subsidy is higher for low wage than for high wage workers.

The Department of Labor is conducting an evaluation of the Jobs Tax Credit as part of an overall assessment of the economic stimulus program. The evaluation is not yet complete, but several of our initial results are interesting. First, a survey of employers revealed that large firms learned quickly about the credit but small firms did not. By February 1978, about 90% of the firms with over 500 employees, but only 30% of the firms with less than 10 employees, had learned about the credit.

A second finding is that only 6% of the firms which knew about the credit claimed that they changed their employment behavior as a result of the credit. These results are not too surprising given the fact that large firms were unlikely to respond to the credit because of the \$100,000 limitation on total credits to any one firm.

At this point, we cannot determine the extent of additional employment induced by the credit. However, even if the Jobs Tax Credit does add to total employment, the Administration strongly believes that Government expenditures and tax credits should be targeted to aid the disadvantaged.

The other existing employment tax credits are the WIN and welfare tax credits, both of which are aimed at reducing structural unemployment and are targeted on the disadvantaged. The Congress established the Work Incentive (WIN) tax credit in the Revenue Act of 1971. In 1975, 1976, and 1977, Congress amended this statute and created the welfare tax credit. Although the WIN and welfare credits have differences in coverage of eligible workers and employers, the purpose of both is to increase the employment of welfare recipients.

Under the WIN and welfare credits, employers may claim 20% of the first year wages of eligible workers as credits against tax liability. Employers may utilize the WIN credit if they employ workers who are registered for the WIN program. The local WIN office certifies to employers those workers who are WIN registrants. Any welfare recipient who has received benefits continuously for 90 days or more qualifies. The WIN credit is restricted to employers engaged in a trade or business while the welfare credit is available to nonbusiness employees, such as household workers. Both the WIN and welfare credits require minimum amounts of employment. To take the WIN credit, firms must employ WIN registrants for an initial 90 days and then another 90 days unless the employee quits, becomes disabled, is fired for cause, or is laid off because of a decline in business. Under the welfare credit, employers must retain eligible workers for more than 30 consecutive days of substantially full-time employment. Employers are restricted from laying off or reducing the hours of other workers eligible for the WIN or welfare credits. The maximum credit an employer may claim for any one tax year, is \$50,000 plus one-half of tax liability over \$50,000.

Since we have several years of experience with the WIN and welfare credits, it is possible to draw conclusions about their effects. The most important conclusion is that the credits have done little if anything to increase employment of welfare recipients because they have been little used. Certifications for the welfare credit have run less than 2,000 per year. In a typical year, employers have claimed WIN credits on behalf of about 30,000 workers. This number is less than 1% of all heads of AFDC families and only about 5-6% of employed AFDC recipients. We are presently unsure of the factors leading to the low utilization rates.

In another finding, researchers could find no evidence that the WIN credits ever caused employers to increase total employment. In other words, even where the credit did cause employers to hire more welfare recipients, the employer simply ended up substituting one worker for another.

To remedy the information problem, the Department is embarking on a nationwide campaign to inform employers and to simplify procedures for using the credits. An initial effort in four demonstration cities appeared effective. The publicity campaign increased certifications for the WIN credit by 100% while the national increase over the same period was only 45%. Unfortunately, we do not know how much of the additional utilization of the credit resulted in additional jobs for WIN registrants and how much came about because eligible employers began claiming credits which they had previously passed up.

EMPLOYMENT TAX CREDIT PROPOSALS

Now, I would like to turn to the proposals for changing the existing employment tax credits. The Administration has recommended enactment of a new tax credit targeted on disadvantaged youth and that the Jobs Tax Credit expire as planned under existing law.

The purpose of the new targeted credit is to reduce structural unemployment and to provide better private sector opportunities for disadvantaged young workers. We believe that the targeted credit will compensate employers for the lack of prior work experience of disadvantaged youth. In this way, we hope to be better able to achieve our 4% unemployment goal without encountering the bottleneck shortages among skilled workers which lead to accelerating inflation.

Under the Administration's targeted tax credit, employers could claim credits for hiring disadvantaged youth, age 18 to 24, and handicapped workers regardless of age. The credit would equal 33% of the youth's wages (up to \$6000) earned in the first year and 25% of the youth's wages (up to \$6000) earned in the second

year. Since firms would have to reduce the wages deductible as business expenses by the amount of the credit and since many workers will earn less than \$6000, the Federal revenue loss per worker is expected to average about \$1150 in the first year and about \$850 in the second year. The youths would have to work full-time and would have to be employed a minimum of 75 days for the employer to qualify for the credit. To prevent wholesale substitutions and excess windfalls, no firm could claim the credit on behalf of more than 20% of its workers.

To qualify as disadvantaged and thus eligible for the credit, a youth would have to meet the CETA criteria. Only youth age 18 to 24 whose family income is less than 70% of the Bureau of Labor Statistics' lower living standard income level could be certified. The national average in 1977 for 70% of the BLS lower living standard income level was \$7,500 for a family of four. Handicapped workers would be certified by local vocational rehabilitation offices.

The Administration believes that targeting tax credits on disadvantaged youth makes sense now that unemployment is becoming more a structural problem than a cyclical problem. They have the highest unemployment rates of any subgroup. These rates were over 30% in March 1977 and are probably only slightly below 30% today. A better measure of distress is the fact that only 33% of disadvantaged youth are employed, as compared to 63% of all other youth. Disadvantaged youth must compete for the limited number of entry level jobs or for other jobs which pay little and require little experience. Unfortunately, the supply of such jobs has fallen far short of the number of youth wanting such jobs. Part of the problem may be temporary and be associated with the jump in the population share of 18-24 year olds. If this is the case, the situation may improve in the 1980's. However, at present, the unemployment and underemployment of disadvantaged youth is an extremely serious structural problem.

We estimate that the revenue loss associated with the targeted tax credit will be about \$350 million in FY 1979 and will rise gradually over 4 years to an annual loss of about \$1.5 billion in FY 1983. The credits in FY 1983 will go to employers in order to pay for 1.8 million person-years of employment. The actual credits could be substantially below the estimated levels if the response is as low as was observed in the WIN and welfare credits. However, given adequate publicity and promotion, we expect the credits to be claimed by employers. It is difficult to predict the number of new jobs for disadvantaged youth likely to be induced as a result of the credit; however, our best estimate of additional youth employment is 160,000 jobs by FY 1983. This implies a \$9,375 cost per new job for youth. Again, we do not know how many are new jobs and how many of the jobs are redistributed toward disadvantaged youth away from other workers. We do believe that the disadvantaged youth will be able to bargain for "better" jobs because of the advantage of bringing an employer a tax credit.

I would like to stress that we consider targeted credits to have important advantages over the untargeted credits.

First, we believe that the Federal Government's priority should be to improve the opportunities of those workers most in need. Thus, the Government should concentrate its limited resources on disadvantaged workers so that as labor markets improve the disadvantaged will not be left behind.

Second, we believe that only a targeted approach can relieve the structural unemployment problem that is a key barrier to reaching full employment. It is possible to increase jobs for the nondisadvantaged through conventional aggregate demand tools. The real difficulty is generating enough jobs for the disadvantaged. Thus, a tax credit will improve our chances of reaching 4% employment only if it stimulates employment of disadvantaged workers. With so much unemployment among disadvantaged workers, increasing demand for these workers will not be inflationary. On the other hand, an untargeted credit will increase demand for all labor and could thereby result in the kinds of shortages and bottlenecks that fuel inflation.

OTHER PROPOSALS

I would like to turn to the Congressional proposals for expanding the current WIN and welfare credits. In my testimony, I will address only the recent proposal put forward by Senators Moynihan, Long, and Cranston. These Senators recommend several important changes in the current WIN and welfare credits. They propose raising the rate of subsidy from 20% to 50% during the first year of employment; providing subsidies for the second and third years of employ-

ment with the same firm at subsidy rates of 33% and 25% ; limiting the wage over which the subsidy applies to \$6,000 in 1979, with increases at the same rate as minimum wage increases; and finally, allowing nonprofit employers to receive tax credits similar to those received by for-profit employers.

The Administration opposes these proposals. We feel that they are beset with a number of serious problems.

First, we oppose the size of the credit. The new credit would permit firms to claim the credit as well as the full wage deduction. Thus, under the new proposal, if the firm hired a welfare recipient at a \$6,000 salary, the firm would gain almost \$3,000 in reduced tax liability from the business deduction and another \$3,000 as a tax credit. Such a credit would make hiring a welfare recipient virtually free for firms making a profit. (These firms would have to pay about \$550 in social security and unemployment insurance taxes.) We do not believe that the Government should provide such extreme subsidies. If the Government is to subsidize virtually the full wage, then the proposed tax credits are, in reality, PSE for the private sector. In this case, regular PSE would be a more direct method of increasing employment among the welfare population, and would provide public goods and services to the public paying the wages of these workers.

Second, the Administration opposes extending eligibility to individuals and nonprofit organizations because nonprofit organizations are already eligible to participate in PSE, and extension of the tax credits to nonprofit organizations would open up the problem of refundability which the Administration opposes. We also believe that Federal tax expenditures should not subsidize dead end jobs in the household sector. In fact, under certain conditions, the tax credit as applied to certain affluent individuals could more than offset the total wages paid.

Third, the Administration believes that any major change in the welfare system should be considered in the broader context of general welfare reform.

It is true that the enhanced credits could stimulate new jobs for welfare recipients. If, however, such success were achieved, it could create a serious danger. As jobs became easier to obtain for AFDC mothers heading families, low income heads of two-parent families could experience far more serious employment problems. In States that provide AFDC-UF, such family heads might be pushed on to the welfare rolls. In States that do not provide AFDC-UF, displaced heads of two-parent families might face severe poverty and could only turn to food stamps. The vastly expanded credit could contribute to the breakup of low income families by increasing unemployment within their families.

This danger is not entirely the fault of the credit proposal. It is largely the fault of a welfare system that excludes most very low income two-parent families. If the President's welfare reform proposal were enacted, employment opportunities for poor two-parent families would be equal to those for one-parent families. However, at the current state of knowledge, we believe that it would be imprudent to commit large sums of additional dollars to employment tax credits, such as those envisioned in the Moynihan, Long and Cranston proposal.

The Administration believes that any employment tax credit should be only one element in a larger overall structural employment strategy and that tax credits should be targeted, especially in this time of increased danger of inflation. In this environment, it is best to proceed with caution. The Administration is moving cautiously by limiting employment tax credits to a target group that clearly faces substantial structural unemployment. Moreover, we view this credit as one of several tools for relieving the severity of unemployment among disadvantaged youth. We shall follow the impact of the targeted youth credit carefully. We believe it can improve the position of those now least able to compete in the labor market.

Mr. PACKER. Thank you, Mr. Chairman.

Senator HASKELL. The next witness is Matthew B. Coffey, executive vice president, National Alliance of Businessmen.

We are glad to have you here, sir.

Mr. COFFEY. Senator, I have a brief statement which I would like to submit for the record.

Senator HASKELL. It will be included in the record in full.

Mr. COFFEY. Thank you.

**STATEMENT OF MATTHEW B. COFFEY, EXECUTIVE VICE
PRESIDENT, NATIONAL ALLIANCE OF BUSINESSMEN**

Mr. COFFEY. I would just like to highlight some of the points in the statement and then answer any questions you might have for us.

My name is Matthew Coffey and I am an employ of the Textron Corp. which is a large, diversified company in Providence, R.I. I have been, for the past 8 months, on loan from that corporation as executive vice president of the National Alliance of Businessmen.

The national alliance was created 10 years ago and focused on structural unemployment. That is its principal concern, and the program it has been working on.

The alliance has gone through two phases and is now entering a third phase. The first phase was its creation phase, which was in response to the riots in the streets in the summer of 1967. President Johnson asked Henry Ford and other chief executive officers of major corporations to join together in a voluntary effort to find employment for structurally unemployed people.

I might say that the phrase "structural unemployment" is a convenient phrase, but it covers up a lot. From a businessman's point of view, structurally unemployed people are people who, under normal circumstances, we would never hire at the gate. They are people who are just not trained to do a job, they are people who have suffered for all of their life from economic deprivation, racial deprivation, and educational deprivation. And that is the way a businessman, in a normal circumstance, would look at these people as unqualified for employment.

The first phase of NAB, which lasted about 5 years, was a combined voluntary and funded program using funds under MDTA. NAB entered into contracts with major employers to reimburse them for the incremental costs of training structurally unemployed people. This training involved training in basic functional skills, from being on time to showing up to work every day in addition to the regular on-the-job training that a normal corporation would engage in.

When the CETA system came in at the end of that 5-year period, the business community essentially laid back. It was a time of economic recession. As a result, business' concern was shifted from structural unemployment and the NAB program in that period of time, up until really this past year, fell into disuse.

We are now engaged on what I see as the third phase. We have looked at the last 10 years and we have learned some lessons. Those lessons are that: one, we have not solved the structural unemployment problem. It is worse today than it was in 1968. More people are structurally unemployed now than then.

We then had a 4-percent unemployment rate. We now have a 6-percent unemployment rate.

I think that several lessons come out of that 10 years, however. One is that job creation is a function of the economy. It is not a function of special programs.

The economy is either healthy and the private sector is creating jobs or it is not.

Second, growth in job creation over the past 10 years has not been in large companies like my own. It has been in smaller companies. It has been with employers of less than 500.

Out of about 11 million new jobs created in the past 10 years, 8.5 million of them were with smaller employers.

Larger employers have the ability and the flexibility to use capital and to use electronic technology to grow. Smaller employees do not have that flexibility. They live much closer to the line. They live from day to day with survival.

As a result, they are highly labor intensive and represent where the growth is in this economy in terms of jobs at the present time.

The fact is that, over the last 5 years or so, the business community has not been participating in the CETA program. I think there was a total of \$140 million in on-the-job training contracts, with the private sector last year, out of a total expenditure of over \$12 billion.

So the CETA program has not been, as far as the business community is concerned, an effective vehicle for new employees. We are engaged in changing that with a new title in the CETA reauthorization bill this year, which has been approved by the full committee in the Senate, which is the administration's private sector initiative program. That program was designed with close cooperation with the business community and I think it will, through the private industry council mechanism, create an effective structural means for the business community to participate in the CETA program.

Right now, job creation is at an all-time high. We have been experiencing months where there have been 600,000 new jobs added to the economy in a single month—unprecedented growth. We are experiencing the largest number of "Help Wanted" ads ever published in the United States at the present time. The Conference Board, Dun's Review, which is a chief executive officer's magazine, U.S. News and World Report, all point to the fact that at any given time today there are about 500,000 jobs going begging for lack of applicants. A tremendous need for employees in the private sector.

We also know that is where the jobs are. Five out of six people employed in this economy are employed by the private sector. So if we are going to solve this problem, we have something of a dilemma. We have job creation growing in small business. We have the majority of Government programs designed and complex enough that only large corporations understand them, and you have a situation where large corporations prefer not to accept Government funds for job-training programs, simply because we have the flexibility to do it on our own.

Just to illustrate this latter point, I would like to point to President Carter's HIRE program. The President asked Bill Miller, who was then chairman of Textron, to head up his effort to employ 100,000 veterans in the private sector over this past year. We are 9 months into the program.

The program was that the President of the United States would write a letter to the chief executive officer of the Fortune 1,000 corporations. The chief executive officer would make pledges, and then the National Alliance would follow up on those pledges.

Based on that simple device, a letter from the President of the United States, in the 8 months that the program has been running to

date, we have in excess of 100,000 pledges by large corporations to hire Vietnam veterans. The NAB staff is now in the process of following up each of those pledges with each of those companies to make sure that by the end of this year there will, in fact, be 100,000 veterans employed.

The small businessman does not really have that flexibility, does not have that ability to respond to a request of the magnitude that the President made on large corporations.

I think that what all of this says to us is that the dilemma we face—growth of employment with small employers, inability of small employers to respond to requests to voluntarily help solve this societal problem, means that we need some mechanism to experiment with.

One very important and useful mechanism that I think all of us, in the business community feel will work is this private sector initiative program.

If title VII of CETA is approved the way the Senate committee has marked it up, I think we have a very workable, reasonable program that might get at some of this structural problem.

Senator HASKELL. Is this program designed for what you call the structurally unemployed?

Mr. COFFEY. Yes, sir. It is designed to create local councils to describe the problem locally. In other words, a majority of businessmen would come together and would survey their labor market, look at what the problems in that labor market are, and would from that decide what type of program is needed to address the structurally unemployed problem.

We are now at a point in the economy when we can spend time on the structural problems simply because job creation has grown just incredibly during the last 3 or 4 months, particularly.

So one of the important aspects of that program is the local aspect to it. More importantly, it is a relatively simple, easy program to understand for the businessman. He has an intermediary from the business community, called this private industry council, which will deal with the government for him so that he will not have to have direct contracts with the Labor Department or with the CETA prime sponsor.

One of the reasons that businessmen have not participated in CETA to date is that the standards just vary all over the lot. Just to give you an example of that, in the labor market in Richmond, Va., you have two prime sponsors. You have the city of Richmond and you have the county which completely surrounds Richmond.

In order for a businessman to enter into a contract with the city of Richmond, he has to go through about 40 pages of boiler-plate that is designed to protect the city from liability. In order to enter into a contract with the county, the businessman has a simple 4- to 10-page form, depending on the complexity of the program, that he can enter into with no difficulty.

Two prime sponsors serving the same labor market and the requirements are totally different. The businessman looks at this and his natural reaction is. I do not really want to get involved in all of this. I do not understand the risks. Why does the mayor feel one way and the county feel another way? There must be something wrong. The busi-

nessman is naturally suspicious of government programs and is very negative about redtape involved in those programs.

I think on the general subject of employment tax credits, we have not seen any evidence that they are spectacularly successful. We have not seen any evidence that they are a failure.

I think my feeling about them is that we have a new approach here, targeting toward youth, that might be a better way to do it than we have done it before. The problem with tax credits is with the smaller employer. The large employer is going to take advantage of these things to the extent that they are available. I think one of the reasons that more employers did not do more hiring under the program has been the cap, the 47 new employees was a cap for larger employers.

Senator HASKELL. Why was that a problem?

Mr. COFFEY. Well, simply because it was not of sufficient magnitude to make a dent in the problem.

Senator HASKELL. In other words, \$100,000 to a big corporation is not all that much?

Mr. COFFEY. That is not that much money, and so many large corporations said gee, it is not really worth all the trouble and shuffle and paperwork and concern.

So I would say that our feelings are that the tax credits are worth continuing, that we are in an experimental phase, that we ought to continue the experimentation, try to measure better than we have been able to measure to date results. In talking to business people, I have the feeling that many of them say: Well, it is a good idea, but we are not really sure it works. We are not really sure that the businessman's decision to hire is going to be changed in favor of the structurally unemployed person by the simple mechanism of the tax credit. We just do not have enough evidence to tell us that that is the case.

Senator HASKELL. Your statement is very interesting in that job creation basically has been in the small business sector and, as you put it, your corporation and corporations like yours have the advantage of advanced technology and can do a great many things that a small business cannot.

So it seems to me, assuming you are correct, how do we make either the jobs credit that I got through last year or the administration credit simple for the small businessman?

Mr. COFFEY. Well, the first thing we have to do is avoid any complexity of formula. When I listen to the proposals and they start talking about percentages and limits and criteria and a certain percentage of this unemployment tax base, and things of that sort, I think the natural reaction is to defeat the purpose of the credit in the first place.

Senator HASKELL. Well, let's take the administration's proposal. There is nothing very complicated about 18 to 24.

Mr. COFFEY. No, I think that is—

Senator HASKELL. That is a pushover.

But is it a problem to make the individual go to the employment office and possibly fill out a long form?

Mr. COFFEY. I think not. I think that is a service to business that is very important. The last thing a businessman wants to be in the position of doing is trying to determine the income level of an individual. In business, that is considered none of our business.

Senator HASKELL. So you think that is simple, from the applicant's view point, to go to the employment office?

Mr. COFFEY. Yes, sir.

Senator HASKELL. Then the next thing, then, is the we have to prevent churning. We have to prevent employers from firing people that are 25 in order to employ people who are 24. What is the simplest thing to do?

Mr. COFFEY. Well, I guess I disagree with that premise, and I disagree with it because employers generally are prejudiced toward older workers. They are prejudiced toward people 25 to 29 because they are more stable, they are more reliable. They show up for work more regularly. They have more obligations, so they have to work more constantly.

So the prejudice of an employer is naturally to hold on to people older than 24. So I do not think the substitution problem is as big as a lot of people would like to make it appear.

Now, there may be some companies where that is the policy, but I think there are sufficient monitoring mechanisms within the Labor Department to find those companies.

Senator HASKELL. OK. I am very interested in your point of view. You have obviously been working on this for some time.

Let's now take the proposal of the chairman of the committee, with Senator Moynihan, to target only toward persons who are on welfare. You see, the administration is saying the test is 18 to 24. I believe Senators Long, Moynihan, and Cranston are saying only give this credit for those on public assistance. What is your comment on that?

Mr. COFFEY. They are structurally unemployed from our perspective. I think that as we look at the problem right now, the problem is with youth.

As I like to say, although it could be challenged, American education used the postwar baby boom quite effectively to increase support to education. The postwar baby boom has now graduated and it is the problem of business.

So that is where the problem is, from our standpoint. It is a problem of the younger worker. The worker who is not used to working, not trained to work—that is where the problem is.

I understand what the Senators are trying to do with welfare recipients, but I think the problem is in both places, and the bigger problem is with youth.

Senator HASKELL. My last question is to see if this is correct. The staff has handed me a piece of paper which says that the experience of your organization over 10 years has been that 70 percent of jobs are created in companies of less than 100 employees and then if you go up to 500 employees, 77 percent of jobs are created in people hiring less than 500.

Is that an accurate statement?

Mr. COFFEY. That is roughly correct, yes. Major growth is occurring in small entrepreneurship. The people are more willing to take the risk to get into business now than they have ever before.

Senator HASKELL. Well, thank you, Mr. Coffey. I think you have added greatly to this hearing, and I appreciate your being here.

Mr. COFFEY. Thank you, Senator.
 [The prepared statement of Mr. Coffey follows:]

STATEMENT OF MATTHEW B. COFFEY, EXECUTIVE VICE PRESIDENT, NATIONAL ALLIANCE OF BUSINESS AND DIRECTOR, NAB PROJECT TEXTRON, INC.

Mr. Chairman and members of the Select Committee on Small Business: On behalf of the National Alliance of Business I appreciate this opportunity to share with the select committee the experiences of our organization in dealing with the structural unemployment problem.

Structural unemployment is distinguished from other unemployment because it deals with those person's unlikely to be hired even in the best job market such as the one we are currently experiencing. Solution of this problem engages business in activities far beyond on the job training. It involves a conscious effort by business to solve problems for the individual that all the previous social institutions have failed to solve whether it be the home, the church or the school system.

Over the past 10 years the National Alliance of Business has been encouraging businesses to work on the structural unemployment problem. We encourage this not just because its the right thing to do, but because it is in our long range interest to have a healthy social fabric of productive people.

The National Alliance of Business program is on the brink of its greatest program thrust in many years. This is true for many reasons:

1. The job market is in an accelerated growth phase.
2. The private sector is where 80 percent of all jobs exist in this economy.
3. The Administration has asked the National Alliance to actively lead its private sector initiative.

I would like to discuss each of these topics briefly.

Job creation is at an all-time high. Look at the recent printed evidence. The Conference Board in New York report that its survey of "Help Wanted Ads" indicates 500,000 jobs are available on any given day in the U.S. Dun's Review for March, 178 headlines "More jobs than workers". "There is a growing job gap in some areas with close to 500,000 unfilled openings. The June 26, issue of U.S. News and World Report headlines "The Surprising Boom in New Jobs."

The important largely unrecognized fact in each of these reports however is that the growth is not occurring in large corporations but in smaller ones. Small businesses, those that employ 500 or less, experience almost 80% of the expansion. That tells all of us concerned about effective manpower programs important things.

We know historically that five out of six jobs in this economy are in the private sector. Many of us tend to believe that most employment is with large organizations in the private sector. That tendency if ever true is not now true. Most employed people are employed in small businesses.

Our National Alliance experience tells us that large corporations, such as: GM-Chrysler, Owens Ill., TRW and my own company Textron, participate in manpower program on a voluntary basis. If the Chief Executive Officer is asked by the President of the United States to help solve a particular manpower problem large organizations have the flexibility to respond.

An example of that flexibility is President Carter's HIRE program for Veterans. The President sent a letter to each Chief Executive Office of the Fortune 1000 largest companies asking them to voluntarily pledge to hire Vietnam veterans. In response to the President's letter, in excess of 100,000 jobs have been pledged in less than nine months. The National Alliance staff under my direction is following up these pledges to assure that 100,000 veterans are employed by year-end.

The point is, that large corporations have the flexibility to hire with or without reimbursement. Reimbursable program or tax credits may stimulate them to do more but only if ceilings are high enough or nonexistent.

Small businesses do not have that flexibility. You don't find large corporate staffs in small businesses. They live much closer to the margin and can only participate in programs of this type if offered compensation and credits to help offset the incremental costs of training.

Mr. Chairman and members of the Select Committee we have a paradox. Any effective solution to structural unemployment must have active participation from small business but they are the least capable of responding.

Governmental solutions seem appropriate but must be carefully designed to solve the problem where and as it is found.

The solution must be administratively simple. Small businessmen have little capacity to cope with complex formulas or extensive forms. The best phrase to remember is whatever you design keep it simple not only in legislation but also in regulation.

The solution must reach for effectiveness with both large corporations and small recognizing the differences between them. Each type can make an effective contribution to solving the structural problem.

The solution must deal with the facts as they are but be flexible enough to adjust for swings in the business cycle.

Let me now talk briefly about two solutions. One is the CETA Title VII private sector initiative and the other, the pending matter before you this morning.

In cooperation with the administration the business community has had an important voice in designing the private sector initiative. I am attaching a brochure to my testimony that discusses the details of the program. I just want to make a few points about it.

Manpower problems are local problems and the private sector initiative is designed to get local business involved in the definition as well as the solution of the problem. Business needs a sense of ownership in order to effectively participate. This is particularly true for small business.

Funds under the program will be administered jointly by the CETA prime sponsors and the business community represented by a local private industry council. This will tend to build confidence in the business community.

The role of the private industry council will be to limit the administrative burden that has prevented most businesses from participating in CETA these past five years.

As you can see the private sector initiative is designed to be easy to understand, locally controlled and with built in mechanisms to limit administrative burden to the employer. It fits my prescription for effective manpower programs. If enacted in its present Senate form it will be the best chance we have yet had for an effective private sector program under CETA.

Employment Tax Credits can also assist this process. The Administration proposal seems reasonable because it targets on the greatest problem, youth unemployment. The design of the credit is flexible and should result in greater participation by employers. The ceiling of 47 new employees is removed which should help both large and small employers. The computation of credit is straightforward and easy to understand.

While the National Alliance Board has not taken any formal position from my viewpoint this new proposal also looks like it meets my earlier prescription for successful manpower programs.

Mr. Chairman, I hope this testimony has been useful background for your Committee. Let me take this opportunity to thank you for your effective work in shaping Title VII of CETA. We at the National Alliance hope you will continue to call on us whenever we can be helpful in providing information or a business point of view on manpower programs.

Senator HASKELL. Our next witness is Prof. Robert Eisner, Northwestern University.

Professor Eisner, we are glad to welcome you back again.

Mr. EISNER. Thank you very much, Senator Haskell. It is very good to be back.

STATEMENT OF ROBERT EISNER, WILLIAM R. KENAN PROFESSOR OF ECONOMICS, NORTHWESTERN UNIVERSITY

Mr. EISNER. I hope it is not too brash of me to include myself with you in a small ingroup of people who have struggled to get employment tax credits into the law and have made, I think, an auspicious beginning, although we have a good way to move. I was happy to be here in February 1977 and earlier in 1975. This is an old hobby of mine—pushing for tax credits and subsidies to try to encourage employment.

I would like to make first a general remark or two on the subject, and that is that the potential in employment tax credits properly formulated and not overly limited, is enormous. The potential is to get people to work and, at the same time, reduce labor costs and, in that way, combat inflation.

I am submitting a statement for the record—

Senator HASKELL. It will be included in full.

Mr. EISNER [continuing]. And also an article just published in Challenge entitled: "A Direct Attack on Unemployment and Inflation," that spells out these ideas a bit further.

Mr. EISNER. I believe we should keep fundamentally in mind the basic analytical proposition that we are out to increase employment, to reduce unemployment, and we can do that using the private market by giving all employers—and I would not restrict myself to business employers or profit employers—give all employers an incentive to hire people, to put them to work, an incentive to hire people where market forces have somehow not operated appropriately.

Now, the most clear and direct indication of a breakdown in the market is simply unemployment itself, and I would urge strongly that in any of our targeting, we keep our eye on the main ball. Our targeting in an employment credit should be to those people who are not working. That includes those who are officially unemployed. That includes, as well, people who are discouraged workers, people who have not gotten into the labor force because they do not think they can find jobs.

You will find, among the unemployed, youth, blacks, women, veterans, minorities generally. If our targeting is to the unemployed, then we will inevitably be helping, in very large measure, the disadvantaged people to whom we want to direct ourselves.

Now, I will divide my remarks and try to be brief. I will speak first on the subject of the current jobs tax credit, which, of course, expires at the end of this year, then discuss briefly the administration proposal, and then amplify a bit on my own extensions of the current credit which, I think, would be a very considerable improvement, both over the current credit and the administration proposal.

The current credit I consider a great advance, simply because it is an effective general credit. It also has the great advantage of being a marginal credit. We want a tax credit, to be blunt, not to relieve taxpayers, not to give people, whether small businessmen or anybody else, more after-tax profits. We want a tax credit to put people to work.

We therefore do not want to give, any more than we have to, a credit to people for doing what they would do anyway.

I consider it rather remarkable that the administration, in its proposal—or in the Treasury's fact sheet—thinks to criticize the current jobs credit as presumably giving benefits to employers to do things they would do anyway, while it is pushing for the investment tax credit and extension of the investment tax credit that is currently costing the Treasury some \$15 billion a year, and notoriously gives benefits for the purchase of equipment that most firms would be buying anyway.

The great glory of the current job tax credit is, to a very large extent, that it is a marginal credit for increases in employment over some

base—a base which I think is too high—so therefore you get a very large bang for the buck. You do not give out tax dollars, to a very large extent not for employment which would be undertaken anyway, but for increases in employment.

Of course, to the extent increases in employment would be undertaken anyway, there is some leakage, but the leakage is much less than you would have in a credit which goes to an entire broad category of people that might be hired in any event.

Now, in terms of the current credit I was glad to see Senator Haskell's repeated questions, or remarks, on the matter of the awareness that business firms had of this. I guess I should not refrain from being blunt. One can almost wonder if there was some international sabotage, or perhaps just bureaucratic ineptness, in the way this current credit information did get out. For, from the very passage of this legislation, we understood there would be a problem.

Of course, the administration opposed it to begin with, but then there was very clearly an inadequate job done in publicizing that and it comes out in the surveys. A survey of the Census Bureau for the Department of Labor indicates that, out of some 3 million firms, a remarkably small number became aware of it. A considerable number of those who were aware were ineligible.

You finally came down to a figure of some 150,000 firms out of some 3 million that (1) considered themselves aware of the credit and (2) considered themselves eligible to use it.

Of these, some 36,000, about 24 percent, said that they used the credit to try to increase employment.

So, if you could project that, you would. I think, come to a somewhat more encouraging figure than the 190,000 estimate of new jobs that we get from the National Federation of Small Businesses, a figure of 190,000 which is rather sustained indirectly by the Census survey.

That, then, was accomplished with inadequate information of the firms, with lack of awareness, with the firms becoming aware of it to the extent they did only when they had to pay their taxes, which is no way to use a credit to stimulate employment. The idea was not to have employers discover from their accountants last March or April, as many of them did—and I have gotten this from personal reports—then they discovered they had a tax credit coming to them. That was not the idea.

The idea was to tell them in advance, "You have a credit. Now go out and hire additional workers and you will get an advantage."

I checked on this in my own district IRS office. I did it—I am not a small businessman—I was not looking for a credit for myself—but by way of inquiry. I found I could not even get, in the Internal Revenue Service Office in my area, the 902 form which gives information on using the credit. They did not know about it. They did not have it. I finally got it by a call to one of these central numbers, but that was no way to get the word out adequately.

Now, the current credit does have some difficulties. I understand the concern for helping small business primarily, but the \$100,000 limit, as pointed out, is really unfortunate in that it not only is not limiting you to a specific amount for larger businesses, but it has another effect which I am not sure if people bother to see. Take a large firm that

would be getting \$100,000, because it is increasing its employment not by 47 or 48 but by 100 workers. Anyway, there is no incentive to go any further. Once you have hired 58 additional workers, you can forget about it.

So again, it is just a giveaway up to a flat amount rather than an incentive. So the \$100,000 limitation, I think, should be removed, and I am glad to see the administration is proposing that change.

Turning then to the administration proposal, it does have the advantage of eliminating the ceiling. It has some advantage of concentrating on 18- to 24-year-olds, and I have long argued, as I am sure that many others have, that it is very important to meet the problem of youth unemployment.

It is, I think, very unfortunate and regrettable to meet the problem of youth unemployment in a way that then leaves out the rest of those who are unemployed and further, to put so many restrictions on it that it, I think, is going to be self-defeating.

Now, a major restriction to which Senator Haskell has pointed in his questions earlier this morning, is, I believe—I should not presume on your belief, but I should say that your questions suggested to me that I could be agreeing with you. In any event, my own opinion is that the 70 percent of the regional lower income standard is a very difficult thing to administer and, indeed, disastrous in concept.

What the proposal says is that eligibility of workers will be limited to those who can be certified as “a member of a household that has an income of less than 70 percent of the regional lower living standard.” At another point, it turns out that this is supposed to be calculated on the basis of an annualized income over the 6 months previous period.

Now, I do not know who is going to try to certify this. Certainly, the employee is not likely to have a very good idea of the annualized income of those in his household over the last 6 months. If he has a good idea, there is every invitation to cheat. In fact, if the thing is to be enforced, there is every invitation to have the kind of fiascos we have known with Aid to Families with Dependent Children.

If it amounted to anything, if the whole program amounted to enough, it would be an incentive to youngsters, to households, to have whoever is earning the income of the family desert, leave the family, announce he is not there, go into the underground, leave his wife so that the kids are then eligible to get certified for these benefits.

By restricting the benefits to those in households below this 70 percent of the regional living standard, you are restricting it to a small proportion of the total available number and you raise, then, I would think, very difficult and, indeed, unnecessary problems.

It is also a politically disastrous kind of thing to do. I think we have heard of districts in Long Island and elsewhere which said they did not want to take aid, because it was aid only for a small group of minorities or someone from outside the district. Here, you are going to have a situation where large categories of people will be excluded from the benefits, benefits which we would like to extend, not just to the individual, but to the economy in terms of getting more people employed. I see no reason why a kid from a family whose income is a little bit more than the 70 percent, whose family income is normal, cannot be encouraged to get a job and have an employer with an incentive to hire him.

Now, finally—just another word on the administration proposal. It is, in many ways, a step backward, and I would hope that these two committees and the Senate and the Congress do not accept that kind of a step backward.

It is much more restrictive, as I am pointing out, than the current bill. It is less in amount. It is restricting it from \$2,100 to a maximum of \$2,000 the first year and \$1,500 the next, that despite substantial inflation since March of 1977 when the original bill was legislated. Thus, in very many ways, it involves a cutting back on what was a very promising beginning last year.

Since I gather time is short, I should perhaps be brief on what I would recommend, and I do have the details in the record. But why not just think in these terms, and see how much of my proposal you could adopt.

You want to stop unemployment. You want to increase employment. Why not target directly at those unemployed?

We pay \$80 a week, on the average, in unemployment benefits. We have some 3 million in covered unemployment—it ran somewhat more than that through most of this past year—3 million at \$80 a week, \$4,000 a year—that is about \$12 billion. I do not know the precise figure. It may be more on unemployment benefits.

Suppose we offer a credit for net additions to employment over a certain base of up to 50 percent on wages paid for up to \$80 a week, this average unemployment benefit? For any worker that is hired on this, there is a net gain to society. You are not having to pay him unemployment benefits and the employer is hiring him and he has earnings, in addition to the \$80 a week, since the credit is at most only half of his income. We gain if he is earning anything more, and he would be earning in addition to the credit at least the amount of the credit that is paid.

You could limit this to those unemployed 5 weeks or more. That could be simple, looking at simple administration. It could be on the basis of the fact that the person has been receiving unemployment insurance benefits, so that is a matter of record. Or you could have a person, if he is not in covered employment, simply register for the benefit and then, after 5 weeks, he would be eligible.

Now, I am very much conscious of the problem of youth unemployment. I would hate to have a situation where you have to wait for a job after you get out of high school or you drop out and the employer says, "I cannot take you until you have been unemployed 5 weeks. Come back then." That is sort of a ridiculous situation.

I would say for those under the age of 20 without jobs and with less than 6 months of prior employment, that there should be no such waiting period, and I would similarly say there should be no such waiting period for those out of the labor market due to child rearing, and that there is every reason to encourage women to come back. They have a problem coming back to jobs or getting jobs after they have been out of the market. And finally, I would certainly extend this immediate benefit to people coming out of military service.

So there would be no waiting period for youths, for women coming off child rearing, and for veterans. For others, they would have to be without a job for 5 weeks.

I would remove the \$100,000 limitation and I would add, by the way, that the payroll tax should be paid for out of General Treasury revenues, earmarking that however you wish. For those under the age of 20 there are good reasons on which I can amplify for doing that.

And finally, I would relate the tax credits to the payroll tax rather than corporation or individual income taxes and this would have a couple of major benefits. One, we talk a lot about fighting inflation. We worry about how we can reduce unemployment without aggravating inflation. This is a beautiful, direct way, because, if you cut payroll taxes by this kind of a subsidy, you are reducing costs to the employer.

There is no blinking from the fact that a major element in determining prices is costs and the major element in costs are labor costs. If you have your credit tied directly to the portion of taxes going to payrolls, you are making it easier for employers to hire. They are reducing their costs, and therefore, we are combating inflation.

And, in addition, by tying it to payroll taxes rather than corporate, or individual income taxes, you do permit an extension to nonprofit institutions. I would urge, if there is not too much feeling against it, that State and local governments, school districts, be included. There is a lot of additional hiring that could be done there and there is no reason to restrict an effort to encourage employment to the business sector, to the profitmaking business sector alone.

They certainly should be included. There is no reason to exclude them.

I am the trustee of a small, private nonreligious school and they, I suspect, could well use this credit to hire additional people. There are schools, universities, churches, if there is no constitutional provision on that, hospitals, all kinds of nonprofit institutions who could hire people, who could hire youths. I think it is an absurd bit of prejudice to say we should not include nonprofit institutions.

I have not studied the Moynihan proposal in detail, but the objection advanced by Secretary Packer against including them is, I think, a very unfortunate objection.

I think I have gone beyond my time. I thank you very much.

Senator HASKELL. Basically, Professor Eisner, you believe in the employment tax credit. You would remove the \$100,000 lid. You would make eligibility depend upon length of unemployment rather than age factors or other factors.

Would that be basically it?

Mr. EISNER. That is correct, sir.

Senator HASKELL. And you would spread it to the nonprofit and governmental sectors as well as to the profit sector?

Mr. EISNER. Right. I would also include that incremental or marginal factor, although I would somewhat lower it and make it more generous. I would suggest that we retain the current credit, in effect, with the expanded amounts and with the eligibility for increases in employment over 102 percent of a previous average, and that would be an average of the previous 3 years rather than the last year. And I would extend the things that I have been talking about to employment over 98 percent of the previous year.

So you would have that 4-percent category for all of the unemployed we are trying to get. Beyond that, you could hire anybody. And that, also, I think, is advantageous.

We do not want to give anybody the notion that you want to hire particular people—youths, unemployed—at the expense of those who already have jobs. And therefore, there is no reason why we should not retain the credit for everybody for increases in employment over 102 percent.

Senator HASKELL. But the lesser percentage would be the targeted?

Mr. EISNER. For the lesser percentage, that is right. So there would be some special aid to the targeted, precisely, by making firms eligible at 98 percent of the previous average. The previous average is likely to be a bit lower than the previous year, because firms do tend to grow. It should also avoid a cyclical phenomenon which, some critics have pointed out, does exist in the current law, and that is there is some incentive for a firm to increase its employment—to cut its employment 1 year, if it really takes it seriously, in order to be able to raise it the next. And there is that kind of churning over time.

I do not know that it is serious, but by relating the base to a previous average, you would reduce that problem.

Senator HASKELL. Thank you sir, very much. I have no further questions.

Senator Long?

Senator LONG. I have no questions.

Senator HASKELL. Thank you very much, Professor Eisner. I appreciate it.

[The prepared statement and article of Mr. Eisner follows:]

STATEMENT OF ROBERT EISNER¹

It is most gratifying to be able to appear before you once more. You have been concerned and attentive to needs to reduce tax burdens in ways that will aid the economy and increase employment.

On previous occasions I have advanced a number of proposals which find expression in some part in existing legislation and current recommendations. The Congress has made an important start in offering incentives for increased private employment. It should be useful now to see what has been accomplished and where corrections and improvements are in order.

The existing jobs tax credit of up to \$2100 per employee for increases of up to 47 workers beyond 102 percent of previous employment has had some success. We cannot claim that it has been of overwhelming importance in the major increases in employment and decreases in unemployment in a period of little more than a year since its enactment. Surveys by the Census Bureau for the Department of Labor and by the National Federation of Independent Business both give evidence, however, of distinct if small contributions to employment. The NFIB offers "a tenuously estimated 195,000 jobs" figure, based on 2.4 percent utilization for its intended purpose. The Census survey, indicating some 2 percent conscious effort to increase employment by February of this year offers an implicit confirmation of the NFIB estimates. Neither survey traces possible secondary effects, negative or positive. Some new employees, may merely be hired away from other employers. But lower after-tax labor costs may encourage lower prices and bring about broader increases in demand, and hence output and employment, than survey respondents are likely to perceive directly.

Both surveys indicate great unawareness of the availability of the credit. The NFIB finds only 50 percent of small firms new of it by April. The Census survey found only about a third of respondents reporting awareness in February.

While these figures tell something about general imperfections and costs of information, they would appear to be prima facie evidence of inadequate administration of the jobs credit. One might argue that it is not a supreme responsibility of the Treasury to make the public fully aware of all possible tax breaks. In this instance, however, realization of the Congressional intent to see the jobs

¹ William R. Kenan Professor of Economics, Northwestern University.

credit used as a device to increase employment required a successful effort by the Treasury to acquaint businesses promptly and fully of the available tax credits. Clearly this was not accomplished successfully.

Out of a total population of over three million firms and sample responses representative of 2.2 million firms, only 768,000 knew of the new jobs credit before February 1978. Of these only 150,000, less than 20 percent, thought that they qualified for the tax credit. Some 30 percent reported insufficient growth in FUTA wages and 18 percent insufficient growth in total wages. A total of 27 percent of firms reporting knowledge about the tax credit said they did not know whether they qualified.

Yet of the 150,000 who were knowledgeable and reported themselves qualified, 36,000, or 24 percent, reported "a conscious effort made to increase employment as a result of the new jobs tax credit." These figures call sharp attention both to the potential of a jobs tax credit and to the measures, administrative and legislative, to make it more effective.

First, the Treasury and the Internal Revenue Service must make a major, good faith effort to acquaint firms fully with the availability of the existing credit or any new credit which is legislated. In my own very unscientific sample of one I found information on the jobs credit difficult to obtain and in considerable part unavailable in my district Internal Revenue Service office. There apparently was not even general availability of publication 902, "Tax Information on Jobs Tax Credit," at the time of our tax preparation in March and April of this year. Yet what was apparently in order was not merely the passive availability of information but a major effort to disseminate it.

Second, the Congress should look to extend and expand the existing jobs tax credit to eliminate the overlay of restrictive features which make the credit unavailable or of little use to so many firms that know about it. For one thing, the threshold restrictions of benefits to increases of more than 2 percent in FUTA wages or more than 5 percent of total wages, while an appropriate focus on maximum impact at the margin, or incentive effect, are set too high. Lowering these thresholds would make more firms eligible and offer these additional firms incentives to increase employment.

Further, the upper bound of \$2100 per employee, given associated employment costs in considerable part imposed by government in the way of payroll taxes, along with uncertainty in many cases as to whether a firm will end up benefitting, makes the credit too small. And major potential stimuli to employment for firms above modest size are currently precluded by the \$100,000 ceiling which essentially limits the credit to a maximum of 47 additional employees per firm.

The new Administration proposal may be viewed in part in the light of the existing credit and our experience with it. First, it improves upon the existing credit by eliminating the \$100,000 limit on benefits. In one sense it also improves upon the existing credit by removing the 102 percent threshold and thus making all firms potentially eligible. The Administration proposal has some particular appeal in offering benefits to workers between the ages of 18 and 24 where along with for younger teenagers, unemployment has been greatest. I have myself offered several proposals, including elimination of payroll taxes for the young, to meet our critical problems of youth unemployment.

Yet, the Administration proposal in a number of important ways represents a step backward, an unfortunate retreat rather than advance, in the scope and force of the existing credit.

First, despite the general inflation which has taken place since early 1977 and which is projected for the future, the Administration proposes a reduction of the maximum credit from \$2100 to \$2000 in 1979 and a further reduction to \$1500 per employee in 1980. Given required payroll taxes for social security and unemployment insurance running about 8 percent (and sometimes more), one notes that the after-tax benefit of the credit for an employee paid a minimal \$6,000 during the year would be no more than about \$900, assuming a 40 percent effective tax rate. For the firm would lose \$2000 in wage deductions for tax purposes while paying \$480 more in payroll taxes. The after-tax benefit would then be some 60 percent of \$2000 minus \$480. In the case of a firm paying \$10,000 to a new employee during the year the net tax benefits after payroll taxes would be in the order of \$720 in 1979 and only \$420 in 1980.

In aggregate terms, the existing jobs tax credit was projected to entail some \$2.4 billion of gross tax subsidy in 1978. The Administration targeted proposal

would lower that figure to \$562 million in 1979, with an ultimate full annual effect of \$1.5 billion. Thus, as compared to the current jobs tax credit, the Administration's proposal would raise taxes immediately in the order of some \$2 billion. This cost would be incurred directly, in overwhelming proportion, by small business and indirectly in added unemployment and consequent loss of income among (at least) the vast majority of untargeted potential workers.

Second, the limitation of eligibility for the credit to workers who can be certified as "a member of a household that has an income of less than 70 percent of the regional lower living standard" raises serious economic and administrative problems. It clearly rules out very large proportions of those who are unemployed, or more broadly, without full time employment whether in or out of the labor force. A large majority of the 18 to 24 youth population would fail to be certified by this criterion. Indeed a majority in the unemployed, partially employed and discouraged worker categories would also fail certification under this criterion.

But further, this needs test for eligibility is a work and income disincentive for other members of the household. The net effect could be to discourage employment and earnings for the household as a whole by as much or almost as much as the "targeted employment tax credit" would increase it.

The administrative problems in the income criterion and opportunities for cheating raise further horrors. Will we need an army of new investigators to ascertain whether a potential worker is "a member of a household that has an annualized income for the six month period prior to certification (exclusive of unemployments) which, in relation to family size, is less than 70 percent of the lower living standard income level . . ."? Would we, as with the tragedies of aid to families with dependent children, encourage income earners to desert a family or sneak into the underground to permit another member of the household to be certified?

I should also fear that the restriction of the pool of available workers to those with certificates, rather than increase employment in the potentially eligible category, may discourage firms from bothering to take advantage of the program. As with apparent difficulty with the WIN credit, it may not pay employers to seek out the relatively small proportion who are eligible. It may not even pay many youths to go through the certification process with all that this may imply for scrutiny of household income.

I would also question the ethical and associated political merit of this kind of restriction. Our aim is presumably to provide jobs. It is true that unemployment is most serious among youths, and youths in poor families in particular. All those willing and able to work in our society should, however, have the opportunity and encouragement to do so. Credits and incentives to work can and should be targeted at the unemployed. If this is done appropriately the most disadvantaged would surely be helped, but helped without excluding any of those looking for jobs. A program targeted as narrowly as the Administration proposal may help some at the expense of a good many others. This is surely bad economics and bad politics, and indeed under the circumstances more than a little unjust.

The proposed limitation of benefits per firm to 20 percent of FUTA wages, ostensibly to prevent layoffs of existing workers in order to hire those eligible for the credit, would not appear to be a sufficient limitation if one is proved needed. For while many firms may have a normal turnover of 20 percent within a year there are certainly others that would not.

The Treasury, in comparing its proposed employment credit to the existing jobs credit, reports, "Recent preliminary evidence from a survey of taxpayers indicates that a very large percentage of the existing credit goes to employers who report no conscious effort to increase employment in response to the credit." Their pointing up that evidence in this context is strange indeed. The large percentage is due in considerable part of the failure of the Treasury to make known in timely and effective fashion the availability and advantages of the credit to the millions of small businesses to which it most applied. Further, the investment tax credit, which the Treasury has been moving to extend and expand, has no marginal incremental threshold and hence clearly offers the great bulk of its \$15 billion in benefits for investment that would be undertaken without the credit. And finally, as compared to the existing jobs tax credit the Treasury-proposed employment credit, with no threshold, would probably offer a larger proportion of its much reduced total of tax benefits for employment that firms would have undertaken anyway without the credit.

The Administration proposal thus, while in some ways an improvement over the existing jobs tax credit, does appear on balance to be a step backward. It is likely to add fewer new jobs than the existing credit, if extended, can be expected to add as it becomes more widely known and understood.

Since the existing credit is due to expire and new legislation is therefore in order, it may be well to consider appropriate improvements. To this end I offer a specific proposal for an expanded jobs credit, which I have written up in an article, "A Direct Attack on Unemployment and Inflation," just published in the July/August 1978 issue of *Challenge* magazine. I should like to submit the article for the record but shall undertake to summarize briefly its main points.

My proposed measure would strike directly at unemployment with particular attention to youths and others disadvantaged in the labor market. Benefits would be larger than under the existing legislation and the Administration proposal. No one unemployed five weeks or more would be excluded. Firms would continue to receive credits for all increases in employment over 102 percent of a base, preferably related to average previous employment. But there would be further credits, for those in the eligible employment-seeking categories, for employment over 98 percent of average previous employment. I propose the following:

1. For net additions to employment offer a 50 percent tax credit of up to \$80 per week (the average unemployment insurance benefit) for:

A. Those unemployed five weeks or more, (1) covered and receiving unemployment insurance benefits; (2) not covered but registered for five weeks or more as seeking work.

B. Those under the age of 20 without jobs and with less than six months of prior employment.

C. Those seeking employment after being out of the labor market due to child rearing.

D. Those seeking civilian employment after being out of the civilian labor force due to military service.

2. Extend the current jobs credit on increases of employment of more than 2 percent, but without the eligibility criteria indicated above, to 50 percent of up to \$80 per week, and remove the \$100,000 limitation for each individual employer.

3. Have the Treasury pay the payroll taxes out of general revenues for those under the age of 20.

4. Relate the tax credit to the payroll tax rather than corporate or individual income taxes. Have the Treasury make contributions to the social security funds corresponding to the credits. Thus, extend the credit to non-profit institutions and ideally, as well, to state and local governmental bodies and school districts which participate in the social security system.

The criterion of employee eligibility for the credit for those in the special categories of unemployed five weeks or more, under the age of 20, and seeking employment after child rearing or military service is that total employment in the tax year be more than 98 percent of that of the average of the three previous years. This can again be calculated on the basis of FUTA contributions (adjusted for any changes in rate or base) with the further stipulation that FICA contributions (adjusted for changes in rate and base) must be at least 5 percent over those of the previous year, as in the existing jobs credit. Firms would continue to receive credits for all additional employees, in any category, corresponding to increases in FUTA contributions beyond 102 percent of the average of the three preceding years.

My article in *Challenge* magazine offers some discussion of this proposal. Very briefly here, I may point out that it builds upon the existing credit in ways that liberalize it and offer more incentive for employment of both youths and others. The liberalization extends not only to the amount of the credit but to the thresholds. These are set in relation to the average of three previous years of employment rather than of the past year, and also are at 98 percent rather than a 102 percent point for those unemployed for five weeks or more or in the youth, child rearing and veteran categories. These innovations reduce any potential contributions to cyclical instability.

Much has been made of the presumed conflict between our goals of increasing employment and output and combatting inflation. Employment tax credits, and particularly the one that I propose, will increase employment while lowering critical labor costs to employers. Hence unemployment will fall as inflation is reduced. As I indicated in my *Challenge* article, if we have been contemplating general tax reductions of some \$20 billion as a general stimulus to the economy, how about this modest investment for a direct attack on unemployment? If it

doesn't work, because employers find even a 50 percent tax credit insufficient to get them to hire the unemployed and increase employment, it will hardly cost much. And if it does work, we will have a big bang for our bucks and peace and prosperity without inflation.

[From Challenge]

A DIRECT ATTACK ON UNEMPLOYMENT AND INFLATION

(By Robert Eisner¹)

With unemployment still reported at six million the administration urges tax cuts to stimulate the economy. Critics object that further stimulus will fuel a stubborn continuing inflation. I propose a tax program focused directly on reducing unemployment *and* inflation.

We have an income tax credit of 10 percent for business purchase of machinery—a credit that the administration proposes to extend and increase. We have payroll taxes of 12 to 16 percent against employment. Let us redress the balance. Eliminate the investment credit and substitute a judicious mixture of lower payroll taxes and an expanded system of tax credits for the creation of new jobs for the unemployed.

