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The Use of Tax Subsidies for Employment

A Report to Congress by the Departments of Labor and Treasury

May 1986

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THE SECRETARY OF THE TREASURY
WASHINGTON

May 29, 1986

Dear Mr. Chairman:

Section 554 of Public Law 95-600, the Revenue Act of 1978, provides that "the Secretary of the Treasury and the Secretary of Labor shall jointly submit to the Committee on Ways and Means of the House of Representatives and to the Committee on Finance of the Senate a report on - 1) the effectiveness of the targeted jobs credit...in improving the employment situation of the targeted groups, and 2) the types of employers claiming such credit. The report...shall also include an evaluation of 1) the effectiveness of the general jobs credit...in stimulating employment and enhancing economic growth and 2) the types of employers claiming such credit."

Pursuant to that section, we hereby submit the "Report to Congress on the Use of Tax Subsidies for Employment."

We are sending a similar letter to Senator Bob Packwood, Chairman of the Committee on Finance.

Sincerely,

William E. Brock
Secretary of Labor

James A. Baker, III
Secretary of the Treasury

The Honorable Dan Rostenkowski
Chairman
Committee on Ways and Means
House of Representatives
Washington, D.C. 20515

Enclosure

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Washington, D.C. 20510

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Chapter 1

INTRODUCTION AND SUMMARY

I. Background of the Study

This report has been prepared to comply with Section 554 of Public Law 95-600 (The Revenue Act of 1978), which directed the Department of the Treasury and the Department of Labor to prepare a report evaluating two provisions of the Internal Revenue Code:

(1) The New Jobs Tax Credit (NJTC), which was enacted on May 23, 1977, as part of The Tax Reduction and Simplification Act of 1977; and

(2) The Targeted Jobs Tax Credit (TJTC), which was enacted on November 6, 1978, as part of The Revenue Act of 1978.

The statute required the report to cover the following topics: the types of employers claiming the credits; the effectiveness of the TJTC in increasing employment of the targeted groups; and the effectiveness of the NJTC in stimulating employment and enhancing economic growth.

The Targeted Jobs Tax Credit has been amended three times during the preparation of this report. Although the report includes some discussion of the amended versions of the TJTC, the analysis in the report focuses on the initial version. In light of changes in the credit's provisions, this report's findings will not necessarily apply to the current version of the Targeted Jobs Tax Credit.

II. Overview of the Report and its Principal Findings

To provide perspective for the evaluations of the NJTC and the TJTC, Chapter 2 contains a general discussion of employment subsidies.

A. Objectives and Limitations of Employment Subsidies

All employment subsidies have the objective of increasing employment, at least for certain target groups, if not aggregate employment. A general result which emerges from the discussion in Chapter 2 is that employment subsidies may also reduce employment for certain firms and workers. An employment subsidy may tend to favor certain workers or firms, even when the subsidy is not formally targeted. The workers or firms which are not favored are placed at a competitive disadvantage, which may result in job losses. Adverse employment effects may also result from government financing of the subsidy. On the other hand, employment subsidies may increase the employment of workers who are complementary to subsidized labor.

Temporary employment subsidies may cause changes in the time pattern of employment. Employment gains while the subsidy is in effect may come partly at the expense of future employment since a temporary subsidy provides an incentive to move planned production and maintenance activities forward. However, the employment gains due to a temporary subsidy are not necessarily confined to the period during which the subsidy is in effect due to fixed costs, such as training costs, associated with hiring the subsidized employees.

A general employment subsidy can be claimed against all of a firm's employment--both employment induced by the subsidy and employment that would have occurred in the absence of the subsidy. In contrast, an incremental employment subsidy attempts to limit payment of the subsidy to employment that was induced by the subsidy. In actual practice, induced employment can be estimated only with considerable error. Consequently, some firms are effectively made ineligible for an incremental subsidy, while others will receive payment for some employment that would have existed in the absence of the subsidy. Ineligible firms are placed at a competitive disadvantage.

B. Legislative Histories of the Jobs Tax Credits

Chapter 3 presents legislative histories of the NJTC, the TJTC, and an earlier employment tax credit, the Work Incentive Program (WIN)/Welfare credit. In addition to being temporary, the NJTC and TJTC shared several other features:

(1) both had ceilings on subsidized wages per employee which encouraged employers to substitute low-wage labor for high-wage labor;

(2) tax-exempt and nonbusiness employers were ineligible for both credits; and

(3) employers' tax deductions for wages paid were reduced by the amount of the credit received.

Otherwise the two credits differed fundamentally in their design. The NJTC was intended to be an incremental credit for any worker hired; the TJTC could be earned only for workers belonging to certain targeted population groups and was not intended to be incremental.

The New Jobs Tax Credit. The NJTC was enacted on May 23, 1977, and expired at the end of 1978. Subject to the limitations noted below, the NJTC entitled employers to a credit equal to 50 percent of the excess of the firm's Federal Unemployment Tax Act (FUTA) base in the current year over 102 percent of the firm's FUTA base in the previous year. For purposes of computing NJTC credits, the firm's FUTA base was defined as the first $4,200 of annual wages paid to each individual employee, summed across all employees who were on the payroll at any point in the year. Since most jobs have annual wages that exceed $4,200, growth in the firm's FUTA base and growth in its employment were assumed to be closely correlated. The threshold level of the current year FUTA base--102 percent of the previous year FUTA base--gave the NJTC its incremental feature.

In enacting the credit, Congress also placed various restrictions on the NJTC to limit its cost and to preserve its incremental nature. These were: (1) the new business limit, which was intended to reduce the special labor cost advantages that new businesses would receive from the credit; (2) the wage bill limit, which reduced the incentive for employers to increase their credit base by substituting part-time workers for full-time workers or by increasing labor turnover; and (3) the small business limit, a $100,000 ceiling on the amount of credit that an employer could earn in any one year. Amounts of New Jobs Credits in excess of a firm's current year tax liability could be used to offset the firm's tax liabilities in the preceding three years or in the following seven years.

The Targeted Jobs Tax Credit. The initial TJTC legislation distinguished seven groups whose members' wages were eligible for credits: (1) economically disadvantaged ex-convicts; (2) economically disadvantaged youth from 18 through 24 years old; (3) economically disadvantaged Vietnam-era veterans under age 35; (4) handicapped vocational rehabilitation referrals; (5) youth, aged 16 through 19, in cooperative education programs; (6) general assistance recipients; and (7) Supplemental Security Income (SSI) recipients. In selecting these target groups, the intent of Congress was to improve the employability of individuals likely to have difficulty obtaining employment.

As initially enacted, the TJTC could be claimed for wages paid or incurred during calendar years 1979-81 for employees who were hired after September 27, 1978, and whose eligibility was certified by a designated local agency. The TJTC provided a credit to employers equal to 50 percent of the first $6,000 of wages paid to each eligible worker in the first year of employment and 25 percent in the second year of employment. The amount of the credit was limited to 90 percent of current year tax liability, except that amounts in excess of the limit could be carried back three years or carried forward seven years. To limit layoffs of workers who were ineligible for the credit, the amount of subsidized wages was limited to 30 percent of the employer's FUTA base.

Amendments made to the TJTC in 1981, 1982, and 1984 extended the life of the credit. The amendments to the TJTC changed the target groups that were eligible for the credit and restricted the extent to which credits could be claimed for workers who were certified after the date of hire.

C. Evaluation of the New Jobs Tax Credit

Chapter 4 evaluates the experience with the New Jobs Tax Credit. The first section focuses on the administrative problems connected with the credit. The second section presents information on the types of employers who used the credit, estimates of the credit's cost, and other information. The final section evaluates the effectiveness of the NJTC in stimulating additional employment. Chapter 5, which evaluates the TJTC, has a similar format.

A problem in designing an incremental employment subsidy is the measurement of incremental employment. The New Jobs Tax Credit used the FUTA base growth above 102 percent of the previous year FUTA base as an imperfect proxy for induced employment growth. Since in the credit's absence firms would have varying rates of employment growth, using a proxy and the arbitrary 102 percent requirement results in an equity problem across labor markets. Some firms would be eligible even though their employment growth rate would have substantially exceeded 2 percent without the credit, while other firms deciding to replace attrition in a depressed market would not be eligible for the credit.

Corporate tax returns from 1977 and 1978 were used to examine employers' use of the NJTC and the impact of the credit's various limitations. Approximately one-half of the employment in the corporate sector was in firms that were eligible for the NJTC. The percentage of corporations eligible for the credit that actually claimed it--the take-up rate--was an estimated 31 percent in 1977 and probably much higher in 1978. Both the eligibility rate and the take-up rate were lower for small companies.

Corporations which were affected by the limitations on the amount of credit earned--the wage bill, small business, and new business limits--accounted for 70 percent of employment growth in corporations claiming the NJTC. Approximately 50 percent of employment growth in corporations claiming the credit occurred in firms affected by the small business limit, 10-12 percent in firms affected by the new business limit, and 6-8 percent in firms affected by the wage bill limit. Approximately one-third of all corporations claiming the credit were affected by at least one of these limitations.

The tax liability limit affected over one-half of all corporations claiming the NJTC. Only about one-half of the credits earned by corporations could be claimed against current year tax liability. The value of each dollar of the remaining credits was typically less than one dollar, since most were either never received or were claimed in some future year.

The amount of NJTC claimed was greater for large than for small companies. Due to the small business limit, however, the credit claimed as a percent of labor cost was higher for small firms. The benefits from the NJTC were unevenly distributed across industries. The industry distribution of NJTC claimed is markedly different from the industry distribution of business receipts.

The available evidence is not sufficient to measure the NJTC's impact on the growth of aggregate employment and output. Due to the credit's eligibility requirements and limitations, only an estimated 30 percent of the employment growth in taxable firms occurred in firms for which the NJTC provided an employment incentive. For these firms, the credit typically reduced the first-year compensation costs of eligible additional workers by 26 percent in 1977 and 20 percent in 1978. The fact that the credit only subsidized the first year of an eligible worker's wages limited its employment incentive, especially for firms where hiring and training costs accounted for a large part of total labor costs. The credit's employment incentive was also limited by its complexity, which made many employers uncertain about the relationship between their employment decisions and the amount of the credit that they would earn.

Evidence from two studies indicates that the New Jobs Tax Credit increased employment in certain firms and industries such as construction in 1977-78. However, these employment gains may have been offset by employment losses in other firms and industries. Therefore, it cannot be concluded from these studies that the NJTC increased aggregate employment.

The estimated total budgetary cost of the two-year (1977-78) NJTC was $9.7 billion.

D. Evaluation of the Initial Targeted Jobs Tax Credit (1979-June 1981)

To ensure that the credit was claimed only for eligible employees, the statutory provisions of the TJTC required that eligibility be certified by a designated local agency. The Labor Department was given official responsibility for administering the certification system.

The Internal Revenue Service was responsible for auditing tax returns to ensure that the amount of credit taken was correct. Both departments shared responsibility for informing taxpayers of the program's existence.

The actual implementation of the Targeted Jobs Tax Credit by local administering agencies did not meet initial expectations, due in part to the limited funding for this purpose. In many areas, the local administering agencies were slow to establish certification procedures.

The Department of Labor certification records show that the credit was claimed most often for the two targeted youth groups. Of the 605,000 certifications issued through June 1981 (prior to the 1981 TJTC amendments), 45 percent were for cooperative education students and 39 percent were for economically disadvantaged youth. Among target groups other than cooperative education students, three-quarters of the workers certified in fiscal year (FY) 1980 earned initial wage rates of $4.00 or less. Among these same target groups, nearly two-thirds of the workers certified during the first three quarters of FY 1981 were certified at least 15 days after their date of hire.