Employment subsidies or tax credits are not new. Nicholas Kaldor urged them in 1936. A number of economists have explored them over the years in various contexts. Most recently, Gary Fethke and Samuel Williamson, and John Bishop and Robert Lerman have examined them sympathetically. They have been applied in other countries and have already been introduced in limited fashion in the United States.

Adequate aggregate demand is vital to combat unemployment. But the glory of payroll tax reductions and employment credits is that they can do everything general demand stimulus can do while reducing critical marginal labor costs. What is more, they can be pointed and guided precisely to our unemployment targets.

I propose two measures:

1. Elimination of all payroll taxes for workers under the age of 20.
2. Institution of a new 50 percent tax credit (or subsidy), subject to certain key restrictions, to employers who hire those without jobs.

The payroll tax elimination for youths, which I have urged before, has various merits. First, to the extent minimum wage provisions may particularly restrict hiring of generally low-paid teenagers, employers are given an extra cushion of 6.05 percent (or up to 10 percent, when unemployment insurance charges are added to contributions for social security). Second, some teenagers will be more attracted to low-paying jobs since their take-home pay will now be higher. Third, employers conscious of experience-rating charges for unemployment insurance contributions will be less loath to hire teenagers, whose unemployment rates can generally be expected to be high, if they are excluded from the calculations. Fourth, in all equity, teenagers should be relieved of the burden of contributions for which the expected present value of benefits must inevitably be extremely low. For those who begin work in their teens have a long way to go before retirement and disproportionately, many never live long enough to get there.

My major measure, the new expanded jobs credit, would be available only for hiring those without jobs. Employers could not benefit by bidding away workers already employed. I would suggest that a sufficient condition for eligibility would be unemployment for five weeks or more, which currently would cover 3.2 millions of 6 million officially counted as unemployed.

But what about youths looking for their first job, and child-rearers and veterans returning to the civilian labor force? Would they necessarily have to endure five weeks of unemployment before prospective employers would find them eligible for the credit? To avoid this, I would make them eligible without such delay. We might, however, restrict that special eligibility for youths to those who have not already had six months of employment.

HOW TO COPE WITH PROBLEMS OF COMPLIANCE

How could we avoid having employers discharge current employees in order to gain the credit on new workers? This can be readily accomplished by making

¹ Robert Eisner is William R. Kenan, Professor of Economics at Northwestern University.

the credit explicitly incremental or marginal. Employers could enjoy it for eligible new workers only to the extent that their total employment in the tax year was more than some base figure, say 98 percent of that of the average of the three previous years. This provision would mean also that, unlike the situation with the current investment tax credit, employers would receive relatively little advantage for what they would be doing anyway without the credit. It would also permit a relatively large credit with a major impact on incentives, yet small sacrifice in Treasury revenues.

How about the danger that the jobs credit would encourage employers, with a 50 percent government subsidy, to bid up already high salaries unconscionably? This can be prevented largely by setting an upper bound to the amount of the credit per employee. I would suggest a cap at \$80 per week, which is approximately the average unemployment insurance benefit. This would dramatize the fact that at worst the credit would be costing the Treasury no more than would be paid to an unemployed worker receiving benefits. Society would be better off, if he were employed, by the value of his output. And this would be equal at least to the half of wages or salaries for which the employer would *not* be compensated.

Would some workers not subject to the credit suffer to the extent those in the various eligible categories are aided? For example, would an adult worker trying to change jobs find no new employer willing to hire him until he had been unemployed for five weeks and hence could carry with him his certificate of credit eligibility? Much of whatever difficulty might occur on this account could be mitigated by the simple expedient of extending the temporary jobs credit enacted by Congress in 1977 but due to expire at the end of 1978. That credit did not have restrictions on eligibility of workers but was limited to a maximum of only \$2,100 per year per worker, \$100,000 per firm and, most important, employment in excess of 102 percent of that of the previous year. It should be extended with the amounts raised to the \$80 per week I have suggested, with the \$100,000 limitation eliminated, but with benefits for employment above the 102 percent benchmark (preferably again related to *average* previous employment) still applied to all new employees. Thus, for employment between 98 percent and 102 percent of their base, employers would find the credit available to them only for the designated jobless categories: those unemployed five weeks or more, youths, child-rearers and veterans. Beyond 102 percent of their base employment, however, they could gain the credit on anyone they hired.

Would there be a possibility of layoffs of higher-priced employees in order to take maximum advantage of the credits of \$80 per week, or at most \$4,160 per year applicable thus to only the first \$8,320 of compensation? This could be avoided by a further restriction, akin to that in the current jobs credit, limiting benefits to 50 percent of the excess of total wages over 105 percent of those of the previous year (the extra five percent allowing for modest wage inflation).

The credit I suggest should be tied not to business income taxes but to payroll taxes. A major advantage of this is that it would entail a direct reduction in labor costs, and in marginal labor costs at that. These could be lowered as much as fifty percent, and more for youths no longer subject to payroll taxes at all. The removal of upward pressure on prices and indeed the pressure of competition to drive product prices down with costs could be dramatic.

By tying the credit to payroll taxes we also could readily include non-profit institutions and nonfederal governmental bodies, both of which could prove important sources of increased employment. Little additional bookkeeping would be necessary for any employers, as FICA records (for social security contributions) could be readily adapted to calculation of the credit. If we are concerned with loss of revenues to social insurance trust funds, we can earmark, say, the first nine percent on all individual and corporate income tax returns for compensating contributions to those funds.

COSTS AND GAINS

How much would all this cost and what would it gain us? Estimates will vary with the distribution of employment possibilities for firms and elusive elasticities of substitution and demand. Simulations reported by Bishop and Lerman yield remarkably large potential effects from even the much smaller and more limited credit enacted by Congress last year, employment demand rising by 4.6 percent and price declining by 1.78 percent. With back-of-the-envelope-type calculations,

I suggest much more conservatively that we might achieve with my proposals, multiplier effects aside, a net increase in employment of two million with credits for some five million man-years of employment involving a gross tax credit subsidy of \$20 billion. Adjusting for savings on unemployment benefits and other income maintenance, as well as increased payroll and income tax receipts from the increased employment and a loss of \$5 billion on payroll taxes for teenagers, leaves a net cost to the Treasury of perhaps \$10 billion.

This amount is of course considerably less than the \$19.4 billion net tax reduction now proposed by the administration. And whatever the imagined or real dangers of a general tax cut aggravating inflation, the measures here proposed would contribute directly to lower marginal labor costs and prices. If we wish a general tax reduction as well, and some temporary stimulus to lagging business investment, I have the accompanying tool for that. Legislate now not the extension and expansion of the investment tax credit, as the administration proposed, but its abolition effective in 1980. We could couple that with a corresponding reduction in corporate and other business income taxes. Then firms would have every incentive to acquire equipment now while the credit is still available and the higher current business income tax rates make associated depreciation and other tax-deductible charges more valuable.

ADVANTAGES OF JOB CREDITS

A great appeal of the job credit core of my proposal should be its potential to find and strike directly at its target. Employers will receive benefits only to the extent that they hire the jobless without laying off those with jobs. If, as is the case, unemployment is high among blacks, firms will find themselves drawn to hiring blacks in order to receive their benefits. If, as is the case, unemployment is higher among women, firms will be drawn to hiring women to receive their benefits. If, as is the case, unemployment is much higher among teenagers, and particularly among black teenagers, employers will be drawn to hiring teenagers and black teenagers in order to receive their benefits. Like a heat-seeking missile, a jobs credit tied to nonemployment will lead employers to seek out exactly those who need jobs.

Leaders of organized labor or others concerned with tax breaks for business should think again before criticizing this. The investment tax credit, for example, will cost the Treasury, even in its present form without extension to structures as proposed by the Carter administration, about \$13 billion in calendar 1978. Whatever impact this may have on business investment, the bulk of the credit surely goes to firms for buying machinery and equipment that they would have purchased without the tax break. To the extent that more machinery is installed, the substitution of machines for workers is likely to take away more jobs than any initially created to produce the machines. But an employment tax credit will increase the demand for labor. It will do far more than a minimum wage law for wages of low-paid workers, let alone their employment. And even with all of its focus on those without jobs, it cannot help but increase the general tightness of labor markets and hence the wages and bargaining positions of all of labor.

So, if we are contemplating general tax reductions of some 20 billion dollars for general stimulus to the economy, how about this modest investment for a direct attack on unemployment? If it doesn't work, because employers find even a 50 percent tax credit insufficient to get them to hire the unemployed and increase employment, it will hardly cost much. And if it does work, we will have a big bang for our bucks and peace and prosperity without inflation.

Our next witness is Mr. John Palmer, senior fellow, Brookings Institution.

Mr. PALMER. Thank you for inviting me here today, Senator Haskell. I have a statement which I will submit for the record and I just want to summarize briefly some of the major points that are in that statement.

Senator HASKELL. Your statement will be made a part of the record.

**STATEMENT OF JOHN PALMER, SENIOR FELLOW, BROOKINGS
INSTITUTION**

Mr. PALMER. First, I think it is important to make the distinction between uses of employer subsidies for basically countercyclical purposes, where the intent is to try to increase general employment, such as is done with the new jobs tax credit, or for more structural purposes, where the intent is primarily to increase employment opportunities for particular target groups, which is more characteristic of the administration's youth proposal.

The first I refer to as general employment subsidies and the second as categorical employment subsidies in the remainder of my remarks. They really are aimed at two somewhat different objectives, and I think the design criteria for a good program to meet each of those goals is quite different. So an important point is that these goals should be kept somewhat separate and different programs ought to be used to pursue them. Trying to mix the two in the same program may lead to neither goal being served as well as if they were separate programs.

Now, obviously the desirability of either kind of program or approach depends very much on what we think the likely consequences of such a policy are going to be. I want to address myself in the remainder of the time, to what it is that we do know about the consequences of these employment tax credits and reach a few general policy conclusions.

With respect to general employment subsidies, there are really two kinds of studies that can be done to try to determine their consequences. In both cases, there is likely to be considerable uncertainty about what the actual effects are.

In the first case, one would actually try to predict, based upon past experience and relationships, what we think would happen if such a credit were put into place. In the second case, one would try to measure, after it has been in place, what actually did happen.

But even in the second case there is a prediction necessary because, if you measure after the fact what happens, you would still have to measure what would have happened if the credit had not been in place in order to know how much of what did happen was a responsibility, or a direct result, of the credit.

So whether you are doing studies beforehand or studies after the fact, you still are having to make predictions based upon our knowledge of what the relationships in these areas are and, in both cases, there is going to be a high degree of uncertainty about what the actual effects are.

So far, there have been studies that have attempted to predict what the effects of the tax credit, like the new jobs tax credit, would be. There is, as I say, considerable uncertainty about those results, but the studies that have been done generally agree that the net results should be that there should be more jobs, perhaps on the order of several hundred thousand, and a lower rate of inflation, perhaps on the order of a little less than half a point than if alternative policies that have the same budgetary impact—such as broader tax cuts, personal income tax cuts, the corporate tax cuts—were pursued.

Now, studies of the actual effects that would be done after the— Senator HASKELL. One benefit the jobs credit is that we are getting people to work and they, in turn, pay taxes. This, in turn, increases the revenue.

Mr. PALMER. Yes; that is right.

For the studies that are done after the fact, it really is a bit too early. There are a number in progress that are trying to look at what the actual experience in 1977 for the new jobs tax credit are. But since the IRS has just been able to make that data available, there really is not very much to report on.

Senator HASKELL. When you make that study, bear in mind the IRS has done virtually nothing to publicize the jobs tax credit. We just heard the Department of Labor say they had done absolutely nothing.

Mr. PALMER. I think the indications are that the actual use of the credit, at least for 1977, was very low, and I think that does have to be taken into account. After 1978 data are in, we will have a somewhat better test, but it will still not be conclusive in the sense that, if people were not well-informed, we do not know what the results would be if there were considerable information.

So the basic thing I want to say is that we do not really have a good feel for what the effects of the credit have been so far.

In addressing the question of whether it should be extended or not, I think that a very high priority right now of tax policy should be to try to reduce the rate of inflation. And, as Professor Eisner indicated, these kinds of credits have the advantage of reducing labor costs to employers and therefore have a favorable effect on price levels and on inflation.

So I would say that very definitely there ought to be some maintenance of tax policies that do have this favorable impact on inflation. If there were some sort of broader payroll tax credit, or even a rollback in payroll tax increases that might be even better. But, in the absence of that, I would certainly say that something similar to the new jobs tax credit ought to be extended as a part of tax policy.

In line with any extension of it, however, I would suggest some modifications. They are pretty much the same ones that Professor Eisner mentioned—removal of the cap, extension to a broader base of employers, and not updating the base quite as much as is contemplated under current law.

Now, let me move to categorical employment subsidies, where particular target groups—the structurally unemployed—are at issue.

Here, I think the consequences of such tax credits are even more difficult to predict than in the case of the more general employment subsidy such as the new jobs tax credit. The reason for this is that it depends very much on the nature of the particular target group that is chosen, the size of the subsidy, the method of implementation that is used, and probably interactions among these factors.

In theory, one would expect that, with such a categorical employment subsidy for a particular target group, you would get an increase in the overall level of employment relative to what you would have had in its absence. You would have an increase in the relative amount of

that employment that goes to the target group that you are subsidizing, and you would have an increase in the relative wage rate of that target group—that is, their wages would tend to be higher relative to the non-subsidized workers than they would have been in the absence of the credit.

The effect on economic growth, over time, however, is uncertain. It could be either positive or negative. It is difficult to say, a priori.

Now, to my knowledge there have really been no studies done at all to enable one to make estimates of what orders of magnitude these various consequences are likely to be under different forms of categorical employment credit, nor how sensitive the results are likely to be to different ways of defining it.

There are some studies that I am aware of that are beginning to get underway which may yield some fruit next year in this regard.

There are, as you know, two programs that have been in effect that are similar to these kinds—that is, the WIN tax credit and the earlier JOBS program which subsidized employers for extraordinary costs of hiring and training disadvantaged workers.

Success under both of these programs has been quite limited. However, I would like to suggest that they are probably not a good guide for what the likely effects of a broader and more streamlined employment tax credit might be for particular target groups.

Particularly this is because they were quite small, they were very short in duration, and the administrative burden, relative to the benefit to employers, was quite large.

So with all the caveats I have suggested about not knowing too much about what the effects are likely to be, I think one can still make some assumptions about what would be the best way to design a categorical credit now, if it were to go into place. Obviously with more analysis and more information, one would hope to make modifications that would improve it. But the basic characteristics, I think, would be that you would subsidize all new hires in the target group that is chosen. The program would be relatively permanent as it applies to that target group, but of shorter duration as it applies to any individual in the target group who is hired, perhaps on the order of 2 or 3 years, and may be phased down in size over that time.

It would be a fairly large percentage of wages, up to some maximum—on the order of, say, 33 to 50 percent. All employers would be eligible, and here I agree very much with Professor Eisner. Not only should we look to the private nonprofit sector, but I think we should also look to State and local governments. In contrast to public service employment programs, to the extent that we could encourage State and local governments actually to hire people straight into regular employment and do it with less than 100 percent subsidy, I think this would be advantageous.

And, finally, it should be structured in a way that the administrative burden is as small, or as negligible, as possible.

Finally, then, is the question of whether we should expand our policies and move ahead with much broader use of these categorical employment tax credits. The problem is severe, there is no doubt about it, and we certainly need to put more emphasis on trying to improve job opportunities in the private sector than current manpower policy does.

Here I am somewhat ambivalent. My instincts as an economic analyst tell me it would be nice to learn a bit more about these policies and what their likely consequences are before moving directly to national programs. On the other hand, the problem is severe. It is a tool that promises some effectiveness and would help to redress the balance in current approaches and put more emphasis on the private sector.

So, at a minimum, I would certainly argue that we should go for some large-scale national demonstrations. On the other hand, I certainly would not raise strong objections to moving immediately into a national program, if that were felt to be desirable.

Senator HASKELL. Thank you, Mr. Palmer. I think your willingness to try something out, as opposed to studying it, is very desirable. This is quite a contrast to a hearing yesterday in which the Department of Energy started studying something in 1976, 2 years later is still studying it, and cannot give us an idea of when they are going to make a recommendation.

I like your attitude of let's give it a whirl.

I have no further questions.

Thank you very much.

Senator Long?

Senator LONG. Let me ask you this question about people who are eligible to draw food stamps. If we can simply have a tax benefit available to the employer if he pays a person enough to discharge his or her family obligation toward his or her dependents, would that not be better than providing food stamps?

Would it not be better to give the employer a tax credit large enough so that he could afford to pay that person enough so that person would not be a welfare client on any of these programs?

Now, that is using a tax expenditure, or a tax subsidy approach, where otherwise you would simply use a direct expenditure by way of a Federal aid program. But would it not be a far more dignified way to help low-income workers rather than to have them go down and apply for the food stamps, or to get in line to apply for the welfare benefits?

Mr. PALMER. I definitely agree that probably the highest priority target group for such incentives for increasing employment opportunities are desirable would be what we generally call the working poor—those people in low income families that have the potential to be in the labor market. To the extent that such subsidies would increase their employment, it would reduce their need to draw on welfare benefits and that would certainly be very desirable.

Senator LONG. This tax benefit we now have on an incremental basis can be improved upon. Part of the problem is that where it only applies to the additional employee that you employ, it is so restricted that the employers do not even know about its being available. It may be discriminatory in that it discriminates against those who already have a job and who should make more income in order to adequately support their families. On the other hand, it fails to do what it is intended to do because it applies to so few people that nobody ever bothers to even get acquainted with the program.

Mr. PALMER. In the case of a categorical credit where there are particular target groups that you are trying to help, I do not think the credits should be incremental to a given employer's employment.

That is, anyone who is in that target group that is hired, regardless of whether the firm's employment base is growing or declining, ought to make an employer eligible for the credit, so that if the employer's work force is static but there is a lot of turnover, this would encourage that among the new hires would be people within the target group you are concerned about.

Now, that does raise, a little more severely, the problem that Senator Haskell has questioned—employers substituting subsidized for non-subsidized employees. I doubt if it would be very severe, and I strongly believe that it is not possible to build in safeguards to prevent it. There is no way to do that without unduly complicating the program.

So I think we live with a little, and assume that, in general, we are having an expanding economy and we are not really going to be depriving nonsubsidized workers of jobs as much as increasing the additional employment more strongly among target groups.

Senator LONG. If we do not do something to subsidize relatively low-income jobs, marginal jobs, it would appear that we are going to have a constant and recurring problem of underemployment. If we do something to subsidize these marginal jobs, we can maintain a substantially larger work force than we can without the subsidy.

Of course, in the long run, what you are doing from a social point of view is to place a burden on those who are doing better to help those who are not doing so well. But in terms of how you are going to do it, you have various options. One way you can do it is by paying people to do nothing, which is a very demeaning thing. In my judgment, anyone who persuades some poor soul that he is better off living on welfare than he is by doing something day by day to make a contribution to society, where the prospect is that as he does a better job he can move up the ladder, is doing that person a very great disservice.

That person is forming all the wrong kind of habits, and the first thing you know, he is getting in a position where he would be a burden on society and, in many respects, a burden on himself. He loses his own self-respect.

It is far better, it seems to me—even if it costs a little more—to avoid the welfare approach by simply creating with tax subsidies enough jobs so that anybody who wants one can have one—particularly if he or she has more mouths to feed.

Do you like that approach?

Mr. PALMER. Well, I think that it is not really possible to have jobs completely substitute for welfare. For example, we do not really know how successful efforts to increase private employment opportunities to these target groups will be, so that I could not agree with the notion of abolishing cash welfare payments in the expectation that the jobs will be there.

However, to, on the margin, put a lot of our additional resources into such credits and incentives to private employers, with the hope that a sizable proportion of those low-income workers who are able to work, will be drawn into private employment, while still retaining the cushion of welfare is very definitely an important goal and ought to be pursued.

Senator LONG. Some years ago the Talmadge amendment was agreed to and that gave us a 20-percent tax credit for someone who would

hire a person from the welfare rolls, and it really has been disappointing in that it has not moved a great number of people into jobs, but it was very limited. In the beginning, you had to hire the person and keep them for at least 2 years in order to get the benefit of the credit.

We have now liberalized it to the point where, if you hire somebody who has been on the welfare rolls for 90 days, you do not have to keep them for 2 years just to get the benefit of the credit.

There still are not many takers, but Senator Moynihan and Senator Cranston and myself are proposing that we go beyond present law to make it a 50-percent tax credit. We would even like to make it a refundable tax credit, so we are not going to argue about whether you have paid that much taxes or not.

We want to say that if you hire these people that are in the target area, you are going to get a 50-percent credit and we would propose that it be a refundable tax credit.

My guess is that if we do that, and if people know about it the way we would like them to know about it, we will have more jobs than we will have takers. But sometimes we are confronted with this problem of narrowing a provision down to where it is just incremental, and then saying that if you displace somebody you do not get it, and by the time all the ifs, ands, and wherefores have been added, it gets back to the old proposition that somebody said you were going to get it, but after you looked into it, you say just forget about it.

That's the kind of thing we must avoid, as I see it, and the way to avoid it is to simply say that if you employ these people and they have children to support, up to a certain income level, the benefit is there. If that is the case, I would think you would have more jobs looking for people than you have people seeking jobs, and one of these days we ought to do something like that.

Mr. PALMER. Well, I would hope you would be correct. I certainly agree—I have not had a chance to analyze the proposal that you are discussing, but the points that I listed at the end of my remarks tentatively indicating what is for probably the best way to structure a categorical employment credit, do, more or less, concur with the bill that you are talking about. So I think, in general, it is probably the way I would like to see it structured if we were to go ahead.

Senator LONG. Let me just give you an example. You have many poor families, where there is a mother who is looking for employment, particularly if the employment is sufficiently attractive over and above what the welfare payment would be, so she can pay someone to look after her children and go out and do some work.

In most of those poor families, the mother has no skills. About all she knows how to do is some household work. But on the other hand, here is another family where the mother would like to work but her husband already has a job, and perhaps that mother has a college education. She has some skills that the marketplace very much needs.

Now, if she works and has to pay, without any tax consideration for help to look after those children, if she cannot net at least 50 percent of what she is earning, it is not sufficiently rewarding for her to leave the home and take the job that is available to her.

But if you give her a tax credit for half of what she is paying, then she could pay this other person enough so that the mother in the low-

income family could take a job looking after the home, and might even take her child along with her while she does some domestic work, while the other woman goes and takes a job in an office. That way both families have a major increase in their income. That way you are helping two families. The tax advantage is theoretically directed to the employer, but actually it is a benefit for both employer and employee. They both share the advantage of it, one directly and the other indirectly.

Now, if in those kinds of situations we make employment opportunities available to women who would like to join the work force, it seems to me that you might find that you have more jobs than you have takers—and decent jobs. I am not saying they are the greatest jobs in the world, but they are jobs that pay enough so that a person would have substantially more income than the family would have under a welfare situation. Both families would benefit, and I would think that this approach might help a great number of people.

I am impressed by the testimony that says if you put this on an incremental basis and you get it so limited down with ifs, ands, wherefores, and whereases—in the first place it will be a year or two before those people in the bureaus ever get through writing those regulations and then even when you get the regulations written, so many people get disgusted with it because they thought it would help them, but actually it does not. The whole thing sort of falls into disrepute.

Senator HASKELL. Senator Dole?

Senator DOLE. I have a statement I would like to include in the record, and I have been listening to the chairman. I think much of what he says makes a great deal of sense. I also read the book that you sent us by Marty Anderson called "Welfare Reform." There are so many disincentives built into the program that there is no reason for anybody to do anything unless we institute some change.

[The prepared statement of Senator Dole follows:]

STATEMENT OF SENATOR BOB DOLE

Mr. Chairman, the concept of an employment tax credit is one which I have supported for many years. I am pleased that these hearings today will address the progress of the jobs tax credit and focus in on possible improvements.

The jobs tax credit adopted in the Tax Reduction and Simplification Act of 1977 was similar to legislation which I have introduced and supported. The credit is an attempt to bring about more jobs in the private sector of the economy by granting credits to businesses that hire more workers. The program is of limited duration and is intended to increase job opportunities while the problem of unemployment is most acute. The law is complicated. Therefore, I was disappointed that it took the administration so long to promulgate and clarify regulations regarding the program. I believe that the promotion of business activity and private sector jobs through jobs credits or similar mechanisms is an important element of our national economic policies.

The administration opposed the jobs tax credit in 1977. However, the administration has proposed to replace the general jobs tax credit with a targeted credit for the hiring of disadvantaged youth or handicapped individuals. In addition, the chairman of this committee, Senator Long, has proposed revising the present welfare recipients credit. Because unemployment has declined, it may be that these approaches are better than the expiring law. I hope that this hearing today will shed some light on the jobs tax credit program.

Senator DOLE. It was true of the FAP program that we had under President Nixon and is probably going to be true in any other welfare reform program. I think the administration's targeted program does

make a great deal of sense. This idea has been around for a long time. It used to be called the Human Investment Credit Act, HICA.

I do not know whether some Republican over in the House thought that up. He started peddling that back in the 1960's. So it has been around a long time. We are finally getting to the point where the administration was against the credit last year. That is why they dragged out the period to promulgate the regulations, and that is why the success story is not very good. But now the administration is supporting it if we limit it to a targeted approach. That may be a better way to proceed.

It seems to me that it is worth trying.

I am not certain about welfare tax credits and the WIN program. Nobody appears to know about them except the authors.

Thank you.

Senator HASKELL, Thank you, Mr. Palmer, very much.

[The prepared statement of Mr. Palmer follows:]

STATEMENT BY JOHN L. PALMER¹

Much as with public service employment programs, an important distinction regarding employment tax credits or other forms of employer wage bill subsidies is whether they are intended primarily as a counter cyclical tool to increase general employment (albeit with an emphasis on low wage workers), such as the New Jobs Tax Credit (NJTC), or primarily as a structural tool to increase the employment of a particular target group, such as the WIN tax credit or the administration's proposal for disadvantaged youth. The first set of policies I refer to as general employment subsidies, the second as categorical employment subsidies. To best achieve their respective goals the former ought to be temporary, utilized only during a period when general economic stimulus is desired, and applied only to the margin of employers' labor forces; whereas the latter ought to be more permanent, in order to encourage continued improved employment opportunity for target groups, and apply to all new hires of target group members. Mixing these two objectives in the same program is unlikely to be effective since the design requirements to best promote each are so different. Thus in my judgment the relevant issues concerning such policies at this time do not so much concern themselves with competition between the NJTC and the administrations' youth proposal as much as they flow from the following set of questions.

(1) If some continued federal stimulus of the economy is desired:

(a) Should a portion of it continue to be in the form of a temporary, general employment tax credit; if so

(b) How much of it; and

(c) Should the exact form of the current NJTC be retained or modified for this purpose?

(2) Should efforts to increase employment opportunities through categorical employment subsidies be expanded beyond the current WIN tax credit?

(a) If so, which are the most appropriate target groups; and

(b) What forms should the subsidies take?

Information on the likely consequences of different forms of both general and categorical employment subsidies, particularly in comparison to alternative policies with similar objectives is, of course, crucial to answering these questions. However, this is an area in which the state of our knowledge is characterized by a high degree of uncertainty. We know quite a bit about what kinds of effects should occur, but far less about their likely magnitude and how sensitive these results are to many aspects of the design and implementation of the policies. In the remainder of this statement I will expand on these points briefly, focusing primarily on categorical subsidies, and offer a few limited policy judgments.

¹ Senior Fellow, Economic Studies Program, the Brookings Institution. The views expressed herein are the author's and not attributable to other staff, officers, or the trustees of the Brookings Institution.

CONSEQUENCES OF GENERAL EMPLOYMENT SUBSIDIES

Sufficient data has not yet been generated by the experience of the NJTC to allow empirical testing of its actual effects. Some studies for 1977 should become available late this year, but they will be very preliminary. There is considerable evidence that many employers were not initially aware of the credit, nor was it in place long enough to effect their behavior for the whole year. Thus 1978 data will be necessary also to provide a good test of the credit.

Several studies have been performed, however, which essentially try to predict the effect of policies similar to the NJTC. They generally agree in their conclusions that such policies should generate more employment and a lower price level than more conventional macroeconomic policies (such as an income tax cut) having the same net budgetary impact—or, put differently, compared to alternative policies having the same net employment effect, such general employment subsidies should result in a lower price level and budgetary impact.

Exactly how much more employment and how much lower a price level will the NJTC result in over the 1977-78 period than, say, a corporate income tax cut of equivalent budgetary impact? Here is where there is considerable uncertainty in all the studies, and some disagreement among them. If I had to rely upon them I would estimate several hundred thousand more jobs over the two years and an inflation rate that is lower by somewhat less than half a point for 1978. Much of the employment effect will come from influencing the timing of employers' hiring decisions rather than the ultimate amount of hiring and by spreading the total of hours worked over more workers.³ I reemphasize, however, the high degree of uncertainty surrounding this best guess. The forthcoming empirical studies of the actual effects should reduce somewhat the degree of uncertainty, but undoubtedly considerable will still remain since it is difficult to determine what would have happened in the absence of the NJTC.

For several reasons, including the temporary nature of the subsidy and the recomputation of the base to which it applies, its relative effectiveness in promoting an improved employment performance for the economy should diminish with time and as the unemployment rate declines.

In light of these and other considerations, what should be the future of the NJTC? Certainly tax cuts that favorably affect the price level ought to be continued or expanded for 1979. I would only consider abolishing the NJTC if it were to be subsumed by a broader credit against, or roll back of payroll taxes, which ought to be the top priority of tax policy, given current inflation concerns. If it is retained, consideration ought to be given to changing its form so that: (1) the base for determining incremental employment is not updated as in current law but made lower; (2) the cap is removed; and (3) the credit is applied to payroll taxes rather than income taxes so all private sector employers can participate.

CATEGORICAL EMPLOYMENT INCENTIVES

The argument in favor of categorical employment incentives is, of course, that certain groups of workers have particularly undesirable employment outcomes. It is hoped that such incentives will either overcome the barrier of entry level wages (whether legally or otherwise determined) that are too high relative to employers' perceptions of workers' productivity, or at least provide the workers with an improved competitive position vis-a-vis other workers. Potential target groups frequently cited are welfare recipients, youth, the handicapped and the long-term unemployed.

It is even more difficult to predict the likely consequences of a categorical employment subsidy than a general employment subsidy. In theory, such a subsidy, abstracting from any indirect stimulative effects, can be expected to: (1) increase the overall level of employment; (2) increase the relative share of employment of the subsidized target group; and (3) increase the relative real wage of the subsidized workers. However, the magnitude of these various effects, the overall cost of the subsidy, and whether it would increase or decrease overall economic growth are all matters of very considerable speculation. One important factor that places a severe limitation on economists' abilities to make such estimates is that information is required on the extent to which employers will be led to

³ Because of the incentive for reducing hours per worker in favor of a greater number of workers inherent in the subsidy, the percentage increase in person-hours of work can be expected to be less than the percentage increase in employment.

greater use of subsidized workers relative to non-subsidized ones within any given level of employment as well as led to expand their overall employment. Very little is known about these "cross-elasticities of substitution" among different types of workers as economists call them. Additional complicating factors are that there are strong reasons to believe that the consequences will depend very strongly upon the precise group of workers subsidized, the amount of the subsidy, and the way in which it is administered—as well as interactions among all these.

Perhaps because of these difficulties and also probably because they previously have not been a burning policy issue, there are very few extant studies of categorical employment subsidies, and none that I know of that provide even general order of quantitative magnitude for the impacts identified above as well as costs. Some are now underway, including one at Brookings, that should bear some fruit next year.

As you know there is some prior and current experience with such categorical subsidies in the form of the JOBS program and the WIN tax credit, neither of which have proven very effective. These programs are not necessarily good guides to the consequences of the types of subsidies now being debated, however, because (among other reasons) they are small, not well publicized, of short duration, and a considerable administrative burden to employers relative to the benefit.

Given the uncertainties I alluded to earlier, my best guess at this time is that the ideal characteristics of any categorical employment subsidy intended to reduce structural unemployment are likely to be along the following lines. (Of course modifications undoubtedly will be called for on the basis of further analysis and actual experience). They should

be for all new hires of members of the target groups;

be a high proportion of wages, say 33% to 50%, at least up to some maximum;

last for at least two years for each new hire, being phased down in magnitude over this period;

be permanent for the category of workers;

be available to as broad a set of employers as possible, including private non-profit and public employers; and

be as negligible an administrative burden for employers as possible.

Given the uncertain effectiveness of categorical employment incentives, should we move ahead with them? I think so. The reasons for this are simple. The problems of inadequate employment opportunities for particular target groups is real and severe. Other methods to deal with this have had mixed results; at best they will be insufficient. We recently have been willing to commit a major level of resources, including over \$7 billion per year, to fully subsidize employment in specially created public service employment, with results that were (and are) no more certain than those of partial subsidies of regular jobs. We should be willing to invest a considerable effort (if not dollars) to explore the possibilities for directly promoting regular employment opportunities for the same target group. Whether this should be approached on a major demonstration basis at this time, or immediately implemented as national programs is a difficult judgment. My instincts as an analyst tell me we ought to know more before going ahead. But my concern over the magnitude and immediacy of the problem, and the imbalance in the existing federal approaches to creating jobs for disadvantaged target groups inclines me toward a learning-by-doing approach.³

Senator HASKELL. Now, we have a panel of employers: Mr. William Anderson, president of the Smaller Business Association of New England, Inc., Mr. Ken Valis, president, Colorado Paint Co.; and Mr. Frank Fairbanks, president, Horix Manufacturing Co.

Gentlemen, if you would proceed in whatever order you want and if it would be possible, please confine your remarks to 5 minutes to give us time to ask some questions. So whoever wants to go ahead.

³ I advance quite seriously the proposal that state and local public employers ought to be eligible for categorical wage subsidies as well as all private sector employers. If additional employment of target groups can be fostered directly in regular jobs with less than a 100% subsidy (as is inherent in PSE) why should it not be done? I see no compelling reasons to treat public and private sector employment differently in this regard.

This does not preclude the desirability of continuing some 100% subsidies for PSE as now structured. However, if the partial subsidies for regular employment prove effective, PSE programs could emphasize the very hard to employ who require a specialized environment, on either a temporary or a permanent basis.

**STATEMENT OF WILLIAM ANDERSON, PRESIDENT, SMALLER
BUSINESS ASSOCIATION OF NEW ENGLAND, INC.**

Mr. ANDERSON. Thank you, Mr. Chairman. I guess I am elected; my name begins with A. It is a pleasure to be here today.

As president of SBANE, the Smaller Business Association of New England, and the owner of a small manufacturing company, my primary interest in the jobs tax credit is that it is good for small business.

The Breckinridge study reports that in the last 8 years the smaller companies have accounted for 99 percent of the increased employment, and I would like to submit for the record a copy of that particular graph showing those figures.

Not only does the smaller business account for the expanded jobs market, but it also provides entry-level jobs in the urban areas and the areas of high unemployment.

Has the jobs credit worked? Let's be altruistic for a minute. The credit provides money where it is needed.

The companies creating new jobs are growing companies and have the greatest problem with cash flow and capital development. Employment is a national economic and social goal, certainly worthy of tax incentive considerations, and during the duration and minimal cost of the job credit to date makes it premature in judging its effectiveness. As the economy winds down, in the coming months, the continuation of this credit becomes imperative.

The President has suggested the elimination of this program in favor of a targeted jobs credit. As an employer interested in human resource development, I can assure you that the program neither exists nor has been conceptualized that will compensate a company for the patience and investment required to successfully rehabilitate many of the members of this targeted group. It will take bold social and economic action to accomplish such a difficult task, and I am an employer who participates in job training programs, both the WIN program and other CETA programs.

We have two in training at all times and the turnover is incredible, because you just cannot get them to stay with the program.

Participation in the present jobs credit program is abysmal. How can an added degree of sophistication possibly increase participation? The fact is that the administration has attempted to obviate the jobs tax credit legislation remaining silent on its existence. It is there if you can find it. It is a veritable Easter egg hunt.

For those companies who have discovered the program, less than 50 percent of those eligible, it has been an important incentive. Almost as much psychologically as economically, faced with rising minimum wages, social security taxes and fringe costs, the inertia in hiring is staggering.

At the end of last year, my company received a \$6,000 job tax credit. After discounting qualifying wages, we ended up with about a \$3,000 increase in retained earnings. Maybe it was not much, but I sense the feeling of reward for helping the job market grow.

In the same period, our Federal income taxes increased \$21,000, so by growing jobs, there was hardly a drain on the Treasury for that particular year.

Certainly, there may be some windfalls in the program, mostly with new companies. Unfortunately, new companies usually do not have any profits. Also, I have been involved in enough startup companies to know that the carryforwards seldom are entirely used.

We recommended in the original program that the credit being against payroll taxes, with many of the smaller companies having an opportunity to utilize the credits against income taxes.

The verdict is still out on the job credit, though we know it directs relief to the area of the greatest need. Until such time as it can be demonstrated to the contrary, we consider it is a totally effective device to increase employment, however underutilized it may be at this point.

I thank you. I have several other examples, if we have time, in my testimony of companies that have experienced good luck with the jobs tax credit in Vermont, New Hampshire, Maine, and Massachusetts.

I forgot to introduce Ed Prendergast on my left, who is the chairman of SBANE's tax committee. I brought him along because, in this esteemed hall, one always needs a tax expert.

Thank you very much.

Senator HASKELL. Thank you, Mr. Anderson. Anything you have that is part of your statement will be included in the record. Are those examples part of your statement?

Mr. ANDERSON. Yes; they are. It is a 10-page statement.

Senator HASKELL. Mr. Fairbanks?

STATEMENT OF FRANK FAIRBANKS, JR., PRESIDENT, HORIX MANUFACTURING CO.

Mr. FAIRBANKS. I am Frank Fairbanks, Jr., president of Horix Manufacturing Co. We are a manufacturer of packaging machinery, located in Pittsburgh, Pa. I represent today the Smaller Manufacturers Council.

SMC is a trade association headquartered in Pittsburgh, with over 800 member companies in Pennsylvania, Ohio, and West Virginia, with a combined employment of over 75,000 people.

SMC appreciates the opportunity afforded us to meet with you today to comment on the recently enacted New Jobs Credit.

We in the small business community feel that the New Jobs Credit is an appropriate addition to the Internal Revenue Code and that it should be continued in its present form. However, to be more effective, it needs much greater publicity. The credit is a targeted program. It reduces taxes on growing small business.

As you know, the credit is, of course, applicable to all businesses, but because there is a \$100,000 limitation, the credit is obviously not very meaningful to very large enterprises.

As all of you gentlemen are well aware from previous testimony, the raising of capital is often the most critical problem in small business growth.

The New Jobs Credit reduces taxes, and thus permits more funds for reinvestment and growth in small business. It gives relief for those companies who are expanding employment. Unlike the investment tax credit, the New Jobs Credit does not reward companies who eliminate employees by the addition of capital assets.

Let me give you an example of the value of the program to Horix for 1977. Our Federal taxes before credits were approximately \$142,000. The new jobs credit amounted to \$18,500 with a net tax savings, because of loss of deductions equal to the credit, of \$9,600. Our investment tax credit for that year was \$9,800.

We know of no better way to help employment than to target benefits to business enterprises that are adding employees. A desirable change would be to expand the credit, at least with respect to the first 5 or 10 employees. Possibly a 100 percent credit would be appropriate for the first \$42,000 of increase due to wages. This would provide even greater help to the very small growth enterprises.

As to the administration's proposal for the new targeted employment tax credit program, we feel the overall objective is worthwhile, but the proposed mechanism may not prove adequate incentive for significant small business participation. The difficulty involved in verifying employee certification, combined with the increased costs which may be incurred in employment of these targeted employees, may significantly reduce any incentive which the targeted employment tax credit program is designed to create.

Further details appear in my written statement. Thank you.

Senator HASKELL. Gentlemen, thank you.

You probably were here when the last two witnesses basically said that the current jobs tax credit was desirable, with some modifications, and they also said that a targeted tax credit with different criteria, either such as the Administration proposes or Senator Long proposes, could both work in tandem. In other words, they felt both were desirable at hitting the unemployment market.

Would it be your feelings that you could have both or would you just say that you should have one or the other?

Mr. ANDERSON. If I could answer first, we had a dialog with the administration when they were developing this program and they asked us how much money would it take to induce you to take on a person in these targeted areas, especially the structurally unemployed. It was very difficult for our members, private businesses, to come up with a number.

Some of them said, if you paid their entire wages for one year, we might think about it, or take a chance at it. It is incredible how much incentive is required to habilitate a large majority of the members of this group.

We think to take a very good and effective tool, like the jobs tax credit, and oversophisticate it by piggybacking on another vehicle is, in fact, going to do, as Senator Long said, it is just going to muddy the waters. And so we do not recommend a piggyback targeted—

Senator HASKELL. I was not thinking of piggybacks. Suppose you have the jobs tax credit as it is now, with the modification that you indicate; then you have a completely separate program, which is your targeted program. You would be free to participate in one or both.

Would you have any objection if it were structured that way?

Mr. ANDERSON. We have no objection. We just do not think it would work.

Senator HASKELL. You just do not think it would work, but you have no objection.

Mr. FAIRBANKS. We have no objection either. We have reservations about whether the targeted program will work, and particularly whether it will work for the smaller enterprises.

Senator HASKELL. I understand. I would like to ask if you were in the room when the Labor Department testified on the jobs tax credit? We all know that the IRS moved with the speed of a tortoise in trying to get out that information.

Were you here when the Labor Department testified that they had not even tried to inform employers of the jobs tax credit?

Mr. FAIRBANKS. Yes; I was here at that time.

Senator HASKELL. I am glad to hear you gentlemen feel that the credit helps you, but certainly the Federal Government did nothing to inform employers generally.

Mr. ANDERSON. Let me make one last statement about the earlier testimony that we are concerned about. There was some testimony about using the jobs tax credit in the public sector, again, as opposed to the private sector.

We in the private sector know of some \$17 billion in CETA funding that is going into the job creation program in the public sector. For the first time the President is acknowledging the importance of building private sector jobs and has come through with \$400 million in the new program targeting training in the private sector.

We would very, very strongly resist the use of tax credits once again in the public sector. There is enough money being funneled in there, and there is no stability in the jobs being created, and they are never going to be able to fill all of the CETA-developed jobs that they have now.

Senator HASKELL. Well, they are filling them, but they are—

Mr. ANDERSON. The only way they are going to fill them is on a full-time funded basis.

Senator DOLE. If you read the headlines, you find there are a lot of abuses in that program, and that is why they ought to look at the private sector.

Mr. Anderson, just really for the benefit of my colleagues, I would like to read from the top of page 5 of your testimony where you say, "Governor Richard Snelling of Vermont, fed up with the IRS' lack of cooperation in publicizing the jobs tax credit, mailed explanatory fliers to 14,000 businesses in the State. The response has been excellent to date, according to the State Commissioner of Employment Security." I just wanted to underline that portion of your testimony.

I have no further questions.

Senator Long?

Senator LONG. One thing that does concern me about this. Anytime we do something that the administration did not initiate themselves, it takes practically forever to get the regulations out to indicate how you can do it or you cannot do it.

When we pass something like this, we ought to say that anybody who does something along this line that could reasonably be construed as being what Congress intended, he gets the benefit of it, until such time that the regulations have been promulgated and approved.

If you read the law and it looks like it was intended for you, you would get the benefit of it until somebody can officially tell you that

you do not, because otherwise we will wait a year or longer to get the regulation that says that you get the benefit of what Congress says you should have.

Mr. FAIRBANKS. That sounds good to us, Senator.

Senator LONG. Meanwhile, if you had another provision that says that all of these regulations would be purely advisory, and not mandatory, we might get on with the business.

Senator HASKELL. Senator Dole?

Senator DOLE. I appreciate the testimony. I remember when Secretary Blumenthal, before he was confirmed, came around to pay a courtesy call I asked him about the jobs tax credit, and I think personally he was opposed to it. He thought it would only help maybe the fast food chains, like McDonald's. In other words, McDonald's might benefit, or some of the fast food chains, where there is a big turnover of employment. One of the criticisms was since a person is expanding business anyway, why should the Government provide a tax credit? That is a legitimate argument.

If you are going to expand your business, or you are a new business, why should the Government pick up the tab for some of your employees? And second, how many of those people you hired under the tax credit program are now on their own and still with your company and are now taxpayers?

Do you have any records on that?

Mr. ANDERSON. I do not think that anybody today hires anybody casually. We can give you records on that. If your question meant that we bring them on and we drop them off just to take advantage of the benefit, I do not know—

Senator DOLE. I am just saying what some of the criticisms were when we tried to get the administration to buy the program.

Mr. FAIRBANKS. The tax credit program is marginal relief at best. The social security tax burden, the health costs, the general costs of putting employees on and just getting them productive is so heavy that I cannot think of any instance where a company would want to bring them on just to utilize the benefit and drop them off.

Senator DOLE. We have heard of those problems. Of course, McDonald's is the only kind of a company that Secretary Blumenthal can relate to. It is a hell of a long way from a small business.

Mr. PRENDERGAST. On the other hand, a good deal of the McDonald franchisees are small businesses, and their growth in employees—they are very careful in their analysis and labor utilization and they will add employees when they are going to add employees because they need them, not because they got a jobs tax credit.

And as far as the particular argument you addressed to the expanding company, that is the company that is in the direct need of capital. That is where the capital formation problem is the worst.

Senator DOLE. Not always, but in some cases. They may have a regular expansion program. I mean, they may not be in dire need.

Mr. PRENDERGAST. In a small, expanding company, the numbers of capital-rich companies that you find are very few. Their ability to attract enough capital is very difficult. There has been a study done by the SBA venture-capital task force that outlines that quite clearly, and the jobs tax credit is one part of the tax policy, to allow a small

business to retain additional earnings as another vehicle for attracting some capital.

The suggestion by SMC of Frank Fairbanks was to limit the amount of credit to the first 5 or 10 employees or something to that extent, that would eliminate significantly the abuses. Furthermore, if you are hiring employees for the benefit of the jobs tax credit in order to get it in the next year, you have to continue to increase the number of employees, and that is not worthwhile, to continue to go on a cycling basis.

Senator DOLE. I think another question was raised that you would, say, lay off 20 people and then be eligible for the credit.

Mr. PRENDERGAST. It is a net gain figure.

Senator DOLE. It would only apply to the increase, so that would not work. That is not a valid argument against the program.

Those of us who support the program want to make certain that we can address some of these questions that are going to be raised. We are going to be told there are abuses.

Frankly, I do not see anything wrong if the program helps some young person. If it puts somebody to work in McDonald's rather than on the streets, it seems to me that might be a big plus. Maybe that is what we are trying to do. I do not see any criticism.

Anything you have in that area that might indicate to the contrary, it would be helpful to us if we discussed it later on.

Senator LONG. I have nothing against McDonald's.

Senator DOLE. I have nothing either.

Senator LONG. Otherwise he will be sitting around on welfare, and if you put him to work at McDonald's, so much the better.

Senator DOLE. Thank you.

Senator HASKELL. Thank you gentlemen very much. The hearing is adjourned and the record will stay open for 10 days to receive answers to questions. Thank you.

[The prepared statements of the preceding panel follow:]

STATEMENT OF WILLIAM B. ANDERSON, PRESIDENT, SMALLER BUSINESS ASSOCIATION OF NEW ENGLAND, INC., WALTHAM, MASS., AND PRESIDENT OF MATRIX, INC., EAST PROVIDENCE, R.I.

Mr. Chairman: The Smaller Business Association of New England, Inc. supports an extension of the jobs tax credit because the credit does what it is designed to do—serve as an incentive to increase employment for the small business community.

The small business community has long held that more jobs can be created for less money by the private sector. We believe the private sector is best suited to underwrite new positions, retain them once they've been established, and constantly spin off other jobs from existing ones.

For representative proof of public sector mismanagement, one need look no further than the documented \$100,000 figure it takes for the Veteran's Administration to spawn one new position.

To its credit, this Administration has broken the succession of public sector programs to develop jobs. In May, President Carter announced that \$400 million in federal government funds will be re-routed from the public sector to the private sector to train and hire 150,000 jobless workers next fiscal year.

In May of 1977 the jobs tax credit was passed to induce private sector employers to create jobs through a tax credit on new hires. Small businesses applauded this credit and your key role, Sen. Haskell, in its passage, and looked upon the development as the start of a more rational stimulative job creation policy.

We are doubly disappointed and disturbed, therefore, that the jobs tax credit, which has been a godsend to so many smaller companies, may be rescinded come January 1.

Documentation we have gathered from accountants, small business and congressmen convincingly favors the retention, and even expansion of this credit.

To determine the effect of the job credit in just one year, SBANE polled 60 of its member CPA firms, including some Big 8 and many smaller firms throughout New England. To a person, they related examples of smaller businesses who derived a benefit from the jobs tax credit in the form of adding new—and needed—positions.

Our poll indicates that 95% of one CPA firm's clients used the credit to some degree and many more firms reported better than half of their small business clients applied the credit.

American businesses are still in the educational phase of implementing this incentive. The SBANE accountants reported many more firms using the credit in 1978 than 1977, and more who plan to consciously use it on 1979, providing the credit remains intact.

Most significantly, the CPA's believe their clients will begin to use this tax break as a planning tool in crystallizing future corporate strategy. The effective maximum tax credit allowed of \$1,806 for one new employee is a lot of money to a small firm, and certainly aids the capital formation process for all smaller concerns.

Letters and calls poured into SBANE from the Association's CPA's telling us of the companies which had favorable experiences with the jobs tax credit. I'll run through some of the testimonials that explicitly define the favorable impact of the credit.

Number One—A Vermont woodenware manufacturer with sales of \$1.5 million contemplated adding a second shift to cope with spiraling demand. Their accountants advised them that their prospective blueprint would save \$24,000 under the jobs tax credit. The company decided to institute the new shift, an expansion of 20 employees.

Number Two—A Massachusetts manufacturer of rubber goods expanded from 40 to 60 employees in 1977, producing a credit of \$32,000. Two new jobs and equipment worth \$8,000 resulted. The company now factors the credit benefits into their fiscal strategy on an ongoing basis, their accountant reported.

Number Three—An architectural firm garnered a tax credit of \$18,000, and will use the credit to create one new professional position. Well-paying positions, not just those with wages associated with typically lower paying clerical or low skilled functions, can be formed as a result. Even though only \$1,806 may be derived from hiring an \$18,000 worker, the extra funds could convince a procrastinating employer to hire the new person.

Number Four—A Vermont restaurant was straddling a decision to expand their service to include lunch, along with dinner. When their accountant calculated that they would save \$8,000 more in wage deductions, the restaurant hired waitresses, cooks and a cashier to handle the lunchtime volume.

Number Five—One accountant stumbled across a situation where his client's growth was negated under the current credit rules. Growth was rampant in an industrial adhesives and coating manufacturer, but when its new positions were added to the employee change in its shrinking subsidiaries, the aggregate wage base didn't exceed 102 percent of the previous year. Thus, the thriving company was punished for its affiliation. If applied correctly in that situation, the credit would have meant substantial savings and the impetus for further hiring.

We believe the positive aspects of these capsules will become much more commonplace in time, with an attendant increase to the workforce rolls.

The early history of the jobs tax credit has not properly been considered in the proposal to narrow application of the credit.

A complaint threading through many of the surveyed CPA's remarks was an anemic public information campaign by the IRS. Their comments ranged from, "The IRS 'how-to' instructions were too oblique," to "Not enough IRS effort has been made to promote the credits."

Gov. Richard Snelling of Vermont, fed up with the IRS' lack of cooperation in publicizing the jobs tax credit, mailed explanatory flyers to 14,000 businesses in the state. The response has been excellent to date, according to the state's Commissioner of Employment Security.

Most small business owners are unaware of the tax credit and are frittering away legitimate opportunities to improve their cash flow and, in the process, galvanize the economy. Many small business owners didn't know the credit existed until they say it on their tax return this year.

One CPA expressed amazement that some of his colleagues in the industry were not fluent enough with the credits to advise their clients about them.

Another CPA reported, that, for the first time this June, some of his clients received an explanatory brochure from the IRS with their quarterly payroll tax statement. This type of education is essential to the success of the credits. We hope explicit information on the credit will become more accessible to small business executives.

These scenarios we hope will soon vanish. With an extension of the credit, financial advisors can get on with the business of helping smaller businesses to parlay the jobs tax credit into new employees, equipment and structural improvements.

The jobs tax credit is a program of such proportions that it deserves full support of the Treasury Department and the Carter Administration.

The opportunities provided by the credit afford small businesses tremendous flexibility, permitting them options that lead to the aforementioned benefits. Several applications of the credit come to mind:

First, an unforeseen jobs credit can evolve from incorporation of a business. Under that tax status, the wages of owner-employees, as well as those paid to spouses of owners, would be subject to federal unemployment taxes, and therefore, eligible for a jobs credit.

Second, especially overworked employers can look at the credit as a training allowance. New employees can reach relatively high levels of productivity at a reduced cost to the owners.

Third, if a business elects to hire two part-time employees instead of one full-timer, the jobs credit might apply to two salaries, instead of one.

Fourth, concerns that anticipate increased subcontractor services should hire the subcontractors and rightfully claim the credit.

We are hard pressed to justify why these and other reasonable tax breaks aimed primarily at small business would be allowed to expire—especially when a similar program will supplant the current one that addresses only selected unemployment.

Any preferential jobs tax credit—like the Administration's—will guarantee additional red tape. Several SBANE accountants harken back to a \$500 jobs credit passed by Massachusetts in 1972. The credit, given to companies who hire those removed directly from unemployment compensation, is aimed at reducing minority unemployment. To a person, the CPA's said the recordkeeping and reporting fees resulting from more layers of government forms nullified at least the \$500 savings. Not one Massachusetts CPA we interviewed had applied that credit to their clients in the six years of its existence. They feared similar difficulties if such a credit became available on the federal level.

The restricted credit raises serious questions as to who suffers most from unemployment. Is it any better to be 30 and unemployed in rural Maine than to be unemployed at 20 in the central city? Many times it is worse for the older country dweller. Family breadwinners are generally over 24 years old, and would be ineligible to be claimed under the President's proposal.

SBANE implores Congress and the Administration to strongly consider these actions:

Retain the jobs tax credit as put forth in the Tax Simplification and Reduction Act of 1977. The ones who implement the credits, tax accountants, uniformly believe the tax breaks can add jobs and continue the growth pattern for many smaller emerging companies.

Continue the philosophy of private sector subsidy of employment. We agree with Massachusetts Senator Edward Brooke, who in commenting on the jobs credit, said, "Such an incentive program is needed because private sector job creation is a much more effective and productive way to reduce unemployment in the long run. Jobs which are deemed necessary by business are not usually doomed to rapid obsolescence. These private sector jobs are usually not static but have real possibilities for career advancement within the company or profession. And these jobs are usually long-term, because a business investment decision to expand or to create new jobs presupposes both need and sufficient capital to sustain that job."

Commit the Treasury Department to a full blown campaign educating employees and accountants alike on the jobs credit. Neither group can apply what they don't understand or are not cognizant of.

The jobs tax credit is just ripening into a viable developer of jobs in the United States. Its full impact is far from being measured. The Smaller Business Association of New England believes it would be folly to excise this justifiable growth incentive for the nation's smaller businesses.

Thank you.

STATEMENT OF FRANK B. FAIRBANKS, JR., PRESIDENT, HORIX MANUFACTURING CO., REPRESENTING SMALLER MANUFACTURERS COUNCIL

I am Frank B. Fairbanks, Jr., President of Horix Manufacturing Company, a manufacturer of packaging machinery located in Pittsburgh, Pa. I represent today the Smaller Manufacturers Council (SMC). SMC is a trade association headquartered in Pittsburgh, with over 800 member companies in Pennsylvania, Ohio and West Virginia, with a combined employment of over 75,000 people.

SMC appreciates the opportunity you have afforded us, together with other business groups, to comment on the recently enacted New Jobs Credit.

NEW JOBS CREDIT

We in the small business community feel that the New Jobs Credit is an appropriate addition to Federal tax law, and that it should be continued in its present form beyond its scheduled expiration in December of this year.

The credit is a targeted program that reduces taxes on growing small businesses. The credit is of course applicable to all businesses, but because of the \$100,000.00 limitation, the credit is obviously not very meaningful to the very large enterprises.

As all of you gentlemen are well aware from previous testimony, the raising of capital is often the most critical problem in small business growth. The New Jobs Credit reduces the taxes, and thus permits greater reinvestment of funds, for those companies who are *expanding employment*. Unlike the Investment Tax Credit, the New Jobs Credit does not reward companies who eliminate employees by the addition of capital assets.

It is not our intent to be critical of the Investment Tax Credit, as we feel that it is a most useful tool in encouraging plant modernization. While the Investment Tax Credit is of real value to small companies. As is of relatively greater value to larger companies, which are typically more capital intensive than small business. Therefore, we feel that the New Jobs Credit provides benefits to the growing, smaller enterprises, which are typically labor intensive.

Let me give you a specific example, the value of the program to Horix. For 1977, our Federal taxes before credits were approximately \$142,000. The New Jobs Credits amounted to \$18,500, with a net tax savings (because of loss of deductions equal to the credit) of \$9,600. Our Investment Tax Credit for 1977 was \$9,800. SMC has not conducted any formal survey in the brief time that has been available to us, but the typical SMC member is enthusiastic about the New Jobs Credit, and feels that it definitely should be a permanent part of the Internal Revenue Code.

I know of no better way to help employment than to target benefits to business enterprises which are adding employees.

A desirable change would be to expand the credit, at least with respect to the first 5 or 10 employees. Possibly a one hundred percent credit would be appropriate for the first \$42,000 of increased FUTA wages. This would provide even greater help to the very small growth enterprises.

We understand the administration has proposed to replace the New Jobs Credit with a Targeted Employment Tax (TET) Credit Program. Although the overall objective of the TET Credit is worthwhile, the proposed mechanism may not provide adequate incentive for significant small business participation. The difficulty involved in verifying employee certification, combined with the increased costs which may be incurred in employment of the targeted employed, may significantly reduce any incentive which the TET Credit Program is designed to create.

WORK INCENTIVE PROGRAM (WIN)

Perhaps a few comments with respect to the WIN Program are in order, at least as we see them in the Pittsburgh district. Mr. William Perer, local manager of the Pennsylvania Department of Labor and Industry, Bureau of Employment Security, recently prepared an article on the WIN Program, which appeared in the June, 1978 issue of the SMC monthly magazine, "The Smaller Manufacturer". A copy of that article is attached hereto. Mr. Perer has advised me that, in the Pittsburgh area, smaller businesses are reasonably active in the program. Horix Manufacturing Company has not participated in the program.

HIRING THROUGH WIN CAN SAVE YOU MONEY

(By William Perer, Manager, Pittsburgh WIN)

WIN, short for the Work Incentive Program, was designed to give business a tax and training incentive to hire welfare people, and welfare people an incentive to leave welfare for payrolls. WIN is authorized by the 1967 and 1971 amendments to the Social Security Act. The tax part of the program which became effective January 1, 1972 was designed to reduce the number of employable welfare recipients by encouraging the nation's employers to place them in productive, income yielding, tax paying jobs. Five out of every six persons are still employed by private industry.

The WIN Tax Credit program basically provides that an employer who hires a WIN enrollee may take a Federal income tax credit equal to 20% of each WIN enrollee/employee's wages paid during the first 12 months of employment. The total maximum WIN Tax Credit limit in any one year is now \$50,000 plus 50% of the federal income tax remaining after all other types of tax credits and the WIN Tax Credit are taken.

Before the credit may be taken, the WIN Enrollee must be employed by the employer for a minimum of 180 days, whether consecutive or not. However, the tax credit applies back to the first day that wages were paid to the employee. The tax is against the Federal Income Tax liability. A temporary lay-off is not considered a termination. Thus, an employee can work a few months, be laid off during a slack period, then be reinstated without endangering the tax credit.

In addition to the tax credit there is reimbursement for the costs of training the hired WIN individual equal to 50% of the starting wage during the training period. The skill level of the job determines the length of training. Some brief examples by the IRS specialist:

If a small corporation nets \$15,000 annually without WIN employees and then contracts with the state agency to hire a WIN application at a salary of \$6,000, the corporation still nets \$15,000.

At current corporate tax rates, the corporation would be liable for \$3,300 in taxes, i.e. 22 percent of \$15,000. With the WIN employee on the payroll this tax liability will be reduced to \$2,100 as a result of the tax credit earned on his wages, 20 percent of \$6,000.

A second example given by the IRS specialist:

In a sole ownership, a partnership or a small business corporation treated as a sole ownership for federal tax purposes, the federal tax rate will vary from 14 percent of one dollar in taxable income to 70 percent of \$100,000 or more.

The taxable income is \$15,000 and the tax liability is \$3,520 before the WIN employee is hired. As soon as he begins work at \$6,000 a year, the WIN employee proves his value with direct savings to the company as it received a direct credit of \$1,200, reducing the tax bill to \$2,320.

A third example:

If a corporation with a net profit of \$80,000 and a tax liability of \$31,000 hires 25 WIN employees at an average salary of \$6,000 a year, the corporation will continue to net \$80,000. In addition, it will pick up a \$30,000 tax credit based on 20 percent of the \$150,000 payroll.

Although these samples are somewhat technical, they should demonstrate the real savings available in the Work Incentive Program, particularly so if tax credits and on the job training subsidies are combined. Employers can be eligible for the subsidy by providing up to 44 weeks and as few as eight weeks of such training. The 20% tax offset can be combined with the 50% wage training offset.

Nationally more than 203,000 welfare recipients found unsubsidized jobs through WIN in the first nine months of FY 1977, producing estimated savings in public welfare costs of \$455 million. About half earned enough to enable them and their families to leave welfare. The others received some welfare assistance but at a reduced level.

Average hourly starting pay for men entering employment from the WIN Program was \$3.70, for women, it was \$2.73. Nearly two-thirds of the jobs obtained by women were in clerical, sales and service occupations. Men's jobs were concentrated in machine trades, structural work and transportation. About 61% of the job holders were women. Many in WIN are promoted from their original jobs.

Nearly 3,000 WIN applicants found jobs in Allegheny, Beaver, and Lawrence counties with 1,243 placed on jobs directly by WIN staff. This was an estimated saving of \$300,000 in Allegheny County alone and of course a major result was the breaking of the welfare cycle. Individuals received jobs they never thought possible. WIN wrote 110 contracts involving \$234,984 with private employers in FY 1977. New applicants available last year were 3,247.

We want to send employers motivated workers who are familiar with the work environment.

WIN has a program to show applicants how to conduct an organized job search with the WIN Program paying expenses for looking for work as well as child care for females. All this in connection with a week long Coping Skills Seminar which discusses how to handle troublesome job situations in terms of the work ethic, by means of video tapes, playbacks and discussion. The idea is not only to get a job but to keep it. The seminar stresses the work environment situation.

A Wall Street Journal article of November 8, 1977 on WIN states:

For a closer look at one of WIN's successes, see what United Technologies Corp.'s Pratt & Whitney Aircraft group is doing at its huge 20,000 employee jet-engine plant in East Hartford Conn. The Plant hires 5% to 10% of its new employees through WIN: In return, the company gets some \$200,000 a year in tax credits. Pratt & Whitney executives say the local WIN office does a better job of selecting workers.

The welfare graduates start work at \$4.50 to \$4.73 an hour and 70% of them stay on the job, a rate equaling or exceeding that for other employees. Their motivation is strong. "Most of them like to forget there was time they needed to be on welfare," William Gilson, Personnel Manager says.

There are some general standard provisions for OJT contracts.

1. Contractor Eligibility—Any private or public company, not in violation of local, state or federal laws, is eligible to participate.
2. Ineligible Occupations—Primarily commission, sewing machine operators (garment and apparel industry—SIC 2300), bartenders, seasonal, and professional occupations requiring licenses.
3. Concurrence of Bargaining Agency—The appropriate bargaining agency must concur.

4. Authorized Training Positions—Normally, authorized training positions may not exceed 25% of the employer's full-time work force where the training is taking place. For those employers with less than full-time employees, one authorized training position will be allowed.

5. The employer must have a vacancy. He or she cannot let another worker go to make room for a welfare worker or he involved in a strike or lockout.

There are other provisions of faster writeoffs for buying, building, reconstructing or rehabilitating facilities specifically to be used for on-the-job training for your workers or prospective workers. There is also the Tax Reductions and Simplification Act of 1977 where there is an additional tax credit for expansion purposes.

Select the worker you want from the WIN participants referred to you by the WIN Program staff of the Pennsylvania State Employment Service. There is a minimum of red tape in the WIN Program and you will have the total cooperation and assistance of a WIN staff member who will be assigned to your company.

For information regarding participation in the Program, contact Mr. William Perer the Commonwealth of PA Department of Labor and Industry, Bureau of Employment Security, Pittsburgh, PA 15222.

[Thereupon, at 11:30 a.m. the hearing in the above-entitled matter was adjourned.]

JOBS TAX CREDIT

WEDNESDAY, JULY 26, 1978

**U.S. SENATE, SELECT COMMITTEE ON SMALL BUSINESS AND
THE SUBCOMMITTEE ON ADMINISTRATION OF THE INTERNAL
REVENUE SERVICE OF THE COMMITTEE ON FINANCE,
Washington, D.C.**

The subcommittee met, pursuant to notice, at 9:35 a.m., in room 2221, Dirksen Senate Office Building, Hon. Floyd Haskell (chairman of the subcommittee) presiding.

Present: Senators Haskell, Hansen, and Culver.

Senator HASKELL. The joint hearing of the Select Committee on Small Business and the Subcommittee on Administration of the Internal Revenue Code of the Finance Committee will commence. Our first witness is Hon. Emil M. Sunley, Deputy Assistant Secretary for Tax Policy of the Department of the Treasury.

STATEMENT OF EMIL M. SUNLEY, DEPUTY ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY

Mr. SUNLEY. Thank you, Mr. Chairman.

I am pleased to appear today to review with you the existing jobs tax credit and to discuss with you the President's proposal for a targeted employment tax credit.

The recent news about employment in the United States has been mostly good news. In the period of 1 year from June, 1977 to June, 1978, 2.8 million people have joined the labor force and employment has increased by 3.9 million people. The overall unemployment rate has been reduced from 7.1 percent to 5.7 percent and labor force participation and employment are at an all-time high.

All demographic groups have shared in the employment growth, including disadvantaged youth. For example, employment of blacks aged 18 to 24 increased by 110,000 during this period. However, the rate of unemployment for black youths remains high. This rate changed only slightly from 29.5 percent in June 1977 to 28.2 percent in June 1978.

Unemployment has become increasingly concentrated on those who are disadvantaged by age, race, family income status and other handicaps.

Because the problem of unemployment is increasingly a structural problem, the administration has proposed that the present jobs credit be allowed to expire as scheduled after this year and that it be re-

placed by a targeted employment credit that will improve job opportunities for disadvantaged young people and the handicapped.

The proposed employment credit would give a direct incentive for taxpaying businesses to make more jobs available and to make better jobs available for young people from low-income families. It will also provide employers an incentive to retain eligible workers during the critical first 2 years of employment in which their work habits and skills are developed.

The President's proposal also continues the tax incentive for employment of handicapped workers who are referred from vocational rehabilitation programs.

Senator HASKELL. Do you think by any chance, Mr. Sunley, in view of the fact that there are lots of witnesses, that you would be able to summarize your statement and then be available for questions.

As I read some of the administration's testimony, some of this has already been put in the public domain already.

Mr. SUNLEY. Mr. Chairman, if you would like, I would be pleased to put my whole statement in the record and take questions at this point.

Senator HASKELL. Well, yes. I think the administration has its targeting on an age basis, and that has merit. Senator Long and Senator Moynihan have a targeted credit on a public assistance basis. Senators Ribicoff and Bellmon have another one.

I would like maybe for you to discuss your views of the relative merits of those and then also if you could address yourself (to the idea of) continuing the present jobs tax credit, on which we have had testimony from representatives of big business and small business, who see no reason why we should not continue the present jobs tax credit. The present credit really has not had enough publicity. Simultaneously there could be a targeted credit.

Those are a couple of the areas I would appreciate your addressing your remarks to.

Mr. SUNLEY. Well, Mr. Haskell, let me try to address those three points, if I may.

With respect to including other groups of disadvantaged workers, possibly those on welfare, possibly those who are disabled or those who are veterans are some of the more common proposals that I have heard, the administration has recommended that the present work incentive credit and welfare credit which is aimed at workers on welfare, be continued. There is clearly a possibility of folding that credit into the new jobs credit—the targeted jobs credit—being proposed by the administration. Jones-Ullmann bill before the Ways and Means Committee would include the welfare recipients who qualify under the current WIN credit as part of the credit. I think the administration can go along with that change.

But there are some problems if you expand the coverage too broadly, and I would think we would want to consider limiting the program to the disadvantage youth—that is to say, youth aged 18 to 24 who come from families with incomes of less than 70 percent of the lower family living standard and to those who are eligible for the current WIN credit.

With respect to your second question, Mr. Haskell, it would seem to us that there would be a great deal of complexity if there were two credits—one, the targeting credit, and then an additional credit for those who have increased employment over some base year.

Senator HASKELL. Would it really be all that complex? All you are doing really is keeping the present jobs credit intact and expanding the WIN credit.

Mr. SUNLEY. Well, the current WIN credit, as you know, is used only in a most limited fashion, probably less than 30,000 workers—

Senator HASKELL. You are expanding it?

Mr. SUNLEY. Greatly expanding it, I would have to say.

I think you will have received testimony from other groups—and the last half of my testimony goes through some of the difficulties with the existing jobs credit. This credit, I think, has a number of flaws that really would suggest that we might be better off scrapping it and starting over.

One of the problems is that it has five different limitations on the use of the credit, making it virtually impossible for most firms to know, at the beginning of the tax year, whether they will qualify for the credit. At the time they have to make an employment decision it is likely that they will not know whether this additional worker will qualify him for the credit.

Your third comment, Senator Haskell, related to the IRS and publicity surrounding the existing credit. I would like to report on the administration's efforts to publicize the new jobs credit over the past year.

The IRS undertook a number of steps to publicize the credit to employers and to the general public. All employers were sent an information insert with the quarterly employers' return forms announcing the credit, and these were mailed during the second quarters of 1977 and 1978.

The credit was also highlighted in a number of standard publications, such as, "Your Federal Income Tax," and the "Tax Guide for Small Business."

Moreover, the IRS undertook to provide training in the jobs tax credit to its taxpayer service personnel who respond to inquiries from and furnish information to the public. The Service also worked closely with the Small Business Administration in publicizing the jobs tax credit at ten regional meetings of the SBA Advisory Council and provided representatives at each of these meetings.

Within the Labor Department the Employment and Training Administration undertook an information program of its own.

Senator HASKELL. Now we had testimony at the last hearing from the Assistant Secretary of Labor who said the Labor Department had not done anything. You now tell me that it has?

Mr. SUNLEY. I believe Mr. Packer was referring mainly to the WIN credit, that very little—

Senator HASKELL. No, no. I beg your pardon. We were referring to the jobs tax credit. I remember that loud and clear. They said they had done nothing.

Mr. SUNLEY. Well, this little green pamphlet is entitled "The Jobs Tax Credit for Employers Hiring More Workers," and it was pub-

lished by the U.S. Department of Labor Employment and Training Administration.

Senator HASKELL. Perhaps the spokesmen ought to get together.

Mr. SUNLEY. There may be some distance between the employment and training administration and the Office of the Secretary. That sometimes happens in large departments.

Senator HASKELL. Anyway, leave that for the file.

Mr. SUNLEY. This little green pamphlet does describe the jobs credit in nontechnical language and has been distributed through local offices of the Employment Service, through the CETA prime sponsors, the regional ETA offices and the regional offices of the Small Business Administration.

So I think the administration has made an effort by direct mailings to every employer in the United States and through various channels, working through the Small Business Administration and the employment and training administration of the Department of Labor.

It is true that when a survey was conducted of employers in February of 1978 to determine whether they were aware of the credit, most employers indicated that they were not aware of the credit. This is particularly true of small employers. And even those employers who were aware of the credit, most of them thought they probably did not qualify for the credit; and even of those who qualified for the credit and who thought they qualified for the credit, only about 25 percent indicated that they made any effort to increase employment as a result of this tax incentive.

Senator HASKELL. We would like the record to show that on July 18 of this year, numerous Senators, including the chairman of the full committee, wrote to Commerce, Treasury, Labor, and SBI urging that these Departments get the word out on the credit in a coordinated fashion as opposed to perfunctory notification.

As far as we know here, nothing ever happened as a result of the letter. I am just making this observation. As far as we can determine here, nothing ever resulted.

At this point, I would like to enter into the record the Congressional Record of July 28, 1977.

[The material referred to follows:]

COMMITTEE ON FINANCE,
Washington, D.C., July 18, 1977.

Letter sent to:
SECRETARY OF COMMERCE,
SECRETARY OF THE TREASURY,
SECRETARY OF LABOR,
ADMINISTRATOR OF THE SMALL BUSINESS ADMINISTRATION:

The new jobs credit recently passed by Congress and signed into law by President Carter is of great interest to us and many of our Colleagues in Congress. As you may know, this provision of the Tax Reduction and Simplification Act of 1977 is an attempt to bring about more jobs in the private sector of the economy by granting tax credits to businesses that hire more workers. The effectiveness of this novel approach to job creation clearly depends on the widespread knowledge and understanding of the program by businesses. Because the tax laws and regulations through which the job incentive is provided may initially appear complicated and so reduce the response of many employers, an extraordinary effort to explain and clarify the effect of the law on businesses' tax and hiring decisions is essential. While the promulgation and clarification of regulations is the responsibility of the Treasury Department, the unique nature of the new jobs credit program is related to the objectives of the Commerce Department. We, therefore, urge the Department of Commerce to initiate efforts, in cooperation and consultation with the Treasury Department, as well as the Department of

Labor and the Small Business Administration, to promote awareness of and participation in this new jobs program by businesses throughout the United States. We believe that such efforts would greatly enhance the success of this program in increasing employment and business activity.

We anticipate continued strong interest in this general approach to generating increased job opportunities in the economy in the context of upcoming Congressional deliberation on welfare reform and on tax reform. Our ability to gain insights from the new employment tax credit program could be a major factor in shaping future legislative initiatives of this type. The timely availability of the data necessary to support a critical evaluation of the employment tax credit program is critically important in this regard. Information normally available through gross National product accounts, business tax returns, and other sources will not be sufficient for these purposes. We have requested that studies to provide the appropriate evaluative information be initiated at the earliest possible date by the Commerce Department, either separately or in cooperation with the Departments of Labor and Treasury and the Small Business Administration. Your support and cooperation in this endeavor is urged.

The promotion of business activity and private sector jobs through jobs credits or similar mechanisms may be an important element of our National economic policies. We believe initiatives of the type requested herein may be of major significance in directing the course of economic policies undertaken in the United States in the coming years. Your efforts and cooperation with other government agencies in this endeavor will be of great assistance in guiding future Congressional decisions.

Sincerely yours,

RUSSELL B. LONG,
LLOYD BENSTEN,
GAYLORD NELSON,
HUBERT H. HUMPHREY,
CARL T. CURTIS,
PAUL LAXALT,

U.S. Senators.

Senator HASKELL. Let's take your targeted approach. One of the things that concerns me is the "70-percent of a certain income factor." Is there not some simpler way of going about it?

Obviously you do not want to give the credit for the hiring of people with college degrees who could get a job anyway, but is there not some other more simple test?

Mr. SUNLEY. Well, first of all, Senator Haskell, the 70-percent of the lower family living standard criteria is the current standard in the CETA legislation, so that we are really building on the existing requirement in the labor legislation.

A number of other alternatives have been suggested, some of which may be a little simpler; most of which might cause mischief.

One possibility, Senator Haskell, would be to make the requirement conditioned on a period of unemployment, because you think it is the hardcore, the disadvantaged, would not have been unemployed for a substantial period of time.

We resisted that requirement because I think it would lead to situations where an employer would say, come back next week or 4 weeks or 6 weeks from now when you have been unemployed for a sufficient period of time to qualify for the credit.

Also, if the employer has existing workers who are otherwise eligible for the credit, the employer may want to lay off those workers and hire workers who have been unemployed for a sufficiently long period of time.

Senator HASKELL. What is going through my mind is that it is important not only that employers know, but it is also important that potential employees know that they might be hired over somebody else.

Now, how is some young person 18 to 24 going to know whether he falls into the 70-percent of the lower family living standard?

One trouble with the law is that we do not get the message out to the people. We have to get the message out to the structurally unemployed as well as to the employers. This is one of the issues that bothers me.

Mr. SUNLEY. We believe that one of the advantages of our proposal is that it does tie into current labor legislation, the Comprehensive Employment and Training Act, and that the prime sponsors under the CETA legislation are often the local employment services. So that when a disadvantaged youth would come into the local employment service to get job referrals, it would be possible at that point to get information about whether he or she might be a qualified individual for this jobs tax credit.

In contrast to this, the Jones bill, which has been introduced on the House side, makes the qualification not depend on certification by the CETA rules but rather that the individual must come from a household eligible for food stamps.

This, it seems to me, would have one disadvantage in that it removes the certification of the eligible individual away from the traditional sources of getting help, of finding jobs, in the labor market.

I think it is also important to recognize that the firm has no requirement to determine the eligibility of the worker. The worker presents a slip of paper from the Employment Service, there is no additional requirement on the firm itself, or on the Internal Revenue Service.

Senator HASKELL. That, I think, is very good.

Thank you, Mr. Sunley, very much indeed. I appreciate your comments. I do not agree with all of them, but I think that this effort the administration is making is very worth while, and it may be that you have figured out the most effective way to get people to take advantage of it.

I do not have any further questions. I might have some questions after I have read your testimony in detail, which I would like to submit in writing. If you would respond, I would appreciate it very much.

Mr. SUNLEY. Senator Haskell, I appreciate the opportunity to appear before you today. I would be most pleased to respond to any written questions. I should say also that in developing our proposal and as the proposal will be modified as it moves through Congress, we have benefited greatly from consultation with the congressional staff on both the House side and the Senate side, and I think that working together we can get a new credit that is a great improvement over the existing credit, and I think that would be a major accomplishment this year, to move in that direction.

Senator HASKELL. I hope we can get new credits, but I would hope we can retain the existing credits. But that may be where we disagree.

I think you are right. Working together, we should get a good targeted credit.

Thank you very much, sir. I appreciate it.

Mr. SUNLEY. Thank you very much, sir.

[The prepared statement of Mr. Sunley follows:]

STATEMENT OF EMIL M. SUNLEY, DEPUTY ASSISTANT SECRETARY OF THE
TREASURY FOR TAX POLICY

Mr. Chairman and Members of the Committees:

I am pleased to appear today to review with you the existing Jobs Tax Credit and to discuss with you the President's proposals for a Targeted Employment Tax Credit.

The recent news about employment in the United States has been mostly good news. In the period of one year, from June 1977 to June 1978, 2.8 million people have joined the labor force and employment has increased by 3.9 million. The overall unemployment rate has been reduced from 7.1 to 5.7 percent and labor force participation and employment are at an all time high. All demographic groups have shared in the employment growth, including disadvantaged youth. For example, employment of blacks aged 18 to 24 increased by 110,000 during this period. However, the rate of unemployment for black youths remains high. This rate changed only slightly from 29.5 percent in June 1977 to 28.2 percent in June 1978. Unemployment has become increasingly concentrated on those who are disadvantaged by age, race, family income status, and other handicaps.

THE TARGETED EMPLOYMENT CREDIT PROPOSAL

Because the problem of unemployment is increasingly a structural problem, ripe as scheduled after this year and that it be replaced by a Targeted Employment Administration has proposed that the present Jobs Credit be allowed to experiment Credit that will improve job opportunities for disadvantaged young people and the handicapped. The proposed employment credit would give a direct incentive for taxpaying businesses to make more jobs available and to make better jobs available for young people from low-income families. It will also provide employers an incentive to retain eligible workers during the critical first two years of employment in which their work habits and skills are developed.

The President's proposal also continues the tax incentive for employment of handicapped workers who are referred from vocational rehabilitation programs. Unlike the present Jobs Credit, the incentive to employ the handicapped would not depend on the employer's forecast of annual overall employment growth.

The Administration program would grant a tax credit equal to one-third of the wages of eligible individuals up to a maximum of \$2,000 per year during the first year that any eligible individual is employed. In the second year, the credit is one-fourth of wages up to \$1,500 per year per employee. I believe that these amounts are large enough to be an effective incentive for employers to fill some job openings with disadvantaged young persons, provided that the employer has a high degree of certainty that the credit will be forthcoming. It is also important that each eligible employee be covered for a long enough period of time to develop experience and skills required to compete successfully in the labor market without further aid.

The proposed targeted employment retains the feature of the existing credit that employers are required to reduce their deductions for wages by the amount of the credit allowed. This provision is very important for the efficiency and fairness of employment tax credits. Without such a provision, there could be extreme cases in which an employer would make money from the tax credit simply by hiring new workers and telling them to stay at home. More generally, the wage deduction offset means that the amount of incentive among employers will not vary with their marginal tax rates. The incentive is the same for small corporations as for large corporations, and it is the same for all unincorporated businesses regardless of the tax rate faced by their owners. That is, for the first year the credit reduces the cost of an eligible employee by 33 percent of the first \$6,000 of wages. Without a wage deduction offset, a new line of tax shelters based upon the jobs credit could appear.

The President's proposal includes a number of other provisions aimed at assuring that the credit is used to provide real opportunities for eligible workers and to minimize potential conflicts with those who currently hold jobs. The proposal also seeks to harmonize the treatment of tax credit carryovers, making all business tax credits subject to the same rules.

The effectiveness of the targeted employment credit in providing job opportunities for the handicapped and for disadvantaged young people depends crucially on its attractiveness to employers. If employers are to make more job opportunities available, they must believe with a high degree of certainty that each eligible worker hired will increase their tax credits, and they should face a minimum of red tape. Under the President's proposal, the employer has no responsibility to determine a prospective worker's eligibility, and the employer faces no issue with the IRS over eligibility rules. In addition, the employer need not forecast employment growth for the year or establish a payroll base for the previous year, as under the existing jobs credit. This "incremental"

nature of the existing credit is the source of great uncertainty for the employer, additional recordkeeping requirements, and new regulations. The President's proposal also contains no recapture rules, which have been the source of uncertainty and complexity under the WIN and welfare tax credits. The only new accounting requirements imposed upon employers by the proposed targeted credit are that they must segregate the FUTA account for eligible workers and keep track of the initial employment date for each.

Eligibility of employees would be determined, at the initiation of the employee, by the local agencies that determine eligibility for other Federal employment programs, such as Public Sector Employment and On-the-job Training. The applicant must be either (1) at least 18 years of age and no more than 24 years of age and a member of a family that has an income of less than 70 percent of the regional lower living standard or (2) a handicapped individual referred to the employer under a vocational rehabilitation referral plan. Thus, the applicant must establish the date of birth and evidence that family income is below the local standard.

Unemployment is not a requirement for eligibility. There are two reasons for this. First, a duration-of-unemployment test would encourage the layoff of disadvantaged young people who are currently employed, and reduce the immediate prospects for those who have not been unemployed long enough. Second, a major objective of this proposal is to aid eligible workers in obtaining better quality jobs that have more opportunity for training, advancement, and job satisfaction. Eligible young people who are presently employed in less satisfactory jobs could seek certification to improve their prospects for meaningful employment.

The proposed certification process is deliberately tied-in with the employment and training system so that the process of certification may be linked to the efforts of the local Employment Service to provide job information and referrals. Job seekers should be able to avoid, as much as possible, the stigma of "welfare". Our experience with the WIN and welfare credits, which have had very low rates of election, suggest that a targeted jobs program should be identified with the employment system, rather than the welfare system.

An Assistant Secretary of Labor Arnold Packer testified here last week, we expect this program to result in approximately 160,000 more jobs for people in the targeted group than would exist without it. In addition, many eligible employees would find better, longer lasting employment. The eventual revenue cost of the program is estimated to be \$1.5 billion.

There will no doubt be suggestions that the cost of such a program may be reduced, without great sacrifice in numbers and effectiveness, by adding more requirements for certification or by limiting the tax credit to growing firms. Such suggestions should be explored very carefully for their potential to produce adverse incentives, as in the case of the duration of unemployment test that I discussed earlier. We do not want to give employers an incentive to lay off young people in order to make them certifiable. To take another example, we would not wish to discourage disadvantaged young people from seeking educational opportunities or encourage them to hide their educational qualifications, as would likely occur if there were an education limit. Limiting the credit to growing firms would add administrative complexities, increase uncertainty for employers, and cause the greatest reduction in effectiveness for those localities where the youth unemployment problem is likely to be greatest.

If the potential for laying off noneligible employees to hire eligibles is a principal concern, this can be approached in a relatively simple way by limiting the total amount of credit to the approximate average amount of turnover. Following this principle, the Administration proposal would allow no more than 20 percent of the wage base to qualify for the credit.

PROBLEMS OF THE EXISTING JOBS CREDIT

In contrast to the targeted tax incentives that I have just described, the present general Jobs Credit is available even for employment of those groups whose unemployment rates are lowest. Also, the credit favors those regions and industries where employment is already growing most rapidly. The existing credit also rewards sporadic growth more than steady growth. If extended indefinitely, it would tend automatically to reduce taxes more in periods of economic expansion and to increase them during recession. It would, thus, counteract somewhat the tendency of the economy to stabilize itself.

I have already noted the importance of certainty for employers for effectiveness of tax incentives. The present credit violates this principle massively. There are 5 separate quantitative tests that an employer must meet if added hiring is to result in increased amounts of credit. There is a test of FUTA wage base growth, of growth of the total wage bill, and of the tentative credit relative to current-year FUTA wages. There is also a limit of \$100,000 per taxpayer and a limit to the employer's income tax liability. For any employer, it is likely that the best estimate of his business outlook for the coming year will be sufficiently close to one or more of these limits to raise doubts about eligibility. Most firms will not have a clear idea of their qualification until the tax year is nearly over.

Each of the quantitative tests that are in the present credit has a defensible purpose. Indeed, considerations of revenue cost and data availability virtually require such provisions for any incremental credit that is to apply generally to employment. But taken together, the complexities of the present jobs credit and the consequent uncertainties and compliance burdens have resulted in what appears to be a very ineffective jobs stimulus program.

Last week, Arnold Packer presented to this Committee survey evidence that most employers were not aware of the jobs credit even after its first full year had passed. Most who were aware of the credit and thought they qualified reported that they had made no conscious effort to change their employment policy because of the credit.

The most recent evidence from tax returns, which is still sketchy and preliminary, indicate that the credit is being claimed at substantially lower rates than would be expected from the general rate of growth in employment over the period. By the end of June, after approximately 90 percent of *individual* returns had been filed, a total of \$494 million of jobs credit had been claimed on approximately 283,000 returns, or about \$1,750 per claimant which is less than the maximum amount for one full-time, full-year employee. The total number of individual taxpayers claiming the credit is about 8 percent of all business taxpayers that have employees. By the end of last week, \$600 million of credit had been claimed on about 85,000 corporate tax returns, an average of \$7,060 per claimant. The corporate totals are much less complete since most large corporate taxpayers have not yet filed for tax year 1977. Unfortunately, there is no tax return information as yet on the distribution of jobs credit claims by size, industry, or region.

I do wish to report to you on the Administration's efforts to publicize the new Jobs Tax Credit over the past year. The Internal Revenue Service undertook a number of steps to publicize the credit to employers and to the general public. All employers were sent an informational insert with the quarterly employer's return forms announcing the credit. These were mailed during the second quarters of 1977 and 1978. The credit was also highlighted in a number of standard publications, such as Publication 17, "Your Federal Income Tax", and Publication 334, "Tax Guide for Small Business". Moreover, the Service undertook to provide training in the jobs tax credit to its taxpayer service personnel, who respond to inquiries from and furnish information to the public. The Service also worked closely with the Small Business Administration (SBA) in publicizing the jobs tax credit at 10 regional meetings of the SBA Advisory Councils, and provided representatives at each of these meetings.

The Employment and Training Administration of the Department of Labor undertook an information program of its own. Beginning in October 1977, about 550,000 "little green pamphlets" describing the Jobs Credit in nontechnical language have been distributed through local offices of the Employment Service, CETA prime-sponsors, regional ETA offices, and regional offices of the SBA. Other educational efforts include descriptions of the credit in regular publications of the ETA and of the U.S. Chamber of Commerce.

SUMMARY

To summarize, the Administration believes that the existing jobs credit is overly complex and uncertain in its effect and that it no longer addresses the most critical unemployment problem. A targeted employment tax credit that we have proposed would concentrate the tax incentive on disadvantaged young persons and handicapped individuals where problems of structural unemployment persist. This proposal would involve much less complexity and uncertainty for taxpayers, which would be a boon especially to small businesses. It would aid the entrance of young people from poor families into the regular private work force and would help them to find better, more lasting jobs.

Senator HASKELL. Our next witness is Malcolm Lovell, representing the Business Roundtable.

Mr. LOVELL. Thank you very much, Senator, and, if I may, I would submit my formal remarks for the record.

Senator HASKELL. They will be reproduced in full.

Mr. LOVELL. I will try to summarize very briefly what they say.

STATEMENT OF MALCOLM LOVELL, ON BEHALF OF BUSINESS ROUNDTABLE

Mr. LOVELL. As you know, the Business Roundtable tries to take public policy positions from time to time. It does not try to cover every issue, but we have been active in the employment and training, manpower and welfare area over the years and have been very concerned about it, and we are very pleased to appear today to support the administration's efforts on targeted tax approach to youth unemployment.

Today with an unemployment rate of 5.7 percent, we really are coming virtually very close to full employment for the normal labor force. We do have very, very serious structural unemployment problems, and certainly the youth area and the minority youth area is particularly important.

So everything we can do to alleviate and to deal sensitively with that problem is tremendously helpful.

As you know, the private sector in the last 18 months has increased the number of jobs by over 6 million. We have really had a tremendous performance in our economy, and if it were not for the tremendous growth of the labor force, the labor force has increased, as you know, more rapidly than the population.

The entrance of women into the labor force which is, over the long term a very valuable and useful thing to our society, has caused temporary problems. This new group has been absorbed reasonably well.

And, of course, the youth problem itself—which is not specific to this country. All over the free world there are problems with youth, as we continue to raise minimum wages and make it difficult for employers to hire youth, and now we have them in greater numbers than ever before, and it is a very serious problem.

So anything that we can do to give special consideration, particularly to the poor youth, we are very supportive of.

We have supported reauthorization of CETA and we feel there that most of the funds—and we would like to see title VI of CETA really be used for the structurally unemployed. We do not think that this is the time to be putting large sums of public money into cyclical unemployment. I am afraid I would have to disagree with you in terms of the existing tax credit, which is really not aimed at the structurally unemployed.

Senator HASKELL. That is true.

Mr. LOVELL. I am not unsympathetic with the needs of small business, and I think you would find us being very supportive of things that were not employment oriented that would deal with a number of problems that small business has. It ill behooves the Business Roundtable coming out in opposition to legislation that is supportive

of small business, because obviously without a strong small business community, our society cannot survive.

What we are saying is that in the nature of dealing with the unemployment problem, the kind of tax credit that we currently have is really not sensitive to the needs of today. So we are not supportive of a continuation of that.

In the welfare area—and in my former life, when I was Assistant Secretary of Labor, I dealt with this committee and one of my responsibilities was running the WIN program—I think this committee really, has been very imaginative in that area, that the tax credit was passed, with really no support from anybody at the time, but it really has great promise.

Even though the Labor Department does draw up booklets and pamphlets, there is a lot of difference between the development of a booklet and a pamphlet and really selling a program.

Senator HASKELL. Surely.

Mr. LOVELL. I think Mr. Packer probably was speaking, if not completely accurately, I think the intent of his message was accurate.

The establishment that runs the welfare and employment service, and I have been associated with it for a long time, is very reticent to withhold anything from any recipient, and the WIN program, which does require a job test, where if they do not take a job that is offered, they are deprived of certain benefits, is very hard to carry out.

In terms of the tax credit, it is something that the welfare establishment never really knew much about, did not care much about, did not think it was very important.

My guess is that an expanded effort, as is suggested by some of these bills before you today in terms of welfare, probably would be useful to dramatize the value to the welfare recipient of the tax credits that we now have in the WIN and the welfare area.

I might suggest, as sort of an aside—and this does not represent any position at the Roundtable, just an off-the-cuff thought—that in terms of the level of benefit, of tax benefit in the welfare area, and perhaps in some of these other areas, rather than Congress setting it every 2 or 3 years, when we really do not know how it is being utilized and what kind of effect it will have, it might be interesting to take a look at the possibility of authorizing the Secretary of Labor and the Secretary of the Treasury to set, within a range, the tax credit levels that will be available for these various targeted programs.

We get into a habit in this country that once we pass something we never repeal it, and even though the need, the specific need for which it was passed has gone, we continue it. So some flexibility in that area might be useful.

I will be glad to answer any questions you may have, sir.

Senator HASKELL. Well, there is always the problem, as we are all aware, of the possibility of churning. The administration's program is 18 to 24; do you think endemic in the proposal, there is any incentive for churning?

Mr. LOVELL. Any what, sir?

Senator HASKELL. Any incentive for churning? By churning, I mean getting rid of employees who are 25, 26, 27, 28 in order to hire 18 to 24 year olds?

Mr. LOVELL. I really do not. The cost of turnover for an employer is very high. The value of an experienced worker is so great that I cannot conceive of any tax credit that would motivate an employer to get rid of an older individual who had developed good work habits for an individual who, by his youth and inexperience would normally be less apt to be hired.

Senator HASKELL. This seemed to be the attitude of people whom I questioned at the last hearing.

Let me ask you this. On a targeted credit, whether it be the administration's or Senator Long's or Senator Ribicoff's or a combination of the three, do you think that big business would seek to take advantage of it?

Mr. LOVELL. Take advantage of the tax credits?

Senator HASKELL. Yes, hire these people.

Mr. LOVELL. Generally speaking, the interest of big business is to hire skilled workers, people that are productive, so that it generally does not—require a tax credit, something like this, is normally not a strong motivation for your big companies.

I think today you will find that most large corporations are concerned enough with public policy issues on a voluntary basis—what they are trying to do is provide more jobs for youth and trying to be sensitive to some of these social issues of the day. As you know, in terms of minorities, of course, both on a voluntary basis and in terms of affirmative action programs, they have been very active.

But I think the importance, really, of these tax incentive programs are to the smaller employers. I do not want to discount the possibility of larger employers taking advantage of it, but I think the major motivation would be in terms of smaller employers.

Senator HASKELL. Thank you, Mr. Lovell. I appreciate your being here and you have contributed very greatly. Thank you very much.

Mr. LOVELL. Thank you very much, Senator.

[The prepared statement of Mr. Lovell follows:]

STATEMENT BY MALCOLM R. LOVELL, JR., PRESIDENT, RUBBER MANUFACTURERS ASSOCIATION, APPEARING FOR THE BUSINESS ROUNDTABLE

Mr. Chairman and members, I am pleased to appear before you today on behalf of the Business Roundtable to discuss Employment Tax Credits.

As a former Assistant Secretary of Labor for Manpower it has been my privilege in the past to work closely with the Senate Finance Committee in developing and administering the Work Incentive tax credit program (WIN), which was the first legislation passed by the Congress in this field. The Senate Finance Committee has led the Congress since 1971 in the effort to develop effective employment tax credit programs. The Committee has persistently studied and then amended the WIN and welfare tax credit legislation in an attempt to design a program structure which would have a substantial impact in moving individuals off the welfare rolls into gainful employment. This set of hearings is further evidence of the foresight and leadership which the Committee has consistently exhibited in this area.

THE STRUCTURAL UNEMPLOYMENT PROBLEM

Mr. Chairman, the American free private enterprise system has once again shown that it is the world's most powerful job creating engine. Since March of 1975 the U.S. private economy has created more than 10 million new jobs, of which 6.4 million have been created in the past 18 months. During this 18 month period the unemployment rate has fallen from 7.8 percent to 5.7 percent and would have fallen to a much lower level if the number of women and young

people seeking jobs had not also grown by phenomenal numbers. In fact, if the percentage of women in the work force was the same as in 1960 the jobless rate would now be well below 5 percent, and if the youth participation rates had stayed at the 1960 level, the unemployment rate would now be down to almost 4 percent.

Despite this record-breaking job creation effort, however, our society continues to have a serious structural unemployment problem. The black unemployment rate is 11.9 percent, the teenage rate is 14.2 percent, the rate for young high school dropouts is 24.6 percent, and the black teenage rate is still a staggering 37.1 percent. It is among these groups, the minorities and youth, that serious structural problems persist which cannot be left to macro-economic solutions.

Among these groups, youth unemployment is the most serious and persistent. Consistently in good years and bad, youth aged 16-24 account for about one-half of total unemployment and the situation is not improving. The ratio between youth and adult unemployment has increased steadily over the post-war period.

The Business Roundtable believes that this society must mount a major and specific attack on structural unemployment, and particularly on youth unemployment.

REFOCUSING CETA

We support and have participated in the development of the Administration's new efforts to reorient the Comprehensive Employment and Training Act (CETA) toward greater emphasis on private sector training and job programs for the structurally unemployed. With four out of five jobs in the private sector, and with the overall unemployment rate nearing full employment levels, we believe it is now necessary and timely to refocus the \$12 billion CETA program away from public job creation to concentrating on training and placing the structurally unemployed in private jobs.

We have given particular attention and support to the Administration's proposal for a new Title in CETA which would call for setting up business-led Private Industry Councils at the local level. It would be the responsibility of these new councils to set up an administrative organization to spearhead a new drive to substantially expand publicly financed on-the-job training and employment contracts with private industry.

This new effort is directly related to the subject of these hearings. Programs offering direct contracts between the government and private business for training and employing the disadvantaged have been operated since 1962. However, these programs have historically not been large relative to the needs and the problem, and even this new effort cannot be expected to attract and involve the numbers of businesses necessary to train and place a sufficient number of the disadvantaged. The interest in and move to experiment with new approaches such as business tax credits has stemmed from the realization that no one program approach is equal to the task.

THE EMPLOYMENT TAX CREDIT

The Business Roundtable supports the Administration's proposed targeted tax credit for the hiring of disadvantaged youth and the handicapped. We believe it could be a valuable addition to an arsenal of programs necessary to attack youth unemployment. We support this proposed new tax credit aimed at energizing the private sector in attacking youth unemployment for the same general reasons that we support the refocusing of CETA. The structural unemployment problem will only be solved in the private job market where the bulk of the permanent unsubsidized jobs exist. In attacking this problem, the government should provide an array of economic incentives, including both direct contracts for training and hiring the disadvantaged and tax benefits for the same purposes. Private businesses vary so much in size, character, and situation that no one program approach will succeed in involving the tens of thousands of private businesses necessary to make a real dent in this problem.

We support the targeting approach in the Administration's proposal, even though we recognize the dilemma which is inherent in the targeting approach. On the one hand, the public has the greatest interest in placing in private employment those in the labor force that are the least skilled and hardest to place. On the other hand, employers find this group the hardest to work with and are, therefore, least interested in them. The question then is what tax incentives or other

program approaches are necessary to join the public goals of society with the economic needs and realities of private employers?

Our experience with all employment tax credit programs to date illustrates that we have yet to find the answers to that question. Despite years of legislative and administrative effort, the response from private employers to both the WIN and welfare tax credits has been disappointingly small. Consequently, I believe we must view the Administration's new targeted proposal as one which generally moves in the right direction.

POTENTIAL PROBLEMS WITH EMPLOYMENT TAX CREDITS

This Committee knows well that the business community has typically been opposed to using the tax system to reach employment objectives. On balance, we now believe that the problem of youth unemployment is of such severity that a tax credit program should be authorized. However, I believe that our past cautions about this type of program are legitimate and deserve attention. I will just cover two of our concerns:

First, the assumed tax credit program advantages can be quickly destroyed if governmental requirements for certification, oversight, and auditing become excessive. The Administration's proposal for certifying disadvantaged youth to participating companies can be made to work, but it will require constant care and diligence. This is only one possibility for program failure due to unnecessary and burdensome red tape.

Second, the potential for abuse by unscrupulous employers is always present in a program of this type. The Administration has tried to guard against the most obvious possibilities by placing a 20 percent limitation on the number of workers per firm who could qualify for the credit and by setting a 75 day minimum working period for qualifying workers. Nevertheless, the I.R.S. and the Department of Labor would need to be alert in spotting these and other potential abuses.

THE CURRENT "NEW JOBS TAX CREDIT"

We prefer the Administration's targeted program to the untargeted New Jobs Tax Credit program enacted last year. The Committee will recall when it was developed almost 18 months ago the rationale for the program fitted in well with the President's overall "Economic Stimulus Program." The economy seemed to be stagnating, and the unemployment rate had averaged 7.7 percent in 1976 and was still stuck at 7.4 percent in March 1977, when the program was first under serious consideration. The purpose of the New Jobs Tax Credit program was to stimulate new employment as part of an overall boost to the economy.

With the unemployment rate down to 5.7 percent and inflationary pressures increasing, the economic need for general employment stimulus is past and we should now move to refocus the program on the specific remaining serious structural unemployment problems.

WIN AND WELFARE PROPOSALS

With respect to the various proposals for altering the WIN and welfare tax credit programs, we would first observe that the programs are central to various overall welfare reform programs and can best be considered in that broader context. However, if the Congress wishes to move specifically in this area, we believe the various proposals are all aimed properly at increasing the incentives to private firms for hiring welfare recipients.

There is no evidence available upon which to base even a guess as to the level of incentive which would interest a substantial number of employers. There is, however, ample negative evidence that the current 20 percent tax credit program has elicited very little interest and participation.

SUMMARY

In summary, Mr. Chairman, The Business Roundtable supports the proposed targeted tax credit program aimed at hiring disadvantaged youth. We view it as one of a number of specific efforts which our society must make to alleviate the human and economic suffering which results from serious structural unemployment.

Senator HASKELL. We have now a panel consisting of Mike McKeivitt of the National Federation of Independent Business and Herbert Liebensohn of the Small Business Legislative Council.

I guess we do not have Mike McKeivitt. I do not see him.

Mr. DENNIS. He was unavoidably detained.

Senator HASKELL. All right. Are you from the National Federation of Independent Business?

Mr. DENNIS. Yes, my name is William Dennis.

Senator HASKELL. Thank you, sir.

STATEMENT OF HERBERT LIEBENSON, SMALL BUSINESS LEGISLATIVE COUNCIL

Mr. LIEBENSON. My name is Herbert Liebensohn. I am vice president for governmental affairs of the National Small Business Association. I am appearing here today on behalf of the Small Business Legislative Council, which is affiliated with National Small Business.

The Small Business Legislative Council is an organization, of national trade and professional associations whose members are predominantly small business. The council today represents approximately 4 million small businesses nationwide. The 89 national trade associations listed in attachment A have agreed in principle that in the elimination of current high unemployment the small business sector should be the employer of first resort with the incentive being provided by a job creation tax credit.

The small business community is very much aware that their well-being for the future is tied to the overall economy. They also are aware that the Treasury loses between \$16 and \$17 billion in revenue for each million persons that are unemployed.

There is certainly conclusive information that indicates that the future growth of our current labor force is with the small business community.

Senator HASKELL. That was actually borne out in the last hearing by representatives of major corporations. I found that very interesting.

Mr. LIEBENSON. We have, attached to our statement attachment B which shows—it may be a duplication of what you have had before—civilian employment data by the Fortune 500 companies and the second 500 and the actual increase over the past few years is only somewhere about 2.3 percent in employment among the thousand largest corporations.

Senator HASKELL. Is that part of your testimony?

Mr. LIEBENSON. It is included with it.

Senator HASKELL. Your testimony will be included in full in the record.

Mr. LIEBENSON. Thank you, sir.

The indication is, that about 98 percent of the future employment, at least based on data for the last few years, future employment is with the small business community, and this is where the emphasis is necessary, to encourage the small business community to get involved.

In fact, there are something like 4 million such firms that currently have the ability to employ people, given the proper incentives.

When we originally discussed the job tax credit several years ago, our concept was to have the job tax credit made available to owners of small job shop, the TV repair firm the auto mechanic, or the print shop. The individuals who owned the shop knew the kids on the block and they knew their community. They knew the families of many of the young people, and we felt that, if given the proper opportunity, they would then be able to select from, among the young people in the neighborhood, the right person that they would like to train.

We felt that the one-to-one relationship between an employer and, especially, a young employee would lend some strength to the young individual. The employer would not only teach the new employee certain skills, but he would act as a model for developing future private sector employers and, at the same time, help guide the individual in his or her day-to-day living experiences.

Unfortunately, when the Tax Reduction and Simplification Act of 1977 was passed and signed by the President, the rules provided by the Department of the Treasury were so complex that only those well acquainted with tax law could interpret the legislation.

In order that the committee might understand the difficulties a small business person would encounter in putting the program into effect, we are attaching for the information of the committee three analyses prepared by tax experts for their clients, explaining the jobs tax credit as passed by Congress.

As you will see, the complexity of its language renders the act virtually useless to the very people who could put it into effect and to good use.

As you may well understand, the Treasury Department was originally opposed to the jobs tax credit and in the opinion of technicians in the field, it was doing everything that it could to dissuade the utilization of the jobs credit.

Initially when we were talking about the jobs tax credit, we met with union economists.

Senator HASKELL. Often it occurs to me is whether there is necessity for regulations. In other words, the tests set up in the statute were reasonably precise. Maybe there were too many tests. Maybe some of them should be modified. But was there really a necessity for regulation under these circumstances?

Mr. LIEBENSON. It had to be tried the way government normally tries things, by regulation.

Senator HASKELL. Well, I just wonder if sometimes government does not go at it backwards. When you have a statute that is reasonably clear on its face, do you need regulations?

Mr. LIEBENSON. Yes; you do.

Senator HASKELL. You do?

Mr. LIEBENSON. You cannot just let it run wild, but there should be just simple guidelines, and we think there can be simple guidelines.

Senator HASKELL. Good. Have you made some suggestions as to what they might be in your prepared statement?

Mr. LIEBENSON. While we have not made those suggestions in this statement, in the past we have considered the possibility of a simple form to be filed by an employer when he takes on a new employee.

Senator HASKELL. Anything you have along those lines you might submit for the record.

Mr. LIEBENSON. We would be happy to.

At one time we considered relating the credit, and the amount of the credit, to the amount of unemployment in that area. As an example, and I am just taking these from memory, if an area had 15 percent or more of unemployment, the employer might get something like a 50 percent credit. The area with, say, 12.5 percent unemployment might get a 45 percent credit, or at 10 percent get something like a 30 percent credit.

The Labor Department every month, I believe, puts out statistics of unemployment based on the standard metropolitan areas. Therefore it is easy enough for an employer to know pretty well in advance exactly what his credit is going to be, once you structure it properly. It is a very simple thing to determine, and the Labor Department is doing the analyses anyway, and all the employer has to do is ask anybody at the Labor Department what is the unemployment rate for his area.

I think it is as simple as that.

When we first got into the jobs tax credit we went to the AFL-CIO and talked in terms of a cooperative effort. The reply we received was the jobs tax credit was a subsidy to the employer and therefore they would not support it.