An early sample of 1979 corporate income tax returns was used to examine which employers were using the credit. Manufacturing and retail trade firms claimed the TJTC most often, but less than 2 percent of these firms claimed the credit. The take-up rate among all corporations was less than 1 percent.1/ "Industrial" firms, such as those engaged in manufacturing, construction, and mining, claimed the TJTC primarily for economically disadvantaged individuals and individuals eligible for welfare programs. "Commercial" firms, such as those engaged in retail trade, finance, and services, claimed the credit primarily for cooperative education students.

The TJTC penetration rate--defined as the percent of eligible hires for which the TJTC was claimed--was estimated to be 21-23 percent among cooperative education students during FY 1981. For no other target group was the estimated penetration rate greater than 10 percent.

No single explanation can be cited for the credit's low penetration rate. A key factor was the cost to the employer of identifying eligible workers. In addition to the direct costs of screening job applicants for TJTC eligibility, risks of violating fair hiring or privacy laws were also perceived to be costs. For many employers, the value of the credit was reduced by the tax liability limit. Other factors contributing to the low penetration rates include: inadequate implementation of the credit by the administering agencies; disadvantages of administering a subsidy through the tax system; and a negative stereotyping of TJTC eligibles by employers.

It is clear from the low penetration rates that the TJTC had a small impact on target group employment. It is not known how this impact compares to the employment that was subsidized by the credit. The evidence on this question that comes from employer

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1/ Total TJTC certifications increased from 202,261 in fiscal year 1982 to 563,381 in fiscal year 1984. These figures exclude cooperative education students. It is known that fewer than 8,400 certifications were issued for cooperative education students in fiscal year 1984.

surveys is inconclusive. For many certified workers, the eligibility determination was made well after the date of hire. In many such cases, the hiring decision could not have been influenced by the credit because the employer was unaware of the worker's eligibility at the time the hiring decision was made. The evidence from two experiments suggests that workers who advertised their TJTC eligibility to prospective employers may not have improved their chances of being hired.

The TJTC penetration rate was highest for cooperative education students. On the basis of interviews with cooperative education staff, a Labor Department study concluded that the TJTC attracted few additional employers to cooperative education programs during the 1979 academic year.

The direct budgetary cost of the TJTC was $730 million during fiscal years 1979-81.

Chapter 2

OBJECTIVES AND LIMITATIONS OF EMPLOYMENT INCENTIVE POLICIES

This chapter discusses considerations relevant for analyzing the employment impact of government programs that subsidize labor costs. The main purpose of these programs is to provide employers with incentives to increase employment of eligible members of the labor force. The effectiveness of such programs depends both on their design and on the characteristics of the labor market.

I. Alternative Employment Incentive Designs

During the past 10 years, Federal employment incentives have had two objectives. "Targeted" employment incentives have been enacted to increase the employment of eligible members of the labor force by reducing employers' costs of using these workers relative to the costs of using other productive resources. Other employment incentive policies have been intended to increase the total employment in the economy.

Hiring incentive programs can provide direct cash payments, such as the on-the-job training grants to reimburse employers for the costs of hiring and training eligible workers under the Jobs Training Partnership Act. Alternatively, such payments can be made by reducing firms' tax liabilities--the tax credit approach taken by Congress in enacting the NJTC and the TJTC.

Employment subsidies can be made available for all labor costs. Such subsidies are "general" subsidies because they are available to defray some fraction of the costs of employing all eligible workers. "Incremental" subsidies have also been used. "Incremental" wage subsidies are only available if some measure of eligible employment grows beyond a certain threshold.

Permanent subsidies will clearly have greater long-run employment impacts than temporary subsidies. The impact of a short-lived subsidy may consist largely of affecting the timing of hiring decisions already made. However, employment subsidies with different durations also have different costs and may serve different purposes. Such factors should figure in evaluations of employment incentive programs.

The New Jobs Tax Credit (NJTC) and the Targeted Jobs Tax Credit (TJTC) have a number of elements in common.

- Both credits were temporary.

- Both credits were specifically designed to encourage the substitution of labor for capital in the production process.

- o Both credits provided greater incentives to use low-wage labor rather than high-wage labor.

- o Tax-exempt and nonbusiness employers were ineligible for both credits.

- o A number of limitations were placed on both the NJTC and the TJTC to limit their costs, to focus the credits on particular employers or employees, and to preserve the value of the credits as hiring incentives.

The credits are distinguished mainly by differences in coverage. The TJTC could be earned for each worker hired from certain population subgroups. By contrast, the NJTC was available for any worker hired, but only to the extent that total employment in the firm increased beyond a certain level.

II. The Effects of Employment Subsidies

The analysis of the NJTC and the TJTC will be facilitated by first considering how a permanent, nonincremental and nontargeted labor subsidy affects employment. Subsequently, the additional considerations relevant to analyzing temporary, incremental, and targeted subsidies are presented. Finally, the effect of particular design features, including the provisions for administering and publicizing the subsidy, are discussed.

A. Permanent, Nonincremental, and Nontargeted Subsidies

The employment effect of labor subsidy will depend on: 1) the technological substitutability of labor for other factors of production--capital, energy, etc.--in production processes; 2) labor's share of total production costs; 3) the substitutability of labor-intensive products for other products in consumers' budgets; 4) the responsiveness of the supply of labor to changes in the wage rate; 5) how the subsidy is financed; and 6) the design of the subsidy, including the provisions for administering and publicizing it.

The individual firm, with a given production process, is a convenient point of reference for analyzing the incentive effects of an employment subsidy. First, by reducing the cost of employing labor, the subsidy encourages the employer to adopt production processes that utilize more labor in place of other productive factors to produce any given level of output. This is the subsidy's factor substitution effect. Second, it is necessary to account for the employment effects of all changes in output induced by the subsidy. Changes in a firm's employment due to changes in the amount of output it produces is called the subsidy's scale effect.

For a firm receiving the subsidy, the substitution and scale effects can normally be expected to increase the employment of labor. However, to evaluate the economy-wide effect of a subsidy, the effect on prices and outputs in all nonrecipient firms as well as in all other recipient firms' must be considered. When these market factors are considered, the subsidy's net impact on employment may be negative for some firms, due to: (1) the output effects of the financing of the subsidy, and (2) the substitution between products which require different relative amounts of labor, which arises because the subsidy affects the prices of such goods differently.

The net impact of an employment subsidy among firms will be shaped by how it is financed and upon the reaction of the monetary authorities to the method of finance. The budget cost of the subsidy must be financed by decreases in government expenditures, increases in government borrowing, or increases in taxes. As a result of these associated fiscal changes, the subsidy's net impact on output may be negative for many firms. In general, the subsidy's net impact on output is most likely to be negative for the least labor-intensive firms, since the subsidy's net cost reduction would be relatively low for such firms. Given that the subsidy may induce only a slight substitution of labor for other factors in many firms, the possibility of a negative net impact on a firm's output implies that the subsidy's net impact on employment could be negative. The method of financing the subsidy may also affect the cost of labor relative to other factors.

The degree to which buyers are willing to purchase more labor-intensive products as their relative prices decrease will be one of the determinants of the subsidy's impact on total employment. An employment subsidy will tend to reduce the prices of labor-intensive products relative to the prices of non-labor-intensive products. The change in relative product prices may be accompanied by an overall decline in the output of some non-labor-intensive products. Buyers may shift their purchases toward the now cheaper products, away from the non-labor-intensive products. However, the subsidy could have a positive net impact on the output of non-labor-intensive products which are complements of labor-intensive products.

The effect of a labor subsidy on employment also depends on the responsiveness of labor supply to wages. In general, the employment effects of a wage subsidy will be greater, the more the quantity of labor supplied responds to an increase in wage rates.1/ Furthermore, a subsidy will generally increase the wages received by workers and reduce the net cost of labor.

Employment can increase if either the number of employees or the number of hours worked per employee increase. The impact of a labor subsidy on these two dimensions of labor input will be determined by whether the subsidy applies to all wages or is paid per employee. In the case of a pure wage subsidy, employers will have an incentive to substitute more hours per worker for fewer employees, since a wage subsidy will not reduce whatever fixed hiring and training costs are associated with each new worker on an employer's payroll. A subsidy per employee will encourage employers to favor part-time workers over full-time workers.

B. Temporary Subsidies

Additional considerations are relevant when an employment subsidy is temporary. The amount of factor substitution induced by a short-term subsidy will be limited by any fixed costs associated with employing capital and labor. Fixed costs reflect the costs of adjusting factor quantities--of selecting and training new workers, of installing or removing machinery. Due to these costs, most capital acquisition decisions and many employment decisions are long-run decisions.2/

A short-lived subsidy will be more likely to influence the timing of factor use. For example, while the subsidy is in effect, a firm could substitute labor for capital by postponing a planned capital acquisition until after the subsidy lapses. A

1/ If there is substantial structural unemployment in a labor market, labor supply will tend to be highly responsive to wage rates. It is frequently contended that structural unemployment is caused by market wages which are above the market-clearing level because of legal or institutional constraints.

2/ A simple example can illustrate this point. Suppose that a firm had planned to keep its production and input levels unchanged for several years. An employment subsidy is then introduced which reduces the annual cost of an additional worker from $10,000 to $8,000 during the one year in which the subsidy is in effect. Without any change in output, the additional worker could substitute for one machine which costs $9,000 annually. If there were no adjustment costs, then the firm would replace the machine with the additional worker. If, on the other hand, it costs $2,000 to remove or install the machine, the firm would not make the substitution. Equivalently, the firm would not make the substitution if there were a $1,500 training and hiring cost per worker.

short-lived subsidy could also increase employment without increasing output in some firms by inducing decreases in the rate of utilization of the capital stock.

The costs of adjusting the stock of capital and the costs of selecting and training employees also tend to limit the scale effect of a temporary employment subsidy. Nevertheless, a temporary subsidy may induce some firms to accelerate the implementation of expansion plans. In any case, the costs of adjusting the capital stock to accomodate temporary increases in output will tend to be lower if the utilization of capital inputs can be temporarily increased.

Part of any increase in output induced by a subsidy may simply represent a rescheduling of production, which could occur by accumulation of an inventory. To the extent this occurs, decreases in output and employment will occur after the subsidy expires. Similarly, an employment subsidy could result in a rescheduling of when labor inputs are utilized. Employers generally have some discretion when to schedule workers for activities like building and equipment maintenance. Employers clearly would have an incentive to schedule these activities for the period when the subsidy was in effect. Again, this implies that increases in employment that are induced by a temporary subsidy may be offset by subsequent decreases in employment. Substitution of labor used in one period for labor used in subsequent periods should not necessarily be viewed as defeating the purpose of a temporary subsidy since the policy objective may have been to alter the time path of employment.

Despite the possibilities for rescheduling production and labor usage, the employment effect of a temporary wage subsidy will not necessarily be confined to the duration of the subsidy. After the subsidy ends, an employer may temporarily retain some of the additional workers. But the employer would not replace any workers that quit as long as his employment level is greater than what it would have been in the absence of the subsidy.

Finally, like a permanent wage subsidy, a temporary wage subsidy will encourage employers to substitute more hours for existing workers in place of hiring additional workers. Indeed this effect will be more pronounced, because any hiring and training costs that result from increasing the number of workers must be recouped over a shorter period for temporary workers.