However, at the same time they were supporting training programs through the Department of Labor that paid employers to train employees, and we just could not understand the logic of their not accepting the job tax credit and yet still supporting the use of Government funds to be paid to employers to train employees.

Now, one of the problems, of course, is that among the smaller companies, because of the Fair Labor Standards Act, OSHA, and other EEOC—anything having to do with government is something they want to stay away from.

Therefore, they pretty much stayed away from the jobs tax credit because of the other experiences they have had.

The biggest problem is that before you can obtain the enthusiastic support of small business, there is a need to communicate with them. To our knowledge, we do not know of any substantive publication directed to small business and simplified to a point where an employer could easily understand the advantage of joining in the various job creation programs.

The Department of Labor and some of the other agencies concerned with creating jobs generally have structured programs which require particular hours of training and particular job duties and skills. This formal, structured training program would not fit the needs of a one- or two-man shop and statistically this is your market for jobs.

Over a period of time, in a small shop, a trainee would obtain the same necessary technical skill. Once we are able to achieve an acceptance of a 1 to 1 training program, we believe hundreds of thousands of new jobs will be created.

In our statement we include a program suggested by Congressman Breckinridge who is chairman of the Congressional Rural Caucus, and he shows statistically that by going through a specific SBA loan program, many advantages could be gained for the Government. I will give you the conclusion.

He says that, simply stated :

The total \$1.6 billion in benefits and less than \$300 million in SBA costs leaves a total net value of \$1.3 billion to the taxpayer each year thereafter.

I would recommend the committee take a look at this suggestion by the Congressman.

On the work incentive program, it has been in operation since 1970. From the beginning of 1973, you had job placements of something like 136,000. Only 18.6 percent of the employers used the credit. It reached a high in 1974 when 22 percent of the employers used the credit.

In 1977, only 13 percent of the employers used the credit, so there has been a consistent decline over the last few years in the utilization of the credit in the WIN program, and therefore I would feel that it has had its chance, it has had its opportunity and it is reaching a plateau where it is no longer doing the job it should have done initially.

Certainly, we would go along with Senators Long, Moynihan and Cranston's suggestions in their proposal of relating to the present welfare recipient credit, and we would also support any of the programs which would reduce the number of people on the welfare rolls.

In concluding, let me say that the Full Employment Act of 1946 committed the country to full employment in theory, but not effectively. The small business community is willing to utilize its efforts to aid in creating full employment in a diverse economy. Government, big corporations and labor have all tried to bring about full employment in the past without success and small business deserves the opportunity to contribute its efforts to implement the Full Employment Act of 1946. Therefore, we support the extension, expansion and simplification of the jobs tax credit.

Senator HASKELL. Thank you, sir, very much indeed.

STATEMENT OF WILLIAM DENNIS, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. DENNIS. Last year about this time, we suspected that you might call hearings to evaluate the credit. So, we incorporated a series of questions into our Quarterly Economic Report for Small Business questionnaire related to the credit, including whether they knew of it, whether they used it, and things of that nature.

In sum, we found that in January of 1978—the questionnaire was run in January of 1978—1.4 percent of the entire population was aware of the credit and utilized it for the intended purposes—in other words, it influenced them to hire.

By the end of the first quarter, April 1978, the second time we ran the survey, 2.4 percent were aware of the credit and has utilized it for its intended purpose.

The preliminary data for July is that 4.1 percent were aware of the credit and have utilized it. There exists a mean of a little over two employees per firm.

That would mean that among the NFIB membership alone, there have been approximately 45,000 new jobs created due to the existing jobs tax credit. If we were to extrapolate our results into the population as a whole, which is a somewhat risky business, it would amount to approximately 300,000 new jobs created because of the credit.

Now, there are some remarkable things here to look at. The first thing that we found was that, as of January, only 42 percent of the

small firms were aware of the credit. By April, it had risen to 50 percent. By July—again preliminary results—it had risen 58 percent.

Still, 40 percent of the small business community is not aware of the credit, so its optimum effectiveness has yet to be realized.

Second, there is obviously a change over time here, and the change over time is a very positive one. More firms are using the credit for the intended purposes now than in January.

We support the existing credit, with some modifications. In particular, we are a little concerned that the employer is not sure at the time that he makes his decision whether or not to hire, the amount his credit is going to be.

It is a bit of an anomalous situation because the credit is intended to stimulate that marginal hiring decision. Yet when he has a marginal hiring decision, he does not know exactly what his margin of return is going to be.

The second problem that we have included—and I am not sure there is really anything you can do about it—involves some of the State interpretations of the small firms State tax liability after having taken the Federal jobs tax credit. We have included at the end a rather lengthy letter explaining in detail what is occurring in the States of New York and Mississippi. We do not know how widespread it is, but we know that it is occurring there, and probably some other States.

We do not support the targeted program, and the reason we do not is because we do not think it fits the small business community.

Rationally, logically, the target proposals that were put forward make sense. But when you consider that small business is the group that is doing the hiring, then it becomes another matter. The logic does not follow.

For example, anything like this is going to involve extraordinarily complex systems. I do not care whether you are going to focus geographically, whether you are going to focus on the individual or what. I do know, however, that it is going to make the credit more complex. Complexity operates against small business.

The second point is that the targeted credit does not consider the way they hire. The first way they hire is by other employee referrals. More small businesses hire that way than any other.

The second way they hire is by walk-ins, people walking in off the street.

The third way they hire is through advertisement and the fourth way they hire is through résumés or vitae on file.

Those are the four principal ways they hire. They opt to go to public employment agencies or private employment agencies on a much smaller scale than those other methods. Therefore, the targeted credit does not fit the way they hire. If small firms are the ones that are expected to do the hiring, and the type of program you have does not fit their characteristics or the way they are operating, you are not going to have a very successful program.

Finally, I think that we have a problem if you are going to focus on some type of unemployment or low-income requirement. Many small employers tend to view with a jaundiced eye those that are currently not working. So, when you ask somebody to come in and certify that he is not working, he is on welfare or something like this, you are making the small employer focus on the fact that the individual does

not have a job rather than focus on the fact he would like a job. I think that is a very important distinction, although it may appear fine, because those are the types of things that small firms hire on.

So I would like to conclude by saying that the jobs credit has been remarkably effective and we would hate to see any major changes.

Thank you.

Senator HASKELL. Thank you, gentlemen. Just one question. I, of course, would like to see the jobs credit extended with the necessary modifications. On the other hand, if others and the administration want a separate and distinct targeted credit, do you see any harm in it?

Mr. DENNIS. No; we would have no problem with a tax credit, something that perhaps went beyond—

Senator HASKELL. And was separate, apart, and distinct.

Mr. DENNIS. Separate and apart, to the extent that it would be on top of or a distinct program.

Senator HASKELL. By distinct, in other words, the current jobs credit would continue with modifications, and then in a separate section there might be a targeted credit. I realize that you do not think it would work, but do you have any objection if it was actually in the bill?

Mr. DENNIS. No; we would not. In fact, we would think that if you had a targeted credit along with the existing credit, you will have a better chance to make the targeted credit work, because at least some of the small firms are thinking in terms of credit. They know they are going to get a credit. They may get more because of the specific category.

Mr. LIEBENSON. I might say, as was suggested before, that the targeted program should be targeted to the areas of unemployment, high unemployment, rather than just targeted to any specific classes.

Senator HASKELL. I understand.

Mr. LIEBENSON. And that is where you are going to bring about the major problems.

Earlier you talked about the utilization of the credit by major corporations, and one of the reasons that the \$100,000 maximum was placed in the law was because we wanted to be sure that it was utilized primarily by small business and therefore the larger corporations looked at the jobs credit as a windfall.

Obviously, from their hiring practices and adding new employees, they still could have had something of a windfall with the numbers that are involved here.

Senator HASKELL. All right.

Thank you both for appearing. Your full statements will appear in the record in addition to our discussions. Thank you very much.

[The prepared statements of the preceding panel follow:]

STATEMENT OF THE SMALL BUSINESS LEGISLATIVE COUNCIL

My name is Herbert Liebenson. I am Vice President for Government Affairs for the National Small Business Association. I am appearing here today on behalf of the Small Business Legislative Council (SBLC) which is affiliated with the National Small Business Association. The SBLC is an organization of national trade and professional associations whose members are predominantly small business. The Small Business Legislative Council focuses on issues of common concern to all small business. The Council today represents approximately four million small businesses nationwide.

We sincerely appreciate this opportunity to comment on the Jobs Tax Credit. The 89 associations listed on Attachment A have agreed in principle that:

"In the elimination of current high unemployment, the small business sector be the employer of first resort, with the incentive being provided by a job creation tax credit."

The small business community has a vital concern with the problems associated with high unemployment which creates downward trends in our economy, high interest rates, and inflation which creates a shortage of venture capital.

From data (Attachment B) obtained from the "Economic Report of the President," January 1978, there is conclusive information that indicates the future growth of our current labor force is with the small business community.

Beginning in 1975 the National Small Business Association, realizing that the responsibility of job creation was with the smaller companies, pressed for legislation for a Job Creation Credit. Our objective was to encourage the small TV repair shop or auto mechanic, and other trades needing skilled personnel, to add one or two employees. Hopefully, whether they were in small towns or major cities, these people in the business community would know which of the younger people in the neighborhood were most apt to be responsible or know their families well enough to be sure that the persons they selected had a desire to learn. Realistically, the group that needed the most help were the disadvantaged, both economically and socially. We felt that a one-to-one relationship between the trainee and the small employer, who had had the initiative and knowledge to create his own business, could serve several purposes. Not only could he teach a new employee certain skills, he could act as a model for developing future private sector employers and, at the same time, help guide the individual in his or her day-to-day living experiences. Unfortunately, when the Tax Reduction and Simplification Act of 1977 was passed and signed by the President, the rules provided by the Department of the Treasury were so complex only those well-acquainted with tax law could interpret the legislation. In order that the Committee might realize the difficulty a small business person might have in putting the program into effect in his or her own business, we are attaching, for the information of the Committee, three analyses (Attachments C, D, E) prepared by tax experts explaining the Jobs Tax Credit as passed by the Congress.

As you can well understand, the Treasury Department was originally opposed to the Jobs Tax Credit and, in the opinion of technicians in the field, it was doing everything they could to dissuade the utilization of the Jobs Tax Credit.

When the National Small Business Association was first exploring the possibility of the Jobs Tax Credit, we spoke with many people, including union economists. The union economists' attitude was that a Jobs Tax Credit was a subsidy to an employer and they were opposed to that subsidy. However, they had supported and continue to support programs in the Department of Labor that paid employers to train individuals. Personally, I can't understand their logic. Frankly, many small employers have become gun-shy of any of the Department of Labor's programs. They are often confused by the FLSA, OSHA, Walsh-Healey, EEOC, etc. as they relate to their businesses.

It has only been within the past few months that groups, such as the National Alliance for Business and Department of Labor's CETA program, have directed their attention and activities to the small business community. Before we can obtain the enthusiastic support of small business individuals or groups, there is a need to communicate with them. To our knowledge, we do not know of any substantive publication directed to small business and simplified to a point where they could easily understand the advantage of joining in the various job creation programs. The Department of Labor and some of the other agencies concerned with creating jobs generally have structured programs which require specific hours of training in particular job duties and skills. This formal structured training program would not fit the needs of a one or two-man shop and statistically this is your market for jobs. Over a period of time a trainee would obtain the same necessary technical skills. Once we are able to achieve an acceptance of a one-to-one training program, we believe hundreds of thousands of new jobs can be created.

In testimony before the Senate Finance Committee early in 1975, former NSB President Milton D. Stewart outlined the need for a Job Creation Tax Credit for small business. At the time there were 9.2 million unemployed. Today's unemployment is 5.8 million. Various economic indicators have shown the possibility of another recession and unemployment still continues to be a major problem. We cannot over-emphasize the need to put hundreds of thousands of people in productive work in business and not on a Government payroll.

On December 13, 1977, Congressman Breckinridge, Chairman of the Congressional Rural Caucus, outlined one approach as to how job creation through Federally guaranteed loan programs could be achieved at a profit to the taxpayer:

"In 1976, the SBA advised that it loaned \$2 billion to various enterprises throughout the nation, creating an estimated minimum of 200,000 jobs in the private sector. SBA's 4,200 employees cost the taxpayers \$200 million in administrative costs. Based on SBA's 5 percent loan loss ratio (\$2 billion times 5 percent), \$100 million will not be recovered. Thus, \$1.9 billion will be repaid to the taxpayers, with principal and interest. The 200,000 SBA jobs created in the private sector cost \$200 million for administration and \$100 million for loan losses, for a total cost of \$300 million.

"These 200,000 jobs are private sector jobs that pay taxes, rather than absorb taxes. Our task force estimates that the total benefit to the taxpayers is as follows:

1976 TAX REVENUE AND SAVINGS FOR 200,000 SBA JOBS

	Dollars per job	Total dollars (millions)
Federal individual income tax.....	\$2,300	\$460
Federal corporation tax.....	1,134	227
Federal welfare savings.....	2,500	500
State and local tax.....	2,114	423
Total.....	8,048	1,610

Note: Simply stated, the total \$1,600,000,000 in benefits, less the \$300,000,000 in SBA costs, leaves a total net benefit of \$1,300,000,000 to the taxpayers each year thereafter.

WORK INCENTIVE PROGRAM

In 1970 Congress passed a Work Incentive Program aimed at encouraging employers to hire persons on welfare rolls. In 1972 Congress instituted a 20% tax credit. This credit increased job placements by over 110% in 1973 the first year employers were able to take the tax credit. Even then, only 18% of eligible employers asked for the tax credit.

Year	Job placements	Using credit	Percent using credit
1970.....	25,000		
1971.....	50,444		
1972.....	60,310		
1973.....	136,783	24,853	18.6
1974.....	177,271	29,488	22.27
1975.....	170,641	26,042	15.26
1976.....	186,062	28,215	15.02
1977.....	276,607	35,226	13.00

Interviews with Labor Department Administrators a few years ago indicated the 20% tax credit incentive was not adequate to encourage more employers to participate in the WIN program. The red tape required by employers in order to obtain the 20% credit was a sufficient deterrent to prevent employers from applying for the credit. Even with the liberalization of the WIN program in 1976, the table shows that there was still not sufficient incentive to utilize the program.

Senator Bentsen and Matsunaga are co-sponsors of S. 3321 which, among its provisions, provides additional incentives for the WIN program by providing a tax credit of 50 percent of FUTA wages—the first \$6,000 of wages per employee would be provided for hiring.

Senators Long, Moynihan and Cranston have introduced a proposal to reduce the present welfare recipient credit. We would support any program which results in reduction of the number of people on the welfare rolls.

CONCLUSION

In concluding, we wish to leave for the Committee's consideration, several facts. These are:

1. Small businesses produce almost 50 percent of our GNP.

2. Between 1969 and 1976 (8-year period) new employment increased 9,582,982. The list of the Fortune Magazine 1,000 largest companies in the U.S. employed only 8/10 of one percent, or 74,879.

3. Small businesses employed 9,508,103, or 99.2 percent.

4. Inflation is not as much a problem when solid foundations of economic policy for workers to be gainfully employed are utilized rather than "job creation" programs, which foster greater government deficit spending.

5. New and existing small businesses create and save more jobs per dollar of business volume than the larger Fortune 1,000 companies.

The Full Employment Act of 1946 committed the country to full employment in theory—but not effectively. The small business community is willing to utilize its efforts to aid in creating full employment in a diverse economy. Government, big corporations and labor have all tried to bring about full employment in the past—without success—small business deserves the opportunity to contribute its efforts to implement the Full Employment Act of 1946.

We support the extension, expansion and simplification of the Jobs Tax Credit. Thank you.

ATTACHMENT A

The following 89 organizations have advised the Small Business Legislative Council they agree in principle that "in elimination of current high unemployment, the small business sector should be the employer of first resort, with the incentive being provided by a job creation tax credit."

American Association of Minority Enterprise Small Business Investment Companies, Washington, D.C.

American Association of Nurserymen, Washington, D.C.

American Gear Manufacturers Association, Washington, D.C.

American Pipe Fittings Association, Stamford, Conn.

American Pulpwood Association, Washington, D.C.

American Road Builders Association, Washington, D.C.

Appalachian Hardwood Manufacturers, Inc., High Point, N.C.

Associated Masters Barbers and Beauticians of America, Charlotte, N.C.

Associated Retail Bakers of America, Annapolis, Md.

Automotive Engine Rebuilders Association, Glenview, Ill.

Automotive Parts and Accessories Association, Washington, D.C.

Automotive Warehouse Distributors Association, Inc., Kansas City, Mo.

Boat Manufacturers Association, Chicago, Ill.

Building Service Contractors Association, McLean, Va.

Casket Manufacturers Association of America, Evanston, Ill.

Christian Booksellers Association, Colorado Springs, Colo.

Colorado Organic Growers and Marketers Association, Denver, Colo.

Computer and Communications Industry Association, Rosslyn, Va.

Connecticut Small Business Federation, Inc., Hartford, Conn.

Cutting Tool Manufacturers Association, Birmingham, Mich.

Delaware Retail Association, Wilmington, Del.

Electrical Generating Systems Marketing Association, Chicago Ill.

Engraved Stationery Manufacturers Association, Chicago, Ill.

Farmers Elevator Association of Minnesota, Minneapolis, Minn.

Food Merchandisers of American, Inc., Washington, D.C.

Greater Washington Business Center, Inc., Washington, D.C.

Idaho Feed and Grain Association, Caldwell, Idaho.

Independent Bakers Association, Washington, D.C.

Independent Media Producers Association, Washington, D.C.

Independent Retail Businessmen's Association, Inc., Burlington, Vt.

Independent Sewing Machine Dealers of America, Inc., Hilliard, Ohio.

International Repro Graphic Blueprint Association, Franklin Park, Ill.

Machinery Dealers National Association, Silver Spring, Md.

Manufacturers Agents National Association, Irvine, Calif.

Menswear Retailers of America, Washington, D.C.

Metal Treating Institute, Phoenix, Ariz.

Metropolitan Contractors Association, Washington, D.C.

Minnesota Motorcycle Dealers Association, Minneapolis, Minn.

Motorcycle Trades Association, Inc., Alexandria, Va.

National Appliance Service Association, Kansas City, Mo.

National Association of Black Manufacturer, Washington, D.C.

National Association of Floor Covering Distributors, Chicago, Ill.

National Association of Furniture Manufacturers, Washington, D.C.

National Association of Glove Manufacturer Inc., Gloversville, N.Y.
 National Association of Independent Lumbermen, Washington, D.C.
 National Association of Men's and Boy's Apparel Clubs, New York, N.Y.
 National Association of Plastics Distributors, Devon, Penn.
 National Association of Retail Druggists, Washington, D.C.
 National Bicycle Dealers Association, Inc., Wickliffe, Ohio.
 National Building Material Distributors Association, Chicago, Ill.
 National Candy Wholesalers Association, Washington, D.C.
 National Coffee Service Association, Chicago, Ill.
 National Concrete Masonry Association, McLean, Va.
 National Electrical Contractors Association, Inc., Bethesda, Md.
 National Electronic Service Dealers Association, Indianapolis, Ind.
 National Family Business Council, West Bloomfield, Mich.
 National Glass Dealers Association, Washington, D.C.
 National Home Improvement Council, New York, N.Y.
 National Independent Dairies Association, Washington, D.C.
 National Independent Meat Packers Association, Washington, D.C.
 National Insulation Contractors Association, Washington, D.C.
 National Kampground Owners Association, Martinsville, Ill.
 National Liquor Stores Association, Washington, D.C.
 National Lumber and Building Material Dealers Association, Washington, D.C.
 National Office Products Association, Alexandria, Va.
 National Office Machine Dealers Association, Inc., Hackensack, N.J.
 National Paper Trade Association, Inc., New York, N.Y.
 National Patent Council, Inc., Arlington, Va.
 National Peach Council, Martinsburg, W. Va.
 National Precast Concrete Association, Indianapolis, Ind.
 National Ready Mixed Concrete Association, Silver Spring, Md.
 National School Supply and Equipment Association, Arlington, Va.
 National Sand and Gravel Association, Silver Spring, Md.
 National Screw Machine Products Association, Cleveland, Ohio.
 National Selected Morticians, Evanston, Ill.
 National Small Business Association, Washington, D.C.
 National Society of Public Accountants, Washington, D.C.
 National Utility Contractors Association, Washington, D.C.
 National Water Well Association, Worthington, Ohio.
 National Woodwork Manufacturers Association, Chicago, Ill.
 New York State Council of Retail Merchants, Albany, N.Y.
 Northeastern Lumber Manufacturers Association, Glens Falls, N.Y.
 Oregon Feed, Seed and Suppliers Association, Portland, Oreg.
 Rocky Mountain Food Dealers Association, Denver, Colo.
 Small Business Service Contractors Association, Washington, D.C.
 Society of American Florists and Ornamental Horticulturists, Alexandria, Va.
 South Dakota Retailers Association, Pierre, S.D.
 Truck Body and Equipment Association, Inc., Washington, D.C.
 Truck Equipment and Body Distributors Association, Cincinnati, Ohio.

EMPLOYMENT DATA OF THE FORTUNE 500 AND TOTAL U.S. CIVILIAN EMPLOYMENT

Year	First 500	2d 500	Total civilian labor force
1976.....	14,836,163	1,874,614	94,773,000
1975.....	14,412,992	1,861,352	92,613,000
1974.....	15,255,946	1,993,976	91,011,000
1973.....	15,531,683	1,966,814	88,714,000
1972.....	14,676,849	1,845,502	86,542,000
1971.....	14,324,890	1,765,418	84,113,000
1970.....	14,607,581	1,719,805	82,715,000
1969.....	14,813,809	1,822,071	80,734,000
Total increase.....	22,354	52,543	14,039,000
Total percent increase (8 years).....	0.15	2.9	14.8
Average annual percent increase.....	.02	.42	2.3

Source: Data for the 1st 500 and the 2d 500 are published in Fortune magazine, May and June respectively, for the previous year. Data for civilian labor force was obtained from the Economic Report of the President, January 1978.

ATTACHMENT C

SUMMARY OF THE JOBS TAX CREDIT—MICHAEL M. SCHARF, CONSULTANT TO THE GOVERNMENT RELATIONS COMMITTEE OF THE SMALLER MANUFACTURERS

The Tax Reduction and Simplification Act of 1977 contains a new jobs tax credit which may be beneficial to your business. Subject to the various limitations which are listed below this new tax provision will permit business taxpayers to claim a job credit of up to \$2,100 (50 percent of Federal unemployment tax wages) for each additional worker employed in 1977 and 1978.

In order to qualify for the credit, the total of the unemployment insurance wages paid by the employer must increase by 2 percent each year. Once this requirement is met, a tentative credit is computed. This credit is equal to 50 percent of the excess of wages for Federal unemployment tax purposes over 102 percent of the aggregate unemployment insurance wages during the previous year. (This 102 percent rule is designed to allow credit only where an employer's gross employment exceeds the normal increases in employment for the economy as a whole.) The following example illustrates the computation of the tentative credit.

The ABC Corporation has 10 employees in 1976. Each employee earned \$10,000 so that the total payroll was \$100,000 and the unemployment insurance wages (FUTA) was \$42,000. In 1977, the ABC Corporation hired four new employees at \$10,000 each. The 1977 payroll cost then was \$140,000 and FUTA wages increased to \$58,800. Its credit is computed as follows:

Tentative credit.—\$58,800 (1977 FUTA wages) less \$42,840 (102 percent of 1976 FUTA wages) x 50 percent = \$7,980.

Unfortunately, this tentative credit is subject to limitations provided in the Act which are both numerous and complex.

The following is a listing of the major limitations which could have a bearing on the availability of this tax credit to your business.

(1) The tentative credit referred to above is limited to 50 percent of the difference between 105 percent of total wages for the prior year and the total wages of the current year. (This 105 percent rule was added to insure that the credit is based on actual increases in employment rather than artificial increases in unemployment insurance wages.)

This limitation would be computed for ABC Corporation in the following manner:

Limitation 1.—\$140,000 (1977 total wages) less \$105,000 (105 percent of 1976 total wages) x 50 percent = \$17,500.

Since the tentative credit of \$7,980 is less than the limitation computed under the 105 percent rule the Corporation is entitled to the full \$7,980 credit.

(2) To further complicate matters, the Act also limits the increase in unemployment insurance wages to 50 percent of the current year's unemployment insurance wages. (The feature was added to limit the amount of credit available to new or rapidly expanding businesses which would be hiring anyway.)

(3) The credit is limited to \$100,000 per year. This amount must be divided among members of controlled groups.

(4) The tax credit cannot exceed the employer's tax liability and is, therefore, not refundable. There are provisions, however, for carrying back the credit for three years or carrying it forward for seven years.

In addition, any credit claimed will reduce the deduction for salary and wage expenses which you can claim in your tax return. For example, if a taxpayer pays \$100,000 in salaries and is entitled to a job tax credit of \$5,000, his deduction for salaries and wages will be \$95,000.

In summary, this new tax provision can be very valuable to your business. However, due to the complicated limitations, we suggest that you contact your tax advisor before taking any action.

ATTACHMENT D

EXTRACT FROM TAX REDUCTION AND SIMPLIFICATION ACT OF 1977:
ITS EFFECT ON BUSINESS—1977 "BUSINESS MONTHLY"

JOBS CREDIT

The act provides business with a new jobs credit for 1977 and 1978. The credit is 50 percent of the increase in each employer's wage base under the Federal

Unemployment Tax Act (FUTA) above 102 percent of that wage base in the previous year. The FUTA base for a year consists of wages paid up to \$4,200 per employee.

The employer's deduction for wages is reduced by the amount of credit. So although the maximum gross credit for each new employee is \$2,100, the effective credit ranges from \$1,806 for a taxpayer in the 14 percent tax bracket to \$630 for a taxpayer in the 70 percent bracket.

The total amount of the credit has four limitations:

1. The credit cannot be more than 50 percent of the increase in total wages paid by the employer for the year above 105 percent of total wages paid by the employer in the previous year.

2. The credit must be no more than 25 percent of the current year's FUTA wages.

3. The credit for a year cannot exceed \$100,000.

4. The credit cannot exceed the taxpayer's tax liability. Credits which exceed tax liability for a year may be carried back for three years and carried forward for seven years.

Although most employers will be able to use the returns they file for purposes of complying with FUTA as a basis for claiming the credit, special rules are provided for businesses, such as farms and railroads, not covered under FUTA. Special rules are also provided for credit computation by groups of companies under common control, for businesses with employees working abroad, and for businesses affected by acquisitions, dispositions, and other changes in business form.

There is an additional nonincremental credit equal to 10 percent of the first \$4,200 of FUTA wages paid to handicapped individuals (including handicapped veterans) who receive vocational rehabilitation.

The credit is based on the first \$4,200 of wages paid to a handicapped individual whose first FUTA wages from the employer are paid in 1977 or 1978. Only wages paid during the one-year period, beginning when the individual is first paid FUTA wages by the employer, are taken into account in computing the 10 percent credit.

The credit for handicapped workers can't be greater than one-fifth of the regular 50 percent credit which would have been allowable without regard to the \$100,000 limitation. However, the special 10 percent credit is not itself subject to any specific dollar limit.

ATTACHMENT E

EXTRACT FROM SUMMARY BY ARTHUR YOUNG & Co., H.R. 3477, "TAX REDUCTION AND SIMPLIFICATION ACT OF 1977"

JOBS TAX CREDIT

In order to stimulate increased employment, a new jobs tax credit, generally not to exceed \$100,000 per year, will be available to businesses that hire new employees in 1977 and 1978. After meeting the limitations described below, a credit of up to \$2,100 will be allowed for each new employee hired.

However, an employer's deduction for wages must be reduced by the amount of the credit taken; therefore, the maximum tax benefit to the employer will range between \$630 and \$1,806 per new employee, depending upon the employer's tax bracket. For example, a corporation in the 48 percent tax bracket could obtain a tax benefit of \$1,092 per employee with a maximum total benefit of \$52,000.

The credit, which is generally limited to the amount of tax otherwise payable, will be available in taxable years beginning after December 31, 1976. Any credit not utilized may be carried back to the preceding three years and then forward in the succeeding seven years. For example, any credit not used in 1977 would be carried back to 1974, then forward to 1975 and subsequent years.

The jobs tax credit allowable is 50 percent of the first \$4,200 of unemployment insurance wages paid to new employees hired in 1977 and 1978. However, this credit is limited to 50 percent of the least of the following amounts:

1. The excess of the sum of "unemployment insurance wages" (up to \$4,200 of wages subject to Federal Unemployment Tax and paid to each worker during the calendar year) over 102 percent of the amount of such wages paid in the prior calendar year.

2. The excess of total wages paid during the calendar year over 150 percent of total wages paid in the prior calendar year.

3. 50 percent of the total "unemployment insurance wages" for the calendar year.

An additional jobs credit, computed without regard to the \$100,000 limitation, is available for hiring eligible handicapped workers.

Special rules are also provided for computation of the credit by controlled groups, for businesses with employees working abroad, and for businesses affected by acquisitions, dispositions and other changes in business form.

STATEMENT OF JAMES D. "MIKE" McKEVITT, WASHINGTON COUNSEL, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. Chairman, NFIB, on behalf of its 540,000 small and independent member businesses, appreciates the opportunity to testify in favor of continuation of the jobs tax credit in a form similar to that now existing. This tax provision is of special interest as it was small business that asked for it, and small business and newly hired employees that are its direct principal beneficiaries.

SMALL BUSINESS EMPLOYMENT INCREASES

Before proceeding to a discussion of the jobs tax credit, it is necessary to reflect upon the growth in employment that has occurred throughout the 1970's.

Economists seem puzzled by the magnitude of hiring that has swept the business community during recovery from the 1974-1975 recession. Many have speculated on its causes, but little, if anything, has been firmly established. While the question "why" is entirely appropriate for a clarification of this phenomenon, we would respectfully suggest that the discussion step backward to the question of "who", for the latter's resolution may assist in the former's.

It is clear to NFIB that small business bears primary responsibility for the enormous employment gains realized by the private sector in this decade. In "Employment and the Small Business Sector," Ed Zayas of our staff demonstrates that a fundamental change has taken place in the American economy since 1967.¹ Until that time, employment in enterprises with more than 1,000 employees appeared to be growing more rapidly than in either medium size business (defined as employing 100-999 people) or small business (defined as fewer than 100 employees). In the 1958-1963 period, for example, employment in large business grew 13.7 percent; in medium size business, employment grew 1.7 percent; and, in small business employment grew 3.9 percent. Clearly, large business was the source principally responsible for employment gains during the period.

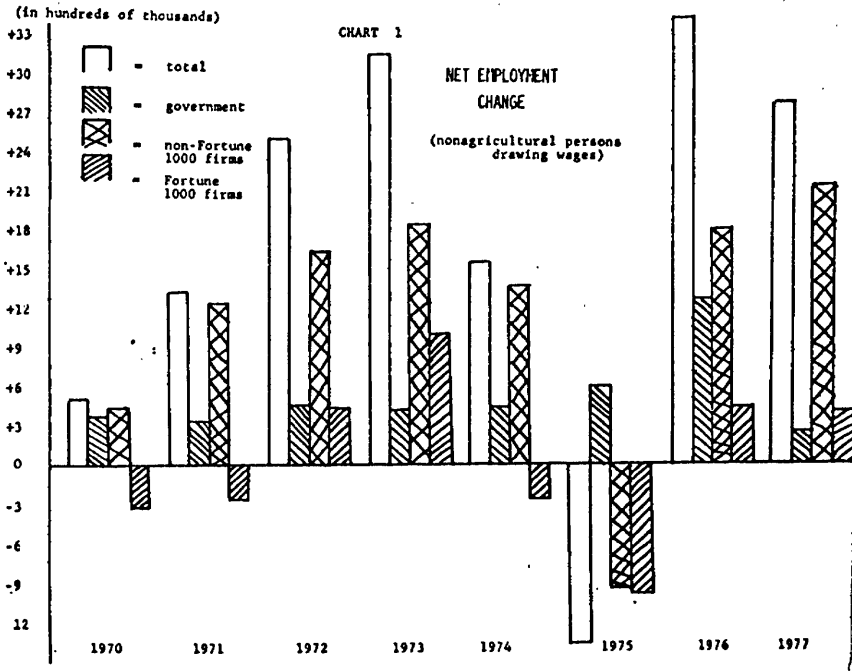
Between 1963 and 1967, a change was evident. Employment increases for small, medium, and large firms were nearly even. By the 1967-1972 period, the change was complete. Small business employment grew 13.2 percent over the period, large business 8.9 percent, and medium business 1.4 percent.

Those data, developed from the Census Bureau's Enterprise Statistics, have been updated using a methodology originated by staff of the House Small Business Committee and developed by Mr. Zayas. The results can be seen in Chart 1. Note the relatively modest increase directly attributable to the Fortune 1,000 firms. This represents only 4 percent of the total net increases registered between 1970 and 1977, and 14 percent in the 1976-1977 period. In contrast, the non-Fortune 1,000 firms produced 65 percent of all net new jobs between 1970 and 1977, and 62 percent in the 1976-1977 period. Government accounted for the remainder.²

¹ Zayas, Ed, "Employment and the Small Business Sector," unpublished paper, Apr. 21, 1978.

² While Fortune 1,000 firms are not synonymous with "big business", they constitute 85 percent of the employment in firms employing 1,000 or more individuals. Merger and acquisition activity which has recently been considerable and inflates net new employment figures for those firms, was not considered. Hence, Chart 1 offers a fair, though not precise, representation of the contribution large firms have made to employment growth in the '70's.

Similarly, non-Fortune 1,000 firms are not synonymous with "small business". A few large firms are included as are all medium size firms (defined as 100-999 employees). But, if we review the employment growth pattern of medium sized firms over time (1958-1972), we find a much slower growth rate than either the large and small classification. Hence, we can assume the growth in employment among non-Fortune 1,000 firms is primarily a function of small business.



Whether this employment phenomenon is permanent or temporary in nature, we do not know. But it is clear, that at this time, small business is supplying the new jobs needed by America's expanding labor force.

EFFECTIVENESS OF THE JOBS TAX CREDIT

The data in Chart 1 suggest the credit may have been helpful in increasing employment. Note the difference in net employment change between 1976 and 1977; total net employment increases in 1977 were greater in the private sector. Of particular interest is the fact that non-Fortune 1,000 firms considerably increased net employment between 1976 and 1977, while Fortune 1,000 firms increased employment in 1977 by slightly less than they did in 1976. Considering (1) the credit was effective for calendar year 1977, but not 1976, (2) the credit provides a greater incentive to small firms than larger ones as small business generally has a lower wage structure, and (3) the cap on the number of new employees for which the credit can be claimed, tends to favor small firms, it is reasonable to suggest that the jobs tax credit is at least partially responsible for the positive hiring performance of small business in 1987. Despite the suggestion these data provide, however, at best they represent no more than that—a suggestion.

Anticipating the Congress would wish to evaluate the credit's effectiveness, NFIB incorporated a series of questions relating to the jobs credit into our "NFIB Quarterly Economic Report for Small Business" questionnaire.⁸ Data on the credit was collected in this manner during the months of January, April, and July 1978. In sum, these data indicate the jobs tax credit has had a direct positive impact on employment.

Table 1 qualifies the impact. Note that in percentage terms, the impact appears quite modest. By January, 1978, only 1.4 percent of the population had utilized

⁸ "NFIB Quarterly Economic Report for Small Business", (eds.) Bailey, Richard M. and Dunkelberg, William C., (National Federation of Independent Business: San Mateo, Cal.), series.

the credit for its intended purpose;⁴ three months later that figure had risen to 2.4 percent; and preliminary results from July show that 4.1 percent have utilized the credit since its inception.

TABLE 1.—EFFECT OF JOBS TAX CREDIT ON TOTAL POPULATION

	[In percent]		
	January 1978	April 1978	July 1978 (preliminary)
Influenced to hire.....	1.4	2.4	4.1
Influenced to hire in previous quarter.....	.5	1.0	NA
Influenced to hire prior to previous quarter.....	.9	1.4	NA
Mean tax jobs per firm.....	2.0	2.3	NA

Several points need to be made in evaluating these results. First, even a small percentage of small businesses translate into large aggregate numbers. There currently exists an estimated 3.5 million small employers throughout the country. Just 1 percent of that number constitutes 35,000 firms. Further, we know firms utilizing the credit often use it to hire more than one employee. Table 1 shows the average was two employees per firm in January and 2.3 in April. We, therefore, estimate the total number of new jobs directly attributable to the credit among NFIB members alone amount to 45,000. To the extent NFIB data can be extrapolated to the entire small business population, we would be discussing over 300,000 new employees.

Making such an extrapolation is risky business considering the small numbers involved. A 0.1 percent change in utilization could make a considerable difference in extrapolating the number over millions of firms. Yet, a Bureau of the Census survey corroborates NFIB data, and in fact makes us appear conservative.⁵

In January, 1.4 percent of the NFIB sample were aware of the credit and used it.⁶ One month later, the Bureau of the Census found that 2.4 percent were aware of the credit and made a conscious effort to increase employment because of it. Considering the differences in the surveys (see footnote 6), it should be expected that the Census figure would be somewhat higher. In fact, the similarity between the two, leads us to conclude that within reasonable limits, the NFIB data is applicable to the entire small business community.

The second point in evaluating the data is that the NFIB time series demonstrates credit utilization is increasing. Note in Table 1 the changes which have taken place over the period examined. Prior to the 4th Quarter, 1977, 0.9 percent had hired due to the credit. In the 4th Quarter, the figure stood at 0.5 percent; it then rose to 1.0 percent in the 1st Quarter, 1978; and, based on preliminary data, rose to 2.5 percent in the 2nd Quarter.⁷

The continuing increase in the credit's utilization should not be surprising. This is our third point in evaluating effectiveness of the credit. Awareness of the credit's existence has been rising. In January, only 43 percent of NFIB members

⁴ Henceforth, when we speak of utilization of the credit, it means utilization of the credit for its intended purpose—unless otherwise noted.

⁵ "New Jobs Tax Survey: Covering 1977 Tax Year," Bureau of the Census, unpublished paper, April 1978.

⁶ NFIB took its initial sample in January; the Census took its sample in February. The NFIB sample was of small businesses with some of medium size; the Census sample was of the entire business community, which is dominated in numbers by small firms as was the Census sample. Questions employed were similar, but not identical.

⁷ NFIB has a modest control device within the questionnaire which allows us to check whether the respondent claiming utilization of credit has actually done so. Early in the questionnaire, we ask for employment increases or decreases within the previous quarter; jobs credit questions are located at the end. We cross-tabulate those responding positively to the credit utilization question (after insuring they were aware of the credit) with those hiring in the previous quarter. If respondents are not "fudging", we should expect that the percentage of firms utilizing the credit would equal those who used the credit in the most recent quarter plus those who had used it at the previous quarterly measuring point. Note in Table 1 that 1.4 percent utilized the credit prior to January; in April that had risen to 2.4 percent. Cross-tabulating actual new employment with credit usage for the 1st Quarter yielded 1 percent. One percent plus 1.4 percent equal 2.4 percent—a perfect match.

were aware of the credit;⁸ by April, it reached 51 percent; and, preliminary data for July indicates awareness has risen to 58 percent. Obviously, greater awareness should (and apparently did) improve utilization. Second, the marginal level at which the credit will provide a sufficient inducement to hiring may not be present at the time a small employer discovers the credit's existence. The small employer may simply need time to factor the credit into his plans. The result is a lag between awareness and utilization. And third, the increased maximum value of the credit in 1978 is probably having a positive impact. Though the impact of 1978's larger maximum credit is unmeasurable, we note that among the NFIB firms aware of the credit but which found the credit not influencing them to add employees, only half as many in April as in January cited the credit as being too small an incentive.

CHARACTERISTICS OF SMALL BUSINESS EMPLOYMENT

Increasing utilization of the credit raises at least one interesting question. Assuming the credit's purpose is to stimulate employment rather than to give small business a tax advantage, and further assuming the credit cannot be an incentive without employer awareness of its existence, what has the Treasury Department or the Labor Department done to advertise the credit's availability? We are afraid the answer is little or nothing. Two sources provided over 80% of our sample with information on the credit's existence. A newspaper, magazine, Mandate (the NFIB publication), etc., provided 41% with the information, and accountants or bookkeepers provided the information to another 41 percent. Other sources were almost insignificant: radio and television—2 percent, someone else in business—3 percent, and "other" which includes government—9 percent.

Clearly, if the credit is to assume optimum effectiveness, a concerted effort must be made to advise the small business community of this opportunity. You must bear in mind that small businessmen do not and cannot have a cadre of tax attorneys investigating possible utilization of any and all tax advantages. These are people with little time to devote to any one area of the business operation, e.g. sales, personnel, finance, etc. Therefore, publishing regulations in the Federal Register or mailing a few general press releases is insufficient. They need to be told directly and then repeatedly reminded.

A second factor operating against the credit's effectiveness among small businesses is the credit's complexity. In particular, the inability of the small entrepreneur to have his credit calculated until the conclusion of the tax year, leaves many wondering whether or not to use the credit. This creates an anomalous situation; the credit is intended to affect the marginal hiring decision; because the decision is marginal, the amount of the credit is important; yet, the employer doesn't know his return until after his decision has been made. This is especially true for a very small employer, e.g. a three man operation, where the credit could defray a significant portion of the payroll.

Regrettably, rather than attempting to simplify the credit, thereby increasing its effectiveness in the small business community, the Administration has suggested a so called "targeted jobs credit." NFIB has no difficulty with a "differential credit" to encourage employment in areas such as inner cities where black teenage unemployment remains a thorny problem. What bothers us is that the credit would be vacated in significant portions of the country and

This proposal or similar ones

fail to recognize the nature of small firms for it adds another significant complexity to the credit. Unemployment is a dynamic phenomenon. It changes daily and changes differently in each geographic area. If the jobs tax credit applied only to areas of high unemployment, then we must assume Treasury or Labor will constantly reevaluate geographic eligibility. That means one day a small employer may be eligible for the credit; the next day he may not. The small employer would be left confused by this situation, and finally reach the point where he would say "forget it". Further, attempts to publicize the targeted credit would always conclude with—"Check

⁸ This contrasts to 34 percent in the Census survey. The difference is accounted for by NFIB members having fewer than 10 employees being more aware than non-NFIB members of the same size. Since the NFIB publication, Mandate, followed the credit's development, the data are understandable.

your eligibility with IRS or the Department of Labor—two of small business' least favorite agencies. Thus while perhaps achieving some positive results in areas of chronic high unemployment where no uncertainty exists, you would render the credit virtually ineffective elsewhere.

Worse in our view would be establishing credit eligibility on the basis of some employee qualification, e.g. the AFDC or employment rolls. From the small employer's standpoint it adds another element of complexity, particularly without some form of self-certification. Second, it runs counter to the methods most small firms utilize in hiring. Their chief methods of employee recruitment include: employee referrals, walk-ins, resumes on file, and advertisements.⁹ And third, many small entrepreneurs view with a jaundiced eye the work habits of persons on welfare or unemployment. By forcing the small employer to specifically seek this type of individual, you could close many of the job opportunities that are currently available by directing the employer's focus to the fact that the individual is not working rather than he wants to work.

WINDFALL

Apparently, one of the principal reasons behind the desire to redirect the program to the "targeted" credit is the fear of a windfall accruing to firms which would have hired whether the credit existed or not. Proponents of this change seem to have reasoned, and we think not incorrectly, that less windfall would accrue by focusing the credit on areas of higher unemployment or specific types of individuals. But we do not think that is sufficient reason for abolishing the credit in its current form.

Unquestionably, there is a "windfall" accruing to some small firms which would have hired whether or not the credit was available. It is the same type of windfall that accrues to many capital oriented firms which take advantage of the investment tax credit. But the windfall accruing from the jobs credit is less than from the investment credit. To be eligible for the jobs credit, an employer must expand his labor force; simple replacement is insufficient. For the investment tax credit, replacement is not only sufficient but expected.

One of the points that has never been adequately explained to NFIB is why a windfall accrues to labor intensive small business from the jobs tax credit, when a windfall apparently does not accrue to capital intensive large business from the investment tax credit.¹⁰ We are not arguing against the investment tax credit; we are arguing against the double standard.

Second, any windfall from the jobs tax credit places additional capital in the hands of those taking a socially desirable action, i.e. expanding employment. You must recognize that a critical problem for small business, particularly rapidly growing firms, is cash flow. The jobs tax credit helps place critical cash in the hands of these firms which allows them to leverage further money, thereby increasing employment again.

Mr. Edward Gaffney, President of Ortho-Kinetics in Waukesha, Wisconsin, an NFIB member, and the nation's "Small Business Person of the Year" explained the situation well:

"The only real place in our economy that meaningful jobs can be created is in *growing* companies. Those companies add people as rapidly as they can get *cash* together to create jobs.

A growing business loses cash to increased receivables, increased inventory, increased taxes, and increased payroll.

Reducing taxes increases the cash available in those companies so that a job is created sooner than would otherwise be possible.

In my business, I can lever cash into jobs about 4 to 1; or a permanent \$10,000 a year job costs about \$2,500 in cash. A temporary job created in the government costs \$14,000. In my business the inventory needed for that job will create business for my suppliers and increase their job creation. The profit on my job generates more cash and stimulates more job creation. Your government job takes away from my business, and leads to fewer jobs.

⁹ See, "NFIB Employment Report for Small Business." (eds.) Bailey, Richard M. and Dunkelburg, William C., (National Federation of Independent Business: San Mateo, Cal.), November 1977.

¹⁰ Two-thirds of the ITC dollars are directed to the nation's largest 1,300 corporations.

Yes, I will eventually create the same job without the credit—probably next year rather than this year—but didn't you want it this year?

The choice is to pay \$2,500 for a permanent job; or to pay \$14,000 for a temporary job while waiting for me to create the permanent job."

Finally, the jobs tax credit is one of the few practical devices available to assist growing unincorporated businesses. Generally, when we speak in terms of business taxation, we speak of corporate tax, investment credit, depreciation, etc. But these have minimal impact on these labor intensive small firms which employ millions of Americans. Thus, while government finds no difficulty in developing means to increase taxes for unincorporated business, e.g. FICA, it does have difficulty developing means to decrease them. The jobs tax credit is an exception.

If you will recall, one of the primary purposes of this bill is to offset some of the tax increases experienced by the Social Security Financing Act of 1977. Can anyone see any portion of the tax bill, including personal reductions, that would remotely accomplish this goal for unincorporated employers? Instead, we are attempting to take one of the few things they can use, windfall or not.

STATES ARE CREATING A PROBLEM

Apparently, some States are negating part of the jobs tax credit's effectiveness by disallowing a State tax deduction on the total amount of wages or salary paid a jobs credit employee. These States have ruled that an employer must subtract the amount of the jobs credit from an employee's wages for purposes of State taxation. Thus, the amount of the credit becomes taxable income.

Mr. Jon Cook, a Certified Public Accountant and NFIB member from Norwich, New York, explains the problem in some detail in the attached correspondence.

CONCLUSION

There is only one major problem with the jobs tax credit—that is, the credit's effectiveness is dispersed so widely across the nation that it lacks a dramatic, highly visible impact on which to base a political constituency. Rather than being responsible for a few new 10,000 employee plants, the credit has been responsible for one or two new employees in thousands of locations. High drama is not made of such incremental gains.

But the positive impact the jobs tax credit has had in the small business sector—the sector currently creating the new jobs—is clear to us. It has created jobs—thousands of jobs. For those remaining skeptical, we would ask "what is your evidence?" We have presented ours. If you have not, but still don't believe us, why change the credit until Treasury can establish some pattern of credit utilization? The jobs credit was originated as an experiment. Why abolish the experiment before the "official" results are in?

NFIB believes two changes in the existing credit would be helpful. First, revision to allow the small employer to know exactly his credit prior to the hiring decision. Second, negate many States' adverse interpretation. The former the Congress can accomplish; the later is quite another matter, although we think the Executive might exercise some moral persuasion in this regard.

We do not seek to increase the maximum credit unless the Congress were to designate certain persons or geographic areas for special consideration. In light of its performance, the size is sufficient (the 1978 level) to affect the marginal hiring decision. Increasing the amount, particularly in low wage areas, could lead to the type of labor substitution neither you nor we desire. Obviously, as wages continue to rise, that assessment could change.

NFIB vigorously opposes a redirection of the jobs tax credit into a "targeted credit". The targeted credit simply does not fit small business for the reasons previously given, and small business is the sector this nation is relying upon to create the new jobs. While target populations appear intellectually rational, they ignore realities and are doomed to failure.

Mr. Chairman, NFIB supports extension of the existing jobs tax credit and hopes the Congress will as well.

Attachment

JON K. COOK,
CERTIFIED PUBLIC ACCOUNTANT,
Norwich, N.Y., February 10, 1978.

Mr. JOHN MOTLEY,
National Federation of Independent Business,
Washington, D.C.

DEAR MR. MOTLEY: This letter is a follow up to the discussion which we had on the telephone Friday, February 10, 1978 in regard to the various problems which we have encountered concerning the New Jobs Credit.

The foremost problem as I see it, is the stipulation that the tax deduction for salaries and wages paid must be reduced by the amount of jobs credit taken. We have been in contact with the states of New York and Mississippi and have been told that we are not allowed to increase the salary deduction back to the original amount for state purposes. Therefore, all taxpayers who take the jobs credit against the federal tax will have to pay additional state tax because of the reduction in the salaries and wages deduction for federal tax purposes. Thus, the credit becomes less advantageous for the employer and turns into a tax bonanza for the state. I do not feel that this was the intent of Congress when the law was passed. A quick calculation reveals the following:

Tax brackets:	Percent
Federal -----	50
State—personal -----	15
State—unincorporated business tax -----	5.5
Calculation of jobs credit:	
New jobs credit available -----	\$10,000
Federal tax	
Jobs credit taken -----	10,000
Increase in tax due to salary reduction \$10,000×50 percent -----	5,000
New York State tax	
Salary reduction -----	10,000
Additional personal tax \$10,000×15 percent -----	1,500
Additional UBT tax \$10,000×5.5 percent -----	550
Net tax effect of credit	
Federal:	
Credit taken -----	10,000
Additional tax -----	(5,000)
State:	
Additional taxes -----	(2,050)
Net tax reduction -----	2,950

This is a computation of the maximum effect, but you can easily see that a substantial portion of the credit is offset by the additional taxes which must be paid to the State of New York.

In certain cases an employer's self-employment tax will also be increased because of the required reduction in the salaries paid deduction.

It is probably too late to correct the injustices inherent in the new jobs credit law for 1977, but I strongly urge you to do what ever can be done to stop the individual states from taxing the required reduction in wages paid and make it effective for calendar year 1977.

Some of our other complaints with the jobs credit are the following:

1. In regard to Partnerships and Sub S Corporation which have a loss (Credit not allowed in year but can be carried back and forward) the salaries should not be reduced by the credit unless the carryback can be utilized. If carried forward, the salary reduction should be made in the year the credit is used.

2. The computations don't always result in a true reflection of the number of new jobs created. In my own personal case, I lose about one-half of what the credit should be, because I had 4 employees in 4 job classifications in 1977 and I had 3 employees in 2 job classifications in 1978. In 1978 one employee left in May and was replaced. Both employees reached the FUTA Base of \$4,200. When computing the jobs credit I get the following result:

FUTA BASE

Job. No.:	1976		1977	
	Employee number 1	Employee number 2	Employee number 1	Employee number 2
1.....	\$4,200	NA	\$4,200	NA
2.....	4,200	\$4,200	NA	\$4,200
3.....	NA	NA	4,200	-----
4.....	NA	NA	4,200	-----
Total base.....	\$12,600		\$16,800	
	x102		12,852	
			3,948	
			x50%	
Credit.....			1,974	
Actual increase in base because of new jobs.....	\$8,400		\$16,800	
	x102		8,568	
			8,232	
			x50%	
Credit.....			4,116	
Difference.....			2,142	

¹ New job in 1977.

Please keep me informed as to any progress which is made in your efforts to correct the situations which we have discussed. As I mentioned on the telephone, I would be willing to help you in any way I can if time permits.

Thank you for your effort.

Very truly yours,

JON K. COOK.

Senator HASKELL. We now have a panel consisting of Prof. John Bishop and Prof. Gary Fethke.

Gentlemen, because of time constraints, if you could put your statements in the record in full and perhaps just talk or summarize, that would be most helpful.

Mr. BISHOP. Fine, thank you.

STATEMENT OF JOHN BISHOP, INSTITUTE FOR RESEARCH ON POVERTY

Mr. BISHOP. I am John Bishop, a research associate at the Institute for Research on Poverty at the University of Wisconsin. I would like to thank you for inviting me to testify today on the design of marginal and targeted private employment incentives.

My testimony will consist of three parts. One is a quick description of the results of my research on the effectiveness of the new jobs tax credit. Second, I will discuss some of the design issues of the targeted employment tax credit that the administration has proposed; and third, I will discuss the new jobs tax credit, whether it should be extended and how it should be modified.

I have been estimating models predicting employment, hours worked per week and prices charged by retailing and construction firms, using aggregate data. This sector of the economy employs around 27 percent of the workers in the economy and it is the sector of the economy where one would expect the largest response through

a new jobs tax credit, if there was one, because it is dominated by small firms.

The procedure used was to estimate a model predicting employment in each month since 1951 with sales in that industry, the wage rate in that industry, prices of alternative inputs, monthly seasonal dummies, time trends and so forth, and then you examine whether something unusual happened in the period in which the new jobs tax credit was in operation.

The result of those estimates are that there seems to have been an 8-percent increase in employment in construction by March 1978 due to the credit and a 2- to 3-percent increase in employment in retailing and wholesaling in response to the credit. For just these industries alone, this totals up to an employment increase due to the credit of 400,000 jobs, plus or minus 200,000 depending on specification.

This is a very large increase. The total employment increase in these industries was about 1.1 million, so it is about 40 percent, or 30 percent, of the employment increase that did occur in those industries.

This credit should, while it increases employment, it should especially tend to increase part-time employment, because the subsidy is a proportion of the first \$4,200 of wages and therefore is a larger proportion of a part-time worker's wage than a full-time worker's wage. We therefore expected a decline in hours worked per week to occur. That is exactly what happened.

It is unusual to have a decline in hours worked per week as you come out of a recession. In retailing hours worked per week were 1 or 2 percent below what one would have expected in the absence of a tax credit. I also looked at the price charged by retail firms for commodities that they sold. These prices are about half of the consumer price index. Predicting these prices were the wholesale prices for those same goods and the unemployment rate and the wage rate for that industry, and the variables for the new jobs tax credit.

Relative to past patterns, the margin between retail and wholesale prices has declined. The last month in the models estimated was April, the month in which we first hit double-digit inflation. Despite the fact of double-digit inflation, the model is picking up a discrepant result that inflation is less than it would otherwise have been.

And here, again, I attribute this to the new jobs tax credit.

The new jobs tax credit should stimulate the formation of new firms. Because of the cap and its zero threshold and the NJTC is an especially large subsidy for a new firm just starting out.

Well, that is exactly what we have been seeing for the last year. New incorporations are at record heights and have been for about 9 months, 10 months, and there has been a 400,000 increase in the number of people self-employed in the economy. That means, according to the household survey, about 400,000 new firms have been created in 1 year.

No one of these pieces of evidence is conclusive, but the fact that the pattern is exactly what you would predict from the new jobs tax credit: A decline in prices while you have an increase in employment, a decline in hours of work per week while you have an increase in employment, suggests that it is the new jobs tax credit that is responsible.

Now let me make a few comments on the targeted employment tax credit that the administration has proposed. Given the budget con-

straint imposed in the planning process, this is a well-designed credit and should be a major stimulus to employment of low-income youths and handicapped workers.

I like the requirement that the family's income for eligibility is 70 percent of the regional lower living standard. This is desirable because an income definition targets this employment tax credit on the needy—those who need the jobs—much more efficiently than would unemployment or any other targeting approach that is available.

A second aspect is that the use of the regional lower living standard means there is an effective variation across the Nation in this standard, and that is very desirable because high cost of living locations need, like New York City and the Northeast, to have their higher cost of living taken into account when determining eligibility for the credit.

It is important that the period over which income is measured be 6 months or more, and that is what was proposed.

The eligibility determination is proposed, to be in the CETA offices, and this is desirable. An alternative is to do it in the welfare offices, and I think that would be a real mistake.

For a lot of people there is a stigma for applying to welfare and people do not want to go down to the welfare office, and I think it is very desirable to have the determination of eligibility and the entire process of determining eligibility for employment that the jobs stimulus be done either at the unemployment insurance offices or at the CETA offices.

The only flaw in the targeted employment tax credit is the exclusion of heads of low-income families with children from eligibility. The Ways and Means Committee seems to be taking the Moynihan-Crans-ton proposal and slotting it into the targeted employment tax credit so that we are likely to have a proposed employment tax credit for youth, 18 to 24, who are poor, and for those on welfare, which will primarily be female heads of families.

I think that to leave out the male head of low-income families effectively says your children can have a job, your wife can have a job if she will leave you, but not you. I think it would be very desirable to make eligible for TETC the male heads of families not on welfare, that meet the income eligibility requirements.

That would increase the predicted cost of the targeted employment tax credit by only around 50 percent over what the administration is proposing now.

Now let me say something about the jobs tax credit. Over the last year there has been a phenomenal increase in employment. Between May 1977 and 1978, employment increased 3.8 million. This is not due to an increase in public service employment for the increases in Government employment was only 200,000. Unemployment declined by only 700,000. There has been a huge flow of new workers into the labor force.

The labor force participation rate from women rose from 48 to 49.2 percent; teenagers from 53.5 to 56 percent; for black teenagers, the rate for labor force participation rose an astonishing 21 percent from May to May, a 25-percent increase from June to June.

So we are having a huge flow of new workers into the labor force. If we create the jobs, a lot more people will enter the labor force.

The coming of age of the baby boom generation and the changing attitudes of married women toward working are causing the labor force of the Nation to grow at phenomenal rates. We have not seen the end of it.

This huge influx of inexperienced and unskilled workers has depressed the wages of these workers and caused high rates of unemployment in the affected groups. Despite the fact that there was a 21- to 25-percent increase among black teenagers, the unemployment rate of black teenagers has hardly changed at all.

At the same time, The Wall Street Journal reports a booming demand for experienced executives and engineers and highly skilled workers. There is a mismatch between the skills and experience that people bring to the labor market and the requirements of firms.

The mismatch cannot be corrected by sending people to school longer. What these new workers need is actual job experience. The new jobs tax credit is an ideal remedy for this structural problem.

It stimulates the employment of women and youth much more than it stimulates the employment of high-paid executives.

In one simulation I did in which total employment increased in response to the credit by 2 percent, the employment of youths rose 3.6 percent, the employment of women rose 3 percent, and the employment of men with much higher skills grew hardly at all.

This occurs because the jobs tax credit is a larger proportion of the wages of part-time, part-year, low-wage workers than high-wage, full-time, highly skilled workers.

In the future, the function of the jobs tax credit should be to aid the transition of new workers into permanent employment. Normally undertaking to train new workers will raise the firms' costs and create inflation. The jobs tax credit is the ideal instrument for stimulating an increase in this employment, because it simultaneously decreases costs.

The study I reported on earlier suggests that some of these reductions in marginal costs have resulted in lower prices. The jobs tax credit has shifted the Phillips curve. Some of this shift is temporary. It is a response to the fact that businesses are receiving a tax cut and their costs are declining, so as long as we increase the tax cut and the costs continue to decline, we will see a decline in prices. However, that is going to be temporary. Eventually prices will start going up, though they will stay below what they would have otherwise been.

When the new workers settle down with one employer and gain experience on the job, there will be a permanent shift of the Phillips curve or the rate of unemployment that is consistent with a nonaccelerating rate of inflation.

The implication of this analysis is that the new jobs tax credit should be extended, but it must be modified, and that it should be extended for more than just 1 or 2 years. I propose 4 years, but I will set that aside.

The first change that is required is that the cap must be taken off. The reason is that when a firm hits the cap, it no longer has an incentive to expand employment any further as a result of this credit, so that the firms that hit the cap, most of the tax benefit is a windfall for them. This year 5,000 to 8,000 firms are going to hit the cap.

So we are losing the opportunity to stimulate jobs in those parts of the economy, plus having to spend a lot of money in a tax credit that does not have influence upon their behavior.

This can be done by just setting a cap of \$100,000 or 20 percent of the employer's unemployment insurance wage base, whichever is higher. Senator HASKELL. How much longer? We have a limit, and I wonder—

Mr. BISHOP. I have one or two more pages.

Senator HASKELL. Can you just summarize it briefly?

Mr. BISHOP. Surely.

Even without a cap the credit favors small firms. Employment in small firms is growing faster than large firms, so they will get more of the credit. The tax credits work to the advantage of those facing low marginal tax rates. Small corporations face lower marginal tax rates.

A small corporation gets a tax savings of \$1,680 from the credit; a larger corporation gets a tax savings of \$1,092 from the credit.

The second change that is required is that the firm must not be able to reduce its threshold of eligibility next year by purposefully reducing its employment this year. A simple extension of the jobs tax credit would give firms the incentive to reduce employment in 1979 in order to increase the credit that the firms can get in 1980.

There are two ways of avoiding this: First would be to make the threshold that will apply in 1979, 1980, 1981 and 1982 a function of the firms' 1977 and 1978 FUTA wage base. The threshold that will apply in each year could be specified as 105, 107 and 109 percent of the average FUTA wage base for 1977-78.

The subsidy of firms' expansion would not be once and for all. It would last as long as the expansion was maintained.

As a result, this method of defining a threshold implies that the rate of the subsidy would be progressively reduced to somewhere around \$1,000 per worker because more and more workers would be receiving a subsidy.

When a firm expands, it would continue to get \$1,000 of subsidy each year for as long as it maintained that expansion.

Alternatively, the threshold can be set at some percentage of the largest of the firm's post-1978 FUTA wages. This way you are using the peak of the last few years of the FUTA wage base, to define the threshold. That way, if a firm cuts employment and then comes back up, it cannot reduce its threshold and thereby increases its subsidy.

Senator HASKELL. Sir, you have been going for about 20 minutes now. Please submit the balance for the record, because we have other people behind you that we must hear, and we must stop, if my understanding is correct, at 11:30 today.

Mr. BISHOP. All right. I am finished.

[The following was subsequently supplied for the record:]

August 29, 1978.

Re House changes in the administrations targeted employment tax credit proposal.

To: Senator Russell Long and members of the Senate Finance Committee.

From: John Bishop, Research Associate Institute for Research on Poverty.

The main point of my April 26 Testimony before the Public Assistance Subcommittee was that putting two parent families on welfare as was proposed in PBJI may destabilize their marriages. The policy implications I drew from the findings of the NIT experiments were that low income two parent families should be aided by increasing the paycheck of the family's working members. EITC's, PSE jobs targeted on the disadvantaged and Targeted Employment Tax Credits would seem to be ideal mechanisms for raising the amount and frequency of the paychecks received by low income families without forcing the family into a demean-

ing and destabilizing association with the welfare bureaucracy. Two parent families have expressed their distaste for welfare and the welfare bureaucracy by avoiding contact with it. Studies by Coe and Mac Donald have found that less than 40 percent of the poor two parent families eligible for food stamps make application for the benefits due them.

Designing a program that targets its aid on low income people without turning it into a welfare program requires some ingenuity, however. The Targeted Employment Tax Credit proposed by the administration solved this problem admirably. The eligibility of 18 to 24 year olds for a TETC was to be a function of family income over the previous six months. Certification was not to be done by the welfare agency but rather by CETA prime sponsors, an agency whose primary purpose is helping people improve their skills and obtain jobs.

Without realizing it the House has drastically changed the Administrations TETC proposal. Except for the handicapped and high school students in work study programs only people actually receiving welfare can obtain a TETC voucher. The effect of this provision will be to draw more people onto welfare than the help in obtaining a job provided by TETC will cause to leave welfare. Limiting eligibility to welfare recipients has four serious flaws.

(1) The fact that almost all recipients of TETC vouchers are on welfare (food stamps) will make employers all the more reluctant to hire them. The voucher will carry with it a stigma. Rightly or wrongly many employers are likely to consider able bodied welfare recipients unencumbered by single parent status to be "loafers" and therefore unattractive as employees.

It would seem foolish to end a program that is working (NJTC has created at least 400,000 new jobs) and substitute for it a program that is a slight modification of one that is not working—the WIN tax credit.

(2) The program will aid only a very small portion of the able bodied low income population. Primarily because of the stigma of being on welfare more than 60 percent of food stamp eligible families with able bodied workers do not apply. The requirement that these families apply for welfare before they can get a TETC will effectively deny job creation help to the very families that are, by avoiding welfare, showing their commitment to the work ethic.

Given the fact that this TETC voucher may in fact make getting a job harder rather than easier, their avoidance of a long and demeaning application process (in Wisconsin the Food Stamp application is 40 pages long) is quite rational.

(3) The limitation of eligibility to welfare recipients will to some extent cause individuals who currently are not receiving welfare to apply for it. This is not desirable for two reasons. Above \$6,000 the effective marginal tax rate on their earnings is raised and this may induce them to give up full time work and take part time or part year work instead.

The second reason is that being on welfare may destabilize their marriages. Careful experimental research has established that placing two parent families on a negative income tax destabilizes their marriages.

The similarities between the structure of the NIT experiments, AFDC-UP and Food Stamps might lead one to fear that an experiment testing for effects of AFDC-U and Food Stamp on marriages might obtain similar results. Until research is done settling this issue, it does not seem wise to make changes in the system that will increase the number of two parent families that pass through the welfare system.

(4) The final problem with using Food Stamp eligibility as the income test is its very short accounting period. One month after quitting ones current job the individual is eligible for a two year subsidy of employment worth \$4,000. This does not create a problem when the income test is being continuously applied as is the case in Food Stamps and AFDC. It does create a problem when an income test applied at a point in time confers benefits that continue after the income test is no longer met. There is no unchanging stock of Food Stamp recipients. Flows in and out of the recipient population are quite large and are likely to respond positively to the TETC the House has passed. Transition rates from employment into unemployment are also likely to increase. What then is the case for having a Food Stamp administered income test? It has been argued that the CETA income test is not administered in a rigorous way. This may very well be true. This is not, however, the great disadvantage it is made out to be.

(1) A rigorous application of the wrong test (i.e. one with a one month accounting period) is not necessarily preferable to a loose administration of the right test (i.e. one with a six month accounting period).

(2) The tighter the administration of the income test the greater will be the tendency for everyone to consider the program a welfare program rather than a

job creation program. If employers and workers consider the program a welfare program, few will participate and costs will be low. Keeping application simple and treating people with dignity will increase the proportion of eligibles that obtain TETC certification.

The participation of non-welfare recipients will upgrade the average quality of certified workers and improve the image of the program. Costs need not rise proportionately with participation, however. With an improved reputation it will be possible to obtain the desired level of employer participation at a smaller per worker subsidy. For a given subsidy rate, tax expenditures will be larger. The benefits—reductions on dependency and increases in labor supply—will be larger still.

(3) Even if contrary to the above argument a less rigorous income test increases tax expenditures by a larger percentage than it increases employment, the outcome is a tax cut for the firm. There seems to be considerable sentiment for cutting business taxes. The TETC is one of the ways of implementing such a tax cut.

If CETA application procedures are considered too lax at present, the proper response is either (a) to force a tightening up of their procedures by undertaking random audits of TETC certifications,

(b) to assign the certification responsibility to an agency like the Job Service, or

(c) to create a new agency.

Income tests do not have to be administered by a welfare office. Most of the federal programs using income tests to determine eligibility—BOGG's, College Work study, NDSL, SEOG rent supplements, public housing, school lunch, etc—have been able to administer them without major scandal and without stigma. There is no reason why TETC cannot be administered just as effectively.

SELECTIVE EMPLOYMENT SUBSIDIES: AN ASSESSMENT OF NJTC AND TETC

(By John Bishop and Robert Haveman¹)

Concern that structural factors impede efficient labor market performance is evidenced in both statistical analyses of economic potential and policy proposals for selective employment subsidies. Both official and unofficial estimates of the level and expected growth of potential GNP have been recently revised downward, with an increase in the definition of the full employment unemployment rate and a reduction in the growth of labor productivity being the primary bases of the revision (*Economic Report of the President*, Perry). The 3.2 percent change in GNP per percentage point change in the unemployment rate implicit in Okun's Law has been revised downward to the 2.1-3.1 range (Clark, Perry). These indications of structural changes in labor markets reinforce statistics on excessively high and sticky unemployment rates of youths and blacks, the increasing labor force participation of women, and the decreasing rate of men. Policymakers apparently perceive the problem similarly. In both the U.S. and Western Europe, large selective employment subsidy policies (SESP) have been enacted to combat the recent unemployment problem, and to offset increased structural labor market rigidities caused in part by government policies such as minimum wages (Haveman).

SESP and changes in potential GNP and Okun's Law are not unrelated phenomena. This paper explores that relationship. Part I presents a brief taxonomy of the primary SESP's which have recently been enacted in Western industrialized countries, and which are currently under consideration in the U.S. In Part II, the economic rationale underlying these measures is discussed. Part III explores the relationship of SESP to the prospective growth of aggregate output, in the context of Okun's Law. If these measures are successful in achieving their objective, the repeal of Okun's Law is implied. However, success of these measures requires that changes in employment decisions be made in response to SESP. Evidence on the existence and magnitude of these changes in the case of the New Jobs Tax Credit is presented in Part IV.

I

The confrontation of a high rate of inflation with high average measured unemployment, driven in part by changes in labor force composition favoring groups

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with relatively unfavorable unemployment experience and an increased variance in sectoral unemployment rates (Perry, 1970), has brought forth numerous policy measures designed to target employment demands on those sectors with substantial excess supply. Wage (or employment) subsidies and direct public service employment (PSE) are the primary measures undertaken, and these have appeared in various guises. The former category can involve a subsidy paid to (1) recruitment (additional hires), (2) the employment stock, or (3) changes in the employment stock. Each of these subsidies can be targeted on particular types of labor (say, by age, sex, region, unemployment duration, or education), or they can be general in nature. Moreover, the subsidy can be a flat amount, or it can vary with the level of earnings, the wage rate, or the duration of coverage. It can be paid to either the employer or the worker, and can be paid directly or via a tax credit. Similarly, direct PSE (which is, in effect, a 100 percent wage subsidy) can vary by the degree of selectivity, the level of government, and the output produced.

Examples of several of these variants have been recently implemented (Have-man and Christainsen). The U.S. New Jobs Tax Credit, for example, is a constrained marginal stock subsidy with no targeting. It provides a tax credit equal to 50 percent of the unemployment insurance tax base (\$4,200) for the first 47 hires in a firm above 102 percent of the previous year's employment level for the years 1977 and 1978. On the other hand, the 1975 British Temporary Employment Subsidy is a reverse recruitment rather than a stock subsidy, and like the New Jobs Tax Credit, it is temporary and non-targeted. This program subsidizes about 30 percent of the wage costs for up to one year of workers who would otherwise be laid off. In 1974, the West German government introduced a temporary targeted recruitment subsidy with a marginal stock constraint. For six months, a wage subsidy of 60 percent was paid to firms in specified regions for employing registered unemployed workers, if firm employment increased from that of a stipulated date prior to passage of the act.

The Netherlands, France, and Sweden have also recently adopted targeted employment subsidies. In the Netherlands, for example, subsidization of 30 percent of the wage costs of long-term unemployed workers hired is provided for six months, with the duration extended to one year if the worker hired is over 45 years old. The French program is similar except that the target group was extended to include youths and first-time job seekers. The Swedish program subsidizes about 50 percent of the wage costs of workers threatened with unemployment for six months, provided the firm retains them and places them in some form of training program. For those countries mentioned, the percent of the labor force on which SESP-type subsidies are paid varies from about .3 percent of the labor force (West Germany) to 3-4 percent in Sweden. In 1978, the New Jobs Tax Credit (NJTC) will be paid on the employment of nearly 1 percent of the U.S. labor force at a total budget cost of at least \$2 billion.

While few reliable evaluations have been made of these SESP's (the numerous extensions of what were to be temporary programs suggest that they have not been viewed as failures in achieving the primary objective—employment increases—set for them. Indeed, in the U.S., the imminent lapse of the NJTC has prompted a number of alternative proposals. The Carter Administration has proposed replacing the New Jobs program with a Targeted Employment Tax Credit that would subsidize firms for 33 percent of the first \$6,000 of wages paid to all low income workers who are 18-24 years or handicapped for the first year of employment and 25 percent for the second. The House-passed Ways and Means Committee revision of that proposal would limit the subsidy to newly hired target group members, extend the group to include various categories of welfare recipients, and increase the subsidy rate for the first year of employment and reduce it for the second.

II

The economic rationale for SESP is a straightforward one: By reducing the price of labor at the margin, employment can be encouraged and unemployment reduced. SESP lowers the marginal cost function for incremental output, and in competitive markets could be expected to weaken pressures for price increases. Because recruitment or marginal stock subsidies tend to benefit new more than existing enterprises, entry would be encouraged, further weakening upward price pressure. For both of these reasons, SESP will tend to be expansionary. Further, for firms engaged in external trade, SESP operates as an export subsidy (Layard and Nickel). Indeed, for a number of Western European nations, this characteristic is viewed as a primary rationale for SESP. A temporary SESP encourages

firms to incur labor costs earlier than otherwise. As a result, inventory accumulation or accelerated maintenance and investment spending will tend to increase. Finally, SESP (particularly, a non-temporary program) will tend to induce the substitution of targeted labor for capital and for non-targeted labor, for example, the adding of a second shift rather than increasing overtime work (Bishop and Lerman; Kesselman, Williamson, and Berndt).

Given the primacy of the employment creation objective for SESP, evaluation of it must be in terms of its net job creation impact defined as the employment level in the economy with the policy less that without it. Clearly, because (1) the output produced by the workers subsidized competes with alternative outputs, (2) the financing of the program entails opportunity costs which represent displaced outputs, and (3) many of the subsidized workers would have been working even in the absence of the subsidy, the net job creation impact will be smaller than the gross number of workers subsidized. The ratio of net to gross job creation is an indicator of these displacement effects and can only be estimated in the context of a fully specified general equilibrium model. At a minimum such a model must be able to estimate the degree to which SESP results in both a reduction in the gap between actual and potential GNP and an increase in the latter, and the effect of SESP on the distribution of wages and employment opportunities. We shall deal with each of these.

If SESP is targeted on a resource in excess supply or with a positive and non-trivial supply elasticity, potential GNP—defined as the level of GNP when NAIRU is attained—will rise. The proposed SESP targeted on handicapped workers, transfer program recipients, and low income youth would seem to meet this test, as large numbers of these workers are not employed because of labor market rigidities (e.g., legal and conventional minimum wages). Hence, substantial employment increases could occur without upward wage pressure and both actual and potential GNP will increase. Econometric work suggests that the labor supply of these target groups is more responsive to changes in the demand for labor than that of other groups (Masters and Garfinkel). This implies that, even if the labor markets for these workers were free from distortions associated with minimum wages and tax and transfer programs, a wage subsidy on their employment paid for by a tax on other workers would raise potential GNP (Bishop). In any case, with an excess supply of the target group labor and a positive and non-trivial supply elasticity of their services, the GNP gap will be narrowed and potential GNP will be increased. SESP can also increase potential GNP even if the labor force participation rate of each demographic group is fixed. This can be accomplished through the effect of SESP in reducing a wage-weighted NAIRU by concentrating employment increases on sectors with elastic sectoral Phillips curves (Baily and Tobin).

The benefits of expanding potential GNP in this manner are increased by the fact that the labor supply decisions of targeted groups are distorted by high backward-shifted employer and employee paid taxes and even higher marginal transfer benefit reduction rates. Because these distortions imply that the value of the leisure sacrificed by such employment increases is very low, any resulting increase in actual and potential GNP is positively correlated with the change in economic welfare. Moreover, pecuniary externalities for taxpayers are created by the increase in tax revenues and decrease in transfer costs associated with SESP, both of which reduce the net budgetary cost of the program (Schmid). Other non-pecuniary externalities may result as well, as people earn their way off welfare.

A subsidy of one of the major costs of doing business will exercise downward pressure on prices during the transition to a new price level. If expectations about inflation are formed by a rational process that takes account of the fact that the lower inflation rates are temporary, there will be no feedback into wage inflation. Many workers, unions and firms are not likely to be aware that the slowdown in price inflation is temporary, in which case the once and for all reduction in prices may have a long term impact on wage inflation. On the other hand, because SESP shifts the demand for labor, unions maximizing some combination of wages and employment will face an improved tradeoff and may press for larger wage demands (Burton). Moreover, to the extent that the expected inflation term in the wage equation involves wage rather than price feedbacks, the impact of SESP on inflation will be less favorable. In this case, the policy will result in some upward wage pressure in industries that employ large numbers of targeted workers, which may cause similar pressure in other firms which attempt to re-establish historic differentials (Baily and Tobin).

In addition to its effects on actual and potential GNP and prices, SESP will tend to shift the composition of employment and earnings toward low-skill target-group workers. If less inequality in the distribution of the adverse effects of poor economic performances is desired, this is a major benefit of SESP. One consequence of this redistribution is that, even with a constant GNP, the number of employed persons will increase as low productivity workers are substituted for those with higher skills.

III

Because of these effects of an employment stimulus-employment redistribution policy such as SESP, the macro-economic relationships between changes in GNP, the GNP gap, and the unemployment rate will be altered. In standard treatments, policy-induced increases in aggregate demand are viewed as closing the gap by increasing actual GNP toward some exogenously determined potential GNP. However, as indicated above, the effect of SESP is to simultaneously increase both actual and potential GNP. The shift in true potential induced by SESP will not be captured in measured potential, however, so as a result, a SESP induced increase in GNP will reduce the measured GNP gap by more than it reduces the true gap.

Similarly, SESP will also alter the relationship between the measured GNP gap and the unemployment rate. A SESP induced increase in GNP will be associated with a larger increase (decrease) in employment (unemployment) than is typically associated with general aggregate demand induced changes in GNP. As a result, the rate of productivity increase as conventionally measured will fall.

Consider the following accounting relationship, in which GNP, productivity (A), employed capital (K), hours worked per week (H), labor force participation rate (L), are all measured as percentage rates of change:

$$d \text{ GNP} = dA + (1 - \kappa_L) dK + \kappa_L (dH + S_n dL - S_n dU) \quad (1)$$

$U = -100 \log (\text{Emp/Lab. Force}) \approx$ the unemployment rate, κ_L is the share of labor, and S_n is the ratio of the skill level of newly employed workers to the economy-wide average. Okun's Law is a reduced form of (1) which states that a 1 percentage point cyclical change in U is associated with a 3.2 percent change in GNP. While a percentage point decrease in U is directly associated in (1) with an increase in GNP equal to $\kappa_L S_n$ (approximately .7 of a percentage point), cyclical changes in other determinants of GNP—namely, L, H, K, and A. The partial derivative of each of these variables with respect to U is negative. It is the sum of these effects that make up the difference between .7 and 3.2.

Because of the characteristics of SESP, there are at least 3 reasons why a one percentage point change in U induced by, say, a targeted marginal stock employment subsidy is not likely to increase GNP by 3.2 percentage points. First, SESP-induced reduction in U will shift the composition of employment toward low-skill workers (i.e., those with $S_n < 1$). Indeed, the very purpose of a SESP is to encourage firms to employ and to train workers who they would otherwise not find it profitable to hire. The inevitable results of such substitution is to reduce measured productivity, at least in the short run. And, while the training and work experience received by the employed workers will manifest itself in future increases in productivity, S_n and $|dA/dU|$ will fall as these costs are recorded in firm accounts.

Second, SESP measures encourage the hiring of part-time workers (especially, if the subsidy is paid on the first \$N of earnings, as has been the case in the U.S.) or the substitution of additional workers for increased overtime of existing workers. As a result, the response of H to changes in U will be smaller than otherwise— $|dH/dU|$ will fall.

Third, to the extent that the unskilled labor likely to be employed by SESP is not complementary with capital services, as is likely, the utilization of capital will not increase as much as in the case of an equivalent general demand stimulus— $|dK/dU|$ will fall.

Finally, because of the limited knowledge on behavioral responses, the effect of SESP on $|dL/dU|$ is unknown. On the one hand, SESP is designed to open employment opportunities for low-skilled workers, which currently form a high proportion of the discouraged worker, non-labor force participant category. On the other, in the face of substantial measured unemployment of unskilled labor,

a SESP may not generate as large an increase in labor force participation as an equivalent reduction in U stimulated by a general expansion in demand.

Thus, at least during the period of adjustment following the initiation of a well designed, non-trivial SESP, Okun's Law is likely to be repealed. This repeal is a direct consequence of the fact that the primary objectives of SESP are to increase employment and potential GNP and to distribute more fairly the costs of high unemployment, from whatever source, and not to decrease the gap between actual and potential GNP. The reduction in the Okun multiplier associated with SESP is evidence that the policy is having the effects desired.

However, these effects do not come at zero cost. SESP is not easy to administer—surely more costly to administer than a general expansion of aggregate demand. SESP of a marginal stock variety tends to give new and fast growing firms and regions an advantage over those with static or contracting employment. In general, SESP will encourage firms to absorb production which had been contracted out, with an adverse effect on suppliers, many of which may have been small enterprises. However, if small suppliers are more aware of the subsidy or possess the flexibility to use it, increased contracting may result. Another concern is that SESP may increase labor turnover, especially if it is temporary or of the recruitment variety. Finally, SESP with narrowly defined target groups (e.g., low income youth or welfare recipients) may result in the displacement of equally disadvantaged workers who may have more central positions in family units. The subsidized employment of a disadvantaged youth may have the anomalous result of disemploying his father.

IV

The economic impacts of SESP which we have described will not develop if firms fail to change their behavior in response to the subsidy. In some past programs, that response has not been substantial. Most employers that hired worker eligible for the WIN and JOBS programs, for example, failed to apply for the subsidy to which they were entitled (Hamermesh). The administrative costs required to secure the subsidy apparently weakened the employment incentive for which they were designed. Further, because the subsidy adheres to specific individuals, it may be viewed as a signal that the job applicant is likely to be a low productive worker, and result in a reduced probability of employment for target group workers.

The New Jobs Tax Credit has been in operation now for more than a year. While a definitive assessment of its effect on employment and prices is not yet possible, a preliminary evaluation can be made to guide current decisions.

In theory, the NJTC should provide a major stimulus to employment, as firms which typically hire part-time or part-year workers will find that the labor costs of an expansion are cut nearly in half. However, the \$100,000 limit on the subsidy available to a single firm suggests that firms with more than 2,000 employees will not receive an employment incentive from NJTC. Hence, the greatest impact of NJTC is likely to be on industries where medium sized firms predominate and part-time part-year employment is common. The construction, retailing, and wholesaling industries studied here fit this description.

Non-seasonally adjusted monthly data on employment and manhours in these industries were regressed on seasonal dummies, trends on the dummies and three year distributed lags of input prices and retail sales (or construction put in place). The input prices are the gross employment (wage) costs borne by employers (W); for construction the wholesale price of construction materials (M) and for retailing the wholesale price of consumer finished goods (P); a price index of materials, business services and energy consumed by the distribution sector (Q); a price index of gasoline and electricity prices (G); and a service price of capital which takes into account changes in excise tax, investment tax credits, and depreciation rules (R). With few exceptions, the lag structures were freely estimated with each input price or price ratio being represented by its contemporaneous value, and that of each of the previous 4 quarters and 4 half years.

A strong case can be made (especially in construction) that wages and man-hours are simultaneously determined. Exogeneity tests were performed by entering future values of the wage rate into the equation (Sims). The hypothesis that the coefficients on this variable were zero was rejected strongly in construction and weakly in retailing. Consequently, all models were estimated using two stage least squares.

The NJTC variable is an average over the past six months of the proportion of firms (weighted by employees) that knew about the credit. It has a value of .057 in June 1977 and rises at an average rate of .0425 per month reaching .343 in January 1978 and .572 in June 1978.

Table 1 presents our results. All of the NJTC coefficients are positive and significant in Models I and II, where input prices enter as ratios. When input prices enter nominally (Models III and IV), the coefficients are smaller and insignificant. Across all of the regressions the average NJTC employment stimulus over the 12-month period from mid-1977 to mid-1978 (obtained by multiplying the average value of the NJTC variable over the year by the coefficient) ranges from 150,000-670,000. For these industries, total employment growth over the period was 1.3 million. The Model III and IV estimates attribute at least 20-30 percent of the observed employment increase in these industries to NJTC. These results are consistent with the observation that between 1977:II and 1978:II in both construction and retailing rates of employment growth have substantially exceeded the rates of output growth. For example, while the growth rate of construction put in place was 4.5 percent over this period, the growth rate of employment was 8.2-9.9 percent that of manhours was 10.4 percent. Even in retailing where cyclical increases in sales are typically handled without hiring extra workers, employment growth—3.4 percent in household data and 4.0 percent in establishment data—outpaced the 3.0 percent growth of deflated retail sales.

The contrast between construction manhours and employment regressions suggests that the NJTC has, as predicted, caused a reduction in average hours per week. This result is consistent with the hours regressions run for the retail sub-sectors reported in an earlier paper (Bishop, 1978).

In competitive industries like those studied, reduced marginal costs imply reduced prices. To test this relationship, the monthly rate of change of the retail price was regressed on current and lagged changes in a number of industry cost variables—wage rates, wholesale price of the product, the price of materials, services and energy consumed by the distribution sector, the rental price of capital, and excise taxes—the unemployment rate, seasonal dummies, and trends on the seasonal dummies. Table 2 presents the coefficients on the first difference of the NJTC variable described above. For non-food commodities and restaurant meals, the retail trade margin is negatively and significantly related to the timing of NJTC knowledge. Between May and June 1978 non-food commodity retail prices rose 4.73 percent while wholesale prices of nonfood consumer finished goods were rising 6.56 percent. This discrepancy of 1.83 percentage points is quite close to the NJTC effect of 2.2 percent (.038·572·100) estimated by the preferred model (column 1). The observed decline in the margin is particularly surprising given recent increases in the relative price of imported consumer goods. (Imported products, it should be noted, are included in retail but not wholesale price indexes.)

Among the sub-sectors, the pattern of coefficients is consistent with a prior expectations. For example, the large negative NJTC coefficients in the restaurant industry equation suggests that in this low-skill intensive sector the 8-12 percent policy-induced reduction in marginal costs resulted in a 1.1 percent decline in output price during the 12 month period. Estimates for moderately wage intensive retail industries (apparel, furniture) indicate that the 5-7 percent reduction in marginal costs induced here is associated with a smaller .5 percent reduction in prices over the period. On the other hand, the small margin, non-wage-intensive retail food industry has a non-significant positive coefficient, reflecting the fact that incremental employment in this sector tends to contribute more to the quality than to the volume of output.

The final rows of the table indicate the reduction of consumer costs due to NJTC-induced compression of the distribution margin implied by the equations. The cost savings of \$1.9-\$3.6 billion can be compared with the expected 1977 credit claim of \$1.5-\$2.0 billion and the expected 1978 claim of \$2.0-\$3.5 billion.

These estimates, it should be noted, measure the impact of NJTC on that sector of the economy in which the largest response is expected. While it is possible that across-industry displacements might result in NJTC reducing employment and raising prices in industries not studied, this result would be surprising. Further, while limited awareness of the existence of NJTC may have reduced its measured effectiveness, a permanent credit may not have as large an effect as a temporary program. A permanent credit would not induce firms to build up

Inventories, as NJTC may be doing. If in a permanent marginal NJTC, the threshold of eligibility were revised periodically to reflect more recent employment experience, raising current employment will reduce the future expected subsidy, thus inducing a smaller response.

No set of estimates based on the first 12 months of experience with a program can be conclusive. Perhaps the NJTC variable is capturing other exogenous forces inducing contemporaneous employment increases and price decreases in the sectors studied. And, if that is the case, perhaps improved specifications would reduce the impacts attributed here to NJTC. Longer or shorter lags, adding the price of energy or a once and for all shift in the relationship during 1974 do not, however, cause major reductions in the NJTC coefficients. There may be other factors at work, however. Hence, the conclusion that the NJTC is having effects on employment and prices must remain tentative until better data on more periods of observation becomes available. However, it should be emphasized that these estimates are based on a procedure that is more robust with respect to assumptions on the impact of taxation changes than those used to estimate the response of investment spending to taxation changes. The procedure in most investment studies is to imbed a multiplicity of tax provisions in a single rental cost of capital variable, and the tests of impact are based on the magnitude and significance of this variable. Such analyses are joint tests of the effect of current and expected capital goods prices, financial market conditions, tax provisions, and the validity of the formula, and not of the policy change alone.

In sum, then, the case for SESP is a strong one. Not only the level but also the composition of employment are likely to be improved more by SESP than by an equivalent increase in aggregate demand induced by a general stimulus. And, the associated price increase is likely to be lower as NAIRU is shifted. If, as is likely, the Okun multiplier will be depressed by SESP, at least temporarily, this is evidence that the policy is inducing the behavior for which it is designed. Using the NJTC as an example, such employer hiring and price responses appear to be in evidence. However, these responses are for a non-targeted program; extrapolation of magnitudes of effect estimated here to a targeted SESP would be inconsistent with the results of prior targeted programs.

TABLE 1.—IMPACT ON THE NJTC ON EMPLOYMENT IN CONSTRUCTION AND DISTRIBUTION

1952-78:06	Sample—						IV, 2 SLS
	I		II		III		
	OLS	2 SLS	OLS	2 SLS	OLS	2 SLS	
EMPLOYMENT							
Wholesale and retail.....	* 0.077	* 0.076	* 0.069	* 0.101	0.076	0.064	0.061
Household data.....	(.048)	(.048)	.049	.050	.057	.059	.044
Retail.....	(.0121)	(.0121)	(.0117)	(.0119)	(.0119)	(.0121)	(.0122)
Establishment data..	*.013	*.045	*.044	*.047	.035	.030	.011
Construction.....	.019	.019	.020	.020	.021	.023	.020
Household data.....	(.0043)	(.0044)	(.0043)	(.0045)	(.0041)	(.0044)	(.0050)
Construction.....	*.168	*.196	.....	.....	.115	.166	.052
Household data.....	.017	.079	.....	.....	.095	.108	.102
Construction.....	(.0316)	(.0336)	.....	.....	(.0271)	(.0297)	(.0353)
Establishment data..	*.187	*.180	.....	.....	.044	.020	.052
Household data.....	.050	.053	.....	.....	.068	.018	.102
MAN-HOURS	(.0169)	(.0175)	.....	.....	(.0153)	(.0155)	(.0173)
Construction.....	.102	.116	.....	.....	.014	.025	.007
Establishment data.....	.071	0/8	.....	.....	.100	.103	.091
	(.0323)	(.0340)	.....	.....	(.0291)	(.0302)	(.032)
AVERAGE NJTC INDUCED EMPLOYMENT — IN 12 MO PERIOD PRECEDING JUNE 6, 1978 (IN THOUSANDS)							
Household data.....	641	669	.....	575	.....	565	410
Establishment data.....	412	412	.....	203	.....	134	255

The standard error of the coefficient and of the estimate are located beneath the coefficient.

- Model I: $E = \beta_0 \cdot NJTC + \beta_1 X + \beta_2 (W/P) + \beta_3 (R/P) + \beta_4 (Q/P)$ for retailing and
 $E = \beta_0 \cdot NJTC + \beta_1 X + \beta_2 (W/M) + \beta_3 (R/M)$ for construction where
 X is the vector of output lags, seasonal dummies and trends
- Model II: $E = \beta_0 \cdot NJTC + \beta_1 X + \beta_2 (W/P) + \beta_3 (R/P) + \beta_4 (Q/P) + \beta_5 (G/P)$
- Model III: $E = \beta_0 \cdot NJTC + \beta_1 X + \beta_2 W + \beta_3 R + \beta_4 Q + \beta_5 P$ for retailing and
 $E = \beta_0 \cdot NJTC + \beta_1 X + \beta_2 W + \beta_3 R + \beta_4 M$ for construction
- Model IV: Same as III except that distributed lags are limited to 1.5 rather than 3 years.

TABLE 2.—IMPACT OF THE NJTC ON THE MARGIN BETWEEN RETAIL AND WHOLESALE PRICES

CPI component	Coefficient on NJTC under alternative specifications ¹				
	1 yr distributed lag				
	Trends on seasonals		No trends with Q	6 mo lag, trends with Q	1 yr lag, trends with Q
	With Q	Without Q			
Food away from home.....	* -0.036 (.013) (.0017)	* -0.037 (.012) (.0017)	* -0.032 (.013) (.0017)	* -0.033 (.013) (.0018)	* -0.051 (.018) (.0017)
Nonfood commodities.....	* -.038 (.015) (.0020)	* -.038 (.015) (.0021)	* -.031 (.016) (.0022)	* -.038 (.015) (.0020)	* -.049 (.020) (.0020)
Food at home.....	.051 (.039) (.0053)	.041 (.038) (.0053)	.051 (.040) (.0052)	.051 (.038) (.0052)	.011 (.059) (.0053)
All commodities.....	-.018 (.016) (.0022)	-.019 (.016) (.0022)	-.013 (.017) (.0023)	-.018 (.016) (.0022)	-.036 (.022) (.0022)
Reduction in consumer costs between June 1977 and June 1978 (in billions):					
All commodity regression.....	3.4	3.6	2.4	3.4	2.5
Disaggregated regressions.....	2.8	3.3	1.9	2.8	2.3

¹ The standard error of the coefficient and the regression are located beneath the coefficient. models 1-4 estimated on monthly data 1953:03 to 1978:06. For model 5, sample period ends 1978:01. Weights for Q are based on the 1967 input output table. It includes gasoline, electricity, telephones, containers, cellophane packaging, supplies, insurance, auto repair, and legal fees.

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Senator HASKELL. Thank you very much indeed. I would like to defer to Senator Culver for a statement.

Senator CULVER. Thank you, Mr. Chairman.

I just wanted to take the opportunity to introduce to the committee Dr. Gary Fethke who is an associate professor at the college of business administration at the University of Iowa. We are very proud of the work that you have done, Dr. Fethke, and we know that you have been recognized as somewhat of an expert on this general subject of employment economic taxation, and we are aware that you testified before this committee last year on the subject of tax credit.

Senator HASKELL. Thank you, Senator Culver. We look forward to hearing from you, Dr. Fethke.

Please proceed.

STATEMENT OF GARY FETHKE, ASSOCIATE PROFESSOR OF BUSINESS ADMINISTRATION, THE UNIVERSITY OF IOWA

Mr. FETHKE. Thank you, Mr. Chairman. I can briefly summarize my remarks.

We have analyzed employment tax credits and looked at general unrestricted employment credits for nearly 3 years, and I will list what I consider to be their outstanding features and then make my recommendations.

The employment tax credit, that is, the unrestricted employment tax credit, possesses many of the features that are attributed to a general stimulus to overall demand. The advantage, I think, of the employment tax credit, which makes it a nice complement to monetary and fiscal policy, is that it does reduce critical costs. In many instances, it takes the pressure off the price level and stimulates demand at the same time. This is a very fortunate aspect of that program.

Second, we have computed the cost of employment tax credit programs and compared them with computations made by economists and other experts, and it does appear that the employment tax credit is a modest cost program. Specifically, the employment credit compares very favorably with public service employment, general reductions in income taxes, and increases in Government spending in terms of job-creating performance and in its cost to Government and to society.

Third, while the Treasury has expressed continuing fears of wind-fall gain, this program does not possess the adverse aspects that many credits do, and certainly it is not nearly as troublesome, as the wind-fall aspects of the investment tax credit.

Fourth, the evidence that we have been able to assess regarding the quantitative impact of the existing new jobs program demonstrates clearly that more needs to be done to advertise the short-term programs to the targeted community, especially in this case where the credit is targeted to the small business population.

Now, the administration is moving toward a targeted employment credit aimed at the young unemployed members of the work force. There are some good reasons for considering this program and suggesting it. However, one has to come to grips with the reasons why unemployed youths are, in fact, unemployed. There are two general notions on this subject.

One argument is that youths experience very high job turnover. When they enter the labor force, they become dissatisfied with the type of jobs that are available to them, the pay is low, and there are so many ready alternatives offered them in terms of Government transfer payments, unemployment compensation, and the like; consequently, they leave jobs quickly. I think that a targeted employment tax credit would not be immediately effective in stimulating jobs if the cause of high unemployment is high turnover.

The other explanation—and I am more attracted to this second explanation—is that high unemployment among the young is caused by rigid wages which prohibit rapid clearing of the labor markets. Minimum wages and large increases in payroll taxes, among other things, have made this situation worse. In short, there is excess supply of low-skilled workers in the economy. A targeted credit will be effective in eliminating this problem and will have a very desirable short-term immediate impact on the economy.

Now, the question that comes up is whether we ought to move at this time from the unrestricted new jobs credit to a targeted employment tax credit. My general feeling is that we should not do this. I think that there are good reasons to argue that we can modify the existing new jobs credit and make it an effective, short-term stimulus to the targeted population without greatly changing its structure.

As currently structured, the new jobs credit already favors the employment of low-paid workers of all ages. This preference can be increased, for example, by raising the maximum credit against the FUTA base. The idea being, that since the program does favor low-wage workers, we can provide an even larger credit to low-wage workers and let employers decide how to hire. I think they will hire in the right direction. In this regard, Dr. Robert Eisner has made some suggestions before this committee about how some modest changes can be made in the new jobs credit to make it more suitable for the targeted population.

A critical point is that for any fiscal program to be effective, the beneficiaries must be aware of that program's existence and benefits. The new jobs tax credit is aimed at the small business community which cannot be expected to acquire and assimilate information about Government programs as quickly as the more concentrated sector. If we move at this time from the new jobs credit, which does contain a number of desirable features possessed by the proposed targeted credit, we are going to lose the stock of information that has already been acquired by the small business community. I think it makes little sense

to discard an incentive scheme that shows much promise, and has many of the desirable features of the targeted credit and, by so doing, increase the present problems in the business community.

In summary, based on our research, the employment tax credit is a useful addition to the arsenal of monetary and fiscal policies. It favors unskilled employees and small businesses, and if the Congress judges this group as deserving, I see no compelling reason to move from the new jobs credit to the targeted credit, but, instead, suggest a slight modification in the structure of the existing program.

Thank you very much.

Senator HASKELL. Thank you, Dr. Fethke, very much indeed.

Do you think we should keep the present jobs credit, which seems to be working, but with some modifications, and then have a separate new targeted credit?

Do you see anything wrong with this as a potential solution?

Mr. FETHKE. I basically agree with that approach. I think that the structure of the credit now has many of the requirements of the targeted credit. I think we have seen some success, and I would not argue that it should be replaced at this time.

I basically agree with your approach.

Senator HASKELL. Well, thanks to both of you. I appreciate both of your being here.

[The prepared statements of the preceding panel follow:]

STATEMENT OF JOHN H. BISHOP, RESEARCH ASSOCIATE, INSTITUTE FOR RESEARCH ON POVERTY, UNIVERSITY OF WISCONSIN

My name is John Bishop. I am an economist at the Institute for Research on Poverty and co-principal investigator of a study on the Potential of Wage Subsidies funded by the Employment and Training Administration of the Department of Labor. My testimony however, does not necessarily reflect the views of either of these organizations.

Let me begin by thanking Chairman Haskell and the members of the subcommittee for inviting me to testify on how best to design a marginal or targeted private sector employment incentive.

In the short time I have I will not be able to offer all the details I would like. I refer you to my written testimony for a more extensive discussion.

My testimony will have three parts: (1) A description of the results of my econometric study of the impact of the existing marginal Employment Tax Credit on employment and pricing in the construction and distribution industries. (2) A discussion of some of the design issues surrounding Targeted Employment Tax Credits like the one proposed by the Administration. The third part will consist of a menu of preferred policy alternatives.

THE LIKELY IMPACT OF THE EMPLOYMENT TAX CREDIT

Key features of the Employment Tax Credit are that it is (a) a fixed proportion of earnings up to a rather low maximum, (b) marginal and (c) temporary. Each of these features has important consequences. The first feature focuses the employment stimulus on low wage, part-time, part-year workers, a group that current suffers from very high unemployment rates. The second feature, that it is based on a threshold employment level defined by last year's employment, makes possible a high rate of subsidy at low cost to the treasury. In the process it restructures the relationship between the marginal and average costs of existing firms and between the average costs of new and existing firms. The third feature, that it expires at the end of 1978 and it has an eligibility threshold that is updated each year to reflect last year's change in employment, tends to make the Employment Tax Credit an "automatic destabilizer."

Employment

The first crucial feature of the New Jobs Tax Credit (NJTC) is that it is paid on only the first \$4,200 of earnings of each extra worker. Amongst full-time, full-year workers the NJTC, therefore, works to the advantage of low-wage workers because the proportionate subsidy of their wages is greater. The NJTC also tends to provide a proportionately larger subsidy of part-time and part-year workers and should consequently stimulate part-time and temporary employment.

There are countless ways in which firms can make use of additional workers. Manufacturing firms can put idle equipment back into production or put on a second shift. Retail firms can open new stores, stay open longer hours, or increase the number of sales personnel on the floor.

Inflation

The Job Tax Credit lowers the firms costs. The more a small firm expands the more its costs will decline. With lowered production costs the firm can afford to cut prices to generate the extra sales necessary to keep the extra workers busy.

In the study that is available to you as part of my written testimony, I have conducted an econometric test of effects of the Jobs Tax Credit on employment, hours worked per week and prices of the construction and distribution industries. Employment was specified to be a function of a time trend, seasonal dummies for each month, trends on the seasonal dummies and a three year distributed lag on sales, wage rates, materials prices and the implicit rental cost of capital. The variable testing for an effect of the Jobs Tax Credit is an average over the past six months of the proportion of firms (weighted by employees) that knew about the credit. The sample period starts in the first year for which all data is available and extends to either March or April 1978.

Results of the study

Statistically significant increases in employment are found to have occurred in construction and retailing in response to the credit. The two stage least squares estimates imply the credit by March 1978 had induced an 8 percent increase in employment in construction and a 2 to 3 percent increase in retailing. For the industries studied the total increase in employment seems to be 400,000 plus or minus 200,000. Regressions predicting hours worked per week find that average hours per week in retailing are now 1 to 2 percent below what would have been predicted in the absence of the Jobs Tax Credit. The most startling finding is that there has been a decline in the margin between the retail and manufacturer's wholesale price of commodities the timing of which coincides with the operation of the Jobs Tax Credit. The point estimates derived from the price equations imply that in April 1978, the consumer price index for commodities was slightly less than one percentage point lower than it would otherwise have been.

Other evidence

The fact that new firms receive a subsidy on all their workers rather than just a few will give them a cost advantage, even though the subsidy per worker is half the standard amount. In competitive industries the 1 to 4 percent reduction in costs this credit will produce may be a significant stimulus to the formation of new firms. The unprecedentedly large number of new incorporations and a massive 400,000 increase in the number of self-employed workers between April/May 1977 and April/May 1978 may in some measure be due to the Jobs Tax Credit.

Because of the \$100,000 cap on the tax credit, small and medium sized firms are—relative to their size—benefited more than large firms. If the smart money on Wall Street were to expect an extension of the capped credit, it would be rational to switch ones investments from large firms into small fast growing firms. Here again the behavior of stock prices is consistent with the hypothesis. For almost a year the NASDAQ and AMEX indexes have been out performing the DOW and New York Stock Exchange indexes.

To sum up all five of the hypothesized effects of a Jobs Tax Credit seem to be occurring. Employment, new firm formation and NASDAQ stock prices have risen above predicted levels. Hours worked per week and prices have fallen below predicted levels. Alternative explanations for each of the phenomena are available so there is no way to be certain the Job Tax Credit is the cause. The JTC hypothesis does, however, have the advantage of being the only single story that simultaneously explains all five events.

The targeted employment tax credit

Now let me make a few comments upon The Targeted Employment Tax Credit the Administration has proposed. Given the budget constraint imposed in the planning process, it is a well designed credit and should provide a major stimulus to the employment of low income youths and handicapped workers. The requirement that the youth come from a family with income below 70% of the regional lower living standard targets the job stimulus on exactly the people who need the help. It is important that the period over which income is measured be at least 6 months long. Substitution of a length of unemployment eligibility requirement would not target the credit nearly as well. Eligibility determination is located in the correct place, CETA offices. It would be a mistake to require individuals to deal with a welfare agency to get certified. A low rate of subsidy that lasts for a long period of time is much better than a high rate of subsidy that lasts a shorter period of time.

The only flaw in the TETC is the exclusion of the heads of low income families with children from eligibility. A similar credit is being considered for welfare recipients. A job stimulus should not be conditioned on applying for welfare. Many people find applying for and receiving welfare to be demeaning. Limiting the TETC to youth and AFDC recipients might create an incentive for marriages to split apart. If the TETC certification is associated in employers minds with being a welfare recipient, certification may carry a stigma that may cause employers to avoid hiring the target group.

Should the jobs tax credit be extended?

In my view a modified version of the credit should be extended for another four years. Two modifications are absolutely essential:

(1) The cap must be taken off. This can be done by setting a cap of \$100,000 or 20 percent of the Employers FUTA wage base whichever is higher.

(2) The firm must not be able to reduce its threshold of eligibility next year by purposely reducing employment this year. A simple extension of the current Jobs Tax Credit would give firms an incentive to reduce employment in 1979 in order to increase the credit the firm is eligible for in 1980. There are two ways of avoiding this:

(a) Make the threshold that will apply in 1979, 1980, 1981 and 1982 a function of the firm's 1977 and 1978 FUTA wage base. The thresholds that will apply in these years could be specified as respectively 105, 107, 109 and 111% of the 1977/78 average FUTA wage base. The subsidy of a firms' expansion would not be once and for all; it would last as long as the expansion was maintained. As a result this method of defining the threshold implies that the rate of subsidy would be progressively reduced to somewhere around \$1000 per worker.

(b) Alternatively the threshold can be set as some percentage of the largest of the firms post 1978 FUTA wages. The stimulative effect of such a credit will tend to diminish when the economy heads into a recession. It would be desirable to make yearly adjustments in the location of the threshold relative to previous peak employment. Within a range specified by Congress, the President would set the threshold for the year on January 1st and Congress could then modify or veto this threshold as it saw fit.

AN ASSESSMENT OF THE EMPLOYMENT TAX CREDIT OF THE TAX REDUCTION AND SIMPLIFICATION ACT OF 1977: IMPACTS UPON THE CONSTRUCTION AND DISTRIBUTION INDUSTRIES

(By John Bishop, research associate, Institute for Research on Poverty,
University of Wisconsin-Madison)

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This paper examines the effect of the Employment Tax Credit of the 1977 Tax Reduction and Simplification Act on employment demand and the pricing policies of the construction, trucking, wholesaling and retail sectors of the economy.

Employing 22.7 million workers in 1976 these industries provided 26% of the nations jobs and 27% of the hours worked by persons engaged in production.