C. Incremental Subsidies

General employment subsidies inevitably subsidize much employment that would have existed even without the subsidy. Some of the subsidized firms may make no adjustments in their employment decisions. Incremental employment subsidies, like the NJTC, are intended to limit the extent of such windfalls and to thereby maximize the employment gain per dollar of subsidy.

An incremental subsidy would ideally be paid only for the wage costs of the increase in eligible employment due to the subsidy, that is, the "incremental" employment. No payments would be made to employers who simply maintain their pre-subsidy employment levels, or who would have hired additional workers without the subsidy.

As a practical matter, there is no sure way of identifying true incremental employment. Feasible procedures for estimating incremental employment are bound to be subject to large errors. If the normal employment level used to define incremental employment is overestimated for some firm, the employment incentive of the subsidy is reduced. If it is underestimated, the firm can reap windfalls. Policymakers are, of course, faced with a trade-off between accuracy and administrative feasibility in devising procedures for estimating incremental employment. More accurate procedures can be expected to entail substantial costs for the government and employers.

One procedure for estimating incremental employment simply assumes that in the absence of the credit all firms would experience the same employment growth rate. Each firm's employment in some base period is then projected into the future, using the predicted value of the aggregate employment growth rate. A subsidy which uses this procedure would put firms that have below-average employment growth rates at a competitive disadvantage. As a result, employment in these firms may decline, offsetting the gains in employment in the firms receiving the subsidy. For the NJTC, a special case of the above procedure was used in which the base period employment was defined as the measured employment in the firm in the previous year. The base period employment for a firm could therefore change as the credit entered its second year.3/

3/ Labor subsidies with this type of "floating" base period may give some firms an incentive which will work against the goal of maximizing the job gains per dollar of subsidy. Lower employment growth in one year will reduce the base for the following year. Hence, a firm which would otherwise not be increasing its workforce fast enough to claim the subsidy in any year may be able to capture the subsidy by deferring employment growth in one year until the next. Through this stratagem, the firm would delay employment growth in order to qualify for the subsidy in the second year. The firm could thus receive the subsidy without increasing its average employment level over the subsidy's lifetime.

D. Targeted Subsidies

When an employment subsidy is targeted to a narrowly defined group of workers, for whom there are close substitute workers, the factor substitution effect between eligible and ineligible labor will far exceed that between eligible labor and other factors. In this case, targeted subsidies could increase eligible employment without increasing total employment or output.4/

A wage subsidy could reduce employment for ineligible workers if it results in: 1) direct replacement of these workers by eligible workers in subsidized firms or 2) shifts in output (and employment) to subsidized firms from nonsubsidized firms. The subsidy could increase the employment of some ineligible workers whose labor is complementary with eligible labor or who are employed in making products that are complementary with the eligible labor-intensive products. While a targeted employment subsidy can increase eligible employment without increasing aggregate employment, this outcome does not necessarily indicate that the goal of the subsidy--more employment for the targeted groups--was not achieved.

Essentially the same considerations are relevant to employment subsidies which are available only to certain types of employers. The NJTC and TJTC were, for example, limited to taxable businesses. Similarly, the NJTC was limited to taxable firms with FUTA base growth in excess of 2 percent. Subsidies targeted to certain employers could reduce employment among ineligible employers as a result of greater product competition from eligible employers or higher wage costs.

E. The Design of Employment Subsidies

Several elements of the design of employment subsidies require particular attention. First, employers must be aware of the subsidy to benefit from it, and employer awareness may be

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4/ A positive net impact on aggregate employment is more likely to occur in the case of a subsidy targeted to individuals with relatively elastic labor supplies. If the supply of the factors which bear the burden of financing the subsidy is generally less elastic, then the decline in their use may be relatively slight compared to the increase in targeted employment.

influenced by efforts to publicize the subsidy and by the duration of the subsidy.5/ The time required for information to be disseminated may limit the utilization of short-lived subsidies. Second, the addition of a ceiling on the amount of subsidy that a firm can receive (such as the small business limitation in the NJTC) may considerably reduce the subsidy's employment incentive for hiring additional workers. Third, a wage subsidy will be claimed only if the employer perceives that the value of the subsidy exceeds the costs entailed in claiming the subsidy.

Administration of an employment incentive involves resource costs distinct from the direct costs of the subsidy provided to participating employers. The administration of an employment incentive requires publicizing the program and a means of identifying eligible individuals. If administrative funding is not available, some of the administrative functions will be shifted to other groups or will not be done at all. For example, if eligible individuals cannot be easily identified and are not identified by the administering agency, a participating employer must bear some of the cost of identifying the eligible individuals. This reduces the net benefit of the subsidy to employers and thus, the employment effect for eligible individuals.

For effective program implementation, the program's goals should also be consistent with the function of the agency designated to administer the program and its costs should be reflected in the agency's budget. An agency evaluated on the number of its direct job placements may give low priority to an employment incentive that does not require its placement services. The incentive to administer a subsidy program

5/ Since the focus of this report is on the NJTC and the TJTC, the theoretical discussion in this chapter presumes that the labor subsidy is given to employers rather than to workers. Simple models of perfectly competitive labor markets would suggest that a labor subsidy paid to workers will have the same overall effects as an otherwise equivalent subsidy paid to employers. However, if the subsidy applies to a labor market which is effectively constrained by a legal minimum wage (or some other wage floor), this equivalence does not hold. A subsidy paid to employers may have the desired effect of increasing employment, while a subsidy paid to workers may only exacerbate unemployment. For a fuller discussion of this issue see Robert I. Lerman, "A Comparison of Employer and Worker Wage Subsidies," in Jobs for Disadvantaged Workers, Robert H. Haveman and John L. Palmer, editors, Washington, DC: The Brookings Institution, 1982.

effectively may also be greater if the program's costs appear directly in the budget of the administering agency. If the subsidy is provided as a tax credit, however, the costs of the subsidy will show up primarily in reduced revenues with little, if any, impact on the administering agency's budget.

The connection between a firm's employment decisions and the costs and benefits of an employment subsidy may frequently not be known with certainty at the time the hiring decisions are made. Uncertainty is apt to be especially great for subsidies, such as the NJTC, which have complex provisions. The fixed costs of claiming a subsidy may also be uncertain. Employers may, for example, believe that claiming an employment tax credit will increase their risk of a tax audit. In general, the existence of uncertainty can be expected to dilute the employment and output incentives of employment subsidies.

Increased efforts to inform eligible employers of an employment subsidy may significantly enhance its effectiveness. When ignorance of the subsidy or its provisions is widespread, the subsidy may cause only a negligible increase in eligible employment. Under some circumstances, the subsidy could even cause eligible employment to decrease.

Chapter 3

LEGISLATIVE HISTORY OF JOBS TAX CREDITS

The United States has had experience with three employment tax credits during the past ten years, the WIN/Welfare Tax Credit, the New Jobs Tax Credit, and the Targeted Jobs Tax Credit. A legislative history of the three jobs credits will help to provide a context for evaluating the latter two employment tax credits. The legislative histories show the intent of Congress in enacting these credits and the rationales for specific provisions in the final legislation.

I. The WIN/Welfare Tax Credit

The Work Incentive (WIN) Program was designed to expand employment opportunities for Aid to Families with Dependent Children (AFDC) recipients by providing them with job training and other benefits.

Although AFDC applicants and recipients may register in WIN voluntarily, most registration (about 85 percent) is not by choice. All AFDC applicants or recipients must register in the WIN program unless they are exempt due to the need to care for children under age 6, illness, residence in an area too remote from a WIN program center, etc. WIN registrants are required to take jobs offered them subject to federal standards regarding suitability which allow considerably fewer grounds for rejecting an offer than do the conditions applicable to unemployment insurance.

The Revenue Act of 1971 contained a WIN tax credit for employers that hired welfare recipients enrolled in the Work Incentive (WIN) program. The WIN credit was intended to increase employment of welfare recipients in trades or businesses. The WIN credit has been available since 1971.

As enacted, tax credits of 20 percent of first-year wages were provided to employers who hired WIN registrants. In any year, the total WIN credits claimed by an employer could not exceed one hundred percent of the first $25,000 of tax liability plus 50 percent of the tax liability in excess of $25,000. Employees for whom the credit was claimed had to be WIN registrants at the time of hire and to remain employed for a period of at least two years. The credit could be disallowed--and recaptured--if the period of employment was shorter, unless the employee became disabled, was fired for misconduct, or quit. The WIN credit could only be claimed by trade or business employers.

The welfare recipient credit was authorized by the Tax Reduction Act of 1975. The legislation essentially extended the WIN credit to individuals who had been recipients of AFDC for at least 90 days before being hired. The welfare credit, however, differed from the WIN credit in two respects: (1) the credit was available for employees who worked the equivalent of full-time for at least 30 days and (2) nonbusiness employers were permitted to claim welfare tax credits on up to $5,000 in wages. Only one tax credit--either the WIN or the Welfare Tax credit--was allowable to an employer for the wages paid to an eligible individual. The Welfare Tax Credit had a sunset provision of July 1, 1976.

In the Tax Reform Act of 1976, Congress liberalized several provisions of each credit in order to increase use of the credits. The limit on the credits claimed was increased to 100 percent of the first $50,000 of tax liability plus 50 percent of the tax liability over $50,000. The required employee retention period for WIN credit was reduced to 180 days, and another exception to the recapture rule was added (for layoffs due to large reductions in business). The expiration date for the welfare credit was extended to January 1, 1980.

Congress made further changes in these tax credit programs under the Revenue Act of 1978. These changes were made because the House and Senate Committees believed that the utilization of the credits was low due to insufficient publicity, complexity, and the low value of the credits. The legislation increased the WIN/Welfare credit to 50 percent of first-year wages up to $6,000 per covered employee and 25 percent of the second year wages up to the same limit per employee. Nonbusiness employers could receive a credit of 35 percent of the first $6,000 in wages per employee (only in the first year) up to a limit of $12,000 in wages for all eligible employees. The wage deduction for business employers was reduced by the amount of the credit, and the credit could be taken against one hundred percent of tax liability. The credit recapture rule under the WIN credit was repealed. The WIN and Welfare tax credits could be earned only for eligible individuals who worked at least 30 days on a substantially full-time basis. Finally, the credit's sunset date of January 1, 1980 was removed.

At the beginning of 1982 the WIN/Welfare credit was subsumed under the Targeted Jobs Tax Credit; WIN/Welfare credit eligibles were made one of the TJTC target groups. Tax credits could no longer be claimed for employment with nonbusiness employers.

Throughout its 11-year history, use of the WIN/Welfare Credit has been modest. The 1978 liberalization increased its use from about 35,000 credits annually, or 13 percent of total WIN jobs entries, to 53,000 credits in FY 1980, representing 19 percent of WIN job entries. Measured against different bases, the WIN/Welfare tax credit takes on less significance. In 1980, WIN/Welfare tax credits were claimed for less than 10 percent of all new WIN registrants. The annual revenue loss attributable to the WIN/Welfare credit was $60 million in FY 1981.

II. The New Jobs Tax Credits

A. Purpose of the Legislation

The Tax Reduction and Simplification Act of 1977 contained a New Jobs Tax Credit provision, which granted tax credits to certain employers whose labor costs had increased. In enacting the credit, Congress was principally trying to provide counter-cyclical fiscal stimulus by encouraging employment, particularly in small businesses. Another purpose of the credit was to help handicapped persons find employment.