Despite their importance and the availability of reasonably good monthly data on input and output prices, wages, employment, hours worked and the sales or output of these industries, time series studies of employment demand have neglected these industries. A large share of the nations low earnings workers are employed in these industries. Average earnings in the retail sector are two thirds the national average. Construction earnings are only slightly lower than the national average but the variance is high. In 1970 45% of teenagers, 21% of black males, and 23% of women were employed in these industries.

Because the lives of capital equipment are short and rates of labor turnover are high, the responsiveness of construction and distribution to tax policy induced changes in input prices may be speedier than in the rest of the economy. The Employment Tax Credit places a \$100,000 cap on the amount of subsidy each firm may receive. As a result it is in industries dominated by small and medium sized firms like construction and the distribution sector where one would expect a response to the Employment Tax Credit if there is one.

The major finding of this paper is that the data are consistent with the hypothesis that firms in the construction and distribution industries have responded to the Employment Tax Credit by increasing employment especially of part time workers and reducing prices. The point estimates of the increase in employment that the credit had stimulated by March 1978 generally lie in the neighborhood of 400,000 with a band of uncertainty of plus or minus 180,000. A 400,000 job stimulus is roughly one third of the growth in employment these industries were experiencing between April 1977 and April 1978. Point estimates of the decline in the margin between the retail price of commodities and manufacturers wholesale prices suggest that by April 1978 the credit had reduced consumer prices index for commodities by slightly less than one percentage point.

The first section of the paper outlines the problem that employment subsidies are designed to address and describes the structure of the currently operating marginal employment incentive. Section 2 discusses how a firm should respond to such an incentive and selects three hypotheses for testing at the industry level in the later sections of the paper. Section 3 describes the estimating equations and hypothesis testing methodology. Section 4 reviews the data and Section 5 presents the results.

1. BACKGROUND

Over the last seven years overall unemployment has averaged 6.2%, nonwhite unemployment 10.8%, and teenage unemployment 16.8%. The unemployment rates of young high-school dropouts have been especially high. In March 1976, the most recent data available, high-school dropouts aged 16-24 were experiencing a 20.7% unemployment rate if they were white and a 34.4% rate if they were nonwhite. This discouraging unemployment record has led both economists and politicians to search for new ways to stimulate the employment of inexperienced and disadvantaged workers. A recent paper by Martin Baily and James Tobin suggest that by focusing the employment stimulus on the lower skilled less experienced workers that it may be possible to lower the rate of unemployment at which inflation accelerates (NAIRU).

One approach is to expand public service employment for the youthful unskilled workers. The cost per job created, however, is high; and it is in any case doubtful that in the long run public service employment results in large net additions to total employment. An additional problem is that the public sector is highly skill intensive. The proportion of workers with at least one year of college is twice as high in the public as in the private sector (45% versus 22%).

These difficulties have led to programs whose objective is to create additional jobs for unskilled and inexperienced workers in the private sector. WIN and JOBS are examples of programs that have attempted to induce the private sector to hire the disadvantaged by offering employers a subsidy to hire workers in their target groups. They have not, however, proved very effective.

Most employers that hire target group workers for which a subsidy is available neglect to even apply for the money (Hammermesh, 1977). The paper work involved in applying for the subsidy seems to have prevented the financial incentive components of these programs from having a major impact. A further disadvantage of this approach seems to be that the subsidy adheres to specific individuals. Employers may feel that eligibility for the subsidy signals that the job applicant is likely to be a low productivity worker—leading to the paradox

that the programs may in fact lower the subsidized worker's chances of getting a good job.

A third approach is to subsidize employment generally. First proposed by Nicholas Kaldor in 1936, this approach has more recently been refined and analyzed by Fethke and Williamson (1976) and Kesselmann, Williamson, and Berndt (1977). These analyses suggest that by paying the subsidy only for increases in employment over a threshold level based on a firm's past employment—that is, a so-called marginal employment subsidy—it is possible to achieve rather large increases in employment at rather limited cost to the government. Independently, several influential members of Congress (Senator Bentsen and Representatives Conable and Ullman among them) were thinking along similar lines and introduced bills implementing this marginal employment subsidy approach.

President Carter's January 1977 tax reduction recommendations contained a nonmarginal wage bill tax credit. The House Ways and Means Committee substituted a marginal employment subsidy for the President's proposal, which, after being somewhat modified by the Senate, was passed and signed into law as part of the Tax Reduction and Simplification Act of 1977.

This law provides businesses a tax credit against corporate or personal income tax liability for expansions in employment in 1977 or 1978.

The credit is 50 percent of the increase in each employer's wage base under the Federal Unemployment Tax Act (FUTA) above 102 percent of that wage base in the previous year. The FUTA base for a year consists of wages paid up to \$4,200 per employee. . . .

The employer's deduction for wages is reduced by the amount of the credit. Therefore, although the maximum gross credit for each new employee is \$2,100, the effective credit ranges from \$1,808 (for a taxpayer in the 14-percent tax bracket) to \$630 (for a taxpayer in the 70-percent bracket).

The total amount of the credit has four limitations: (1) the credit cannot be more than 50 percent of the increase in total wages paid by the employer for the year above 105% of the previous year, (2) the credit must be no more than 25% of the current year's FUTA wages, (3) the credit for a year cannot exceed \$100,000 and (4) the credit cannot exceed the taxpayer's tax liability. Credits which exceed tax liability for a year may be carried back for 3 years and carried forward for 7 years. (Joint Committee on Taxation, 1977).

The requirement that the total wages paid rise by at least 5% is designed to insure that the Employment Tax Credit is based on actual increases in employment rather than artificial increases in unemployment insurance wages (for example, an employer could increase unemployment insurance wages by dividing full-time jobs into part-time or part-year jobs). The requirement that the credit not exceed 25% of FUTA wages limits the amount of credit that new and rapidly expanding businesses can receive. (An extra 10% subsidy of the first \$4,200 for each worker is available for hiring handicapped workers, with no limit on the total amount of subsidy. This paper does not analyze the effects of the credit for the handicapped.)

2. THE LIKELY IMPACT OF THE EMPLOYMENT TAX CREDIT

Key features of the Employment Tax Credit are that it is (a) a fixed proportion of earnings up to a rather low maximum, (b) marginal and (c) temporary. Each of these features has important consequences. The first feature focuses the employment stimulus on low wage, part-time, part-year workers, a group that currently suffers from very high unemployment rates. The second feature, that it is based on a threshold employment level defined by last year's employment, makes possible a high rate of subsidy at low cost to the treasury. In the process it restructures the relationship between the marginal and average costs of existing firms and between the average costs of new and existing firms. The third feature, that it expires at the end of 1978 and it has an eligibility threshold that is updated each year to reflect last year's change in employment, tends to make the Employment Tax Credit an "automatic destabilizer."

Employment

The first crucial feature of the New Jobs Tax Credit (NJTC) is that it is paid on only the first \$4,200 of earning of each extra worker. Amongst full-time, full-year workers the NJTC, therefore, works to the advantage of low-wage workers because the proportionate subsidy of their wages is greater. The NJTC also tends to provide a proportionately larger subsidy of part-time and part-year

workers and should consequently stimulate part-time and temporary employment.

Since members of minority groups, women, and teenagers predominate in all three types of employment—low wage, part-time, and part-year—the NJTC should provide a major stimulus to their employment. This is generally thought to be desirable because it will target the employment stimulus on groups that currently experience very high rates of unemployment.

Price inflation

The impact of the marginal employment subsidy on the pricing policies of firms is of major importance. If the subsidy is immediately passed on to consumers, the employment stimulus will be larger because the lower price will cause an expansion in demand for real output. This once and for all reduction in the price of output will also temporarily reduce inflation. How large these effects will be depends on how firms set prices.

Tax incidence theory tells us that the size of the price reduction induced by the subsidy depends upon the nature of the market and slopes of the demand and supply curves. Defining industry demands as $P_d = B + bQ$, $b < 0$, and the supply curve as $P_s = A + aQ + S$, $a > 0$, $S < 0$, the impact of a subsidy (S) on price in a competitive industry is $dP/dS = d/b - a$. An industry's long run supply curve depends on the average costs of production of new entrants and the incremental total costs of expansion by existing firms. If there are no factors specific to the industry (i.e., the price of factors supplied to the industry does not depend on that industry's output), the long run supply curve should be quite flat ($a \approx 0$). Thus, except for agriculture and mining, dP/dS should be closer to 1 than to zero. In the long run, shocks to demand should have only minor effects on prices; and changes in costs of production will be passed on to the consumer almost completely. Thus, in the long run prices will behave as if they were set according to a standard markup on normal average costs.

Normal average cost pricing is also a popular theory of short run pricing behavior and currently predominates in certain lines of econometric work on inflation (Nordhaus 1974). For competitive industries like retailing and services, the basis for using this theory to predict short term pricing behavior is that rates of entry and exit are very high and that, since most firms operate substantial excess capacity, marginal costs do not increase as sales rise. For oligopolistic industries, the primary theoretical justification for firms administratively setting prices according to a normal average cost rule is limit price theory. According to this theory an oligopolistic industry's price is set in order to forestall or minimize entry of new competitors into the industry. It is, therefore, set below the average costs of new entrants and adjusted up or down as these costs change. To the extent that changes in the normal average costs of existing firms approximate changes in the costs of entry, normal average costs will be good predictors of short term pricing behavior.

A permanent Employment Tax Credit with a fixed threshold changes the relationship between the average costs of existing firms and the average costs of new entrants. The fact that new firms receive a subsidy on all their workers rather than just a few will give them a cost advantage, even though the subsidy per worker is half the standard amount. Existing firms that choose to expand by bringing out a new product line or opening an establishment to serve a new market will also have a cost advantage over firms that are already serving that market. The New Jobs Tax Credit causes the limit price that will forestall entry to determine by substantially more than the decline in average costs of existing firms.

Because they lack an established reputation with customers, have inexperienced managers, and need to start from scratch in recruiting and training a labor force, new firms compete at a substantial disadvantage. The advantage that a permanent Employment Tax Credit would give new firms are not likely to outweigh these disadvantages completely. When the costs of energy, materials, and capital are included, the cost advantage (at current levels) is only 2% in manufacturing, 1.5% in retailing, and 3-4% in services. Relative to the current environment, however, it could be expected to provide an important stimulus to the formation of new firms and the expansion of small ones.

A permanent Employment Tax Credit with a fixed threshold and no upper limit on the subsidy per firm might therefore, reduce prices by more than it reduces the average costs of existing firms. It is hard to say, however, whether the temporary and constrained credit of the 1977 Tax Reduction and Simplification Act will have any substantial impact on prices.

The \$100,000 maximum on the per firm credit limits the size of the subsidized expansion to 48 workers for existing firms and 96 for new firms. The expiration date means that a new firm cannot plan on receiving a subsidy for more than the first two years (i.e., for a maximum of 192 workers). As a result, the credit will be of only minor help to entrants into industries with scale economies that require firms to employ many more than that. Almost 50% of all private wage and salary workers are in firms that employ more than 500 workers. However, in many cases the large firms compete directly with small firms in certain segments of their business. The NJTC should be more effective in such situations. Computer software, auto parts manufacture, and steel wholesaling and fabrication are examples of this type of industry. In these markets the cost advantage of small but growing firms is likely to produce a major reduction in prices and reduce the larger firms share of the market.

The fact that permanent increases in employment receive an ETC subsidy only in the first year also lowers its impact on average costs of production over a 10-year horizon. This feature will limit the credit's effect in lowering the entry forestalling price. It also means, however, that the potential entrant can be sure he will get the credit even if his attempt at entry fails. If he fails to make profits, the credit (which can be carried forward for seven years) is still worth something to potential purchasers of the business.

Employment stability

The temporary nature of the credit is likely to increase year-to-year variations in the number of workers a firm employs and increases the cyclical instability of aggregate employment. The credit is set to expire at the end of 1978. Since employers cannot be sure it will be extended, the expiration date creates incentives for firms to reduce order backlogs, to build up inventories, and to undertake deferred general maintenance of plant and equipment before the end of 1978. Inducing firms to produce now rather than later may help the economy recover from the 1975/76 recession, but it may also create a recession in 1979. The high unemployment rates of unskilled and inexperienced workers are not a temporary phenomenon. They existed before the recession and are likely to remain with us until long-term remedies are found and implemented.

Even if it becomes a permanent part of the tax law, the ETC is temporary in the sense that permanent increases in employment produce a credit only in the initial year. The yearly updating of the threshold means that some firms will find it optimal to contract employment as much as possible every other year in order to maximize the size of the firm's tax credit in the following year. Alternately expanding and contracting employment in successive years will maximize the firm's receipts of tax benefits from the credit, it will also increase the level of frictional unemployment.

A permanent Employment Tax Credit with yearly updated eligibility thresholds would have a strong tendency to increase cyclical employment instability. During a recovery from a recession most firms will be eligible for the credit, leading to an accentuation of the normal cyclical recovery by the credit-induced inventory building and substitution of labor for materials and capital. Instead of increasing output by scheduling more overtime, firms will have extra workers. Laying them off later will no longer be an unattractive option because of the threshold feature of the credit.

A dramatic turnaround occurs when a cyclical peak has been reached. As extra workers become harder to obtain and the growth rate of demand slackens, more and more firms will not meet the employment growth target of 2%, lose their eligibility for subsidy and, therefore, end the temporary changes in labor intensity and inventory accumulation induced by the subsidy. Other firms will find that, since their feasible growth of employment is now small, the advantages of receiving the subsidy for which they are eligible this year are outweighed by the advantages of increasing the amount of subsidy they will be eligible for next year. Like the firms that lose their eligibility involuntarily, these firms will cut back employment and run down their inventory. Since most firms will be going on and off the credit at similar points in the business cycle, a permanent credit with thresholds updated yearly will accentuate booms and worsen recessions—constituting a "built in destabilizer."

Apparently aware of these problems, congressional planners seem to be planning to manipulate the credit to achieve counter-cyclical objectives. Attempting to manipulate an instrument that is inherently a built-in destabilizer to achieve stabilization is, however, tricky business—especially for a political institution like Congress.

The inherently destabilizing feature is the yearly updating of the threshold. Destabilizing effects can thus only be avoided by establishing and adhering to firm-specific subsidy thresholds. Changes in a firm's threshold from year to year should not be under the influence of the firm.

The hypotheses

The list of ways in which the NJTC may be changing firm behavior is quite long. For example:

(1) Work that used to be contracted out such as cleaning, maintenance, accounting, etc., may now be profitably done internally.

(2) If it can be done by new hiring, deferred maintenance should be completed before January, 1979.

(3) Where manufacturing firms have low wages and high turnover, there should be a build up of finished goods inventory.

(4) Large firms that are no longer subsidized on the margin by NJTC may contract work out to firms that are eligible for NJTC and the negotiated price for that work may be lower as a result.

(5) Groups of workers that were avoided because of their high turnover rates may now become especially desirable.

In the empirical work only three hypotheses will be examined, however:

- (1) Employment will rise;
- (2) Hours worked per week will fall;
- (3) Prices will fall.

Behavior will change only if the firm is aware of the subsidy and can increase its tax credit by increasing employment. Small firms tend to be unaware of the credit (only 30% of 1-10 employee firms had heard of it by February 1978). Firms with over 2000 employees will generally have hit the \$100,000 cap without having to change their behavior. Consequently industries dominated by medium sized firms should respond more than industries composed wholly of either small or large firms.

Specification

In a world of perfect information, no inventory and zero adjustment costs, the firm would have and be able to achieve an ideal level of employment and scheduled hours of work per week that would solely be a function of the current level of sales and the prices of output and each input. In a world of imperfect information, inventory holding, and adjustment costs, the firm's optimal employment and hours in period t depends upon the realized level of employment in period $t-1$ and upon anticipated levels of sales and input prices in both current and future periods.

$$E_t = f \left(S^e, \frac{W^e}{P^e}, \frac{Q^e}{P^e}, E_{t-1} \right) \quad (1)$$

S , W , P , and Q denote sales, wages, output prices, and input prices respectively and the e superscript denotes a vector of anticipations of future values based on all information available up to time t .

When the observable lagged values of S , W , P , and Q are used in an estimating equation, lag distributions will vary not only because adjustments to different stimuli take different amounts of time but also because the expectation formation process for each variable will have different lag structures.

Since the information set used to predict future values of a particular variable may include other variables in the model, coefficients on lagged values of sales or wages may not follow a regular pattern. The primary objective of this study is to obtain unbiased measures of the Employment Tax Credit's impact on employment and prices. Imposing regularity conditions on the lag structure might bias our estimates of the ETC's effect. Consequently, estimating techniques are employed that produce free estimates of the lag structure.

Since E_{t-1} , E_{t-2} , . . . , etc. are themselves a function of lagged values of S , W , P and Q , we may substitute it out of the equation. Since expectations about P may be formed very differently than expectations about W and Q the most general way to write our equation in terms of observable contemporaneous and lagged values is

$$E_t = f(S, W, P, Q) \cdot u_t \quad (2)$$

The bar denotes a vector containing current and lagged values of the variable.

Econometric studies of labor demand often estimate their models under some rather strong maintained hypotheses. Many of these hypotheses have recently

received severe criticism. Clark and Freeman have demonstrated that the constraint that the real capital prices have as large positive impact on employment demand as the negative effect of real wages is rejected for manufacturing. Constraints requiring identical lag structures across variables have also been found to be inconsistent with the data (Sims, Clark and Freeman).

Estimates of systems of demand equations that have included materials, and energy inputs typically reject the weak separability of materials and energy from capital and labor (Berndt and Wood, Gallop). This implies that the correct specification of a labor demand function contains the prices of materials and energy. Since the prices of materials may be correlated with capital prices or wages, estimates of labor demand functions derived from a value added production specification are likely to be biased.

A number of other potentially troublesome maintained hypotheses will be tested. The hypotheses to be tested relate to the exogeneity of industry sales and wage rates in regressions predicting employment. Sims has shown that under fairly general conditions that a test of the hypothesis that coefficients on future values of the wage rate or sales are all zero can be regarded as a test of the hypothesis that the equation is in fact a structural equation. Rejection of this hypothesis will be taken as evidence for simultaneity, and the equation will be reestimated using two stage least squares. Potential exogeneity problems with the price of output are eliminated by treating P as a function of nominal input prices and solving P out of the model.

Our models were estimated under two alternative sets of maintained hypotheses. The relative wage model assumes that the information set used in generating expectations about future input price ratios is limited to current and lagged information about input price ratios. This specification implies that a simultaneous 5% increase in all input prices will leave current and all future employment levels unchanged. While the tests for exogeneity that were applied to this model were rejected for some industries, there was no attempt to apply 2 SLS using this model because it would have involved simultaneously instrumenting all input prices.

The second somewhat more general specification is the "nominal input price model." Using nominal input prices as regressors rather than price ratios means we are dropping the assumption that the information set is limited to input price ratios. Firms are certainly aware of the history of nominal prices. Rational behavior implies that expectation formation take into account the noise to signal ratio of a series. This implies that the time pattern of response to each nominal input price should be estimated separately. In this model we choose not to impose the constraint that the coefficients on input prices sum to zero, because errors in measurement in the rental price of capital and price indexes for consumable materials and business services are likely to be larger than errors in measurement in wholesale prices and wage rates. (Especially in the disaggregated retail industry models.) Imposing this constraint would increase the transmission of an error in variables bias to the wage coefficients. (Clark and Freeman demonstrate this for simple cases.) If we are wrong, and the constraint should have been imposed, we lose efficiency only.

Since the primary purpose of the paper is to provide a powerful test of the effects of the ETC, the specification of this variable is important. The effect of the tax credit is likely to be very different from the effect of an equivalent change in the wage rate. The ETC is capped, temporary, marginal, and requires the firm have tax liability to receive benefits. In February 1978 more than half of all firms were unaware the credit existed and many of those that had heard of it wrongly thought themselves to be ineligible.

In February 1978 a Census Bureau survey asked a large sample of firms whether they had heard of the tax credit and if so when they heard of it. Large firms were much more likely to have heard of the credit and to have heard of it immediately after its passage in May 1977. Using the distributions of employment in retailing by employment size class in the 1972 Enterprise Statistics, the proportion of retail employees in firms that knew about the credit were estimated for each month of 1977 and 1978. Firms employing more than a thousand workers were excluded from this calculation.

It was assumed that once a firm knows about the credit its response to the credit is distributed over the following six months. The Employment Tax Credit variable is therefore an average over the past six months of the proportion of firms (weighted by employees) that knew about the credit. The firms that reported hearing of the credit before it was passed were assumed to have waited

until passage before responding. Defining the ETC variable in this way means that despite the fact that the House passed a bill with the credit in early March, we are assuming that anticipation of the credit was not responsible for any part of the spring 1977 upswing in employment.

The ETC variable has a value of .057 in June 1977, and rises at an average rate of .0424 per month. By March 1978 it has achieved the value of .435. Multiplying the coefficient on ETC by .435 provides our estimate of the effect of the credit on the March 1978 value of a dependent variable.

Note that this specification implies while the credit might have had important impacts on the level of employment in November and December, 1977, we are assuming that almost the entire impact of the credit on the average level of employment will occur in 1978 rather than 1977.

Results

Relative input price model regressions using three year distributed lags on sales, wages, the rental rate on capita, and materials input prices are presented in Table 2. Corresponding nominal input price model regressions are presented in Table 4. The two stage least squares results for construction and retail aggregates are presented in Table 5. All the results reported are for models estimated with data transformed to correct for serial correlation of residuals. The estimate of ρ used to correct the data is presented in the second to last column of the tables. The Durbin Watson statistic is for the regression using the transformed data and is therefore a test for second order serial correlation of the residuals.

For construction the output variable is construction put in place deflated by an interpolated NIA deflator for structures. For the retail industry aggregate output is defined as retail sales deflated by the consumer price index for commodities. Industry specific output measures for the disaggregated segments of the retail industry are retail sales for that segment of the industry deflated by the appropriate components of the CPI. For trucking it is a seasonally adjusted index of the volume of general freight hauled by Class I and II common carriers of property. For wholesaling we use the sales of merchant wholesalers deflated by the consumer price index for commodities. For trucking and wholesaling only partial coverage of the industries is provided by these indices. The data on employment and hours are obtained from separate samples of firms than the data on retail or wholesale sales. When industry subaggregates are being used sampling error in the industry specific sales variable can become a serious problem. All of the disaggregated runs therefore contain the additional scale variable of current and lagged total retail sales. The impact of changes in wage rates and other input prices on employment is presented in columns 2 through 7 of these tables.

Our focus is on the ETC variable, however. Most of the coefficients are positive. In the relative input price model we may reject at the .05 level or better the hypothesis of zero or negative effects of the ETC on employment for establishment data on construction and retailing and for the industry subaggregates for Apparel, Food, Furniture and Other Retailing. In the nominal input price model statistically significant positive coefficients on the ETC variables are obtained in the 2 SLS result for construction and retailing establishment data aggregates. In the OLS results statistically significant positive coefficients are obtained for eating and drinking places and other retailing. Tables 3 and 6 summarize the sensitivity of the ETC coefficient to reductions in the length of the lags on all variables. At the bottom of these tables we sum the effects implied by each industry equation across industries to obtain for March 1978 a total effect for the industries studied. For the relative wage model the estimates of employment stimulus are 470,000 for the preferred 3 year lag. In the nominal input price model of Table 6, estimates of employment stimulus range between 225,000 and 580,000. During this period employment rose 1,140,000 in these industries and roughly 3,800,000 in the nation as a whole.

Hours

Table 7 present coefficients on the ETC in regressions predicting the log of hours worked per week. Coefficients are consistently negative in retailing. Statistically significant negative coefficients are obtained for the retail aggregate and for Food, Furniture, and General Merchandising. The coefficient in the construction hours equation may be biased by simultaneity. The manhours 2SLS regression reported in Table 5 has a considerably smaller coefficient than the corresponding employment equation. When one takes into account the reduction in

average hours worked per week the Employment Tax Credit seems to be producing in the retail sector, the percentage increase in manhours worked is likely to be only half the percentage increase in employment.

Prices

The payroll of the distribution sector is less than 20 percent of the retail price of the commodities sold to consumers. Only in the restaurant and tavern industry does payroll approach 30 percent. Consequently, there is only a limited amount of room for reductions in prices in response to a subsidy of payroll costs. Nevertheless, the hypothesis of a zero or positive effects of the ETC on prices can be rejected for the price of restaurant meals and for the non-food commodity aggregate. The pattern of ETC coefficients is consistent with expectations. The industry with the highest payroll costs, restaurants, has the largest negative coefficient. Food stores, the retail industry with the smallest margins, smallest payroll, and important opportunities to use labor to upgrade the quality of its product (bagging and delivery to your car) has a non-significant positive coefficient. The marginally significant negative coefficient on furniture, appliance, and TV and radio prices is especially surprising in the face of the rising relative prices of imports which are included in consumer prices but not in the wholesale price index used in the equation.

Taking these coefficients at face value, we calculated the dollar amount of the reduction in consumer prices they imply. Considering that the firms of the distribution sector almost certainly received less than two billion dollars in tax savings from the Employment Tax Credit, price reductions of that aggregate to more than 4 billion dollars imply that consumers and workers will receive benefits that substantially greater than the tax expenditure.

Unfortunately these benefits are not likely to be available to us permanently. Permanent marginal employment subsidies are difficult to design. Notions of fairness are likely to force us to periodically revise the thresholds above which we subsidize a firms employment. Basing that revision on the firms recent employment experience as is done in the DISC subsidy of exports, may result in the firm modifying its response to the subsidy in a way that reduces the efficiency of the subsidy.

TABLE 1.—THE HISTORY OF THE TAX TREATMENT OF CAPITAL AND LABOR INCOME AND OF RELATIVE INPUT PRICES

	1950.01	1955.01	1960.01	1965.01	1972.01	1975.01	1978.03
Present value of depreciation deduction:							
1. Structures.....	0.287	0.445	0.508	0.508	0.508	0.508	0.508
2. Retail equipment.....	.417	.580	.644	.698	.720	.720	.720
3. Trucks.....	.799	.849	.908	.908	.951	.951	.951
Implicit rental cost:	No tax						
4. Structures—Corporate.....	0.094	.161	.170	.159	.158	.159	.158
5. Equipment—Corporate.....	.707	.278	.288	.245	.235	.235	.224
6. Equipment—Proprietorship.....	.207	.237	.237	.245	.222	.224	.221
7. Trucks—Corporate.....	.37	.439	.447	.398	.382	.382	.373
Log ratio of retail wage to:							
8. Wholesale price of consumer finished goods.....	0	.157	.329	.505	.731	.612	.703
9. Price of business service and materials.....	0	.128	.261	.415	.591	.501	.533
10. Price of capital goods.....	0	.042	.058	.136	.211	.176	.206
11. Rental cost of capital.....	0	.155	.217	.497	.717	.657	.747
12. Nominal compensation in retail.....	1.00	1.294	1.619	1.953	2.967	3.672	4.701
13. Marginal tax rate on compensation of low wage labor.....	.169	.216	.238	.282	.290	.322	.329 (-.171)

TABLE 2.—EQUATIONS PREDICTING EMPLOYMENT, RELATIVE WAGE MODEL¹

	ETC	Wage			Total	Other inputs	Capital		Sales			Ind. sales, 3 yr	Total ret. sales 3 yr	σ_e	ρ	DW
		1 quarter	1 yr	2 yr			Rental rate	Price	1 quarter	1 yr						
Retail and wholesale HH data	0.094 (.055)	0.176	0.102	-0.631	-0.420		+0.595	-0.581	0.230	0.667	1.153			0.0117	0.62	2.02
	.068 (.041)	-.199	-.430	-.482	-.295	+0.574	+ .307	-.507	.288	.626	.897			.0117	.50	1.76
Retail established data	1.48 (.026)	+ .150	+ .127	-.187	-.232		+ .165	-.367	.273	.563	1.013			.0041	.78	2.08
	1.045 (.028)	+ .074	.079	-.229	-.488	+ .313	+ .157	-.371	.264	.558	.995			.0040	.78	2.15
Eating and drinking (64-78.03)	-.025 (.06)	-.087	-1.310	-2.63	-3.10	+3.88	+ .873	-1.948	.158	.693	-1.316	2.532		.005	.15	1.809
Apparel (52-78.03)	.0125 (.064)	-.202	.62	.182	-.162	-.0196	+ .330	-.660	.329	.514	.6034	.632		.013	.27	2.03
Other retail (61-78.03)	.0727 (.0266)	-.014	-.223	-.148	-.038	-1.124	-.296	0	.253	.481	.901	.815		.003	.42	1.602
Food (61-78.03)	.112 (.037)	-.134	.064	.076	-.707	-.6903	-0.177	0	.213	.659	-.035	.998		.005	.45	1.602
General merchandise (52-8.03)	-.054 (.0417)	-.221	-.288	-.355	-.28	-.796	+ .339	0	0.403	.658	0.909	.141		.0089	.41	1.92
Furniture (61-78.03)	.122 (.026)	.167	.084	-.412	-.448	-.315	+ .702	.568	.1624	.37	.597	-.23		.003	.28	1.89
Wholesale (52-78.03)	.007 (.021)	-.088	-.149	-.417	-2.296	+ .346	-.228	-.445	.126	.303	-.019	.275		.0031	.715	1.51
Construction est. (52-78.03)	.230 (.082)	-.283	-.128	-.321	+ .285	+ .224	-.674		.254	.355	.176	0		.0154	.789	1.71

¹ All input prices are entered as ratios to the wage. This imposes the constraint that an equal percentage change in all input prices leaves employment levels in all future periods unchanged.

TABLE 3.—THE IMPACT OF THE ETC ON EMPLOYMENT UNDER ALTERNATIVE SPECIFICATIONS OF THE RELATIVE WAGE MODEL

	Employment 1977 (thousands)	3-yr lag	2-yr lag	1½-yr lag
Eating and drinking (61-78:03).....	3,854	-0.025 -.41 (.0050)	-0.054 -1.08 (.0059)	-0.006 -.19 (.0066)
Apparel (52-78:03).....	821	.0125 .20 (.013)	.028 .63 (.013)	.067 1.67 (.014)
Other retail (61-78:03).....	4,021	.073 2.74 (.0029)	-.028 -1.24 (.0035)	-.026 -1.57 (.0041)
Food (61-78:03).....	2,116	.112 3.04 (.0048)	.113 3.44 (.0057)	.184 5.25 (.0072)
General merchandise (52-78:03).....	2,541	-.054 -1.28 (.0089)	-.035 -.953 (.0094)	.051 1.35 (.0107)
Furniture (61-78:03).....	551	.122 4.73 (.0031)	-.024 -1.47 (.0045)	-.018 -1.14 (.005)
WHLEMP (52-78:03).....	4,389	-.012 -.54 (.0032)	-.014 -.68 (.0033)	.045 2.20 (.0037)
Trucking (61-78:03).....	1,131	-.224 .070 (.0063)	.251 4.73 (.0091)	.213 4.49 (.0110)
Constr. est. (52-78:03).....	3,844	.230 2.81 (.0154)	----- ----- -----	----- ----- -----
Increase in employment by March 1978 (thousands).....	474	-----	-----	-----

TABLE 4.—EMPLOYMENT IN CONSTRUCTION AND DISTRIBUTION INDUSTRIES—(REAL SALES AND NOMINAL INPUT PRICES HAVE 3-YR LAG)

	ETC	Hourly compensation in nominal terms				Materials price	Rental fixed capital	Sales		Ind. sales 3 yr	Total ret. sales 3 yr	r	p	DW
		1 quarter	1 yr	2 yr	Total			1 quarter	1 yr					
1. Construction estab. data.....	.065 (.104)	-0.230	0.701	0.237	-0.638	1.162	-0.235	0.531	0.745	0.947	0	0.0143	0.818	1.98
2. Retail and wholesale HH data.....	.041 (.071)	-.795	-.583	.700	.092	.623	-.143	.274	.741	1.017	0	.0122	.657	2.00
3. Retail estab. data.....	.067 (.034)	.187	.475	.402	-.171	.343	-.159	.236	.515	.777	0	.0043	.846	2.24
4. Eating and drinking.....	.250 (.066)	.122	-.447	-.580	.054	.526	-.218	.387	.605	-.515	1.275	.0060	.584	1.54
5. Food.....	-.044 (.031)	.005	-.339	-.126	-.106	.497	-.116	.091	.414	.506	.206	.0046	.616	1.89
6. Apparel.....	-.119 (.052)	-.095	-.590	-.780	-.653	.728	.019	.318	.406	.007	.900	.0140	.387	2.04
7. Furniture and appliance.....	-.001 (.033)	.183	-.070	-.400	-.665	.014	.538	.212	.605	.267	.915	.0041	.663	1.73
8. General merchandise.....	.073 (.062)	-.163	-.337	-.296	-.151	-.344	.390	.379	.615	1.020	-.126	.0092	.575	2.09
9. Other retail.....	.053 (.027)	-.037	.078	.476	-.355	.142	.185	.173	.474	-.487	1.668	.0036	.510	1.49
10. Wholesaling.....	.007 (.028)	.165	.143	.174	.089	.135	-.200	.147	.324	.203	.273	.0032	.774	1.49
11. Trucking.....	-.013 (.061)	-.317	-.200	.097	.085	-.533	.223	.377	.523	.984	-.514	.0072	.408	1.83

TABLE 5.—COMPARISON OF OLS AND 2SLS MODELS OF EMPLOYMENT NOMINAL INPUT PRICE MODEL

	ETC	Wage				Material price	Capital rent	Sales		Ind. sales 3 yr	σ	ρ	DW
		1 quarter	1 yr	2yr	Total			1 quarter	1 yr				
CONSTRUCTION													
Ordinary least sqs. employment:													
HH data	0.095 (.152)	-0.744	-0.114	0.59	-0.477	0.672	-0.075	0.521	0.767	0.799	0.0251	0.722	1.89
Estab. data	.065 (.104)	-.230	.701	.237	-.638	1.162	-.235	.531	.745	.947	.0143	.818	1.98
Man-hours	-.046 (.138)	.100	.99	.009	-.701	1.273	-.283	.598	.891	1.068	.0280	.530	2.17
2-stage least sqs. employment:													
HH data	.199+ (.133)	-.371	1.089	.369	-.351	.518	-.039	.485	.677	.659	.0265	.668	1.70
Estab. data	1.174 (.098)	-.944	1.133	.259	-.614	1.064	-.196	.556	.771	.959	.0148	.820	1.89
Man-hours	.048 (.131)	-.330	1.283	.241	-.800	1.235	-.206	.591	.977	1.140	.0287	.601	2.14
RETAIL													
Ordinary least sqs. employment:													
HH data	.041 (.071)	-.795	-.583	.118	-.490	.622	.016	.274	.743	1.019	.0122	.657	2.00
Estab. data	.067 (.034)	.187	.476	.407	.288	.342	-.159	.287	.516	.778	.0043	.845	2.24
2-stage least sqs.:													
HH data	.056 (.067)	-1.200	-.706	.115	-.491	.694	-1.96	.298	.751	1.050	.0123	.657	2.01
Estab. data	.069 (.032)	.094	.415	.390	-.164	.364	-.170	.29	.518	.792	.0043	.846	2.26

¹ Double 2SLS involves applying 2SLS to the data twice. In the first application we assume that w at all lags is endogenous. This produces a consistent estimator of $\hat{\rho}$ which is used to transform the

data. 2SLS is then applied to the data a second time assuming only the current w endogenous.

TABLE 6.—IMPACT OF EMPLOYMENT TAX CREDIT ON EMPLOYMENT UNDER ALTERNATIVE LAG STRUCTURE
(NOMINAL INPUT PRICE MODEL)

	Employment 1997 (thousands)	Coefficient on employment tax credit, length of lag			Full impact of wage in model with 1½-yr lags
		3 yr	2 yr	1½ yr	
Construction, HH data, 51:02-78:03.....	3,844	0.095 .62 (.0251)	0.124 .89 (.0261)	1.194 1.43 (.0263)	—0.06
Construction, estab. data, 51:02-78:03....	3,844	.065 .63 (.0143)	1.149 1.57 (.0147)	1.190 2.06 (.0148)	— .219
Retail and wholesale, HH data, 51:02-78:03..	18,292	.041 .57 (.0121)	.002 .03 (.0122)	.012 .21 (.0122)	— .431
Retail estab. data, 51:02-78:03.....	13,903	.067 1.96 (.0043)	.016 .55 (.0044)	1.044 1.56 (.0046)	— .043
Eating and drinking, 58:02-78:03.....	3,854	.250 3.79 (.0059)	.161 3.43 (.0064)	1.127 3.90 (.0065)	.233
Food, 58:02-78:03.....	2,116	.044 1.40 (.0046)	.036 1.24 (.0051)	1.089 1.51 (.0053)	.059
Apparel, 52:02-78:03.....	821	.119 2.27 (.0140)	.125 2.59 (.0140)	.122 2.56 (.0140)	— .192
Furniture and appliance, 58:02-78:03....	551	.001 .02 (.0041)	.035 1.67 (.0042)	.049 2.41 (.0043)	— .512
General merchandise, 52:02-78:03.....	2,541	.073 1.18 (.0092)	.004 .08 (.0099)	.050 1.05 (.0170)	.098
Other retail, 61:02-78:03.....	4,021	.053 1.94 (.0026)	.007 .52 (.0029)	.016 1.22 (.0031)	.090
Wholesaling, 51:02-78:03.....	4,389	.007 .27 (.0032)	.007 .36 (.0033)	.019 1.00 (.0035)	.043
Trucking, 58:02-78:03.....	1,131	.013 .21 (.0072)	.006 .18 (.0076)	.029 .93 (.0078)	.072
Life insurance, 61:02-78:03.....	519	.019 .55 (.0030)	.014 .66 (.0039)	.001 .03 (.0041)	.341
Increase in employment by March 1978 in construction and distribution (in thousands):					
Using detailed indust. model.....		566	471	581	-----
Using estab. data aggregates.....		441	334	580	-----
Using HH data.....		398	225	379	-----

Note: The t statistic is found on the 2d line below the coefficient. The 3d line is the standard error of the regression adjusted for degrees of freedom. All models were estimated with the same p correction.

TABLE 7.—HOURS WORKED PER WEEK IN CONSTRUCTION AND DISTRIBUTION

Lag length	Impact of ETC under alternative specifications—Nominal compensation model			Short run Impact of wage change 4 mo
	1½ yr	2 yr	3 yr	
Construction.....	0.034 .77 (.0166)	0.041 .90 (.0167)	0.022 .40 (.0167)	-0.004 (-.879 in 1 m)
Retail, 64-78:03.....	-.028 3.66 (.0033)	-.021 2.83 (.0031)	-.049 2.58 (.0026)	-.468
Eating and drinking, 64-78:03.....	-.002 .07 (.0059)	-.039 .94 (.0059)	-.101 1.49 (.0055)	-.234
Food.....	-.027 1.77 (.0048)	-.032 1.81 (.0048)	-.023 1.02 (.0047)	-.390
Apparel.....	-.005 .22 (.0067)	-.006 .31 (.0067)	.008 .32 (.0066)	-.245
Furniture.....	-.061 3.95 (.0056)	-.064 4.26 (.0053)	-.088 3.76 (.0034)	-.164
General merchandise.....	-.079 3.72 (.0060)	-.030 1.31 (.0057)	.023 .74 (.0055)	-.256
Other retail.....	.006 .58 (.0036)	.024 2.42 (.0031)	-.021 .89 (.0028)	-.195
Wholesaling.....	.017 1.86 (.0032)	.023 2.33 (.0031)	.013 1.10 (.0026)	-.059
Trucking.....	.004 .17 (.0080)	.029 1.34 (.0076)	-.105 2.31 (.0072)	.170
Life insurance.....	-.013 .66 (.0060)	.027 1.13 (.0052)	-.080 1.73 (.0040)	.074

TABLE 8.—EQUATIONS PREDICTING CONSUMER PRICES AND CONSTRUCTION DEFLATOR WITH 1-YEAR LAGS ON WAGES AND 2 DIFFERENT MATERIALS PRICES

	Sum of coefficients on—										
	ETC	Sales tax	Controls	$\Delta \log$ unemp.	Wage	Wholesale price	Service and material price	Rental on capital	σ_e	ρ	DW
Nonfood commodities, 53:03-78:04	¹ -0.037 (.021)	¹ 1.08 (.66)	0.002 (.011)	-0.002 (.066)	0.396	0.569	0.075	0.023	0.0026	0	2.30
Apparel, 53:03-78:04	.009 (.024)	1.0	-.005 (.012)	-.009 (.006)	.236	.779	.168	-.061	.0029	0	1.88
Furniture, 58:03-78:04	¹ -.026 (.017)	1.0	-.002 (.009)	-.004 (.007)	.186	.534	.188	.071	.0014	.38	1.85
Food away, from home, 53:03-78:04	² -.044 (.017)	1.0	-.0072 (.0079)	¹ -.023 (.005)	.311	.291	.158	.190	.0016	.27	2.06
Food, 53:03-78:04	[†] .027 (.053)	1.0	-.007 (-.027)	-.003 (.013)	.043	.755	.195	-.091	.0068	0	2.71
All commodities, 53:03-78:04	-.022 (.017)	² 1.37 (.54)	-.0003 (.008)	-.0004 (.004)	.263	.691	.031	-.061	.0021	0	2.21
Construction deflator, 53:04-78:03	-.025 (.036)		-.0017 (.016)	-.0004 (-.0098)	.192	.750		.001	.0022	.622	1.31

¹ The apparel equation has trends on the seasonals.
[†] Significant at 0.10 level on a 1 tail test.

¹ Significant at 0.05 level on a 1 tail test.
² Significant at 0.025 level on a 1 tail test.

TABLE 9.—IMPACT ON ETC ON PRICES

	Expenditures in 1976 (billions)	Share of retail price going to—		Coefficient on ETC under alter. specifications				
				12-mo lag			6-mo lag	
				Manuf. and farm	Payroll in retail	With Q	Without Q	Trends on seasonal	With Q	Without Q
Nonfood commodities.....	403	0.59	0.124	-0.037 .021 (.0026)	-0.039 .021 (.0026)	-0.035 .021 (.0026)	-0.022 .021 (.0027)	-0.028 .020 (.0027)
Apparel.....	76	.59	.147	-.109 .029 (.0036)	-.022 .028 (.0036)	.009 .024 (.0029)	-.018 .027 (.0036)	-.017 .027 (.0036)
Furniture and appliance and TV.....	41	.56	.148	-.026 .017 (.0014)	-.032 .017 (.0015)	-.018 .107 (.0014)	-.023 .017 (.0014)	-.029 .017 (.0015)
Food away from home.....	44	.40	.243	-.044 .017 (.0016)	-.046 .107 (.0016)	-.039 .107 (.0016)	-.034 .017 (.0017)	-.033 .017 (.0017)
Food.....	155	.68	.084	.027 .053 (.0068)	.024 .052 (.0068)	.037 .051 (.0064)	.029 .051 (.0067)	.029 .051 (.0067)
All commodities.....	597	.60	.123	-.022 .017 (.0021)	-.022 .017 (.0021)	-.018 .016 (.0021)	-.007 .016 (.0021)	-.012 .016 (.0021)
Construction deflator.....	160	.60	.314	-.036 .036 (.0022)	-.025 .036 (.0022)	-.012 .036 (.0022)	.....	-.020 .035 (.0023)
Reduction in consumer costs by March 1978 (billions at annual rate):								
Using all commodity regression.....				5.6	5.6	4.8	1.8	3.1
Using nonfood, food and restaurant models.....				5.5	6.1	4.4	4.5	3.6

Note: The sum of coefficients on wholesale price in table 6 should approximate col. 2. The sum of wage coefficients will generally exceed col. 3 because of payroll costs in wholesaling and transporta-

tion and the opportunity cost of the proprietors time. Q is an index of prices of gasoline, electricity, telephones and consumable materials and business sales.

APPENDIX A

CALCULATION OF RENTAL PRICE OF CAPITAL INDICES

The rental price of capital services for the i^{th} industry is given by :

$$R_i = P_{K_i} \left[r_p + \frac{(1 - uz - k + uz k')}{(1 - u)} (\delta_i + r - \dot{P}_{K_i}') \right]$$

P_{K_i} = Price of investment goods used by the "n"th industry.

r_p = Property tax rate on business property.

u = The Effective tax rate on business income (depends upon form of organization).

z = Present value of depreciation deductions.

k = Statutory rate of the investment tax credit.

k' = The statutory rate of the investment tax credit during the period of the long amendment when firms were required to subtract the investment tax credit from their depreciation base.

δ = Rate of replacement

r = Nominal rate of return

\dot{P}_{K_i}' = Expected rate of price appreciation of capital goods.

This formula was separately applied to the corporate and noncorporate business sector. The share of corporate business in each of our industries was estimated from the 1967 Statistics of Income by calculating the share of total business receipts of proprietorships, partnerships and corporations in the industry that went to corporations with more than \$25,000 of profits. This share is 75% in wholesaling, 66% in retailing, 47% in eating and drinking places, and 72% in trucking. The business receipt ratio for construction of 68% was adjusted down to 60% to reflect the greater importance of subcontracted work in large corporately held construction firms.

The rental price used in the equations is a composite of rental prices for structures and for equipment. Estimates of gross stocks of plant and equipment for each industry were taken from Fawcett's "Development of Capital Stock Services by Industry Sector." Updates of the time series of effective tax rates and present values of depreciation deductions for nonresidential structures published in Christensen and Jorgenson's "Measuring Economic Performance in the Private Sector" were graciously provided by Lau Christensen.

For each period 1947-54, 1954-62, 1962-71, 1971-78, separate present value of depreciation deductions were calculated for 4 types of trucks, 2 types of construction equipment, 2 types of office and business equipment and for office furniture. It was assumed that between 1954 and 1962 20% of new investment continued to be depreciated by straight line methods. Starting January 1, 1959, small businesses have been able to take an immediate write-off of 20% of the value of new investments in equipment with tax lives of 6 or more years. It was assumed that lack of knowledge and the \$4,000 cap per joint return causes only half the proprietorships and partnerships to claim this deduction and the present values of office furniture and business equipment depreciation deductions were adjusted accordingly. The timing of changes in depreciation policy was taken to be the date of announcement for the administrative liberalizations of 1962 and 1971 and the date of enactment for legislated changes. Effective rates of property taxation were taken from another Christensen and Jorgenson paper "The Measurement of Real Capital Input, 1929-1967".

The 7% investment tax credit was part of the Revenue Act of 1962 which became law October 16, 1962. The Long Amendment was repealed by the Revenue Act of 1964 which became law on February 26, 1964. As an anti-inflationary measure, the credit was suspended from October 10, 1966 to March 9, 1967 and from April 19, 1969 to August 15, 1971. The period of the Long Amendment is therefore taken to the 1962:11 through 1964:02. The periods of suspension are defined as 1966:10 through 1967:02 and 1969:05 through 1971:07. The value of the tax credit was raised to 10% by the Tax Reduction Act of 1965 which was enacted on March 20, 1975. Bischoff has recommended that the effective rate of the investment tax credit be adjusted downward to reflect the lower rate available on short lived equipment and on equipment purchased by utilities. Our assumptions are that for fixed PDE, retail and wholesale industries were eligible for 6/7 of the statutory rate of the credit. Corporations were assumed to receive a tax credit of 3/7 the statutory rate for trucks and 4/7, the statutory rate for construction

equipment. Because they face lower marginal tax rates proprietorships and small corporations will prefer the higher tax credit that reporting a 5 year lifetime for trucks and equipment over the speedier depreciation deductions that a 3 year lifetime provides. The Asset Depreciation Range System has this option and we assume they exercise it and adjust the value of depreciation deductions and the Investment tax credit ($\frac{1}{3}$ of the statutory rate) to reflect it.

We assume that real after tax rates of return (nominal after tax returns minus expected capital gains on plant and equipment) are equated across industries and constant over time. The average of the after tax real rates of return given in Christensen and Jorgenson for 1947 through 1969 are 5% for corporations and 4.8% for noncorporate business. We adopt 5% as our assumed real rate of return.

Price indexes for nonresidential structures were obtained from the Data Resources Data Bank. Wholesale Price indexes for trucks were adjusted for the federal excise tax and used as the price index for trucking equipment. The Wholesale price index for construction equipment was used in Construction. The Price index for nontransport producers durables equipment in wholesaling and retail industries is an average of wholesale price indexes adjusted for state and federal excise tax changes. Its components are office and store machines equipment (wt=.30), office furniture (wt=.35), and general purpose machinery (wt=.35). Replacement rates for retailing of .044 for plant and .157 for nontransport equipment were provided by Gollop and Jorkenson. Replacement rates for trucks and construction equipment were .32 and .2858 respectively.

In both 1963 and 1967, 41% of the retail and wholesale industry's purchases of new equipment were from the motor vehicles and equipment industry. Since the replacement rate for trucks is twice that of other PDE in the industry, this translates into 25.8% of the industry stock of equipment in motor vehicles.

APPENDIX B

THE RESULT FOR THE REAL INPUT PRICE MODEL

Early Runs, the tables for which are presented in this Appendix, used a "real input price models". It may be roughly characterized as a lag structure and length generalization of Clark and Freemans preferred model. Lag lengths of three years are specified for sales and wage rates and are freely estimated using monthly data for the first year of sales (quarterly for wages) and half yearly averages for the second and third years. Wage rates were deflated by the price of the industry's output. The ratio of wholesale prices of materials to the consumer price of output was entered as a 6 month weighted average with declining weights.

The rental costs of capital and consumable materials and business services were not entered into the model. Though typical of the literature these models require that we maintain the following hypotheses: (1) Separability of capital consumable materials and business services from labor and inventory; (2) exogeneity of the industry's wage rates, sales and output prices (tests of wage rate exogeneity were rejected for construction and some other industries); (3) expectation formation processes relate to the ratios of wage rates to output price.

Under his specification the estimates of the impact of the NJTC are generally larger than those presented in the main body of the paper. Summed across all industries studied the implied increases in employment range from a low of 536 thousand to a high of 1.28 million.

TABLE C1.—EMPLOYMENT IN DISTRIBUTION INDUSTRIES. MODEL HAS 3-YR LAGS ON SALES AND WAGES AND INPUT PRICES ARE SPECIFIED RELATIVE TO THE CONSUMER PRICE OF THAT INDUSTRY

	Real wage		Industry sales			Total retail sales 3 yr	Materials inputs	Output's relative price	r	p	DW	
	NJTC	1 yr	3 yr	3 mo	1 yr							3 yr
Eating and drinking.....	0.186	-0.182	-0.374	0.297	0.898	1.081	0.576	0.048	0.320	0.0062	0.69	1.38
	(.054)							(.078)	(.346)			
Food stores.....	.044	.396	.084	.157	.273	-.057	.803	-.190	.733	.0045	.61	1.87
	(.026)							(.094)	(.149)			
Apparel.....	.213	-.836	-1.094	-.038	-.264	+.254	1.133	.265	.122	.0138	.68	2.29
	(.076)							(.352)	(.278)			
Furniture.....	.068	-.126	-.718	.114	.200	.442	.726	-1.159	-.137	.0036	.60	1.82
	(.020)							(.086)	(.001)			
General merchandise.....	.141	-.205	-.160	.169	.252	.603	.309	-.636	.024	.0092	.67	2.17
	(.049)							(.101)	(.251)			
Other retail.....	.094	-.435	-.360	.222	.291	-.249	1.130	-.200	-.042	.0031	.75	1.32
	(.026)							(.099)	(.193)			
Wholesaling.....	.022	-.001	-.233	.170	.190	.286	.471	-.213		.0032	.82	1.46
	(.081)							(.077)				
Trucking.....	.081	-.508	-.581	.116	.076	.047	1.324	1.057		.0073	.40	2.14
	(.037)							(.076)				

Note: NJTC—The proportion of firms that know about the NJTC averaged with lags of up to 6 mo. Materials input price is the wholesale price of consumer finished goods of the appropriate type averaged over the previous 6 mo. In trucking it is the price index for trucks averaged over the previous

3 yr. Wages and materials input prices are deflated by the consumer price minus the indirect business taxes on that product. Wages include fringes, social security and employment insurance taxes.

TABLE C. 2.—THE EFFECT OF ALTERNATIVE SPECIFICATIONS ON THE ESTIMATE OF THE IMPACT OF THE NJTC AND THE REAL WAGE ON EMPLOYMENT¹

	Average hours per week, 1977	Ho: No future wages effect	Coefficient on new jobs tax credit					Sum of coefficient on wage					
			3 yr	4 yr	2 yr	18 mo	Const wage effect	Ind sales only	Pers inc incl	18 mo	Const wage effect	Ind sales only	Pers inc incl
Household data, retail and wholesale.	33.3	Ac	0.125 (.051)	0.134 (.052)		0.107 (.050)	0.121 (.049)	0.125 (.051)	0.075 (.055)	-0.70	-0.72	-0.77	-1.098
Establishment data, retail, total.	31.7	Ac	0.086 (.025)	0.081 (.026)		0.093 (.026)	0.097 (.024)	0.086 (.025)	0.075 (.028)	-0.55	-0.54	-0.56	-0.67
Eating and drinking.....	27.5	Ac	0.186 (.054)	0.166 (.065)	0.163 (.053)	0.080 (.033)	0.122 (.039)	0.149 (.051)		-0.15	-0.54	-0.10	
Food stores.....	32.3	Ac	0.044 (.026)	0.029 (.029)	0.004 (.025)	0.159 (.031)	0.118 (.023)	0.086 (.026)		+0.57	-0.48	-0.17	
Apparel.....	29.8	Rej	0.213 (.076)	0.226 (.076)	0.166 (.076)	0.198 (.076)	0.226 (.070)	0.248 (.081)		-0.62	-1.04	-0.19	
Furniture.....	35.9	Rej	0.068 (.020)	0.053 (.030)	0.045 (.019)	0.001 (.020)	0.053 (.018)	0.066 (.021)		-0.67	-0.78	-0.47	
General merchandise.....	30.5	Ac	0.141 (.049)	0.095 (.053)	0.131 (.047)	0.122 (.049)	0.119 (.048)	0.154 (.044)		-0.14	-0.22	-0.08	
Other retail.....	36.4	Rej	0.094 (.026)	0.092 (.028)	0.0902 (.027)	0.018 (.022)	0.040 (.024)	0.120 (.021)		-0.29	-0.30	-0.25	
Wholesaling.....	38.9	Ac	0.022 (.016)	-0.006 (.020)	0.025 (.016)	0.031 (.017)	0.031 (.016)	0.030 (.017)		-0.20	-0.22	-0.15	
Trucking.....	40.7	Rej	0.081 (.037)	0.080 (.047)	-0.059 (.029)	-0.103 (.025)	0.027 (.034)	-0.123 (.058)		-0.55	-0.66	-1.04	
Construction	36.9												
Establishment data.....		Rej	0.167 (.097)	0.178 (.114)		0.086 (.098)	0.265 (.124)	0.167 (.097)		-1.24	-0.86	-1.32	
Household data.....		Rej	0.049 (.139)	0.165 (.160)		0.014 (.136)	0.161 (.143)	0.049 (.139)		-1.23	-0.93	-1.36	
Increase in employment by March 1978 in construction and distribution:													
Using detailed industrial model.			971	886		536	993	920					
Using established data aggregates.			726	711		581	972	627					
Using HH data.....			962	1280		690	1102	847					

¹ In all models, input prices are specified relative to output prices.