B. Legislative History of the New Jobs Tax Credit

An employment tax credit was initially proposed as part of President Carter's January 31, 1977, proposal to stimulate the economy. The provision was substantially changed by the Congress and eventually enacted on May 23, 1977.

1. The Administration's Proposal

Originally, the Carter Administration recommended that businesses be given a choice of: (a) receiving a credit against income tax of 4 percent of Social Security payroll taxes paid by the employer or (b) an increase in the investment credit for machinery and equipment investments made in 1977. This choice of credits constituted the business portion of a package that also recommended tax cuts for individuals. Overall, the Treasury estimated that the business tax proposals would reduce tax liabilities by about $2.6 billion.

2. The House Bill

The Ways and Means Committee showed little enthusiasm for the proposed choice between an additional investment tax credit and the social security tax credit. The House committee members also regarded the employment tax credit proposed by the President as being too small to be meaningful; it would have had the effect of reducing the payroll tax rate by less than one-quarter of 1 percentage point (4 percent of the employer's social security tax rate of 5.85 percent). In addition, the President's proposal was criticized because it would compensate employers regardless of whether or not they made an attempt to expand employment because of the credit. Committee members argued that the credit would stimulate employment more if it were made incremental. With an incremental credit, firms would receive a subsidy only if they expanded employment.

In designing an administratively feasible incremental credit, the Committee was faced with two major issues: (1) defining incremental employment and (2) determining an appropriate measure of employment. The Committee resolved the first issue by defining incremental employment as only that employment which exceeded a certain threshold level.1/ In general, the threshold level would depend on employment growth in the previous year. The Committee resolved the second issue by settling on an indirect measure of employment. Not all firms could be expected to have information on the number of employees.2/ However, firms would have information on the wages they were required to pay tax on under the Federal Unemployment Tax Act (FUTA). In 1977, the FUTA base for each firm consisted of the first $4,200 of wages it paid to each employee. The Committee staff suggested that, since growth in a firm's FUTA base corresponded roughly to growth in the number of its employees, a firm's FUTA base growth could be used as an approximate measure of its employment growth. The Committee decided to follow this suggestion.

Several features of the House bill are worth noting. First, the credit would have been limited to 40 percent of the amount by which the credit base (defined as the first $4,200 of FUTA wages paid to each employee) in the current year exceeded 103 percent of the credit base in the previous year. Second, since the Committee was interested in providing special assistance to handicapped employees, it provided an additional 10 percent credit for firms which hired such employees. Third, to focus relief on small businesses, the House decided to limit the credit available to $40,000 for any one firm.

It was recognized that a firm might be able to expand its FUTA base, but not necessarily employment measured in total work hours, by replacing full-time employees with part-time employees. For example, by replacing a full-time worker making $8,400 with two part-time workers earning $4,200, a firm could double its credit base. In an attempt to prevent this response, the House committee added a provision making the amount of credit available to an employer dependent upon total wages, not just on the growth

1/ The difficulties posed by these problems and the Committee's solutions to them are discussed more thoroughly in sections IA and IIIA of Chapter 4.

2/ Actually, there are no reliable data on employment in each firm in the economy. Even if data on the number of employees were available, another problem with an incremental employment credit is whether an employer that adds a full-time worker should receive more credit than an employer that adds a part-time worker.

of the FUTA wage base. Specifically, the credit would only be available if current wages exceeded 103 percent of the total wages paid by an employer in the previous year. The rationale for this provision is as follows: Because of normal wage growth, a firm's wages might grow by 3 percent a year even with no growth in actual employment. Making the credit contingent on wages exceeding this "no growth" limit would reduce the possibilities for increasing the credit base without increasing employment. Another feature of the House bill was that employers would not have been required to reduce the deduction for wages paid by the amount of credits received.

3. The Senate Bill

The Senate Finance Committee made a number of changes to the House bill: (1) the deduction for wages paid was reduced by the amount of the credit; (2) the $40,000 cap on the employment tax credit was removed to allow large employers to benefit from the credit by hiring additional employees; (3) the extra credit for hiring the handicapped was eliminated; (4) the Administration's approach of requiring firms to choose between an extra 2 percent investment tax credit and the new employment tax credit was reinstated. The committee recognized that new businesses with no wages in the previous year would always exceed a credit base growth threshold of zero. To reduce the advantages that new businesses would have, the committee limited the amount of wages eligible for the credit to 50 percent of the current year's unemployment insurance wages. Finally, to reduce the revenue loss resulting from its changes, the committee decided to reduce the rate of the credit from 40 percent to 25 percent.

More changes were made when the legislation reached the Senate floor. First, the rate of the credit was increased from 25 to 50 percent. Second, the Senate reinstituted a cap of $100,000 on the amount of credit a firm could earn in one year. An additional 10 percent tax credit was added for employers who hired certain disadvantaged individuals and the definition of these workers was broadened. The threshold eligibility requirement for credit base growth was lowered to 101 percent for employers in states with unemployment rates higher than 7.5 percent. Finally, the full Senate eliminated the optional increase in the investment tax credit.

4. Conference Committee

The Conference Committee generally decided to follow the provisions adopted in the Senate passed bill. There were a few exceptions, however. The 103 percent credit base growth threshold was lowered to 102 percent. The lower threshold for high unemployment states was eliminated and the definition of disadvantaged workers eligible for the extra 10 percent credit was restricted to the handicapped as in the House bill.

C. Description of Final Legislation

The New Jobs Tax Credit (NJTC) enacted by Congress on May 23, 1977, provided a credit for 50 percent of the difference between each employer's current credit base--the first $4,200 of FUTA wages paid per employee--and 102 percent of the credit base for the previous year. Employers received an additional 10 percent credit on the first $4,200 of FUTA wages paid to handicapped people whose first such wages from the employer were paid in 1977 or 1978. The credit claimed in any year could not exceed (1) 50 percent of the difference between an employer's total wages in the year and 105 percent of total wages paid by the employer in the previous year; (2) 25 percent of the current year's unemployment insurance wage base; (3) $100,000; or (4) the employer's tax liability for the year.3/ Credits earned that exceeded the tax liability for a year could be carried back for three years and forward for seven years. In addition, the income tax deduction for wages and salaries had to be reduced by the amount of the credit. The NJTC legislation had an expiration date of the end of 1978.

III. The Targeted Jobs Tax Credit

A. Purpose of the Legislation

The Revenue Act of 1978 contained a Targeted Jobs Tax Credit provision, which granted tax credits to employers hiring certain types of targeted workers. The credit was intended to increase the employment of certain segments of the population which had relatively high rates of unemployment, and to increase participation in certain educational programs.

B. Legislative History of the Targeted Jobs Tax Credit

1. The Administration's Proposal

In April 1978, President Carter proposed the Targeted Jobs Tax Credit (TJTC) as part of his Urban Initiatives program. This provision was to replace the existing, New Jobs Tax Credit (NJTC) which rewarded employers for increases in total employment. The

3/ The $100,000 limit could be exceeded if handicapped workers were hired. Special additional rules were provided for agricultural and railroad employees not covered by FUTA unemployment insurance. Moreover, all employees of corporations that were members of the same controlled group of corporations were treated as employees of a single employer, and special adjustments had to be made for corporate acquisitions or dispositions.

credit, as proposed, was to be focused on young people from low-income families, who as a group were experiencing high rates of unemployment. Special employment incentives were believed to be necessary for this group even when the national unemployment rate is low. In addition, the proposed legislation would continue to provide a special tax incentive for retaining the handicapped, a provision of the NJTC.

In recent years, the average unemployment rate among disadvantaged youth (ages 18-24) has been several times the average rate for the labor force as a whole. In addition, there was evidence that employment of minorities within this group had not responded to the overall decline in unemployment in the 1976-1978 recovery as rapidly as was forecast from previous recoveries. The TJTC, used in addition to a program of overall fiscal stimulus, was meant to reduce this structural unemployment problem.

The rationale for the TJTC was that it would increase the employment of the targeted groups by lowering the relative cost of hiring these workers. Because the target population is a small part of the labor force and some displacement of ineligible workers would occur, the credit was not expected to significantly reduce the overall unemployment rate.

The proposal focused the employment incentive on disadvantaged young people, defined as individuals aged 18-24 from households with total family income less than 70 percent of the regional lower living standard. This income standard was taken from the existing CETA legislation.

The same incentive was to be available for hiring handicapped individuals who were referred from vocational rehabilitation programs. These handicapped individuals had been eligible for an additional credit of 10 percent of FUTA wages under the NJTC.

2. <u>The House Bill</u>

The legislation that emerged from the House of Representatives closely resembled the Carter Administration's proposal. The House bill contained no provision for extending the NJTC and, instead, focused the tax incentives on specific labor groups. It also incorporated the existing WIN credit into the new proposal.

The House legislation expanded the Carter Administration's proposal by increasing the amount of the credit and by making more workers eligible for the program. The House bill increased the rate of subsidy in the first year from one-third of qualified wages to one-half, but reduced the rate of subsidy for the second year of employment from 25 percent to 16-2/3 percent. The minimum length of employment was dropped, the limitation on qualified wages was raised to 30 percent of aggregate FUTA wages, and the limitation of the credit was raised to 100 percent of the current-year tax liability. The House bill included economically disadvantaged youth and handicapped individuals, but also added five other target groups. Four of these new groups were defined by federal and state programs for the needy: (1) Supplemental Security Income (SSI) recipients, (2) general assistance recipients, (3) Work Incentive (WIN) program registrants, and (4) Vietnam Veterans on Food Stamps. It was argued that increased employment among these groups would lower program outlays. In addition, cooperative education students were included in order to encourage employers to participate in an educational program deemed to be valuable.

The criterion for economically disadvantaged youth was changed from CETA definition to one that specified members of a household receiving food stamps. The Food Stamp program was chosen as a screen to identify needy youth because it already served a high proportion of needy youth with what was believed to be a well-suited definition of economically disadvantaged and a relatively reliable eligibility test of an applicant's income and assets.

The House bill was estimated to have a revenue cost of $900 million in calendar year 1979 and budget outlays were to be reduced by $875 million the same year. In addition, the House bill would have terminated the separate WIN/Welfare credit at the end of 1978.

3. The Senate Bill

The Senate bill provided for a three-year Targeted Jobs Tax Credit. The maximum credit was to be $3,000 per employee for the first year of employment, $2,000 for the second year, and $1,500 for the third year. The Senate bill contained the Carter Administration's proposals of a 75-day minimum employment requirement, the 20 percent aggregate FUTA wage limitation, and the 90 percent of current year tax liability limitation.

The Senate bill also provided for several additional target groups. As compared to the Carter proposal, the targeted groups were expanded to include disabled SSI recipients, general assistance recipients, economically disadvantaged Vietnam veterans, and economically disadvantaged ex-convicts.

The Senate modified the WIN/Welfare credit, but kept it separate from the targeted jobs credit. The Senate provided for a WIN/Welfare credit of 75 percent of wages up to $6,000 for the first year of employment, 65 percent in the second year and 55 percent in the third year. For years of employment beginning in 1981, the amount of the qualified wages was to be increased to $7,000. The provisions authorizing credits for employment other than in a trade or business were also liberalized.

The Senate bill also set a sunset provision of the end of 1981 for the targeted jobs credit. The WIN/Welfare credit change was to be permanent. The Senate Finance Committee believed that the WIN/Welfare credit "should be separate from the new, experimental targeted jobs credit program."4/

On the Senate floor, the revenue bill was amended to extend the New Jobs Tax Credit (NJTC) for two years with several changes. The amount of the NJTC would be equal to 35 percent of up to $6,000 of wages per additional employee--a maximum credit of $2,100, as before. The total amount of the NJTC would no longer be limited to a percentage of the increase in an employer's total wages over total wages in the previous year. The targeted credit was to be adopted in addition to the extended NJTC.

4. Conference Committee

The Conference Committee dropped the Senate floor amendment for extension of the NJTC. Under the Conference agreement, the targeted jobs credit was limited to two years with the rate of subsidy equal to 50 percent of qualified wages in the first year of employment and 25 percent in the second year--up to $3,000 and $1,500 per worker, respectively. The targeted groups eventually included seven categories of eligible workers. No minimum employment requirement was included and a sunset provision was set for January 1, 1982. A drafting error setting this date as December 31, 1980, was later corrected in the Technical Corrections Act of 1979. The WIN/Welfare credit was kept separate but was structured like the targeted jobs credit.

C. Description of Final Legislation

The Targeted Jobs Tax Credit was enacted by Congress on November 6, 1978, as part of the Revenue Act of 1978 (P.L. 95-600).5/ It provided for a tax credit equal to

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4/ U.S. Senate, Committee on Finance, Report on the Revenue Act of 1978, No. 95-1263, p. 134.

5/ A number of technical corrections in the TJTC provisions, were made in the Technical Corrections Act of 1979 (P.L. 96-222), April 1980, including raising the age limit for cooperative education students to 19.

50 percent of the first $6,000 of an eligible employee's wages in the first year of employment and 25 percent in the second year. Seven groups were eligible:

- o economically disadvantaged youth aged 18-24;
- o economically disadvantaged Vietnam veterans under age 35;
- o economically disadvantaged ex-convicts hired within 5 years of prison release or date of conviction;
- o recipients of Supplemental Security Income;
- o recipients of general assistance;
- o students in qualified cooperative education programs age 16-19; and
- o handicapped participants (or ex-participants) in vocational rehabilitation programs.

The Targeted Jobs Tax Credit could be claimed for wages paid during calendar years 1979-1981 to employees who were hired after September 26, 1978, and whose eligibility was certified by the local agency designated by the Secretary of the Treasury and the Secretary of Labor. The credit could not be claimed for employees for whom the employer received payments from CETA on-the-job training contracts or claimed the WIN tax credit. A firm's qualified wages could not exceed 30 percent of its aggregate FUTA payroll. The credit was limited to 90 percent of the current year tax liability after other nonrefundable credits were claimed, except that credits that exceeded this limit could be carried back for three years or forward for seven years. The deduction for wages and salaries had to be reduced by the amount of the credit.

The New Jobs Tax Credit was allowed to expire at the end of 1978 while the WIN/Welfare credit sunset provision was removed.

D. The 1981 Amendments to the Targeted Jobs Tax Credit

The Economic Recovery Tax Act of 1981 extended the Targeted Jobs Tax Credit for eligible individuals hired before the end of 1982. Several changes were made to improve the credit's effectiveness. It was required that certifications of eligibility be issued or requested before the day the eligible individual began work, which limited the extent to which certifications could be retroactive.6/ Vouchers for members

6/ This requirement was phased in and did not become fully effective until September 27, 1981.

of economically disadvantaged families were made valid for 45 days after issuance. The ceiling on a firm's qualified wages (30 percent of its aggregate FUTA payroll) was removed. The legislation also authorized appropriations of $30 million for program administration, including $5 million for systematically testing the validity of TJTC certifications. While $30 million were authorized for program administration, actual appropriations were $20 million in FY 1982.

In addition, the WIN credit was terminated as a separate program, effective January 1, 1982, with AFDC recipients and WIN participants becoming TJTC target groups. The age limitation for Vietnam veterans (under age 35) was eliminated and eligible cooperative education students were limited to those who are economically disadvantaged. One additional target group was made eligible for a job credit--employees laid off from public service employment funded by the Comprehensive Employment and Training Act (CETA).

E. The 1982 Changes in the Targeted Jobs Tax Credit

The Tax Equity and Fiscal Responsibility Act of 1982, extended the TJTC for two years, making the credit available for persons newly hired on or before December 31, 1984. This law also modified TJTC, as follows:

- A new target group was added: "qualified summer youth employees," economically disadvantaged youth 16 or 17 years old on the date of hire. Their employers are entitled to an enriched credit equal to 85 percent of wages up to $3,000 per qualified employee paid for work performed in any 90-day period between May 1 and September 15. [Credits may be claimed for former "qualified summer youth" rehired by the same firm if they qualified as members of another targeted group.]

- The "involuntarily terminated CETA employees" target group was dropped, effective January 1, 1983.

- The definition of qualified general assistance programs was broadened to include programs providing assistance through "voucher or script."

- Certifications must now be obtained or requested in writing no later than the day on which the individual starts work.

- "Such sums as may be necessary" are authorized for TJTC administration during FY 1983 and FY 1984.

- Beginning in calendar year 1982, the Secretary of Labor shall provide to the tax-writing committees of the Congress an annual report on the results of tests of the accuracy of TJTC certifications mandated by the 1981 TJTC amendments.

F. The 1984 Changes in the Targeted Jobs Tax Credit

The Deficit Reduction Act of 1984 extended the TJTC for one year, making the credit available for individuals who begin work for the employer before January 1, 1986. The law also extended the authorization for administrative funds through fiscal year 1985. Several minor technical changes were also made.

Chapter 4

THE NEW JOBS TAXS CREDIT

This chapter evaluates the experience with the New Jobs Tax Credit. The first section focuses on the administrative aspects of the credit. The second section presents information on the type of employers that claimed the credit, the credit's cost, and other quantitative data on the credit. The final section evaluates the success of the program in achieving its objectives. The credit's history and provisions are described in Section II, Chapter 3.

I. Administrative Aspects of the New Jobs Tax Credit (NJTC) Program

The NJTC was enacted to provide incentives for employers to add workers to their payrolls during 1977 or 1978. Congress wanted to subsidize only the additional--or incremental--jobs created by the credit. The attempt to achieve this objective produced a complicated credit. Experience with the NJTC illustrates the administrative difficulties connected with incremental employment tax credits, that is, tax credits based on additional employment.

A. Defining the Credit's Base

The main problem in administering an incremental credit is determining what incremental employment is for each firm in the economy. Incremental employment is defined as the difference between: (1) the firm's employment and (2) what the firm's employment would have been had there been no credit.

With enough resources, it might be possible to obtain reasonably accurate measures of employment in each firm in the economy after an employment tax credit was enacted. However, in general, there is no way of measuring what employment in a firm would have been if there had been no credit. This is because employment in different firms will grow at quite different rates in the absence of the credit. Table 4.1 illustrates the problem.

Table 4.1

Measured Employment Growth Versus
Incremental Employment Growth

	Measured Employment Growth (1)	Employment Growth with-out Credit (2)	Incremental Employment Growth (3)
Firm A	10%	8%	2%
Firm B	5%	0%	5%
Firm C	25%	24%	1%

The first column of the table shows measured employment growth during the year, the second shows what employment in each firm would have been without the credit. Incremental employment growth is the difference between columns one and two. The administrative problem is that the information in column 2 can only be roughly estimated. One administratively feasible design for an incremental employment credit would have incremental employment defined as employment growth in excess of some arbitrary fraction of the previous year's employment. For example, if the proportion were 5 percent, this rule would deny Firm B any credits for expanding employment even though it might have increased employment most because of the credit, whereas Firm C could have received the highest credit even though it might have increased employment least because of the credit.

Even when incremental employment is defined by the above arbitrary rule, there is the additional administrative difficulty that firms do not have records that accurately reflect the average number of workers that they employ each year. At best, only approximate measures of employment growth are available at the enterprise level. Ideally the measure adopted should be a good proxy for employment; it should impose minimal additional costs on users of the credit and the administering agency; and it should not be capable of being artificially manipulated.

The New Jobs Tax Credit used the taxable wage base under the Federal Unemployment Tax Act (FUTA) as a proxy for employment. At the time the NJTC was enacted, the FUTA base was defined as the first $4,200 of wages that the firm paid to each of its workers. Since each $4,200 of a firm's FUTA base corresponded roughly to one employee, changes in this base were used to measure employment growth. The value of the NJTC was determined by FUTA base growth in excess of 102 percent of the FUTA base in the previous year. Throughout this chapter, the term "credit base growth" will mean FUTA base growth.

It needs to be emphasized that the relationship between a firm's credit base and its average annual employment is imperfect. If the annual wages associated with a job slot were less than $4,200, then the job's contribution to the FUTA credit base would necessarily be less than $4,200. On the other hand, for job slots with annual wages above $4,200, FUTA wages could also exceed $4,200, because of employee turnover. For example, a job slot with annual wages of $12,000 would generate $8,400 in FUTA wages if it were filled by two different employees in succession, each working six months. This effect is reflected in the fact that FUTA wages per covered employee averaged over $4,500 in 1977. This is greater than the total FUTA wages for a single employee working for one employer for the entire year. Because FUTA wages were not effectively capped by the $4,200 limit for low-wage workers and for workers changing jobs, FUTA wages rise with inflation. Between 1976 and 1977, the average FUTA wage per employee rose 1.87 percent.1/

B. Efforts to Limit Artificial Expansions of the Credit Base

Both Congress and the IRS imposed restrictions on the NJTC to prevent artificial expansions of the credit's base.2/ These also complicated the credit and made it more difficult to use.

1. Regulations Covering Controlled Groups of Businesses

Regulations were written to prevent transfers of employees within a controlled group of businesses from generating any credits. The rule simply required commonly owned establishments to aggregate FUTA wages. Other rules were added to establish FUTA bases for businesses that were purchased and sold during the year.

1/ Each month employers paying FUTA taxes report the number of individuals on their payroll at any point during the pay period which includes the twelfth day of the month. This information provides a measure of aggregate FUTA covered employment in a given month. The aggregate ratio for each month of annualized FUTA wages to covered employment averaged $4,431 in 1976 and $4,514 in 1977.

2/ For example, this was one rationale for the NJTC's wage bill limit. See the discussion of the NJTC's legislative history in Chapter 3.

The regulations required that when an individual purchased a business, the employment credit must be computed on the basis of the FUTA wages and total wages paid by the seller in the previous year. Thus, if A paid FUTA wages of $100,000 in 1976 and sold the business to B in 1977, B would be ineligible for the credit unless B paid at least $102,000 (102 percent for 100,000) of FUTA wages in 1977.

Since purchasers of businesses had to use the wage base information of previous owners to compute their credit eligibility, the regulations allowed sellers of a business to reduce their wage base in the previous year by the amount of wage base transferred to purchasers. Otherwise, taxpayers could be denied credits for transactions that increased both employment and the FUTA base.

2. Rules for New Businesses

While the rules on sales of businesses would prevent persons from qualifying for credits by exchanging business ownership, other avenues were available for capturing the credit without actually increasing employment. One possibility was to dissolve a corporation and incorporate it under a different name. In the absence of legislation, the only thing preventing individuals from exercising this strategy was the cost associated with changing the legal status of corporations.

Congress realized that new businesses with zero FUTA bases in the previous year would have clear advantages in generating FUTA base growth. Accordingly, a special feature was added to the legislation which limited the credit to 25 percent of FUTA wages in the current year. Under this provision, if a new company had FUTA wages of $100,000, its credit would be reduced from the normal $50,000 to $25,000.