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INTRODUCTION

In recent years, two types of wage subsidy programs for stimulating employment have been introduced by policy makers in various world economies. The first and most prevalent category consists of a growing array of selective programs that subsidize the wage payments or hiring costs of particular classes of workers, for example, younger workers, the handicapped. Aid to Families with Dependent Children (AFDC) participants, veterans, and the poor. The second category of wage credits consists of general coverage programs that provide employers with a tax credit incentive for increasing their overall use of labor services.

The selective programs seek to redress some structural imperfection in the labor market and are often directed at potential rather than actual members of the work force. For example the contract portion of the Job Opportunities in the Business Sector (JOBS) program is designed to stimulate the private sector employment of unskilled workers and low income members of the work force. The Work Incentive (WIN) tax credit is intended to encourage private sector employment of welfare recipients. The current selective credit proposal by the Carter Administration for a "Targeted Employment Tax Credit" is aimed at young persons (18-24) from low income families.

The general wage credit programs, on the other hand, are typically designed to be short-term measures for stimulating employment and alleviating involuntary unemployment. As such, their purpose is to offset various imperfections and short-term rigidities that characterize major labor markets. The general coverage wage credit programs are not developed to deal with long-term structural causes of unemployment, nor are they intended to encourage private business to substitute one category of labor for another or to substitute labor for capital.

A REVIEW OF THE NEW JOBS TAX CREDIT PROGRAM OF 1977

The general employment tax credit is a new fiscal measure for the United States economy, however, other countries have recently adopted similar programs. The Netherlands, France, the United Kingdom, Japan, Sweden, The Federal Republic of Germany, Ireland Spain and Italy have all introduced various types of temporary employment tax credit or wage subsidy programs. While several of these programs require specific eligibility requirements all seek to stimulate employment directly by reducing the cost of labor services to private business.

A general employment tax credit program was first introduced into the United States economy in 1977. The New Jobs Tax Credit, which became law as part of the Tax Reduction and Simplification Act of 1977, provided a tax credit to firms who increased their employment level from the previous year's base. Specifically, the credit reduced the income tax liability of employers whose total wage payments exceed prescribed dual base levels.

The major characteristics of the New Job Tax Credit are that: (1) it provides a relatively large per-employee credit for net increases in the wage bill—that is, it is an "incremental employment tax credit"; (2) it is a temporary program that extends only through 1978; (3) there is a ceiling on the total program that extends only through 1978; (4) the credit possesses very few restrictions regarding the employment (unemployment experience of eligible workers); (5) the form taken by the credit leads to a reduction in the cost of low-wage employees, relative to high-wage employees.

CONCEPTUAL FEATURES OF EMPLOYMENT TAX CREDIT PROGRAMS

The New Job Tax Credit and other general employment tax credit programs directly reduce the cost of labor and can conceptually be thought of as supply-side fiscal programs. This direct, supply-side approach contrasts with most traditional monetary fiscal policies which are demand-side programs designed to change employment and GNP indirectly by altering the spending levels of households, business and government.

The choice between demand and supply-management aggregate policies depends to a large extent on the following considerations: (1) the causes of short-

term unemployment; (2) the length of the lag between implementation of the policy and its effect on employment; (3) the inflationary consequences of the policy; and (4) the practical difficulty associated with implementing the policy.

Using these criteria, are there attractive features of supply-management fiscal programs such as the New Jobs Tax Credit that are not possessed by traditional demand-management, policy measures? Our research indicates that there are such features (Fethke, Policano, and Williamson; 1978). Indeed, we argue that supply-management fiscal programs, such as the New Jobs Tax Credit, potentially offer some attractive policy alternatives at the aggregate economic level. As a result, there is a place in the arsenal of fiscal programs for both selective employment credits targeted at particular types of workers, and for a general employment credit policy that addresses short-term cyclical problems of unemployment.

The primary advantage of a general employment tax credit is that it directly stimulates employment and output without placing inflationary pressure on the economy. If unemployment is precipitated by rigid wages and sluggish labor market responses to changing economic conditions, a temporary wage credit will reduce the real cost of labor and stimulate employment and output. The credit acts to reduce real costs by lowering the nominal wage rather than by raising the level of prices.

It is interesting to contrast traditional policy with the employment tax credit during a slack period in the economy following a decline in aggregate demand. Under these circumstances, traditional monetary and fiscal policies act to stimulate demand and the price level. This increase in the price level, assuming some wage rigidity, lowers the real cost of labor services and induces employers to increase employment and output. Alternatively, the employment tax credit reduces wage costs and directly increases the demand for labor, thereby, stimulating output and employment. In contrast to traditional policies, the employment tax credit can increase output and employment without precipitating a rise in prices. In fact by directly stimulating supply, the credit tends to exert deflationary pressure on the system.

It is also useful to examine the efficacy of general employment credit strategies during a downturn in business activity resulting from an aggregate supply shock to the economy. In recent years, the energy and raw materials crisis, the devaluation of the dollar, and various demographic changes have caused short-term changes in the level, or at least in the growth of aggregate supply. A decrease in aggregate supply and output results in simultaneous increases in the price level and decreases in the level of employment. Traditional demand-management policies that seek to stabilize the economy under these circumstances must do so by inducing price increases and lowering the real wage. Thus, to stabilize output, the rate of inflation must increase. In contrast, the employment tax credit directly increases employment and real output, without necessarily increasing the price level. In fact, the employment credit initiated in response to a decrease in aggregate supply can actually lower the inflation rate while simultaneously stimulating employment and output. Again, the inflationary consequences are less severe for employment tax credit policy than for traditional macroeconomic policies.

A further advantage of the employment tax credit is that by directly affecting the real cost of labor, this program can potentially circumvent some of the response lags associated with demand-side management policies. The impact of the employment tax credit may be dampened by the existence of a long recognition lag between the time the credit is implemented and the time firms become aware of the program. This type of lag generally exists for most fiscal subsidies but can be minimized by a strong commitment to publicizing the program.

Consider next the possible implementation problems associated with employment tax credit policy. Admittedly, because of the political process, the administration of any short-term fiscal program is difficult. In this regard, there may be some reason to prefer traditional monetary policy that can be implemented with a degree of autonomy. With this implementation lag in mind, some legislative proposals have suggested that the employment tax credit be automatically set to accord with an aggregate measure of excess capacity. Some have suggested a program that would progressively link the credit rate to the rate of unemployment, with the credit disappearing when the unemployment rate declines below a prescribed level. The legislation suggested by Senator Bentsen would have the eligibility base of the credit adjust to labor-market conditions. In principle, at least, such an automatic triggering of the credit overcomes some of the implementation lags that are common to fiscal policy measures.

In summary, our theoretical analysis reveals a number of desirable qualitative properties of employment tax credit policy. In particular, we examine the employment, price level, and output responses to changes in the credit base for alternative financing strategies of the government. Our analysis shows unambiguous positive responses for both employment and output to increases in the credit rate. On the other hand, the price level response cannot be qualitatively established because implementation of the credit not only increases aggregate supply but also increases aggregate demand by increasing disposable personal income. However, a significant result is that under several financing strategies, the price level need not rise and may fall in response to an increase in the employment tax credit rate.

EMPIRICAL FEATURES OF UNIVERSAL COVERAGE EMPLOYMENT TAX CREDIT PROGRAMS

The direct evidence regarding the effectiveness of the New Jobs Tax Credit program has been limited and incomplete at best. A survey was initiated by the Department of Labor and conducted by the Department of Commerce on a representative sample of eligible firms for the tax year 1977. A principle result of that survey was that firms most likely to benefit from the program were, as of February 1978, unaware of the programs existence. Specifically, smaller firms with 50 or less employees typically expressed no knowledge of the program. These results were also confirmed in a study conducted by the National Federation of Independent Business which reported that awareness of the jobs tax credits' existence was low at the end of the 1977 tax year. Since the New Jobs Tax Credit possessed a ceiling on the amount payable to any single taxpayer, it was important that smaller establishments be made aware of the program's benefits. This did not appear to be the case.

In the Department of Labor survey, the number of firms reporting a conscious effort to increase employment because of the jobs credit was a low six percent: an additional seven percent of the "knowledgable" firms indicated that they discovered the credit too late in the year to affect their employment decisions. These results, however, seem too preliminary and inconclusive to form any definite opinion regarding the effectiveness of the New Jobs Tax Credit, and they certainly do not provide sufficient evidence to reject the program.

Several attempts have been made to develop some indirect evidence on the potential impact of employment credit programs on the United States economy. Kesselman, Williamson, and Berndt (1977) analyzed the relative effectiveness of an investment tax credit versus an employment tax credit. In particular, for the period from 1962 to 1971, they simulated the impact on United States manufacturing output of replacing the investment tax credit with an employment tax credit of an equivalent cost to the government. Their main conclusions were that total employment would have been from one-half to more than one percent higher in many of the years and that use of capital services would have been from one to six percent lower during the period. They also argued that an employment tax credit would have induced firms to substitute blue-collar workers for capital and for white-collar workers. Subsequent empirical work by Berndt (forthcoming), using the same data, demonstrated that the removal of energy price ceilings and investment incentives and the adoption of a four percent employment tax credit would have decreased energy use in manufacturing by five percent and increased employment by over two percent. One problem with these studies is that they examine the effect of a permanent employment tax credit without considering the full supply response of the system. Specifically, by assuming that the elasticity of supply of labor services is infinite, they ignore the question of shifting of the credit through increases in wages.

Hamermesh (1977) constructed estimates of the probable effects on the United States economy in 1975 had an employment tax credit been implemented in mid-1974. One of the main results of his analysis was that the implementation of a subsidy limited to net job creation above a base level equal to 100 percent of 1974 employment would have produced relatively few jobs in 1975. Because the economy was in the middle of a severe recession, few firms would have qualified for a credit on net job creation above the 1974 level of employment. As a result, Hamermesh advocated implementing a subsidy at employment of 85 or 90 percent of the base year employment. In these cases, his computations indicated that an employment tax credit would have created a substantial number of jobs even if aggregate employment were decreasing. Hamermesh also examined the demographic composition of the employment induced by a percentage marginal employment tax credit program. His results suggested that in a recess-

sion the program would be biased slightly toward the hiring of prime-age workers and slightly against hiring younger, particularly black workers.

Hamermesh's results can be compared to those obtained by Johnson and Tomola (1977) with regard to the composition of public service employment under the Public Employment Program (PEP) and the Comprehensive Employment and Training Act (CETA) of 1973. Johnson and Tomola found a significantly larger percentage of youths aged 16-24 and nonwhites employed for PEP and CETA than Hamermesh found for the employment tax credit. These results suggest that the PEP and CETA programs which offer a dollar subsidy per worker rather than a percentage subsidy of the total wage bill would be preferable if the goal is to employ the younger, nonwhite worker. Specifically, a dollar amount subsidy provides a greater percentage subsidy for hiring low-wage workers.

Johnson and Tomola also formed estimates of the cost per job for several alternative job creating programs. For an increase in direct government expenditures their estimates indicate a cost per job equal to \$18,600 after four quarters. A cut in taxes will yield a cost per job of \$21,000 after four quarters. Finally, their estimates reveal a cost per job of \$14,500 for public service employment. These estimates can be compared with those developed for a wage bill tax credit levied on the United States economy.

In the context of a complete aggregate model of the United States economy, we've computed the cost per job of a ten percent wage bill credit with a 95 percent base (Fethke, Policano, and Williamson, 1978). The computation is conducted using 1976 as the base year for several alternative strategies of financing the employment credit. Based on these estimates, it can be concluded that the employment tax credit is a modest cost fiscal-method for stimulating employment and GNP. For example, if the employment credit is deficit financed, the program is estimated to cost \$3.03 billion and provide 774,000 jobs after four quarters. The resultant cost per job is \$3915. If the employment credit is accompanied by an equivalent reduction in government expenditure, the cost per job equals the change in government expenditure plus the change in the deficit (\$5.29 billion) divided by the number of additional jobs (644,000). The computation yields a cost per job of \$8215.

**THE CARTER ADMINISTRATION'S CURRENT EMPLOYMENT CREDIT PROPOSAL:
"TARGETED EMPLOYMENT TAX CREDIT"**

The Administration is now proposing to replace the New Jobs Tax Credit with a selective tax credit program that possesses fairly narrow eligibility requirements. Specifically, the proposed Targeted Employment Tax Credit seeks to reduce sharply the two-year wage cost of younger members of the work force from low income families. The amount of the credit is proposed as one-third of the employee's wages subject to Federal unemployment taxes (\$6,000), up to a maximum credit of \$2,000 for the first year and in the second year, a credit of one-fourth of those wages up to a credit of \$1,500.

There seem to be two major reasons for suggesting a selective credit program replacement for the New Jobs Tax Credit. First, young, unskilled employees experience sharply higher unemployment rates than do other members of the work force. Second, there is an unsubstantiated impression that the New Jobs Tax Credit provides excessive windfalls to private business without providing additional employment. The purpose of the proposed selective credit is to alter the mix of employment in the economy towards workers who experience high rates of unemployment. Presumably, the lower cost of unskilled labor will also encourage employers to spend more money on training younger workers.

The effect of a selective employment tax credit program on the employment of unskilled workers depends on the reasons for their higher rates of unemployment, and there is considerable disagreement on this issue. One argument is that the high unemployment rate is the result of rapid job turnover among low-wage, unskilled workers. The high turnover is, in turn, the consequence of undesirable jobs, poor working conditions, and the ready availability of various government transfer programs, including welfare, food stamps, and unemployment insurance. If high turnover is the problem, it is not altogether obvious that a selective credit program that reduces employer's cost and increases demand for unskilled workers will have an immediate effect on the high unemployment rates. In this case, training programs that enhance the skill levels of workers seem more appropriate.

A second reason often given for the existence of high unemployment among unskilled, low-wage workers is the presence of various legal and social restrictions that combine to fix the relative wage of these members of the work force. A rigid relative wage prohibits the unskilled labor markets from clearing and absorbing all workers who seek employment. In this regard, recently legislated increases in the minimum wage and sharp increases in payroll taxes contribute to the explanation of the unacceptably high rates of unemployment of low-wage workers.

If high unemployment rates of unskilled workers are caused by legal and social impediments to wage flexibility, then a targeted employment tax credit program will act to reduce the cost of low-wage workers and will stimulate their employment. The program will have an effect similar to that of reducing the minimum wage or to reducing the employer payroll tax liability. The immediate (short-term) cost to society of such a program will be quite insignificant since employment and output will increase without an accompanying increase in inflationary pressure.

The longer-term consequences of the program are less obvious than are the short run responses, and possibly are not as socially desirable. A reduction in the cost of low-wage employees may encourage employers to substitute a number of low-wage (low productivity) workers for presumably a smaller number of labor services, overall unemployment will decline. The decline in unemployment rate is measured in the number of persons rather than the effective amount of labor services, overall unemployment will decline. The decline in unemployment will represent a policy-induced change in the employment mix of skilled to unskilled workers. It will not necessarily coincide with an increase in overall employment and real GNP.

The selective credit will also lead to a redistribution of income from high to low-wage employees. Income redistribution results from both the relative increase in employment of low-wage workers brought on by the credit and the relative increase in the wages of low-wage to high-wage workers. Conceivably, the improvement in the relative income position of low-wage workers will reduce the high job turnover of this group and further reduce the aggregate unemployment rate.

A permanent credit may initiate changes in the skill mix of the economy and lead to an eventual reduction in real GNP. Specifically, if the selective credit acts to redistribute income towards low-wage, unskilled workers, the incentive to enter high skill categories will be reduced. In other words, while the short-term effect of a targeted employment tax credit may be low cost increase in employment and output, the longer term implications are a reduction in output and productivity of the work force. In this regard, job retaining programs that seek to increase the supply of skilled workers appear to have a long-term advantage over wage subsidy programs that increase the demand for unskilled workers.

In summary, if the high unemployment rate of young, unskilled members of the work force is caused by legal and social impediments to wage flexibility, a selective wage credit program will lead to an increase in demand for unskilled labor and a short-term increase in GNP. Unskilled workers exert very little bargaining power, and the resulting increase in output will not be accompanied by an immediate increase in the inflation rate. Since an increase in the wage of unskilled workers relative to that of skilled workers can lead to an eventual reduction in real output, the longer term implications of a permanent wage credit are less desirable.

WHERE TO GO FROM HERE?

There are some good reasons for adopting a short-term wage credit program directed at younger, unskilled members of the work force. We feel, however, that there are also good reasons for maintaining the New Jobs Tax Credit, possibly with some minor adjustments in the eligibility requirements.

As currently structured, the New Jobs Tax Credit program offers a powerful incentive to employers for hiring low-wage workers. For example, the pre-tax cost to an employer of adding an \$8,000 employee is reduced by 26 percent per year, while that of a \$20,000 employee is reduced by 10.5 percent. Further, the wages of part-time employees are reduced relative to those of full-time workers. This means that the New Jobs Tax Credit should stimulate the employment of low-wage workers whose ranks include a high proportion of younger workers, minorities, and women. Because of this, the existing employment credit program already contains one of the primary features of the proposed Targeted Employment Tax Credit.

An apparent reason for moving to a selective credit with narrow eligibility requirements is that the New Jobs Tax Credit provides unacceptably large windfalls to growing firms. Specifically, critics of the program argue that many employers receive a tax credit for wage bill increments that take place as a consequence of natural growth in employment. While the windfall aspects of the existing program are over emphasized, it appears that minor adjustments in the wage bill base will eliminate most of the problem.

As previously mentioned, small business is just now becoming aware of the program's existence and benefits. The New Jobs Tax Credit, because of the \$100,000 ceiling per taxpayer, is aimed primarily at the small business community. As previously mentioned, small business is just now becoming aware of the potential benefits provided by the credit, and we anticipate a lively response to the program in 1978. If the current legislation is replaced by the more restrictive Targeted Employment Credit, much of that awareness will be lost. In this regard, it makes little sense to discard an incentive scheme that possesses many of the desirable features of a targeted credit and, by so doing, induce confusion and uncertainty into the business community.

In concluding, we continue to feel that a general employment tax credit is a useful addition to the arsenal of monetary and fiscal policies. The New Jobs Tax Credit favors unskilled employees and small businesses. If these groups are judged as deserving by policy makers, there appears to be no compelling reasons for discarding the existing program in favor of the proposed Targeted Employment Tax Credit.

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Senator HASKELL. Now we have a panel consisting of Mr. William T. Diss, American Institute of Certified Public Accountants and Mr. Alford F. Yaude, National Society of Public Accountants.

It is nice to have both of you here, particularly since I have known Mr. Diss for about twenty years.

STATEMENT OF WILLIAM T. DISS, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Mr. DISS. Thank you, Mr. Chairman.

My testimony relates to the technical difficulties that have been encountered and experienced through the new jobs credit and some recommendations for their solution. The first set of problems arises from the disallowance of the compensation that is paid for wages and salaries paid equal to the amount of the credit. This has the effect of producing an ingressive incentive—that is, the higher-bracket employer has a smaller incentive to employ than the low-bracket employer.

It creates problems in the area of capitalized labor costs for inventory and in the other depreciable assets.

In the case of subchapter S corporations, the disallowance of wages creates undistributed taxable income that is greater than the surplus that can be legally declared as a dividend under the State corporation codes and prevents a subchapter S company from current distribution of earnings to avoid the lock-in problem.

There is an artificial increase in self-employment income and self-employment tax in the event the partner or proprietor employer has not reached the FICA wage ceiling, and as previously mentioned, there are some severe problems with the State income tax effect for those States that tie into the Internal Revenue Code for definitional purposes.

Some additional problems are mentioned in my complete testimony for this particular area.

The second technical difficulty area relates to the taxpayer who is reporting income from a subchapter S corporation, partnership or fiduciary and I think these are of particular significance, since many small businesses are conducted in the format of subchapter S corporations or a partnership. And, for some reason, a limitation was proposed here, not present for the investment credit, based upon taxable income of the partnership of subchapter S company reported by the partner or shareholder.

There is no similar limitation preventing the passthrough of the credit in the case of divisions of large corporations or proprietorships carried on by a wealthy individual, so you have an unfortunate discrimination on the form of business organizations.

The third problem relates to the carryback and carryover of unused credits. If the partnership is not in existence in the preceding year, or the subchapter S company, say in a later year because of a business failure, the unused credit cannot be used and is wasted, even though the salary deduction has already been lost under the set-off rule.

In the case of an individual employer or reporting shareholder or partner, there is further difficulty in the requirement of the regulations that itemized deductions, not attributable to any specific activity, be subtracted from the taxable income reported from the sub-S company or partnership. This further aggravates the problem on the passthrough of the credit.

We believe there are some difficulties in use of the credit mechanism compared to the deduction mechanism, and these are covered in my paper.

Finally, just for general problem areas—section 51(b) was intended to prevent replacement of high-paid with low-paid employees. In practice, this limitation really impacts upon the new business, or rapidly expanding business, and reduces the credit that would otherwise be available, and I refer to the limitation of 50 percent of wages for the year, this current year.

The restriction under section 52(c) regarding the acquisition of the business eliminates any incentive for the employer to purchase a failing business and preserve existing jobs because he cannot count that into his increased employment.

Now for our recommendations. We feel that the Congress might consider precedents in previous legislation. One of them is that the

investment credit, for example, flows through without regard to whether the subchapter S company or the partnership, for that matter, has an income or a loss.

Second, if there is to be a basis penalty it should not be imposed until there is a tax benefit and utilization of the credit, and this is found in the minimum tax rules as well as other areas mentioned in my paper.

In sum, we first recommend that the credit be made elective. If all the complications are left in the law that produce an actual tax detriment, say for a loss partnership or a subchapter S company, the employer should be allowed to elect out from the credit.

Moving beyond that, which we view as a minimum desired and needed modification, we agree that consideration could be given to a reduction disallowance. Repeal of this set-off disallowance solves the State income tax problems. It solves the accounting problems for self-constructed assets and the manufacturers' inventory.

If the credit is not made elective, and if the reduction disallowance is continued, then the salary penalty or disallowance should be deferred until the credit has actually been utilized in that carryback or carryover.

I do have a misprint in my No. 4 recommendation, and that is it should be 53(b), rather than 52(b) and I refer to the limitation on subchapter S companies and partnerships. This discriminates in 52(b) and it is my recommendation that it should be repealed, and I refer to the limitation that you must have income from the business before you can take the credit.

The legislative history of the credit indicates that there are two prime purposes, one for ease of administration and the second for understandability by employers. It is possible that you should consider a straightforward, refundable credit. This avoids the carrybacks and carryovers and could be explained to the business community.

If the disallowance is left in the law, perhaps the Congress should do something about the State income tax problems and there is a precedent for this in the legislation on the 1974 rebate.

Finally, if section 53(b) is left in the law, the limitation on subchapter S companies and partnerships, and if the salary penalty is left in the law, then we do recommend following the precedent of the investment credit again, that if the credit is used during that period then a salary expense deduction should be allowed in that final year. I referred to the principle that was applied to the investment credit when the credit reduced the depreciable basis of the property. The basis was restored if the credit expired without tax benefit. This basis reduction provision was later repealed and therefore is only of historic interest.

I have appended to my testimony an example of a small business where everything went wrong, based on these limitations in the new credit, and perhaps that will be helpful in dramatizing the problems.

Senator HASKELL. Well, thank you, Mr. Diss. I am going to ask staff to look over your paper very carefully because some of the points you raise are very serious problems and hinder the use of the credit.

I know, as the author of the credit, that it was intended to be elective and was intended to provide maximum benefit possible. So I will ask the committee staff and my staff to review your testimony

very carefully and see if we cannot incorporate some of these suggestions.

Thank you very much, and now I would like to hear from you, Mr. Yaude.

STATEMENT OF ALFORD F. YAUDE, NATIONAL SOCIETY OF PUBLIC ACCOUNTANTS

Mr. YAUDE. Good morning, sir. Since you have not known me as long, may I introduce myself? I am an independent accountant in public practice in the State of North Carolina. I am presently vice chairman of the National Society of Public Accountants Federal Taxation Committee. I am also a past president of the North Carolina Society of Accountants and have been enrolled to practice before the Internal Revenue Service since 1960.

In the interest of time, I would request that our written statement be submitted for the record and I will just comment briefly on the highlights of my statement.

The observations that I have, as you might expect, are somewhat unscientific, given the short term that the law has existed. However, most of these observations come from employers who are our clients, and the observations of other accountants.

As to the publicity of the law, I can only say that if we could get as many appropriate agencies of Government as possible involved in publicizing things as soon as possible, it would be helpful. I know you agree with this concept.

First, I want to talk about the effects of the jobs tax credit on hiring practices that we have been able to observe. We find that established and economically sound companies have not, in our experience, changed their hiring practices merely to get the credit. These established—and I am talking about small business primarily here—companies that are sound economically still observe sound management practices in hiring and the credit to them is not that great an inducement. "If we need the man, we hire him. If we happen to get a credit, that is nice." This seems to be their attitude.

Then there is another class of companies who are less sophisticated, less economically sound, and these people simply cannot afford to hire any more people because their business is not yet that strong. And this is probably one of the reasons we might not get the desired results from the credit—the ideal that you intended when this legislation was passed.

So I guess what I am saying is, the tax credit will not necessarily change the behavior and hiring practices of small economically sound businesses.

I might say this, that in some areas of the country, the skills needed by the employers are not available. In my own area, we have an unemployment rate of something like 2.7 percent. The skills simply cannot be found and obviously the employer is not going to waste money on skills he does not need.

I talked to some accountants and we pointed out that this could help certain industries that had high turnovers such as the hotel, restaurant and the construction industries. It could help larger, well-funded businesses by allowing them to hire additional persons to eliminate the need for overtime work.

As to the other provisions of the credit, I would have to agree with Mr. Diss that the subtraction from wages of the credit, seems to have a counterproductive effect, in my judgment. It seems that if we are going to give the employer the credit, to induce him into a certain economic behavior, certainly give it to him clean and clear, and if there are limitations, perhaps it should be amended.

There is also the possibility we could use some change of measurement, like the rate change in the credit, or something of this type.

I have looked at the proposed regulations under section 52 having to do with the subchapter S, the partnerships and so forth, and it seems to me that while these regulations appear to be fully in accordance with the law that Congress passed and in my judgment fairly interprets that law, the provision is unduly complex in the way the measurements are figured. I wonder if it could not be simplified at the pro rata credit assigned to each member of the entity, subchapter S or partnership, by simply doing some other things that we do in the Code—for example if there are three partners, give each one a third, and if he has been in a fraction of the year, pro rate it by the number of days, and hopefully we can solve that problem in that manner.

There was some comment about the targeted credit this morning and it seems to me—and my colleagues agree with this to some extent—that a full series of credits seems to unduly complicate the tax law, because, as you go along the line, you have certain credits that you take into consideration in determining the definition of taxable income for making other measurements. And I am wondering if, perhaps, we could not somehow go back to the drawing board, as it were, and get a restructuring, that is to combine the jobs credit and the targeting credit in some manner. I do not know how we would propose to do this; I have not studied this very thoroughly; but I would just suggest this as a possibility for simplifying the tax law, knowing full well that we do have to balance complexity with the effectiveness of the law and, of course, our revenue situation.

In fact, I am not too sure if, in this complexity area, perhaps sometimes we ought to have a kind of taxpayer impact study before we pass the law to see what this will do to them.

Mr. Chairman, I believe this substantially concludes my remarks. I would be glad to answer any questions you might have, if I can.

Senator HASSELL. Thank you, gentlemen. I do not have any questions. We will examine your testimony with diligent care, because we want to make this jobs tax credit—assuming that we can extend it—as workable and as helpful as possible. I want to thank both of you for appearing here; even though I have not known you for 20 years, I am very glad to see you, too.

Mr. YAUDE. Thank you, sir. I appreciate it.

[The prepared statements of the preceding panel follow:]

STATEMENT OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS,
FEDERAL TAX DIVISION, BY WILLIAM T. DISS

SUMMARY OF PROBLEMS AND RECOMMENDATIONS

The legislative history of the new jobs tax credit portrays an awareness by Congress that a very complicated provision was being added to the Internal Revenue Code for taxable years of affected employers beginning in 1977 or 1978. Experience in application of the provision by taxpayers and practitioners

confirms the complications originally foreseen as well as numerous additional complexities and unintended tax disadvantages to employers, as well as discrimination in the form of business organization used by the employer.

In addition, the combined effect of the disallowance of the taxable income deduction for employee compensation and the credit mechanism distorts the employment incentive so as to make it less attractive to the classes of employer who would otherwise be more apt to hire additional employees. Finally, the interplay of the deduction disallowance and the credit has created significant state income tax reporting problems and disadvantages for employers.

Legislative action should, at a minimum, be taken retroactively to amend the new jobs tax credit to make such credit elective by the affected employer. Serious consideration should also be given to a retroactive amendment which would reduce the amount of the credit and repeal the compensation deduction disallowance. If the deduction disallowance is not repealed, consideration should be given to a Congressional enactment which would prevent state income taxation of the compensation deduction disallowance amount.

If the new jobs credit is continued into 1978, whether broad based or targeted, consideration should be given to a simple, straightforward, refundable credit.

DETAILS OF PROBLEMS AND RECOMMENDATIONS

Problems resulting from disallowance of compensation expense deduction

1. The hiring incentive to a prospective employer is made ingressive; that is, only a \$630 benefit, net of the disallowance effect, is enjoyed by a 70 percent bracket employer, compared to the \$1,806 benefit for a 14 percent bracket employer.

2. Combination of the deduction disallowance with the credit limitation, based on taxable income, of a taxpayer in a Subchapter S corporation-partnership-fiduciary entity reduces the loss otherwise deductible from such entity. Such losses are frequently incurred in a new or financially troubled business, and inability of the taxpayer to deduct his full share of the loss may endanger continuation of the business.

3. An artificial taxable income is created for employer/taxpayers in states whose local income tax is defined by reference to Federal taxable income. Thus, an employer/taxpayer entitled to the maximum \$100,000 credit may pay, for example, an additional \$8,000 in state income tax. This disadvantage is aggravated in those states where a taxpayer is entitled to deduct his Federal income tax in determining state taxable income, because the credit reduces his Federal tax.

4. Many small business concerns maintain their general ledger so as to agree with earnings shown on payroll records, and in addition prepare financial statements on a "tax basis". These concerns are now required to reconcile payroll records to the ledger, and financial statements to the tax returns, for the disallowed wage and salary deduction.

5. A manufacturing concern encounters a considerable complication in computation of direct and indirect labor costs included in produced inventory. No guidance is provided in the proposed regulations for allocation of the disallowed compensation expenditures.

6. A similar problem arises for an employer holding self-constructed assets, with capitalized labor costs. It should be noted that reduction of the depreciable cost for such property from the disallowance also reduces the basis of eligible property for the investment credit computation.

7. In the case of a profitable Subchapter S corporation, the undistributed taxable income is increased by the disallowed compensation, and the resulting total UTI is larger than the earned surplus available under state law for payment of legal dividends. This prevents the electing corporation from following the common practice of distributing all earnings currently in order to avoid "lock in" problems.

8. In the case of a partner or proprietor employer, the self-employment income and self-employment tax will be artificially enlarged from the disallowed salary expense.

9. An uncertainty is created as to the application of the limitation under section 404(a)(7) of the Internal Revenue Code regarding deductible employee retirement plan contributions, based upon total compensation of participants.

10. The employer/taxpayer disadvantages from the deduction disallowance are immediately imposed, and not deferred until an unused new jobs credit is finally utilized. This inequity is completely opposite to the precedents afforded

in section 56(b), where a current operating loss has deferred the benefit from a tax preference item, and Proposed Regulation section 1.57-4, relating to non-applicability of certain tax preference items where no regular tax benefit is present.

11. The computation of earnings and profits for a corporate employer is uncertain, but administrative clarification would be helpful regarding deductibility of the disallowed compensation expense for this computation.

12. The employer or taxpayer reporting income from a Subchapter S company-partnership-fiduciary cannot avoid the complications by relinquishing the new jobs credit; that is, the credit is not elective.

Problems resulting from the taxable income limitation for a subchapter S company, partnership, or fiduciary

1. The limitation based on taxable income from the entity, in the case of a Subchapter S shareholder, partner, or beneficiary of an estate or trust, hereinafter termed "reporting taxpayer", does not apply to a proprietor, or a corporation engaged in diverse activities. This limitation discriminates, based upon the form of organization, and particularly against the partnership and Subchapter S company formats typically used by a small business concern.

2. As stated above, no smaller limitation applies to divisions of a large corporation, proprietorship business activities carried on by a wealthy individual.

3. The unused credits arising from the limitation must be carried back or carried over to years where taxable income from the same entity is reported. If the entity is terminated or sold, the balance of unused credits is wasted. In the event such termination is the result of a business failure, the typical outcome is disallowance of the salary and wage expense to the investing taxpayer, coupled with denial of the credit.

4. Allocation of itemized deductions which are not attributable to any specific activity may limit the new jobs credit for an individual with large charitable contributions or other itemized deductions. Such allocation of nonattributable deductions does not appear to be required by section 53(b), but the Proposed Regulation section 1.53-1(d) is supported by footnote 13 on page 75 of Senate Report No. 95-66 (3-28-77).

5. Use of the credit from a fiscal year entity is deferred until the taxpayer's calendar year return within which the fiscal year falls.

6. The policy for limitation of the credit to the reporting taxpayer is completely opposite to the precedents of the investment credit and the WIN credit, both of which pass through irrespective of taxable income reported from the entity by the taxpayer.

Problems resulting from use of the credit mechanism

1. The ordering rules for utilization of credits become more complex as Congress adds additional credits to the system. This creates multiple layer computations for carryback and carryover of the various unused credits.

2. States which define taxable income by reference to the Internal Revenue Code face pressure to enact counterpart credits, which complicate their previously simple "piggyback" state income tax returns. Historically, credits have been altered frequently by Congress, creating instability in the statute, and further complications in carrybacks and carryovers.

3. For example, if a net operating loss is sustained for 1977 or 1978, the net operating loss carryback is reduced by the compensation expense disallowance under section 280C, yet all other credits, including the investment credit, take priority in carryback of unused credits, since section 53(a) establishes last priority to the new jobs credit.

4. A supplemental or accelerated deduction would be simpler to administer and provide corollary state income tax benefits for the employer or reporting taxpayer (in Federal conformity states).

Other problems and concerns

1. The limitation under section 51(b) was intended by Congress to prevent replacement of high-paid with low-paid employees. In practice, this limitation impacts on a new or rapidly expanding business. The policy of the credit should be to encourage such businesses, since they have more potential for increasing employment.

2. The section 53(c) limitation restrains the adoption or change in form of business organization. Thus, incorporation of a partnership will force wastage of any unused new jobs credit carryovers. The same result occurs where a Sub-

chapter S corporation terminates its election and reports as a "straight corporation."

3. The compensation deduction disallowance under section 280C is not coordinated with a reduction in basis under section 1378 for the stock investment by a Subchapter S shareholder, whereas a basis reduction is required for the partnership interest of a partner by section 105(a) (2) (B).

4. The expressed Congressional intents in enacting the new jobs credit are substantially defeated, viz., benefits concentrated on small business—by the section 83(b) limitations on a reporting Subchapter S shareholder, partner, or beneficiary, and ease of administration—by the section 280C disallowance complications.

5. The restriction imposed by section 52(c) eliminates any incentive for an employer to purchase a failing business and save existing jobs, because the resulting increase in employment cannot be "counted" by the purchasing employer.

6. Apparently, both the new jobs credit under section 44B and the WIN credit under section 50A can be claimed on the same wages. The legislative intent appears unclear in this respect.

7. Placement of the credit in the Internal Revenue Code is somewhat clumsy, and involves both Subparts A and D under Subchapter A, and four sections, viz., 44B, 51, 52, and 53; only one section, section 44, was required for the purchase of a new principal residence.

8. The credit scheme, although commendable in intent, further aggravates complication of the Internal Revenue Code.

Recommendations

1. Make the new jobs credit elective. This is regarded as a "must" recommendation, in order to avoid the actual tax disadvantages to investors in a new, or unprofitable, business.

2. Reduce the credit amount, and repeal the compensation deduction disallowance. The proverbial claim of credit by a dentist who has placed his mistress on the clinic payroll can be policed by enforcing section 162(a) (1).

3. If the credit is not made elective, and the deduction disallowance is continued, then such disallowance should be deferred until utilization of unused credits by carryback and carryover.

4. The section 53(b) limitation on Subchapter S companies, partnerships, and fiduciaries should be repealed, or extended to all employers. The former course is preferable.

5. Serious consideration should be given credit which would achieve the policy objectives (concentration on small business, and ease of administration) by replacing this incentive with a straightforward refundable credit, using a rate of perhaps 20 percent or 25 percent, on the total increase in FUTA wages up to a determined total base amount.

6. In the event section 280C is not repealed, consideration should be given to a Congressional enactment which would encourage those states which tie into the Internal Revenue Code to enact a modification of Federal taxable income to deduct the Federally disallowed compensation deduction. Precedent may be found in Public Law 94-12, section 102 (3-29-75), which prevented the states from treating the 1974 Federal income tax rebate, under repealed section 6428, as income for Federally funded welfare programs.

7. Consideration should be given to amalgamation of the WIN credit with the new jobs credit, or perhaps application of the WIN credit only to household, or other nonbusiness, employment.

8. If section 53(b) and section 280C are not repealed, then provision should be made for subsequent allowance of the disallowed compensation deduction, in the year that an unused credit expires without tax benefit.

ILLUSTRATION OF NEW JOBS TAX CREDIT PROBLEMS ENCOUNTERED BY SMALL BUSINESSES

Adams, Baker and Clark ("A, B and C") organized Business Dispatch, Inc. ("BDI") on April 1, 1978 to publish a weekly business and legal newspaper. BDI filed an election, and A, B and C as equal stockholders filed consents, to report under Subchapter S.

A, B and C forecasted operating losses for BDI of \$5,000 a month for two years, followed by profitable operations commencing in April, 1980. Fourteen persons were employed, for a total of \$17,000 monthly payroll. A, B and C were successful professional persons and expected a 50% Federal income tax benefit from the

BDI Subchapter S loss, using the maximum tax computation for personal service income from their practices.

A, B and C consulted their tax advisor and explained that an after-tax cash budget had been developed by them, based on information gleaned from popular newspaper accounts of new jobs tax credit benefits. Specifically, A, B and C expected a credit of \$29,400 for 1978 based on \$2,100 for each of the fourteen new employees. In addition, income tax savings from offset of the Subchapter S losses from their professional earnings were expected for nine months in 1978, all of 1979, and three months in 1980, for a \$60,000 total based on \$120,000 total operating losses. Accordingly, a budget of approximately \$30,000 had been arranged.

The advisor then disappointed A, B and C by describing the compensation expense disallowance of approximately \$30,000, and A, B and C arranged to increase their total budget arrangements to \$45,000. Operations are proceeding as forecasted.

The tax advisor now is presenting the results predicted for A, B and C's 1978 individual income tax returns. The deductible Subchapter S loss will be \$15,600, not the \$45,000 loss (ignoring depreciation) based on net cash operating expense. The difference represents the expected \$29,400 new jobs credit. The advisor explains that "it could be worse," had the newspaper commenced operations October 1, 1978. In that event, the \$51,000 in salaries for the three months would have produced only a \$25,500 credit, based upon the § 51(b) limitation.

The advisor also explains that the income tax system for their state follows the Internal Revenue Code and that their combined individual state incomes thus will be \$29,400 larger for 1978. Use of the marginal 8% rate will produce additional \$2,368 state income tax from the compensation deduction disallowance.

The advisor stressed two "silver linings," first that no self-employment tax results since a Subchapter S company rather than a partnership is involved, and second that since no Federal credit will be usable for 1978, there will not be the further (or second) \$2,368 increase in state tax from the lower Federal income tax deduction.

The follow-on "bad news" is that the unused credit for 1978 cannot be carried back, since BDI was not in existence during the three preceding years. At 1978 year-end, A, B and C will show a cash outlay of \$45,000 and expect 1978 income tax savings of approximately \$9,000 on the allowable \$15,600 Subchapter S loss, for a net \$36,000 cash outlay. Their original expectation had been a cash surplus of \$10,500 based upon a \$29,400 credit and \$26,100 in reduced 1978 Federal and state income taxes, based on a \$45,000 Subchapter S loss.

Taking the revised \$45,000 cash budget and the \$36,000 net outlay, \$9,000 remains for 1979 operations. This will provide pre-tax funds of approximately \$20,000, permitting operation of BDI only to April. Unless A, B and C increase their budget, the newspaper operation will be terminated and the recently employed persons discharged.

No credit will be available as a carryover in 1979, because of the further operating loss to April, and no carry-over will be available to 1980 or later years, because BDI has been "dispatched." If the credit had been usable, the resulting cash flow would have permitted BDI to continue operations until the point of profitability, preserving jobs for fourteen people.

STATEMENT OF THE NATIONAL SOCIETY OF PUBLIC ACCOUNTANTS

My name is Alfred F. Yaude. I am an independent accountant in public practice in the state of North Carolina. I am presently vice-chairman of the National Society of Public Accountants' Federal Taxation Committee and a member of its Board of Governors. Also, I am past president of the North Carolina Society of Accountants and have been enrolled to practice before the Internal Revenue Service since 1960.

I am pleased to be here on behalf of all of the members of the National Society of Public Accountants, to offer testimony regarding our evaluation of the effectiveness of the jobs tax credit based upon our professional experiences. Gentleman, even, though we have become aware, during the past year and a half, that the credit has not been extremely instrumental in creating jobs and reducing unemployment, we feel it definitely has the potential to become economically beneficial to the business community. It is therefore the opinion of the National Society

that the United States Congress should reenact a modified version of the jobs tax credit upon its expiration at the end of 1978.

We find it necessary to take this position after analyzing the apparent reasons for the credit's seeming lack of success in 1977. It was our experience that many clients with whom we had no contact prior to tax filing season, simply were not aware of the existence of the jobs tax credit; therefore, their hiring policies in 1977 were in no way influenced by the credit. Few of those who were aware of it, received their information directly from the Internal Revenue Service. Consequently, as in the past, we urge that Congress make a greater effort to enact tax legislation in time for IRS and its employees to digest and disseminate its provisions to the taxpaying public and that the IRS place even greater emphasis upon the importance of this service.

However, since many businessmen and women only became aware of the jobs tax credit when their 1977 income tax returns were prepared, NSPA is hopeful that many taxpayers will take advantage of its benefits in 1978. Conversely, we feel that some modifications and simplifications must be made before the jobs tax credit will have substantial economic impact upon the small business community.

For instance IRS Code Section 280C requires that the taxpayer's income tax deduction for salaries and wages be reduced by the amount of the allowable jobs tax credit including that credit carried back or forward to another tax year. Additionally, the "conformity" statutes in some states resulted in taxpayers paying higher state income tax because there was not time to amend state statutes to grant tax relief from the limitations inequitably imposed upon deductions from income for state tax purposes. The National Society of Public Accountants feels that no reduction in the salaries and wages expense should be required.

This reduction as well as other limitations and special rules unnecessarily complicate the law and merely erode away the benefits to the taxpayer and the stimulation to the economy. Many small businessmen and women feel the complications and limitations far outweigh the incentives of the jobs tax credit and therefore hesitate to take advantage of any benefits to be derived.

The National Society of Public Accountants would like to assist the Senate Small Business and Finance Committees in this or other related matters as much as possible. Therefore, at this time I will be happy to answer any questions you may have about my own, my clients and my colleagues' experiences with the jobs tax credit.

Senator HASKELL. Our last witness is Mr. Joseph J. Cuneo who is president of the Energy Transportation Corporation.

STATEMENT OF JOSEPH J. CUNEO, PRESIDENT, ENERGY TRANSPORTATION CORP.

Mr. CUNEO. Good morning, Mr. Chairman. I am president of the Energy Transportation Corp., and with me today is George M. Foote, Jr., who is an attorney of the firm of Cadwalader, Wickersham & Taft.

Senator HASKELL. For brevity's sake, if you could put your statement in the record and just tell me what your comments are.

Mr. CUNEO. I will do that, and keep the remarks very brief.

As we all know, the jobs tax credit was enacted to stimulate U.S. employment. However, the companies in the U.S. merchant marine engaged in international trade, may have been excluded unintentionally from eligibility for the credit.

Section 51(g)(1) of the Internal Revenue Code provides that for wages to be taken into account for the credit, more than one-half of the wages must be earned for services performed within the United States. Thus, wages paid to American crewmembers on vessels in international trade will rarely, if ever, be taken into account because the ships are normally either in foreign ports or in the international waters of the world.

Although the congressional policy to focus the credit on U.S. employment is both clear and sound, an apparent oversight in the law

denies the incentive to an industry that, at least in our view, is as much a part of the U.S. economy as the corner grocery store.

By law, only U.S. citizens may be officers on American-flag vessels, and at least 75 percent of the crewmembers must be U.S. citizens. In actual practice, most U.S. shipping companies have 100 percent U.S. citizens onboard their vessels, and these are citizens who reside in the United States.

The employers of these officers and crewmen withhold Federal and State income taxes along with social security taxes. They make social security contributions and pay the unemployment insurance taxes on which the jobs tax credit is based.

Almost all of the wages paid to the employees on American-flag vessels are either deposited in U.S. banks or sent to the families of the crewmembers in the United States. The transportation of crewmembers back and forth to the vessel is generally by U.S. airlines, and most of the food and supplies for their support onboard the vessels come from the United States.

These officers and crewmen are generally represented by the U.S. maritime unions.

It is congressional policy to strengthen the U.S. merchant marine fleet. Partly because of wage costs, the number of employees in the U.S. merchant marine has dropped dramatically, from approximately 50,000 to 21,000 since 1967.

By a simple amendment, I am proposing that the credit and the stimulus offered to all other American industries be made available to the U.S. merchant marine.

We have been advised informally by the Internal Revenue Service that, while there is some merit to the inclusion of a company such as ours and employees such as ours, that the Service will promulgate no regulations or rulings on this subject.

Senator HASKELL. Have you discussed your proposed amendment with the maritime union?

Mr. CUNEO. With the maritime union?

Senator HASKELL. With the maritime union.

Mr. CUNEO. No; we have not discussed it with the unions at this point.

Senator HASKELL. I think you might discuss it, and perhaps they would want to submit some comments.

Mr. CUNEO. Yes; I think they would. That is a valid point.

I think that concludes my statement.

Senator HASKELL. Thank you. I really do not know what my reaction is. It is our purpose to get American citizens employed. That was the basic purpose.

Possibly your point is well taken, and we will take it into consideration. I think it ought to be sort of an industry position, though, and that is why I suggested discussing it with the maritime union.

Mr. CUNEO. Yes, sir.

For most purposes that I can think of, an American ship is considered to be American territory.

Senator HASKELL. Yes.

Mr. CUNEO. The way the law seems to be written, it does not quite meet the traditional definition, and it is peculiar to us as to why that is.

Senator HASKELL. Thank you very much. I appreciate your being here.

[The prepared statement of Mr. Cuneo follows:]

STATEMENT OF MR. JOSEPH CUNEO, PRESIDENT, ENERGY TRANSPORTATION CORP.

Mr. Chairman and members of the committee and subcommittee, my name is Joseph Cuneo. I am president of the Energy Transportation Corp. I am accompanied by George M. Foote, Jr., an attorney with Cadwalader, Wickersham & Taft.

The Energy Transportation Corp. is a U.S. corporation which operates American-built U.S.-flag vessel in international trade. All of our officers and crewmen are U.S. citizens.

The Jobs Tax Credit (the Credit) was enacted as part of the Tax Reduction and Simplification Act of 1977¹ to provide a direct incentive to American business to increase employment.

The Credit is available for taxable years 1977 and 1978 to most employers which have a net increase in Federal unemployment wages (FUTA wages). Section 51(g) (1) of the Internal Revenue Code provides that the FUTA wages paid to an employee may be taken into account only if more than one-half of the remuneration is for services performed in the United States. This limitation is intended to insure that the Credit is claimed only for employees in the U.S. economy.²

For most employers the geographical limitation does not work a hardship. However, if the requirement of "performance of services in the United States" is strictly limited to a territorial concept of the United States without expansion to include services performed on American vessels, wages paid to American seamen on such vessels may not qualify for the Credit. I believe that this is an unintended oversight in the statute.

The law should allow the application of the Credit to wages paid seamen on American vessels no matter where the services are performed. Such application would be consistent with the existing close relationship of the Credit to FUTA wages.

The determination of the amount of the Credit is made by reference to "unemployment insurance wages" which, according to Section 51(f) (1), means "wages" as defined in Section 3306(b). Section 3306(b) defines wages to mean all remuneration for "employment." Under the Federal Unemployment Tax Act employment includes services performed on or in connection with an American vessel³ if the contract of service was entered into within the United States, or during the performance of which and while the employee is employed on the vessel it touches at a United States port, provided the employee is employed on or in connection with such vessel when outside the United States.⁴

Congress based the Credit on FUTA wages so that "employers can easily understand their status with respect to the Credit."⁵ Thus, because of the special FUTA provision relating to wages paid to seamen employed on American vessels, such wages should automatically be taken into account for the Credit. Without a geographical limitation under Section 51(g) (1) the wages would be so treated.

In addition to the close relationship of the Credit to FUTA wages Congressional policy argues for inclusion of the wages of seamen on American vessels in computing the Credit. The policy behind the Credit is to create employment in the American economy, an important part of which is the Merchant Marine. By

¹ Public Law 95-30.

² "The Committee concluded that the new jobs tax credit should apply only to employment within the United States (that is, the 50 states and the District of Columbia). Consequently, an employee's wages are taken into account only if more than one-half of the wages are for service performed in a trade or business in the United States." H. Rep. No. 95-27, Part I, 95th Cong. 1st Sess. 53 (1977); S. Rep. No. 95-66, 95th Cong. 1st Sess. (1977).

³ The term "American vessel" means any vessel which is documented or numbered in conformity with the laws of the United States. It also includes any vessel which is neither documented nor numbered under the laws of the United States, nor documented under the laws of any foreign country, if the crew of such vessel is employed solely by one or more citizens or residents of the United States or of any State. Section 3306(m); Reg. § 31.3306(m)-1(a). However, it should be noted that "employment" for FUTA purposes does not include services performed on or in connection with a vessel not an American vessel if the employee is employed on or in connection with such vessel when outside the United States. Section 3306(c)(4); Reg. § 31.3306(c)(4)-1.

⁴ Section 3306(c). The word "section" in this statement refers to a section of the Internal Revenue Code of 1954.

⁵ H. Rep. No. 95-27, Part I, 95th Cong. 1st Sess. 52 (1977); S. Rep. No. 95-66, 95th Cong. 1st Sess. 67 (1977).

law, only U.S. citizens may be officers of U.S. flag vessels, and at least 75% of the crew of each ship must be U.S. citizens. In practice, most U.S. flag ship owners hire only U.S. citizens who are U.S. residents. The employers of these officers and crewmen withhold U.S. and state income taxes and social security taxes. They pay unemployment insurance and social security taxes. Almost all of the wages paid to the employees are deposited in U.S. banks or sent to their families in the United States. Their transportation to or from foreign ports at the beginning or end of a tour of duty is primarily by U.S. airlines. Their food and supplies are usually purchased in the United States. The officers and crewmen are represented by various seafaring unions.

I am sure that if Congress had known the full impact of the territorial limitations when it enacted the Credit, there would have been an exception for wages paid seamen on U.S. vessels. Through inquiries at the Internal Revenue Service we have learned that no regulations will be promulgated under the Credit, nor will any rulings be issued. Since the only apparent remaining remedy is an amendment to the statute, I have taken the liberty of providing a suggested new paragraph for Section 51(g). The language is intended to extend the Jobs Tax Credit to employers of American citizens on U.S. flag vessels:

(3) EMPLOYMENT ON AMERICAN VESSEL.—For purposes of paragraph (1) of this subsection remuneration paid by an employer to a U.S. citizen for employment on or in connection with an American vessel within the meaning of Section 3306(c) shall be treated as remuneration for services performed in the United States in a trade or business of the employer.

Thank you.

Senator HASKELL. The hearing is adjourned. The record will stay open for 10 days for additional submissions.

[Thereupon, at 11:20 a.m., the hearing in the above-entitled matter was adjourned.]

[By direction of the chairman, the following communications were made a part of the record.]