To further restrict the credit, Congress added a provision which prohibited self-employed individuals from designating themselves as employees to qualify for the credit. Congress also considered, but rejected, provisions that would ban conversions of contract workers to employees and disallow the credit to employers that fired some workers and hired others to earn the credit. These were regarded as too difficult for the IRS to administer.

3. Credit Pass-Through Provisions

Two separate tax liability computations were required of employers who received jobs credits from subchapter S corporations, partnerships, and trusts. Such taxpayers first had to compute, on a pro-rata basis, the share of their total tax liability attributable to the entity generating the credit. The amount of the credit that a taxpayer could receive from such outside sources of income could not exceed these separately computed tax liability limits even if employers had tax liability as a result of their own business activities. Employers could, however, use any tax liability generated in their own businesses to claim credits for their employees.

The purpose of the dual tax liability limit was to limit the extent to which the NJTC subsidized transactions that did not increase employment. Without this limitation, individuals could form partnerships and make other legal arrangements to obtain the NJTC earned by entities with insufficient tax liability. For example, suppose that Firm A earned $50,000 of credits, but the firm had only $5,000 of tax liability. In the absence of rules on credit pass-throughs, a firm with $45,000 of tax liability could have obtained Firm A's unused credits by becoming its partner. With the special rules, there would be no payoffs to such tax-induced mergers since the credit available to both partners would be limited to $5,000.

A complex tax form, Form 5884, was developed to lead taxpayers through the sequence of calculations and comparisons necessary to compute the credit they could receive. A copy of the 1978 version of this form and its accompanying instructions are attached as exhibits in Appendix A.

C. Informing Taxpayers of the Credit

As noted in Chapter 2, a credit will not be effective if taxpayers are unaware of its existence. To spread awareness of the credit among employers, the Internal Revenue Service and the Department of Labor issued news releases, prepared brochures, and distributed other material.

II. Statistical Summary

This section presents quantitative information on the New Jobs Tax Credit. The data presented here are based on samples of corporate tax returns filed in 1977 and 1978 and a sample of firms from the Business Master File (BMF) matched with Social Security payroll data. The data samples are described more fully in Appendix A.

A. Utilization of the Credit

The New Jobs Tax Credit legislation established three eligibility criteria for earning the credit. First, employers had to be in a trade or business. Second, an employer's credit base had to exceed the previous year's credit base by at least 2 percent.3/ Third, the employer's total wage bill had to exceed the previous year's total wage bill by at least 5 percent.

It is estimated that 176,500 corporations claimed the NJTC in 1977 and 356,900 corporations claimed the NJTC in 1978. These represented 9.8 percent and 18.9 percent, respectively of all corporations (other than DISC and Subchapter S corporations) filing tax returns.4/

Some firms were ineligible for the credit because they did not have credit base growth greater than the 2 percent threshold and/or annual wage bill growth greater than the 5 percent threshold. Table 4.2 shows the distribution of corporations and the distribution of employment by the 1976-77 growth rate in FUTA wages and total wages. The distribution of FUTA wages can be used to approximate the distribution of employment. From Table 4.2, it can then be estimated that 64 percent of 1977 employment was in firms which had credit base growth exceeding 2 percent and that 72 percent of total 1977 employment was in firms which had wage bill growth rate exceeding 5 percent. Firms that met both eligibility criteria are estimated to have amounted to 32 percent of all firms and to have had 52 percent of total 1977 employment. Using credit base growth as a measure of employment growth, an estimated 70 percent of the employment growth in firms with employment growth occurred in firms satisfying both eligibility criteria.

Table 4.3 shows utilization of the NJTC in 1977 by industry classification. "Industrial" corporations, such as manufacturing, mining, and construction corporations, were more likely to file for credits than "commercial" corporations, such as retail trade, finance, and service industry corporations.

3/ For the purposes of this chapter, the term credit base is defined as the first $4,200 or less of wages that a business employer paid to each of its employees during the year, summed across all employees.

4/ A Domestic International Sales Corporation (DISC) is a corporation whose income is predominantly (95 percent) derived from export sales. DISCs are allowed to defer paying taxes on a portion of the income derived from export sales. Jobs credits could not be earned by DISCs. Shareholders in Subchapter S corporations pay personal taxes on the distributed and undistributed income of the business. Subchapter S corporations were excluded from eligible corporations because New Jobs Tax Credits could not be claimed on these corporate returns, although they could be claimed on the individual returns of the owners of these corporations.

Table 4.2

Distribution of Firms and Employment by FUTA Base Growth and Wage Bill Growth Between 1976 and 1977

Percentage Change in FUTA Base 1/

	Less than 0%	0.0-0.9%	1.0-1.9%	2.0-2.9%	3.0-3.9%	4.0-4.9%	5.0-7.4%	7.5-9.9%	10% or more	Total
Percent of Firms	33.5	25.6	1.5	1.5	1.5	1.4	3.3	3.0	28.7	100.0
Percent of Employment 2/	27.1	6.0	2.6	2.6	4.4	3.3	6.5	9.4	38.1	100.0

Percentage Change in Wage Bill

	Less than 0%	0.0-0.9%	1.0-1.9%	2.0-2.9%	3.0-3.9%	4.0-4.9%	5.0-7.4%	7.5-9.9%	10% or more	Total
Percent of Firms	31.4	17.8	1.4	1.5	1.5	1.6	3.8	3.7	37.7	100.0
Percent of Employment	22.4	4.1	1.7	1.7	1.9	2.7	10.3	6.2	49.0	100.0

1/ FUTA wage base ($4,200 per worker in 1977) was the credit base for each firm.

2/ The FUTA base is a proxy for employment.

Source: Department of the Treasury.

Table 4.3

Use of New Jobs Tax Credit by Industry - 1977 1/

Classification	Number of Corporate Returns (1)	Percent Eligible for Credit 2/ (2)	Estimated Eligible Returns (3)	Returns with Credit Claimed (4)	Take-up Rates Among Eligible Corpora-tions 4/ (5)	Percent of all Corpora-tions Claiming Credit (6)
Agriculture	45,300	9%	4,100	2,700	66%	6%
Mining	15,900	35	5,600	1,700	30	11
Construction	165,200	35	57,800	20,000	36	13
Manufacturing	193,300	40	77,300	32,600	42	17
Transportation, Communication, and Utilities	66,100	34	23,100	5,900	26	9
Wholesale Trade	189,500	34	64,400	24,200	38	13
Retail Trade	329,400	33	108,700	37,400	34	11
Finance	381,500	28	106,800	19,100	17	5
Services	416,900	32	133,400	32,000	24	8
Other	3,800	25	1,000	100	10	3
Total	1,807,100 3/	32	578,200 3/	176,500 3/	31	10

1/ Does not include DISC and Subchapter S returns.

2/ Percent of firms with FUTA growth exceeding 2 percent and total wage growth exceeding 5 percent.

3/ May not add to total due to rounding. In addition to rounding, column (3) numbers may not add due to differences between the industrial distributions of the two files used to estimate eligible returns.

4/ The take-up rate is the percent of eligible corporations that claims the credit.

Source: Department of the Treasury.

Table 4.3 shows that an estimated 578,200 trade and business corporations were eligible for the NJTC in 1977, meeting both eligibility criteria. Of these, 31 percent earned and filed for the credit. Column 3 of the table shows the number of corporations that earned the credit, i.e., that had FUTA wage growth exceeding 2 percent and total wage growth exceeding 5 percent. Column 5 shows the estimated number of firms that claimed the credit, i.e., the number of firms which both earned the credit and claimed positive amounts of credit. An estimate of the number of corporations eligible for the credit in 1978 was not derived. The number of corporate returns with the credit claimed increased from 176,500 in 1977 to 356,900 in 1978. The percent of eligible firms filing for the credit would be higher in 1978 than in 1977. The information on the number of firms filing for the credit is derived from first-year tax returns and does not include amended tax returns.

Table 4.4 presents information on the use of the NJTC in 1977 by the size of the corporation. In general, small companies were less likely to participate in the program than larger firms. Approximately 6.6 percent of the companies with total receipts under $1 million had credits in 1977 compared with 26.7 percent of those with total receipts of $1 million or more. This difference results from smaller companies having both a lower likelihood of eligibility than larger firms and a lower probability of claiming the credit if eligible.

B. Impact of Credit Limitations

Data from an early sample of corporate tax returns were used to evaluate the impact of the various limitations on the NJTC. The information presented in this section is considered to be representative of qualitative experience with the credit limitations. However, the estimates based on this sample understate the total amount of credits claimed.

Even if a firm qualified for and claimed the NJTC, its credit could be less than the maximum tentative credit (50 percent of FUTA wage growth in excess of the 2 percent threshold) because of three other limits that were placed on the amount of credit that could be earned. As indicated in Table 4.5, these additional constraints on the credit were: (1) the new business limit, (2) the wage bill limit, and (3) the small business limit. In order to claim a credit, the firm was required to calculate a dollar value for each of these limits. Regardless of its credit base growth, the credit available to a firm could not exceed the least of these three limits.5/ In addition, the amount of credit claimed could not exceed the firm's current tax liability--the tax liability limit.

5/ However, Congress granted extra credits for employers that met the threshold credit base growth requirement and hired certain disabled workers.

Table 4.4

Use of the New Jobs Tax Credit by Size of Firm - 1977 1/

Total Receipts ($000)	Number of Corporate Returns (1)	Percent Eligible for Credit 2/ (2)	Estimated Eligible Returns (3)	Returns with Credit Claimed (4)	Take-up Rates Among Eligible Corporations 4/ (5)	Percent of all Corporations Claiming Credit (6)
0 - 25	368,900	23.8	87,800	1,200	1.4	0.3
25 - 50	151,600	27.1	41,100	2,500	6.1	1.6
50 - 100	207,200	31.5	65,300	8,400	12.9	4.1
100 - 500	616,100	38.1	243,700	56,500	23.2	9.2
500 - 1,000	178,700	45.3	81,000	31,200	38.5	17.5
1,000 - 10,000	253,600	53.6	135,900	65,100	47.9	25.7
10,000 - 50,000	25,300	58.1	14,700	9,400	63.9	37.2
50,000 - 100,000	2,600	61.0	1,600	100	6.3	38.5
100,000 or more	3,100	52.2	1,600	1,300	81.3	41.9
Total	1,807,100 3/	31.9	576,500 4/	176,500 3/	30.6	9.8

1/ Does not include DISC and Subchapter S returns.

2/ Percent of firms with FUTA growth exceeding 2 percent and total wage growth exceeding 5 percent.

3/ May not add to total due to rounding.

4/ Column may not add to total due to rounding and differences in the distributions of total receipts in the two files used to estimate eligible returns.

Source: Department of the Treasury.

Table 4.5

Impact of the New Jobs Tax Credit Limits - 1977 and 1978

	Provisions Limiting Credits Claimed				
	None (1)	Wage Bill Limit (2)	Small Business Limit (3)	New Business Limit (4)	Total (5)
1977					
Percent of Corporations Affected by Limit	68.2%	11.1%	2.6%	18.1%	100.0%
Share of Total Employment Growth 1/	30.8	6.1	52.8	10.4	100.0
1978					
Percent of Corporations Affected by Limit	62.1%	13.3%	1.9%	22.7%	100.0%
Share of Total Employment Growth 1/	27.4	7.7	52.6	12.3	100.0

1/ As measured by credit base growth. Entries represented the credit growth by companies in each column as a percent of the total credit base growth in all companies earning credits.

Note: The information presented in this table is based on an early sample of tax returns. Although it understates the number of corporations and the total credit amount of credit taken, the relationships illustrated are expected to be representative of experience with the credit.

Source: Department of the Treasury.

The first column of Table 4.5 indicates that 68.2 percent of the corporations that claimed credits in 1977 were unaffected by the limits on credits claimed. These corporations were able to claim the maximum credit for credit base growth beyond the 2 percent threshold. The remaining 31.8 percent of corporations that claimed the credit received less than the maximum credit. While over two-thirds of the corporations claimed the maximum credit, they accounted for less than 31 percent of the employment growth that took place in the corporations claiming the credit.

1. The New Business Limit

Under a rule that the credit available would equal 50 percent of credit base growth beyond the threshold level, a new business could claim the credit for any wages subject to FUTA withholding. The purpose of the new business limit was to reduce the advantages that new businesses would have in earning credits. Specifically, this provision limited the credit available to 25 percent of FUTA wages paid in the current year. If a new employer had FUTA wages of $100,000, the new business limit reduced the credit available from $50,000 to $25,000. However, the new business limit also reduced credits for established businesses.6/ For example, a firm with $25,000 of FUTA wages in 1976 whose FUTA wages grew to $100,000 in 1977 had threshold wages of $25,500 = (102% X 25,000). FUTA wage growth beyond the threshold was $74,500 = ($100,000 - $25,500). Although 50 percent of FUTA base growth beyond the threshold was $37,250, the new business limit reduced the credit available to $25,000 = (25% x $100,000). Table 4.5 shows that 18.1 percent of the corporations claiming the credit in 1977--approximately 32,000 corporations--were affected by the new business limit. These companies were responsible for less than 11 percent of the employment growth that occurred in the corporations that earned credits in 1977.

2. The Wage Bill Limit

The wage bill limit was designed to reduce the extent to which employers could increase their credit bases--and their ability to earn credits--without increasing their employment measured in man-hours. Without any limitation, employers could have earned credits by replacing full-time workers with part-time workers. Alternatively, employers could have increased employee turnover by substituting part-year workers for full-year workers.

6/ In fact, many of the companies limited by this provision were not new businesses. Over 46 percent of the corporations subject to the new business limit in 1977 had paid FUTA wages in 1976. In 1978, 87 percent of these corporations had paid wages in the previous year.

This provision did not entirely prevent exploitation of the NJTC through the substitution of part-time (part-year) workers for full-time (full-year) workers. Firms for which the total wage bill would ordinarily grow at an annual rate greater than 5 percent were still in a position to claim the NJTC without increasing the growth rate of employment measured in man-hours. More generally, many of those firms that increased man-hours as a result of the credit could have earned more credits by making the substitutions that the wage bill limit was meant to discourage.

The wage bill limit failed to prevent another type of windfall gain that did not even require any changes in the firm's employment policy. A windfall could have been realized by firms in which a large proportion of the positions paid annual wages of less than $4,200 as long as their total wage bill increased by more than 5 percent annually. For example, a firm in which annual wages for each job were $3,500 in 1977 and $3,850 in 1978 (a 10 percent increase) but whose total employment was unchanged at 100 workers in both years would have qualified for $14,000 in tax credits.

Although it reduced total credits, the wage bill limit increased the credit for hiring an additional worker over the range of employment where it was binding and total credits were non-zero. The credit over this range equaled one-half the wage cost of the additional position, which would normally exceed one-half the associated FUTA wages for any position paying more than $4,200 annually. The range of employment over which this could occur depended inversely on the rate of growth of average per employee wages and on the wage cost of additional positions relative to the FUTA wages generated by additional positions. The wage bill limit was typically not binding if the firm's average wage increased by over 3 percent per year.

Table 4.5 shows that the wage bill limit affected 11.1 percent of the 176,500 corporations which claimed the NJTC in 1977. The companies whose credits were reduced by the wage bill limit had 6.1 percent of the employment growth in the companies that earned the credit.

3. The Small Business Limit

To direct relatively more NJTC benefits to small business, the amount of credit that could be claimed by any employer was limited to $100,000.7/ As Table 4.5 shows, this provision limited the credit for 2.6 percent of the 176,500 corporations that claimed the credit in 1977. While relatively few companies had credit reductions because of this limit, 52.8 percent of the employment growth occurred in these companies (Table 4.6). Once the $100,000 limit was reached, the NJTC provided no incentive to a firm for hiring additional workers.

7/ If handicapped workers were hired, the small business limit could be up to 20 percent higher.

4. Tax Liability Limit

The three limits just described affected the total NJTC earned. The amount of credit claimed in any one year could not exceed the firm's current tax liability after all the other credits available to it were exhausted. Credits limited by current tax liability could, however, be used to offset taxes in other years. Because of the carryback feature, credits earned that could not be "used" because of inadequate current tax liability could be claimed if the taxpayer had "unused" tax liability in any of three previous years. If the credits earned could still not be claimed, they could be used to offset tax liabilities incurred during any of the subsequent seven years.

The second line of Table 4.6 shows that 54 percent of the corporations that claimed the NJTC in 1977 had insufficient tax liability to use all the credits they earned in the current year. Over one-half of these corporations would have been unaffected by any other limit. Companies limited by the new business limit were the most likely to be constrained by the tax liability limit.

With the information available from the sample of tax returns, it is not possible to determine how many of these corporations had enough tax liability in the three previous years to use all the credits earned. However, based on experience with other credits, it is estimated that tax liability from prior years was used to take only about 6 percent of the credits that could not otherwise be taken currently. Thus most of the corporations that lacked sufficient tax liability to claim their credits probably had their credits delayed. Like any future payments, delayed credit payments have a lower value than current payments of an equal amount. An estimate of the expected value of unused credits received in later years is described in the following section.

The impact of the limitation provisions on credits earned and claimed in 1977 is summarized in Table 4.7. The impact was very similar in 1978, as shown in Table 4.5 and 4.6. The share of employment growth in firms affected by the limits was much larger for the small business limit than for either the new business limit or the wage bill limit. The impacts of the limits are summarized as follows:

(1) At least one of the various limitations applied to 60 percent of the companies claiming the credit. These companies accounted for over 80 percent of the employment growth among companies claiming the credit.8/

8/ See Table 4.7.

Table 4.6

Impact of the New Jobs Tax Credit Limits Including the Tax Liability Limit - 1977 and 1978 1/

	Provisions Limiting Credit Claimed				
	None (1)	Wage Bill Limit (2)	Small Business Limit (3)	New Business Limit (4)	Total (5)
1977					
Percent of Corporations Affected by Limit	68.2%	11.1%	2.6%	18.1%	100.0%
Percent with Insufficient Tax Liability to Claim Total Credits Earned	54.0	57.7	46.2	81.8	59.2
Average Credits Earned ($000)	9.8	7.3	100.0	9.4	11.7
Average Credits Claimed ($000)	5.8	3.8	63.0	3.0	6.5
Credits Claimed as a Percent of Credits Earned	59.2	52.1	63.0	31.9	55.6
1978					
Percent of Corporations Affected by Limit	62.1%	13.3%	1.9%	22.7%	100.0%
Percent with Insufficient Current Tax Liability	56.0	61.7	47.4	38.3	60.2
Average Credits Earned ($000)	9.4	6.5	100.0	8.5	11.5
Average Credits Claimed ($000)	5.8	3.4	65.6	2.9	6.0
Credits Claimed as a Percent of Credits Earned	61.7	52.3	65.6	34.1	52.2

1/ Does not include DISC and Subchapter S corporate returns. Data may not add to total because of rounding.

Note: See note to Table 4.5

Source: Department of the Treasury

Table 4.7

Employment Growth in Corporations by the Value of Credits Received - 1977 1/

	Full Credit	Partial Credit			
	No Limits	Tax Liability Limit Only	Small Business Limit	Other Limits	Total
Percent of Corporations	37.9	36.9	2.6	22.7	100.0
Share of Employment Growth 2/	16.1	16.3	52.8	14.9	100.0

1/ Does not include DISC and Subchapter S corporate returns. Data may not add to total because of rounding.

2/ As measured by credit base growth.

Note: See note to Table 4.5.

Source: Department of the Treasury

(2) Over 20 percent of the companies had their credits reduced by the new business limit. These firms had 10-12 percent of the employment growth among companies claiming the credit.

(3) Approximately 15 percent of corporations earning the credit were affected by the wage bill limit. These firms had 6-8 percent of the employment growth among companies claiming the credit.

(4) Less than 3 percent had reduced credits because of the small business limit, but more than one-half of the employment growth occurred in companies subject to this limit.

(5) Over one-half of the corporations which earned and filed for the credit were affected by the tax liability limit.

C. Differential Impact of the Credit by Industry and Firm Size

This section presents data on the distribution of credits among corporations of various sizes in different industries. The question of whether the New Jobs Tax Credit favored some industries, possibly at the expense of others, is addressed.

Table 4.8 shows information on the average NJTC taken for different size companies. In both years, the average credit taken tends to rise with the size of the corporation. For example, the average credit taken was less than $3,100 for the smallest corporations in each year, whereas it exceeded $67,000 for the largest corporations. The average credit taken fell from $9,600 in 1977 to $8,700 in 1978, reflecting the relatively greater use of the credit by smaller corporations in 1978.

To obtain the credit, companies had to report information on the total wages they paid. Table 4.8 shows credits claimed as a percent of total wages for the corporations that claimed credits. The NJTC reduced the wage bill of the average corporation claiming the credit by less than 2.5 percent in both years. In contrast to the positive relationship between the average credit claimed and firm size, columns (3) and (6) show that the credit generally reduced the average labor costs of small companies more than it reduced the labor costs of larger companies.

Table 4.9 shows the average credit claimed and the credit as a proportion of total labor costs by industry. The average credit claimed by a manufacturing company was $17,100 in 1977, more than three times the average credit claimed by an agricultural corporation. Table 4.10 shows that the NJTC amounted to a

Table 4.8

New Jobs Tax Credit Claimed by Size of Firm - 1977 and 1978 1/

Total Assets ($000's)	1977 Total Credit Claimed ($000)	1977 Average Credit Per Return ($000)	1977 NJTC as Percent of Wages of Firms Claiming Credit	1978 Total Credit Claimed ($000)	1978 Average Credit Per Return ($000)	1978 NJTC as Percent of Wages of Firms Claiming Credit
	(1)	(2)	(3)	(4)	(5)	(6)
0 - 250	$ 250,400	$ 3.0	10.7%	$ 519,500	$ 2.8	12.0%
250 - 1,000	402,700	8.0	8.8	783,500	8.1	9.9
1,000 - 5,000	536,400	19.0	6.5	943,400	19.7	7.3
5,000 - 10,000	159,900	31.2	4.6	281,600	35.8	5.2
10,000 - 25,000	129,700	29.4	3.4	218,900	33.6	3.7
25,000 - 50,000	66,900	25.6	1.9	106,300	29.9	2.2
50,000 - 100,000	47,600	28.7	1.2	76,800	34.0	1.3
100,000 - 250,000	43,100	38.2	0.7	62,900	41.7	0.7
250,000 or more	67,100	67.0	0.1	100,800	70.1	0.2
All Corporations	$1,703,800	$ 9.7	2.0%	$3,093,900	$ 8.7	2.5%

1/ Does not include DISC and Subchapter S returns. Figures may not add to total because of rounding.