STATEMENT OF SENATOR HOWARD BAKER

Mr. Chairman and distinguished members of the Committee, last March, Senators Bellmon, Ribicoff, Danforth and I introduced a welfare reform bill (S. 2777) which was called the Job Opportunities and Family Security Act of 1978. As the title indicates, major emphasis was placed upon employment, with particular attention to the creation of private sector jobs for the structurally unemployed.

Senator Bellmon and I subsequently testified before the Public Assistance Subcommittee of the Finance Committee on the specific provisions of S. 2777. My testimony dealt primarily with the employment provisions of our bill. As a preface to my remarks on employment tax credits in general, and targeted tax credits in particular, I should like to recount briefly the testimony on those provisions.

Although S. 2777 called for a combination of public and private sector jobs for the hard-to-employ, clear preference was stated for jobs in the private sector. The advantages of private over public sector employment are obvious and have been cited repeatedly at these hearings. However, it is equally obvious that private sector employment remains elusive for those people who are collectively characterized as the structurally unemployed.

Though our primary response in the past to structural unemployment has been the creation of more PSE jobs and training opportunities, this is no longer considered an adequate solution. It is now generally recognized that private employers can be encouraged or induced to hire the hard-to-employ by providing them with a sensible and adequate financial incentive. The most effective incentive is a partial subsidy for the wages paid one who is normally hard-to-employ.

In S. 2777, we proposed two private sector job creation initiatives: a targeted employment tax credit and a similarly targeted wage voucher. The two programs were intended to complement each other and were similar in the people targeted, the size of the subsidy (\$1/hour), and the duration of the incentive (1 year).

The targeted employment tax credit was drafted in such a way as to build upon or modify the existing credit enacted last year in the Tax Reduction and Simplification Act. It maintained the requirement for increasing wages by 102

percent of the previous year's employment base, continued the \$100,000 ceiling per firm, substituted a \$1.00 per hour credit for the 50 percent of the first \$4,200 of FUTA wages, and targeted the credit on employable AFDC recipients, long-term unemployed (more than 26 weeks), disadvantaged youth and CET participants who had completed their job assignments and were unable to find unsubsidized private employment.

Even though I noted certain deficiencies which I believe exist in the present credit, such as the "growth" or "102 percent" requirement, I did not recommend that it be changed because of the availability of a wage voucher alternative. The proposed wage voucher consisted of a subsidy equal in amount to that provided under the tax credit, and targeted at the same groups of people. However, there was no requirement for expansion by the firm, nor was it limited to \$100,000 per taxpaying entity.

We believed that the wage voucher would be preferred by most employers for a variety of reasons. And yet, in view of the probability that only a targeted tax credit may be enacted this year, I should like to amend my earlier testimony and make new recommendations which do not assume the availability of a wage voucher program.

Few, if any, dispute the assertion that the present tax credit is dreadfully deficient and must be amended substantially, if not permitted to expire. Its problems are numerous and have been listed by many of the witnesses. They include the requirement for growth in a business, the lack of any targeting, the \$100,000 ceiling per firm each year, and the absence of an adequate effort to advertise the availability of the credit.

The Administration and others have sought to address those problems in various proposals now pending before this Committee. Although the Administration proposal is sound in many respects, I believe it is flawed in others.

For instance, their proposal is targeted solely at disadvantaged youth and handicapped workers. Despite the appropriateness of those groups, I firmly believe that the target is too narrow.

I would propose that the tax credit be targeted on employable AFDC recipients and long-term unemployed (26 weeks or more) in addition to disadvantaged youth and the handicapped. In order to be eligible as a youth, the individual would have to be 18 to 24 years of age and from a family whose income is no more than 70 percent of the Bureau of Labor Statistics lower living standard income level. This credit would replace the seldom used WIN tax credit and the present welfare credit.

Another problem with the Administration proposal is the limit on the number of employees upon whom credits may be claimed. Their limit of 20 percent of a firm's employees diminishes the ability of small businesses to hire a significant number of people upon whom a credit can be claimed. For instance, if a firm had only 10 employees, it could claim a credit on only two employees. I believe that it would be more effective to set a limit of \$100,000 or 20 percent of the firm's employees, whichever is higher.

The problem of possible displacement could be dealt with not only by the imposition of such alternative limits, but also by requiring that no employer hire a tax credit eligible if within the past 60 days a non-subsidized salary employee paid a comparable wage was laid off. The employer would be required to sign a statement to that effect before hiring a tax credit eligible employee.

In addition to those changes which I would propose to the Administration's tax credit proposal, I would also suggest that the credit be provided at the rate of at least \$1.00 per hour of the prevailing wage in the first year and at least \$.50 per hour in the second year. A two-year credit would seem to strike the right balance between encouraging retention of an employee long enough for them to learn a useful skill and subsidizing employment beyond the point of necessity.

Individuals from the targeted groups should be certified as eligible by either the state employment agency or the state welfare agency. In view of the importance of minimizing the stigma attached to welfare and the state welfare agency, it might be preferable to charge the state employment agency with the certification task. An option as to the certifying agency might be left to the respective states.

Although the credit should be refundable, the employer should be required to reduce his business expense deduction for wages by the total amount of credit claimed. This would prevent possible windfalls while not penalizing firms with little or no tax liability.

In summary, Mr. Chairman, I propose a single targeted tax credit that would replace all existing employment tax credits with the following provisions: a two-year credit equal to \$1/hour for the first year and \$.50/hour for the second year; targeted at employable AFDC recipients, long-term unemployment (28 weeks or more), disadvantaged youth (as previously defined), and handicapped workers; a ceiling of \$100,000 per firm each year or 20 percent of the firm's employees, whichever is higher; a state option on whether the state employment agency, the state welfare agency, or both, should certify eligibility; a requirement that no employer hire a tax credit eligible employee if within the previous 60 days a non-subsidized salary employee was laid off; and a requirement that business expense deductions for wages be reduced by the amount of the credit claimed.

In order to make such an approach attractive to private sector employers, two other considerations are essential. First, the credit must be aggressively advertised at the national, state, and local level. The benefits of the credit to both small and large businesses should be emphasized.

Second, administration of the credit program must be as simple and red-tape free as possible. Experience indicates that one of the primary reasons for the past failures of employment tax credits has been the fear that participation in such a program would subject the employer to massive amounts of paperwork or red-tape.

In my judgment, if a targeted tax credit along the lines I have outlined is recommended by the Committee and enacted by the Congress, I believe we can begin the long process of solving the problem of structural unemployment in this country.

STATEMENT OF THE U.S. LEAGUE OF SAVINGS ASSOCIATIONS

The U.S. League of Savings Associations* is pleased to have this opportunity to comment on the existing jobs tax credit and its administrative interpretation under recent IRS regulations.

We have been particularly concerned about the denial of equal benefits under this law to members of the savings and loan business. Since its enactment in the Tax Reduction and Simplification Act of 1977, savings and loans have been denied the full benefit of the jobs tax credit incentive (IRC Section 44B) because of a discriminatory limitation (IRC Section 52h) contained in that legislation. Under Section 52h, thrift institutions, including savings and loan associations, are denied 50 percent of the jobs tax credit available to other corporations. The restriction of Section 52h is a carry-over from the antiquated limitation under the investment tax credit (IRC Section 46e) imposed when thrift institutions had nominal effective tax rates. However, since 1962, the tax liability of our business has risen dramatically to the point where our 1977 effective tax rate of 26.7 percent was equivalent to the typical corporate rate in the industrial-mining sector of the economy.

Savings and loan associations currently provide the major source of U.S. financing of long-term residential mortgages, particularly single-family mortgage loans. As a consequence of supplying our nation's mortgage financing, the savings and loan business plays an important role in creating the many construction and related industry jobs which contribute to a healthy economy.

Our business estimates that 898,000 job results from the economic activity generated by savings and loan mortgage lending. In addition, our business directly employs 216,800 workers. As anyone familiar with financial institutions would recognize, there are many entry-level job opportunities at savings and loan associations. However, in spite of this substantial employment contribution to the growth and development of our economy, our members continue to be handicapped under the special job tax credit provision. If the true purpose of the jobs credit is to stimulate the hiring of the unemployed, then we urge this Com-

*The United States League of Savings Associations (formerly the United States Savings and Loan League) has a membership of 4,400 savings and loan associations, representing over 98% of the assets of the savings and loan business. League membership includes all types of associations—Federal and state-chartered, insured and uninsured, stock and mutual. The principal officers are: Stuart Davis, President, Beverly Hills, Calif.; Joseph Benedict, Vice President, Worcester Mass.; Lloyd Bowles, Legislative Chairman, Dallas, Tex.; Norman Strunk, Executive Vice President, Chicago, Ill.; Arthur Edgeworth, Director-Washington Operations; and Glen Troop, Legislative Director. League headquarters are at 111 E. Wacker Dr., Chicago, Illinois (60601); and the Washington Office is located at 1709 New York Ave., N.W., Washington (20006); 202-785-9150.

mittee to extend the full benefits of this incentive to all productive economic partners, including savings and loan associations.

The inequity of this jobs tax credit restriction is further compounded by recent Internal Revenue Service regulations interpreting Sections 44B and 51-53 of the Internal Revenue Code. The regulation in question, IRS Reg. 1.52-3(a), reduces by half not only the amount of the credit determined under section 51(a), but also the \$100,000 credit limitation contained in section 51(d), effectively restricting our institutions to a \$50,000 maximum credit. We feel strongly that Congress intended section 52(h), with its 50% limitation, to apply only to the initial determination of the amount of the credit (section 51a) and not to the additional \$100,000 credit limitation of section 51(d). (The U.S. League comment on the IRS regulation is attached).

The present statutory restriction on the jobs tax credit for thrift institutions, in addition to the strict interpretation of this provision contained in the IRS regulations, unjustly frustrates the original full employment intent of this tax incentive. The U.S. League of Savings Associations petitions this Committee for removal of our statutory impediment (IRC section 52h) to the existing jobs tax credit. Additionally, we urge the Committee that enactment of any similar job incentive plans, whether broad-based or targeted as President Carter has recommended, apply without discrimination to all employers based solely upon providing economic opportunity for the unemployed.

We thank the Committee for granting us this opportunity to comment on the problems the savings and loan business has experienced with the existing jobs tax credit.

MAY 24, 1978.

COMMISSIONER OF INTERNAL REVENUE,
Constitution Avenue, Washington, D.C.

Attn: Robert M. Fowler, CC:LR:2.

GENTLEMEN: We would like to take this opportunity to comment on the proposed regulations issued under Sections 44B and 51-53 of the Internal Revenue Code, the so-called "New Jobs Credit".

The United States League of Savings Associations represents approximately 4,600 savings and loan associations holding more than 98 percent of the assets of the savings and loan business. Savings and loan associations are the major source of financing of long-term residential mortgages, particularly mortgage loans for single family homes.

The League believes that the proposed regulations, in general, effectively implement the statute and the underlying congressional intent, with one notable exception. That is proposed Section 1.52-3(a), which would divide by two not only the amount of the credit determined under Code Section 51(a), but also the \$100,000 limitation on credit provided in Section 51(d).

Proposed Reg. Section 1.52-3(a) is derived from Code Section 52(h), which provides that in the case of an organization to which Section 593 applies (such as a savings and loan association), "rules similar to the rules provide in Section 46(e) shall apply in determining the amount of the credit . . ." (emphasis added). Significantly, this legislative language plainly tracks Code Section 51(a)—"Determination of Amount"—and nowhere mentions a restriction on the \$100,000 limitation on the credit.

There is further evidence that Congress intended Section 52(h) to apply only to the initial determination of the amount of credit. Code Section 46(e) (in conjunction with Section 46(c) in effect divides in half the amount of investment credit available to savings and loan associations, and also reduces by half (to \$12,500) the amount of tax liability against which the credit can be fully applied. Section 46(e) places no absolute ceiling on the amount of credit available to savings and loan associations. Therefore the reference in Section 52(h) to Section 46(e) can apply only to determination of the amount of credit, as Section 46(e) simply does not deal with a ceiling, and any "similar" rules enacted under Section 52(h) likewise could not deal with a ceiling.

We accordingly suggest that Proposed Reg. Section 1.52-3(a) be amended to read as follows:

"(a) *Mutual savings institutions.*—In the case of an organization to which section 593 applies (that is, a mutual savings bank, a cooperative bank, or a domestic building and loan association), the amount of the credit allowable under section 44B shall be determined after reducing by 50 percent the amount otherwise determined under section 51(a), or, in the case of an organization under common control, the proportionate amount of the credit determined under section 51(a) after applying the special rules of section 52 (a) or (b)."

We believe that this amended proposal would more accurately reflect the statutory language, as well as fully recognizing the congressional intent that the New Jobs Credit encourage full employment. In their present form, the proposed regulation would in many instances thwart this intent.

Thank you for your attention to these comments. We apologize for our tardiness in submitting them to you.

Yours very truly,

WILLIAM C. PRATHER,
General Counsel.

JOHN T. SAPIENZA,
Special Counsel, Covington & Burling.

STEPHENSON & Co.,
Denver, Colo., July 14, 1978.

Ms. LAURA KALLICH,
*Office of Senator Floyd Haskell,
Senate Office Building, Washington, D.C.*

DEAR LAURA: I appreciate you taking the time to investigate the problems created by the technical deficiencies in the Job Tax Credit Provisions of the Internal Revenue Code. From what I know of the intent of Congress in passing this legislation, the impact of these provisions certainly does not accomplish the legislative objectives. I would like to outline the impact of the problem on us in starting our newspaper in Denver and suggest the changes that might correct the problem.

The newspaper is being started this month and will have initial employment of fourteen new jobs. Our payroll for the next twelve months will exceed \$200,000.00. The first provision of the Act that causes problems for us is the nonelective character of the Job Tax Credit Provisions. Because we have organized as a Subchapter S Corporation in anticipation of losses for the first twelve to twenty-four months of operation, we will receive no benefit whatsoever from the credit itself, and yet be forced to disallow the deduction of one-half of our payroll. Quite clearly, the impact of the losses of this deduction will exceed \$50,000.00 per year negative influence on our cash flow. Given our pro forma budgets for 1979, the loss of this cash flow will shorten the life of our company but approximately ten months inasmuch as we expect to lose approximately \$5,000.00 per month during the start-up period. The obvious correction to this problem is to make the Job Tax Credit elective for all businesses. Any potential abuses of the rules can be addressed in other ways by the Internal Revenue Service. None of these abuses are present in our situation inasmuch as it is a legitimate new enterprise.

The second problem is that we lose the Investment Tax Credit altogether because we will not make a profit for the first two years. I believe this is unfair and that the Job Tax Credit should be flowed through the Subchapter S Corporation to the individual owners just as is the Investment Tax Credit. I do not believe that entrepreneurs who choose to incorporate should be penalized simply by the form of their organization, which is the reality of this current legislation. I believe that this could be accomplished relatively easily.

The third item that I believe should be changed is the reduction of the payroll by 50 percent for those companies that can use the Job Tax Credit. This merely cuts the Job Tax Credit in half and does not make for more incentive to create jobs. It seems that if Congress had wanted the Job Tax Credit only to be half of what it is, they would have simply reduced the percentage by 50 percent rather than using a complex set of rules to accomplish that.

I have presented our problems in their order of priority with the elective provision being by far the most important to the survival of our new company. The other two would simply be incentive to do exactly what we are doing. Under current law, we will be penalized substantially for trying to create new jobs, and even with the elective provision in place we would not receive any benefit of the incentives that Congress intended to give people who create new jobs.

Mr. William Diss of Arthur Young and Company in Denver will testify before your committee on July 28 regarding these provisions. Mr. Diss is the CPA for our company and is intimately informed about its impact on our new enterprise. I hope you will encourage all of those involved in consideration of this legislation to make the revisions suggested above in order to better achieve the goals of the original legislation. I appreciate very much your help in this matter, and I hope that you will keep us informed as to its progress through Congress.

Very truly yours,

A. EMMET STEPHENSON, Jr.

STATEMENT OF NICOS AVRAAMIDES, SENIOR TECHNICAL COORDINATOR, BUSINESS AND TAX SERVICES GROUP OF GENERAL BUSINESS SERVICES, INC.

Mr. Chairman and members of the Committee and Subcommittee, my name is Nicos Avraamides. I am a Senior Technical Coordinator of the Business and Tax Services Group of General Business Services, Inc.

General Business Services is a national organization providing vitally needed management services to small businesses and helping them fulfill their important role in America's economy. Through our local business counselors, we bring the small business owner a wide variety of business management and tax services. Being the largest consulting firm and having the largest small business clientele in the U.S., we undertook an advertising campaign for our clients emphasizing the importance of reducing unemployment for the U.S. economy and also stressing the tax advantages of the jobs tax credit.

During the past year our Tax Services Department performed numerous studies for clients from various geographical areas of the U.S., outlining the overall economic and tax effect of adding new employees to their businesses.

After the end of the current tax season we ran a survey through our business counselors to ascertain whether the jobs tax credit had the effect that was meant to be by the 1977 Tax Reduction and Simplification Act.

The majority of our clients were happy to receive the tax credit, but the general feeling was that the employers did not hire the people in order to gain the tax benefit but because they needed the additional help.

PROBLEMS AND RECOMMENDATIONS FOR THE JOBS TAX CREDIT

Problems

The jobs tax credit once introduced into the tax code created enormous problems for the taxpayers and for the tax practitioners. The taxpayers, due to lack of publicity and educational material from the part of the government, cannot fully understand the jobs tax credit and its effects and the tax practitioners are burdened with extra complex mathematical formulas that are needed in order to compute the credit.

Some of the most common complaints we received from our clients were:

A. Increase of self-employment tax due to the jobs tax credit. This is true under the current jobs tax credit law that when the tentative credit reduces the wages and salaries, the net profit for the business is increased and therefore the basis for the self-employed tax calculation is increased.

B. Loss of the job tax credit if business is sold during the year. This is a very difficult area that the taxpayers do not understand. For example, an owner of a business who operated for a number of years expanding and creating many new jobs over the years, because he decided to sell the business 12-30-77 for any reason, does not get any jobs tax credit.

As an example of a complex mathematical formula I would like to summarize the section 53(b) for the pass-through credit limitation and the proposed IRS regulations for this section.

Background of section 53(b)

When Congress passed the new Jobs Tax Credit, they defined the amount of the Jobs Tax Credit allowed for the given year as the amount of tax imposed, reduced first by certain credits such as foreign tax credit, tax credit for the elderly, investment credit, etc. The Act also includes an additional limitation that applies to a partner in a partnership, a beneficiary of an estate or trust, and a shareholder in an electing small business (Subchapter-S) corporation. Specifically, the limitation provided above required that the credit may not exceed a value (separately computed with respect to such person's interest) determined by taking an amount that bears the same relationship to such limitation as the ratio of that portion of the person's taxable income allocable to his interest in the entity relative to his taxable income for the year reduced by his zero-bracket amount, if any, (hereinafter referred to as Section 53(b) limitation).

PROPOSED IRS REGULATIONS ON NEW JOBS TAX CREDIT

The proposed IRS Regulations section 1.53-1 deal with the computation of the pass-through limit of the new Jobs Tax Credit.

The following is the formula to be used to compute the Section 53(b) limitations as proposed by IRS:

$$(1) \text{ Section 53(a) Tax} \times \frac{(4) \text{ portion of taxpayer's taxable income attributable to the taxpayer's interest in the entity}}{(2) \text{ taxable income less} \\ (3) \text{ the zero bracket amount}}$$

An analysis of the above formula is as follows:

(1) Section 53(a) Tax—Income tax less all credits that are used prior to new Jobs Credit (reference federal Form 5884, Line 17).

(2) Taxable income as defined by 1977 tax act—Adjusted gross income less excess itemized deductions less personal exemptions (reference federal Form TC, Line 3).

(3) Zero bracket amount—statutory deduction built into the 1977 tax rates and schedules.

(4) Taxable income attributable to the entity:

* (a) Amount taxpayer is required to include in gross income from the entity (Example: salary, ordinary income, capital gains, et cetera.)

* (b) Less, the amount of the deductions allowed to the taxpayer that are attributable to the entity (Example: 50 percent capital gains deduction, attributable portion of dividend exclusion, employee business expense, et cetera.)

(c) Less, a proportionate share of the deductions allowed to the taxpayer not attributable to a specific activity. (Example: 50 percent capital gains on miscellaneous transactions, charitable contributions, medical deductions, zero-bracket amount, pro rata share of dividend exclusion, et cetera.)

The following formula is recommended by IRS in order to compute (c):

$$\text{Deduction not attributable to specific activity} \times \frac{\text{Gross income from the entity reduced by the amount of the deductions that are attributable to the taxpayer's interest in the entity.}}{\text{Gross income reduced by all deductions related to a specific activity}}$$

RECOMMENDATIONS

I would like to see the jobs tax credit continue indefinitely with a number of improvements.

1. Eliminate the adjustment for the jobs tax credit which reduces the wages and salaries deduction. This will correct the present distortion of income and the increase of the self-employment tax. Also this elimination will correct any net operating loss computations.

2. Specify dates where it is possible to dispose of a business and still get the credit.

3. Simplify or eliminate the limitations of a pass-through credit.

4. Make the jobs tax credit elective.

5. Increase publicity for the jobs tax credit on the part of the government.

TEAL, BECKER, PLACE & CHIARAMONTE,
CERTIFIED PUBLIC ACCOUNTANTS,
Albany, N.Y., July 19, 1978.

Mr. MICHAEL STERN,
Staff Director, Committee on Finance, Dirksen Senate Office Building,
Washington, D.C.

DEAR SIR:

JOB'S TAX CREDIT

Suggestion I

From an administrative point of view I think the greatest simplification that could be made to the Jobs Tax Credit is to eliminate Sec's 53(b), 280 C and the percentages in Sec. 51(a) should be reduced, say to 25%

The above would accomplish the following :

- (1) Conformity with state law would be automatically achieved.
- (2) Loss businesses such as partnerships and SUB(S) corporations which create jobs can take advantage of the credit.
- (3) Self-employment income would not be changed.
- (4) Earned income would not be changed.
- (5) Medical and charitable deductions would not be changed.
- (6) The favoring of low income taxpayers over high income taxpayers would be removed. The credit is designed to create jobs, not to increase the progressive nature of the income tax system.

Suggestion II

At the very least the credit should be elective, with the provision that the election could be made within the three year statutory period.

This would allow a loss proprietorship, partnership or SUB(S) corporation, which projects a loss continuing for five years, to forego the credit. At present, a business can actually be penalized for hiring new people, since its pass-through losses are reduced without anyone being able to use its credits.

Very truly yours,

RALPH G. ISAACS, C.P.A.

ALEXANDER GRANT & Co.,
CERTIFIED PUBLIC ACCOUNTANTS,
Chicago, Ill., July 20, 1978.

Hon. FLOYD K. HASKELL,
Committee on Finance, U.S. Senate,
Washington, D.C.

DEAR SENATOR HASKELL: We understand that the Subcommittee on Administration of the Internal Revenue Code together with the Senate Select Committee on Small Business is holding hearings on the administrative problems of the jobs tax credit. This letter details some of the compliance problems our firm has encountered in applying the jobs tax credit. We would appreciate inclusion of this letter in the record of the hearings of the Subcommittee.

Alexander Grant & Company, headquartered in Chicago, is the ninth largest CPA firm in the United States. We have more than 50 offices located in the major commercial centers of our nation and are represented in some 150 cities abroad through the international firm of Alexander Grant Tansley Witt. Our clients are of all sizes and types, from multinational corporations to individual proprietorships.

The observations below are a summary of our firmwide experiences with the jobs tax credit. They are not presented on behalf of any of our clients and may or may not represent a particular client's point of view.

The most serious problem we have encountered in complying with the jobs tax credit rules is that the credit appears to be mandatory. An explanation of why this is a problem is shown below. Three other technical problems which are also noted include: the conflict between § 52(a) and § 52(c)(1); negative salary expense; and some problems of controlled groups. These problems generally affect small and medium size taxpayers since they most often arise with Subchapter S corporations and partnerships rather than regular corporations. The following explanations and examples will be helpful.

JOBS TAX CREDIT APPEARS MANDATORY AND WAGE EXPENSES MUST BE REDUCED

As the jobs tax credit provision moved through Congress, the Senate added a provision that wages for the taxable year must be reduced by the amount of the jobs tax credit allowable for the taxable year. (This provision is now contained in IRC § 280C.) This reduction of wages is to be made even if the potential jobs tax credit cannot be used in the taxable year. Further, wages must be reduced even if the jobs credit can never be used by the taxpayer (see examples 1 and 2 below) or if the jobs credit is passed to another taxpayer (see example 3 below).

Example 1

Assume a Subchapter S corporation incurs a loss for calendar year 1977 so that its jobs tax credit is unavallable due to the net income limitation imposed by § 53(a). Assume further that no carryback is available either because it is the corporation's initial taxable year or it had losses during the carryback period. In 1978, it loses its status as a Subchapter S corporation for any reason which

terminates the election as of the beginning of the taxable year. What then happens to the jobs tax credit carryover?

In this situation, according to § 53(b), the jobs tax credit is passed to the individual shareholders who may avail themselves of a carryforward if there is income derived from the Subchapter S corporation which generated the jobs credit. In this example, the corporation will not be considered the same entity for jobs tax credit purposes due to the change in its taxable status. Thus, the shareholder will neither realize income nor incur a tax with respect to the entity creating the jobs tax credit during the carryover period. Accordingly, the credit will be lost since the limitation expressed in § 53(a) will always be zero. The wages expense deduction of the corporation would nevertheless be reduced by the amount of the jobs credit.

Example 2

Assume the same facts as Example 1 except that the Subchapter S election is terminal as a result of the corporation becoming a subsidiary of a consolidated group. In 1978, the former Subchapter S corporation incurs a further loss, but the consolidated group realizes a net profit. The IRS National Office takes the position that the consolidated group will not be able to use the jobs credit carryover. The Service position is based on the theory that the credit will be subject to limitation on an individual company basis much like the limitation applicable to net operating loss carryovers.

Nevertheless, wages are reduced in 1977 by the jobs tax credit available.

Example 3

During the taxable year ended December 31, 1977, X Corporation realized a jobs credit of \$50,000 which it could not use to offset liability. During the third preceding taxable year (carryback year), X Corporation was a member of an affiliated group which filed a consolidated income tax return with the common parent company. In 1975, all of the stock of X Corporation was disposed of by the common parent. As a result, the income, deductions, credits, etc., of X Corporation for a part of 1975 were included in the common parent's 12/31/75 consolidated return. A short period separate return for the period ended 12/31/75 was also filed by X Corporation.

Thus, the unused new jobs credit for the year 12/31/77 is a carryback to the three preceding taxable years as follows:

- 1975 Consolidated (Part Year).
- 1975 Separate (Part Year).
- 1976 Separate.

Pursuant to Reg. 1.1502-78(b), the \$50,000 credit attributable to the carryback to the 1975 consolidated return is payable to the common parent corporation.

Therefore, X Corporation must reduce its wages expense while the former common parent corporation gets to use the jobs tax credit.

Claiming the jobs tax credit appears to be mandatory rather than elective. Therefore, taxpayers in the above examples have no choice but to take the credit. (IRC § 44B(a) states, "There shall be allowed as a credit . . .") Because the wages are required to be reduced by the jobs tax credit available and the credit appears mandatory, some taxpayers end up with a rather odd result. They are unable to avail themselves of the credit; and because wages expense must be reduced by the credit which is available, any partnership or Subchapter S loss they might utilize is reduced.

These examples produce a result that appears contrary to the intent of Congress. Our reading of the Committee reports and testimony relating to the jobs tax credit does not indicate that Congress intended any negative results being created by the jobs credit. Making the credit elective rather than mandatory would remove this inequity while at the same time not impairing the Congressional objective of insuring that an employer not get tax benefits exceeding 100% of an employee's wages.

Other technical problems we have noted include:

JOBS CREDIT AND ACQUISITIONS—CONFLICT BETWEEN § 52(A) AND § (C) (1)

Assume a partnership is incorporated on December 15, 1977, but remains in existence for purposes of winding up its affairs; both the partnership and the corporation file on a calendar year basis. The newly-formed corporation and the partnership are presumably a controlled group within the meaning of §§ 52(a) and (b) and, as such, the jobs credit realized by the component members should be allocable among them in accordance with their proportionate increase in creditable wages. However, the transfer of the business by the partnership to the corporation also falls within the provisions of § 52(c)(1), which requires that

the successor entity compute its jobs credit as if it had paid the creditable wages of the employees of the transferred business for the entire year. This would result in all of the jobs credit being attributed to the acquiring corporation and none of the partnership.

We understand that the Internal Revenue Service feels this conflict should be resolved by allowing the provisions relating to acquisitions to apply in determining the credit. Therefore, no allocation is required under § 52(a).

JOBS CREDIT AND ACQUISITIONS—NEGATIVE SALARY EXPENSE

Assume the same facts as above. Since the corporation acquired the business on December 15, 1977, it will have little salary expense for the short period until the end of the calendar year. Since the jobs tax credit is computed with respect to salaries paid by the predecessor partnership for the entire year, the credit may exceed the salaries paid by the corporation. Thus, the reduction in salary expense required by § 280C may exceed the salaries paid by the corporation. The Service believes this to be an appropriate result and is not disturbed by the negative salary expense.

PROPOSED REGULATIONS ON JOBS CREDIT CAUSE PROBLEMS FOR CONTROLLED GROUPS

While the proposed regulations do indicate the nature of the brother-sister or parent-subsidiary relationship which must exist, they do not indicate when the relationship must exist. Is it at the end of the taxable year of the members of the group, the beginning of the year, or some specific period of time within the year? There are obviously many problems created by this omission.

Some problems that come to mind are:

If the requisite control must exist between related companies at year end, which year end should be used for purposes of comparing opening and closing FUTA wages when such companies have different taxable years?

Alternatively, if the rule is applied without reference to control at year end, is the rule intended to apply to a member of the group who has been a member for only a portion of the taxable year?

Does it matter how long a company was affiliated? For example, if A, B, and C are a controlled group and are all on a calendar year basis, what happens if C is sold to an unrelated party on June 30, 1978? Are C's FUTA wages for all of 1978 included in determining the jobs tax credit for 1978, or are its FUTA wages included with those of the group only through June 30, 1978? Or, are none of C's FUTA wages included in determining the jobs tax credit for the group for 1978 since it is not a member of the group for the entire year?

It is our understanding that the Service requires allocation of the jobs tax credit based on the relative contribution to the increase in the total FUTA wages as of the beginning and end of the taxable year. This allocation is required of all corporations who were members of the group during the year even though a member has ceased to be a member of the controlled group as of the year end. Further, the allocation between the members is made without respect to the relative number of days that each of the members were in the group.

If the disposition of a member of a controlled group were by way of a merger, the acquisition rules would govern. Therefore, using the facts in the example above, if C were merged with X, no allocation would be required as between C and A and B, but only as between C and X.

We would be pleased to discuss any aspect of this statement with you, other members of your Subcommittee, or your staff.

Very truly yours,

ALEXANDER GRANT & Co.,
A. KUSHINSKY,
National Director of Tax Practice.

PRICE WATERHOUSE & Co.,
Washington, D.C., July 28, 1978.

Hon. FLOYD K. HASKELL,
Chairman, Subcommittee on Administration of the Internal Revenue Code Committee on Finance, U.S. Senate, Washington, D.C.

DEAR SENATOR HASKELL: We are writing to you to express our firm's views on two inequities that have arisen in the administration of the present jobs tax credit (I.R.C. 50A, et. seq.). The views expressed are solely the views of our firm,

and we are not speaking herein on behalf of any client or group of clients served by the firm.

The jobs tax credit, which was enacted in May of 1977 and which expires in 1980, is a noble attempt to encourage increased employment by creating a tax incentive to those businesses that have specific increases in unemployment insurance wages. In many cases the credit as enacted provides this incentive. However, as a result of some oversights in drafting, most notably in connection with the interaction of I.R.C. § 280C with I.R.C. § 53(b), this credit actually creates a disincentive for some partnerships, estates and trusts, and Sub-chapter S corporations.

Partners, beneficiaries, or Sub-chapter S shareholders with distributable losses from their respective entities often are unable to utilize the jobs tax credit due to IRC § 53(b). The Section provides that a person's amount of allowable jobs tax credit is computed under a limitation based on the amount of income that the person receives from the entity generating that credit. At the same time I.R.C. § 280C requires a reduction in the wage deduction for partnerships, estates, and Sub-chapter S corporations, thus increasing each partner's etc. distributable income. The unallowed credit can be carried forward for seven years and back for three years; however, many of these entities may not have taxable income during this period. In addition, it is possible that a Sub-chapter S corporation may terminate its election while it has an unutilized credit. In these cases the credit will be lost forever while the partners, beneficiaries, and Sub-chapter S shareholders would have reported an artificially higher income because of the requirement of I.R.C. § 280C.

There appear to be several possible solutions to this problem. Although each of these solutions may have minor inequities, all would provide a more equitable incentive for creating jobs.

I.R.C. § 280C could be amended to read "credit allowed" rather than "credit allowable." In effect, this would prevent an offset to the wage deduction until the credit is utilized. If the credit is never utilized no offset to wages would be required.

I.R.C. § 53(b) could be amended so as to eliminate the restriction that the credit be limited to taxable income derived from the business activity generating the credit. As a result, the credit would be utilizable even if the partnership, estate or trust, or Sub-chapter S corporation has no taxable income. No other credit in the Internal Revenue Code has a restriction similar to that imposed by § 53(b) and we can think of no good reason for such a restriction. The idea behind the statute is the encouragement of employment and we believe that employment should be equally encouraged whether or not the employer entity is profitable.

Another simple and practical solution to this matter would be to decrease the jobs tax credit from 50 percent to 25 percent of the increase in unemployment insurance wages and repeal § 280C. This solution assumes that everyone receiving the credit is in a 50 percent tax bracket, which may not be true, however, we believe that from a practical point of view there will be very little effect in terms of revenue lost or individual credits earned by making this assumption.

A second problem, which occurs in many professional partnerships, is caused by the restrictions imposed by I.R.C. § 51(c). This section restricts the amount of credit to an amount which would have been determined for such a year if (a) "the aggregate amounts taken into account as unemployment insurance wages were determined without any dollar limitation," and (b) the restriction is based on 105 percent of the prior year's unemployment insurance wages.

This section places a very unfair limitation on a partnership where some of the highly compensated employees are promoted into the partnership. Their total wages are included in the base period, but no portion of their wages are included in the current year's "wages without dollar limitation." In many cases, due to this limitation, a partnership which otherwise had increased its creditable employment would be precluded from receiving a jobs tax credit.

An appropriate solution to this problem would be to provide that upon the occasion of an employee being admitted to the partnership the employee's wages would be eliminated from the base period wages for purposes of this limitation and for purposes of computing the increase in unemployment wages upon which the credit is calculated.

We do not believe the Congress intended by its action in 1977 to enact provisions that result in problems such as we have described above. We hope that these problems and our suggested solutions will be considered by your subcommittee and by the members of your staff who will be drafting new jobs tax credit legis-

lation. We would be happy to confer with your staff and to render any other assistance that we can provide.

Yours very truly,

FRANK T. REA.

CHAMBER OF COMMERCE OF THE UNITED STATES,
Washington, D.O., August 7, 1978.

Hon. FLOYD K. HASKELL,
*Chairman, Subcommittee on Administration of the Internal Revenue Code,
Finance Committee, U.S. Senate, Washington, D.O.*

DEAR MR. CHAIRMAN: I am writing on behalf of the National Chamber's 75,000 members to express our support for the concept of a targeted employment tax credit, as proposed in several bills being considered by the Subcommittee on Administration of the Internal Revenue Code and the Senate Select Committee on Small Business.

In general, we support a targeted tax credit as an effective mechanism for helping to redirect federal employment programs toward private sector jobs. In addition, we support a targeted tax credit because we believe federal employment programs should focus on the structurally unemployed.

We view the linkage of federal employment programs with private sector jobs as a significant and promising new direction in federal policy. Existing employment programs rely too heavily on subsidized public jobs and provide too few incentives for private sector hiring of the hard-core unemployed. Five of every six jobs are in the private sector. Last year over 4 million jobs were created in the private sector, the greatest job expansion in the history of the country. Yet, we have little evidence that these jobs absorbed Comprehensive Employment and Training Act public job holders or other structurally unemployed people for whom federal employment policies are designed.

Permanent, self-sustaining employment which makes an individual economically self-sufficient should be the primary objective of our employment policy. The federal government recently has been willing to commit a major level of resources—some \$8 billion annually—to fully subsidize employment in specially created public service jobs. The effectiveness of this effort is quite uncertain. It seems reasonable to explore the possibilities for direct promotion of regular employment opportunities for this same group.

Current public jobs emphasis—to the near exclusion of private job linkage—has done little to address the problems of the structurally unemployed. Individuals most "job-ready" have been served by these programs, while individuals who lack skills, work motivation, and basic literacy have remained at the bottom of the ladder.

Overall unemployment has declined in recent months, and employment has increased significantly. Yet, unemployment rates for teenagers and young adults have tended to move upward and are consistently higher than the rates for the overall labor force. Young workers, aged 16–24, lacking education—high school dropouts—had an unemployment rate of 24.6 percent in 1976, as compared to an overall unemployment rate of 7.7 percent. In June 1978, minority youth, aged 16–19, had a 37.1 percent unemployment rate, as compared to an overall 5.7 percent unemployment rate.

With federal resources limited, we should focus incentives on groups not likely to be hired without a subsidy. The tax credit will compensate employers for the lack of prior work experience and job skills of the structurally unemployed while moving those individuals from the hard-core unemployed category to the employable category.

While not linking our support to any one of the several employment tax credits your committee is considering, in general we support:

A tax credit of 50 percent of Federal Unemployment Tax Act (FUTA) wages (the first \$6,000 of wages per employee) the first year; a tax credit of 25 percent of FUTA wages the second year.

Eligibility for (1) AFDC recipients who register for the WIN program; (2) handicapped individuals; and (3) individuals aged 18–24 who are members of households eligible for food stamps.

We will appreciate your consideration of our views on a targeted tax credit and request that this letter be made a part of the hearings record.

Cordially,

HILTON DAVIS,
Vice President Legislative Action.

STATEMENT OF THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

The Associated General Contractors of America is a national association representing more than 8,800 general construction firms. These firms perform approximately 60 percent of the annual contract construction volume in the United States and provide employment for some 2 million Americans. Furthermore, our member companies represent the full range of the industry, including the construction of highways, buildings, municipal and utilities facilities, water and wastewater treatment facilities, and heavy and industrial projects.

We appreciate this opportunity to express our views about the jobs tax credit which, in its present form, may adversely affect a majority of small business contractors. The credit, which was enacted under the Tax Reduction and Simplification Act of 1977, unfairly discriminates against certain forms of business organizations commonly used by employers and, therefore, should be changed. Specifically, Subchapter S corporations and partnerships, both of which are prevalent in the construction industry, stand the distinct chance of being penalized for hiring new employees. This occurs when, in accordance with IRS Code Section 280C, such business organizations are required to reduce their wage and salary deductions for the allowable jobs tax credit being passed through to partners or shareholders. But at the same time, the current law does not take into account that the credit may be limited. Contractors who operate as joint venture partners and uses the completed contract method of reporting income are a good example of one category of employers frequently affected by this inequitable result.

It is hard to believe that Congress could have intended to penalize any taxpayer for his efforts to reduce the nation's unemployment through the hiring of new employees simply because his business was organized in one form instead of another. Therefore, we refer to and wholeheartedly endorse the recommendations of the Associated General Contractors of California which were submitted to this Subcommittee on July 14, 1978 in written testimony. They are as follows:

1. The reduction for salaries and wages which result from the jobs tax credit should be made at the taxpayer level and should be limited to the amount of the jobs tax credit realized by a taxpayer as opposed to allowed, or
2. The jobs tax credit that will never be realized should revert to a salary and wage deduction under the tax benefit rule of IRC, Section 111.
3. The new jobs tax credit should be made elective.

We, as a national association, strongly urge the Subcommittee on the Administration of the Internal Revenue Code to make these necessary changes so that, in the future, the jobs tax credit will not penalize employers who hire new employees, but instead will truly provide them "with a tax incentive to create new jobs" in accordance with the law's intended and stated purpose.

NATURE OF PROBLEM GENERATING INCOME DUE TO JOBS TAX CREDIT

	Taxpayer is member of a joint venture which is using completed contract and which has a loss	Taxpayer is member of several joint ventures which use completed contract	Taxpayer is member of a joint venture which is profitable but taxpayer has a loss the year contract closes	Taxpayer is member of a joint venture which is profitable and taxpayer has income the year a contract closes
Taxpayer's taxable income (loss) before partnerships (that are separate employer groups) and job credit.....	\$100,000		(\$60,000)	\$500,000
Reduction of wage expense, i.e., increase taxable income, for job credit of taxpayer employer group.....	100,000			100,000
Joint venture income (loss) to taxpayer before job credit (taxpayer's share).....	(60,000)	\$200,000	30,000	40,000
Joint venture(s) reduction of wage expense, i.e., increase taxable income, for job credit(s) of joint venture employer group(s) passed through to taxpayer (taxpayer's share).....	40,000	\$160,000	20,000	\$40,000
Taxable income.....	180,000	360,000	(10,000)	680,000
Increase in taxable income from job credit allowable.....	140,000	160,000	20,000	140,000
Job credits—realizable.....	100,000	100,000		4,800 100,000
Taxable income created by job credit.....	\$40,000	\$60,000	\$20,000	\$35,200

¹ Because of the completed contract election, there will be no carryovers.

² Assumes taxpayer is a member of more than 1 joint venture employer group.

³ Assumes partnership limitation.

⁴ Assumes taxpayer employer group job credit can be carried back.

FELLNER AND KUHN, P.C.,
 CERTIFIED PUBLIC ACCOUNTANTS,
 Portland, Oreg., July 27, 1978.

Mr. MICHAEL STERN,
 Staff Director, Committee on Finance, Dirksen Office Building,
 Washington, D.C.

DEAR MR. STERN: As practicing CPA's, we have had experience with the job tax credit in 1977. We would like to submit the following statement for the record of the hearing by the Subcommittee on Administration.

Our own firm and a substantial number of our clients qualified for the job tax credit in 1977. Neither our firm nor any of our clients would have hired a single employee because of the credit allowed for this year. Most of our clients were surprised as to the size of the credit, if they qualified, and accepted it as an unexpected reduction of the income tax liability.

It makes no sense to businessmen to hire an unnecessary employee for the sole reason that he will get credit for part of the first year's cost against taxes. The same is true for the WIN Credit, and we expect that it will again happen to the proposed Targeted Employment Tax Credit.

The proposal runs contrary to any attempt of simplifying the Internal Revenue Code by adding one more credit to the many we already have. It reduces revenue at a time when the Federal deficit is continuously increasing. It will not promote hiring of persons 18 to 24 years of age from low income households unless they are qualified for a job and are employable anyway. We believe this Committee should direct its efforts to more worthwhile projects.

Yours truly,

PAUL FELLNER.

COMMENTS ON PROPOSED REGULATIONS, SECTION 1.53-1 JOBS TAX CREDIT BY
 ASSOCIATED GENERAL CONTRACTORS OF CALIFORNIA, INC.

"The Reduction and Simplification Act of 1977 created a new jobs tax credit which *provides* (emphasis added) employers with a tax incentive to create new jobs." I.R.S. Publication 902. The above quote and the Congressional Committee reports relating to the jobs tax credit provide the intent of Congress in passing the new jobs tax credit. However, the current law and the proposed regulations offer the significant possibility of penalizing a taxpayer for hiring new employees. This is especially true if the taxpayer is a member of a partnership or Subchapter S corporation. This effect of certain limitations on these groups will be especially catastrophic to the small business entity.

The current jobs tax credit requires an employer entity to reduce its wage deduction for the allowable jobs tax credit it is passing through to its taxpayer partners or shareholders, Code Sec. 280C, but it does not take into consideration that said credit may be limited. This effect manifests itself in the construction industry in which many taxpayers operate as joint venture partners and use the completed contract method of reporting income. The jobs tax credit benefits created by Congress are reduced, if not eliminated, when the following traditional business conditions are present:

The completed contract provides for the recognition of all income or loss in the period the contract completes. Because a joint venture terminates at the completion of the project, carryovers cannot be utilized.

The allowable credit a taxpayer may claim for any one tax period is limited to a maximum of \$100,000 even though more than \$100,000 of jobs tax credit was generated by various employer groups of which a taxpayer is a member.

The apportionment limitations based on the ratio of taxpayer's share of partnership or Subchapter S income to taxpayer's total taxable income further distorts the allowable credit which can be recognized.

Examples of these inequities are attached.

We are certain that it was not the intent of Congress that taxpayers utilizing partnerships or Subchapter S be penalized for hiring new employees. We do not feel Congress anticipated these adverse results.

To alleviate the existing inequities in the present law and in the proposed regulations, we respectfully request that at least one of the following be adopted:

- (1) The reduction for salaries and wages resulting from the jobs tax credit be made at the taxpayer level and be limited to the amount of the jobs tax credit realized by a taxpayer, as opposed to allowed, or

(2) The jobs tax credit that will never be realized should revert to a salary and wage deduction under the tax benefit Rule of I.R.C. Section 111. If public testimony would assist in this request or further information would be helpful, please contact us.

STATEMENT OF THE SMALL BUSINESS ADMINISTRATION

Mr. Chairman and members of this committee: Thank you very much for this opportunity to comment on the employment tax credit issue, and the effect of SBA programs on employment in the inner-city.

As you know, new employment tax credit was provided by the Tax Reduction and Simplification Act of 1977 for the years 1977 and 1978. Obviously the intent of the credit is to reduce the unemployment rate, and, of course, reduction of the unemployment rate is a major priority of this Administration.

It is our understanding that the Department of Labor is currently evaluating the effect Jobs Tax Credit has had on unemployment. However, whatever the results of that evaluation, the Administration believes that employment tax credit should be targeted to assist the disadvantaged in the employment marketplace—specifically, disadvantaged youth whose unemployment rate over the past 12 months, according to DOL figures, has been only slightly less than 40 percent.

It is the position of this Administration that new employment tax credit targeted on disadvantaged youth be enacted, and the current Jobs Tax Credit expire as planned.

You have requested any information we have regarding :

1. The effect of the Jobs Tax Credit on inner-city businesses,
2. The structural composition of inner-city businesses, and
3. The effect of SBA programs on employment in the inner-city.

Unfortunately, SBA does not have hard data on any of these three issues. The only SBA loan program which is specifically directed toward cities is the Economic Opportunity Loan Program under Section 7(1) of the Small Business Act. We are statutorily required to make "at least 50 percentum of the amounts loaned or guaranteed... to small business concerns located in urban areas identified by the Administration as having high concentrations of unemployed or low-income individuals or to small business concerns owned by low-income individuals."

Our annual report for 1977 to Congress will show that in that year we made some \$75 million in EOL loans in urban areas (65 percent of the total).

Regarding the effect of the Jobs Tax Credit on inner-city businesses, we have no information. On the structural composition of inner-city businesses, the principal sources of data available to us are Bureau of Census publications.

From the Census of Retail Trade, information is published for retail stores in the central business districts of large cities. Central business districts are identified as areas of high land value, high traffic flow, or high concentration of selected types of businesses. The information provided concerns the number of establishments, and the sales and payroll for selected groupings of businesses. We do not know if the Bureau of Census has a capability for developing similar tabulations for low-income areas. The low-income publications do not provide information on the number and characteristics of businesses. The Bureau has developed a substantial amount of information regarding the population of the inner-city, and housing characteristics of low-income areas of the 50 largest cities.

Our difficulties in developing information on assistance programs for the inner-city are similar to those for other data series. From our records, we cannot relate program assistance directly to the census tracks of low-income areas.

However, we do carry numerous forms of identification in financial assistance records. These include county codes, zip codes, city codes, minority borrower codes, and economic opportunity loan codes. Under our special program data, business loans made under our pilot Neighborhood Business Revitalization Program can also be identified.

This pilot program, which is being used in 25 cities, is designed to stimulate commercial and industrial small business revitalization in declining but viable urban neighborhoods, towns and rural communities. Responsible revitalization creates jobs, strengthens existing small businesses, spawns new small business enterprises, provides necessary community business and professional services,

improves real property values, and reinforces community stability and economic health.

Financial assistance to small business concerns is made available from existing SBA programs—primarily through Local Development Company loans (Section 502 of the Small Business Act), regular 7(a) business loans, and Economic Opportunity Loans (EOL). SBA works with the Department of Housing and Urban Development and the Department of Commerce's Economic Development Administration (EDA) in an effort to provide simultaneous assistance for all the necessary elements of neighborhood revitalization. An interagency agreement for cooperation was signed in March 1978.

Local Development Companies are composed of local citizens whose primary purpose is to improve their area's economy by assisting small business concerns. SBA makes loans to the companies, which in turn loan the money for specific projects, or to small business concerns. The companies must provide a reasonable share of the cost of the project to be financed—usually 20 percent of the total amount.

SBA's planning and evaluation personnel currently are evaluating the impact and effectiveness of the Local Development Company Program. The evaluation will measure the impact of the program on small firms, including changes in employment within the firms, and on the local business environment. Problems of program operation will be identified and recommendations for improvements will be made.

This concludes my statement. Thank you very much.

APPENDIX

QUESTIONS SUBMITTED TO SECRETARY PACKER BY SENATOR NELSON AND THE ANSWERS TO THEM

Question. What has been the stimulative effect of the WIN credit? Can you compare experience under the WIN credit to experience under the current Job Tax Credit? Can it be demonstrated that either of these credits has acted as an incentive for employers to hire a target population which would not have otherwise been employed in the absence of the credit?

Answer. Current information indicates that the Win tax credit has stimulated few jobs for welfare recipients. An evaluation of the WIN credit found that 5 percent of employers said the credit contributed substantially to the decision to hire WIN participants. Although annual WIN certifications have run at about 28,000-30,000 the actual number of full-year equivalent jobs covered by the WIN credit amount to only about 15,000. Perhaps 5-10 percent of these 15,000 jobs represent increases in jobs for welfare recipients stimulated by the WIN credit.

In contrast to these clear results, the findings related to the Jobs Tax Credit are mixed. Some analysts claim to have found that the Jobs Tax Credit stimulated hundreds of thousands of jobs; but most analysts are skeptical and do not believe the Jobs Tax Credit induced such effects. The Census Bureau undertook an employer survey at our request last February to determine employer responses to the credit. According to the survey, only 34 percent of firms knew about the credit as of February 1978; 19.5 percent of these firms thought they qualified for the credit but only 6 percent of the firms said they made an effort to increase employment because of the credit. These survey results provide only one indication of the effects of the credit. A better indication of the credit's impact will only come with additional data and research.

Question. Does the Administration's proposal for a targeted Jobs Tax Credit provide adequate protection against displacement of the current work force, including partial displacement such as reduction in overtime work?

Answer. Yes. Our proposal does not allow firms to claim credits on behalf of more than 20 percent of their work force. Since normal turnover within firms far exceeds 20 percent per year, firms have little incentive to utilize the credit to displace existing workers. However, we intentionally provide firms with the incentive to choose disadvantaged youth in filling new openings.

Question. Under the Administration's proposal, what will prevent an employer from hiring a highly skilled, technically trained youth? If the target of the credit is the structurally unemployed, shouldn't it be focused on those youth who are least likely to obtain unsubsidized employment even in the best of economic conditions—i.e. those lacking academic credentials or skill training? Shouldn't the objective of the credit be to induce the employer to hire persons who he otherwise would not have, but for the fact that the credit will cover the cost of lower productivity?

Answer. The objective of the credit is to simulate employers to hire workers with special disadvantages in the labor market. However, it is difficult to implement eligibility criteria which are highly complex. We believe that the disadvantaged youth target group is the one facing the most severe employment barriers. They are least likely to obtain employment in the best of economic conditions. We believe it would be unwise to restrict eligibility beyond the category of disadvantaged youth. For example, excluding disadvantaged youth who are high school graduates relative to dropouts would discourage some disadvantaged youth from graduating high school.

Question. What justification is there for extending the tax credit for two years instead of one year?

Answer. The justification for extending the tax credit for two years is twofold. First, the two year credit raises the incentive to the firm to take a chance on a disadvantaged youth. Second, extending the credit for two years encourages the firm to retain the worker. Without the second year credit, firms would face

higher incentives to shift from workers already with the firm for a year to new hires.

Question. Will providing the tax credit for employers who simply retain their current workforce have a stimulative effect?

Answer. No. However, employers who receive credits for their existing work force of disadvantaged youth are more likely to try to take further advantage of the credit by picking more disadvantaged youth from among their new hires.

Question. Since an employer may receive a credit for keeping a person in his employ for 75 days, won't the credit be used by employers who have only temporary, dead-end jobs—e.g. agricultural and seasonal work?

Answer. The restriction limiting the credit to jobs lasting more than 75 days will exclude much short-term employment. It turns out that existing turnover among disadvantaged youth is very high, perhaps as much as 100 percent per quarter. To enact a stricter limitation would exclude too many jobs and be counterproductive. As for the issue of dead-end jobs, our policy is to try to place young workers in jobs. The ideal would be to place youth in good career jobs. However, we realize that job mobility and job shopping characterize the youth years and thus we believe the primary goal is to increase disadvantaged youth employment from all kinds of jobs.

Question. Since the primary indicator of structural unemployment is length of unemployment, shouldn't this be a criteria for eligibility for all persons with the exception of in-school youth?

Answer. Although length of unemployment is an indicator of structural unemployment, we believe it would be unwise to add an unemployment criteria to the existing eligibility criteria. We do not want to exclude a youth who comes from a low income family, has low earnings, but has worked a few hours during the few weeks prior to his application for eligibility.