Source: Department of the Treasury

Table 4.9

Corporate Claims for the New Jobs Tax Credit, by Industry - 1977 and 1978 1/

	1977			1978		
	Total Credit Claimed ($000)	Average Credit Per Return ($000)	NJTC as Percent of Wages of Firms Claiming Credit	Total Credit Claimed ($000)	Average Credit Per Return ($000)	NJTC as Percent of Wages of Firms Claiming Credit
Agriculture	$ 12,800	$ 4.8	30.0%	$ 31,100	$ 6.1	14.6%
Mining	27,100	16.4	10.5	44.100	14.4	13.4
Construction	238,700	11.4	26.4	481,300	10.4	30.8
Manufacturing	558,800	17.1	1.9	956,200	16.3	2.5
Transportation, Communications, and Utilities	70,700	12.0	4.0	123,800	11.2	4.2
Wholesale trade	183,800	7.6	2.0	345,300	7.0	2.4
Retail Trade	290,700	7.8	1.0	515,600	7.0	1.3
Finance, Insurance, Real Estate	126,800	6.6	1.0	204,200	6.4	1.0
Services	193,200	6.0	8.5	386,000	5.0	10.5
Other	1,200	18.8	8.6	6,100	5.8	5.1
All Industries	$1,703,800	$ 9.7	2.0%	$3,093,900	$ 8.7	2.5%

1/ Does not include Subchapter S and DISC returns. Figures may not add to total because of rounding.

Source: Department of the Treasury

subsidy of about $0.18 per $1,000 of total industry sales in transportation compared with about $0.03 per $1,000 of construction sales. The subsidy to sales ratios were undoubtedly higher in 1978 since the total amount of the credit claimed by corporations increased by 81 percent from 1977 to 1978. Column 5 of Table 4.10 shows that for those corporations that were able to claim the credit, the subsidy was no greater than $.59 per $1,000 of sales, or less than 0.6 percent.

D. The Budget Cost of the Credit

Tax return information for 1977, the first year of the New Jobs Tax Credit, shows a total amount of credits earned by corporations and individuals of $3.75 billion. In 1978, $6.38 billion of credits were earned. The total revenue cost over the life of the credit, including the costs of carryovers continuing for several years was at least $5.7 billion. The revenue cost estimate is based on the amount of credits earned on returns filed in 1977 and 1978. This estimate does not include credits reported on late or amended returns.

The estimated cost of the NJTC in reduced tax revenues may appear to be considerably smaller than the estimated cost of providing a direct subsidy with the same actual cost, i.e., the credits actually earned and claimed. The amounts that employers claimed for the NJTC were taxable, since employers were required to subtract these amounts from their deductions for wages and salaries. The additional tax receipts resulting from this requirement were counted in estimating the credit's net revenue cost. A direct subsidy which is taxable has similar effects on tax revenues, but cost estimates of direct expenditure programs take no account of these effects. The inconsistent accounting procedures make government programs operated through the tax system appear to cost less than otherwise identical direct expenditure programs. For example, it is estimated that the NJTC reduced income tax revenues by at least $5.7 billion; if funded as a direct expenditure program, its gross cost would have been estimated to be at least $9.7 billion. The difference arises because a direct wage subsidy program similar to the NJTC would have increased employer tax liability by about $4 billion.

III. Evaluation of Effectiveness

This section examines how well the New Jobs Tax Credit achieved its objectives. The credit had several goals. The NJTC was to increase total employment by reducing the wage costs of only the new jobs created as a result of the program. It also was intended to provide special assistance to small business and to help handicapped persons find employment.

The limited information which this section provides should be viewed in relation to the general economic climate of the time. Recovery from the severe recession of the mid-1970's was

Table 4.10

New Jobs Tax Credit as a Proportion of Business Receipts by Industry - 1977 1/

Industry	Total NJTC Claimed ($000's)	Total Business Receipts ($000's)	New Jobs Credits Claimed as a Percent of Total Receipts	Business Receipts of Corporations Claiming Credits ($000's)	Credit as a Percent of Business Receipts of Corporations Claiming Credits
Agriculture	$12,800	30,482,600	.04%	3,997,700	.32%
Mining	21,100	93,718,600	.03	54,905,900	.05
Construction	238,700	163,620,800	.15	45,071,300	.53
Manufacturing	558,800	1,632,112,900	.03	745,471,700	.07
Transportation, Communications, and Utilities	70,700	323,946,300	.02	118,789,200	.06
Wholesale Trade	183,800	576,126,200	.03	181,312,400	.10
Retail Trade	290,700	551,652,200	.05	245,779,000	.12
Finance, Insurance, Real Estate	126,800	399,725,200	.03	181,484,900	.07
Services	193,100	164,257,900	.12	46,137,300	.12
Others	12,000	2,962,600	.04	208,100	.04
Total	1,703,800	3,937,605,200	.04	162,315,400	.10

1/ Excludes Subchapter S and DISC returns. Figures may not add to totals because of rounding.

Note: See note to Table 4.5

Source: Department of the Treasury

well underway when the NJTC was enacted in May 1977. During both 1976 and 1977, real GNP grew by over 5 percent annually. Private nonagricultural employment grew by 3.6 percent in 1976 and by 4.4 percent in 1977. The seasonally adjusted unemployment rate declined during the two years preceding the NJTC's enactment, from 9.0 percent in May 1975 to 7.1 percent in May 1977. Nevertheless, the unemployment rate remained far above its pre-recessionary level. The unemployment rate (seasonally adjusted) declined while the NJTC was in effect, from 7.1 in May 1977 to 5.9 in December 1978. It is not known what, if any, role the NJTC played in producing this decline. During the year following the end of the NJTC, 1979, the unemployment rate remained relatively steady at just under 6 percent.

A. Effect on Employment

1. An Incremental Employment Incentive

The NJTC was intended to stimulate employment by lowering the wage costs of employers. The credits were also designed to be incremental. That is, they were supposed to subsidize only the additional, or incremental, jobs created by the policy. A major problem with designing an incremental employment credit is to determine how many workers would have been hired in the absence of the credit, (*i.e.*, the "ideal" base for an incremental credit).

a. Problems of Defining the Base of an Incremental Employment Incentive

The NJTC subsidized only employment growth beyond a threshold level. As a practical matter, true "incremental" employment, i.e., only the employment that would occur because the subsidy was available, cannot be accurately measured. The reason for this is that firms' employment plans vary greatly, due to factors totally unrelated to the subsidy. For example, one-third of all employers may have suffered a setback in production and employment from the previous year. Another third may experience a "normal" growth of two percent in employment, and another third may plan a 10 percent expansion in employment. The first group would be virtually precluded from earning the NJTC unless they were to raise employment above the previous year's level. The second group would earn some NJTC only if they responded to the incentive. The last group would earn the NJTC whether or not they responded to the incentive. Thus, any chosen threshold will restrict access to the subsidy and/or dilute its incentive effect unless it can be accurately established for each individual firm. As shown in Table 4.2, an estimated 36 percent of business employment was excluded by the two precent credit base growth threshold in 1977.

An imperfect threshold for an incremental credit will affect certain firms and industries differently. Cyclically sensitive industries would be the least likely to qualify for the credit in a business cycle downturn, and they would be most likely to qualify in a business cycle upturn, such as occurred in 1977 and 1978.

b. Implications of the New Jobs Tax Credit Base

To qualify for the NJTC, a firm's level of employment had to exceed a threshold level equal to 102 percent of its previous year's employment. The small business limit created a cap level of employment above which the amount of the credit did not increase as additional workers are hired. Since the small business limit placed a $100,000 ceiling on the credit and the subsidy for each worker above the threshold was $2,100, the cap level of subsidized employment above the threshold was 48 workers.9/

For firms that would have had employment above the cap level in the absence of the NJTC, the credit provided no employment incentive. For these firms the credit provided a windfall gain of $100,000 without inducing any increase in employment. Firms that had planned on a level of employment between the threshold and cap levels were the most likely to increase employment as a result of the credit. For these firms, the cost of employing an additional worker up to the cap level of employment was reduced by $2,100. Firms that had planned on a level of employment below the threshold were less likely to increase employment in response to the credit. For these firms, the credit reduced the cost of an additional worker only after employment was beyond the threshold.

Firms which expected 1977 and 1978 employment levels not to exceed the threshold level may have pushed 1978 employment beyond the threshold level by deferring some of the planned 1977 hiring until 1978. These firms may have earned credits without necessarily having increased their average level of employment over the entire period when the credit was in effect.

2. Value of the Credit for Expanding Employment

The NJTC provided some employers with an incentive to expand employment by reducing the first-year wage cost of certain workers hired during 1977 or 1978. In this section, the

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9/ In this discussion, it is assumed that none of the credit limits other than the small business limit apply. It is also assumed that each job slot generates $4,200 in FUTA wages per year.

percentage reduction in first-year wage cost of additional workers is estimated for 1978. An estimate is also made of the percentage reduction in wage costs during the 1977 period that followed the enactment of the NJTC. It should be cautioned that the employment incentive of the NJTC cannot be gauged simply on the basis of these estimates. Given the existence of hiring, training, and separation costs, employers do not base their hiring decisions solely on the first-year wage costs. For some employers, even a large percentage reduction in the first-year wage costs may give rise to only a small increase in their employment.

To examine the credit's effect on the cost of additional labor in 1978, consider the case of a worker hired by a firm at the start of the year and who remained employed with the firm for the entire year. If the firm was unaffected by any of the credit limits (and was eligible for and aware of the credit), the additional worker would have generated a tax credit equal to one-half of the worker's salary, up to a maximum credit of $2,100. Thus, the credit reduced the first-year wage cost of additional workers earning less than $4,200 by 50 percent. For additional workers earning above $4,200, the percentage reduction was less. For workers earning the average annual compensation of $12,000, (including fringe benefits and legally required supplements) for all private sector, nonfarm, full-time workers, the NJTC reduced the first-year hiring cost by 17 percent.

The reduction in calendar-year labor costs also depended upon when in the year any new positions were created, because the credit was not pro-rata for part-year positions. The average production worker employed continuously from the beginning of June 1977 through the end of the year earned wages of approximately $5,855; using the BLS data on compensation this corresponded to total compensation of $6,930. For hiring this worker to fill a new position, the employer would have received a credit of $2,100, reducing the 1977 calender-year cost of the new position by 30 percent. As noted earlier, for a given employment level FUTA wages and NJTCs increase with turnover. Adjusting for labor turnover would yield a somewhat higher estimate.

The employment incentive of the NJTC in 1977 was somewhat limited by the effect of increases in that year's employment on the amount of potential NJTCs earned in 1978. Increases in 1977 employment raised the 1977 FUTA base used to determine the amount of the credit in 1978. For a given level of employment, the credit in 1978 was reduced by increases in 1977 employment. As a result of this linkage, the NJTC provided few employers with an incentive to add temporary positions lasting only through 1977. On the other hand, the linkage only slightly dampened the incentive to establish a position in 1977 lasting at least

1978. For an employer unaffected by any of the credit limits, a $4,200 increase in the 1977 FUTA base carried over into 1978 reduced the potential 1978 credit by $42.10/

The tax liability limit significantly reduced the value of the NJTC to many firms. For example, those companies whose credits were restricted solely by the tax liability constraint could, on the average, claim only about 26 percent of the credits earned against their current tax liabilities. Of the remaining "unused" credits only a fraction are ever received, and most of those are carried over to future years. On the average, each dollar of credit that cannot be claimed against current tax liability is worth only sixty cents. Hence, for firms affected only by the tax liability constraint, the expected present value of each $1 of credit was earned about 70 cents.11/

Considering the entire group of corporations without restrictions on credits earned, 59 percent of the NJTC earned in 1977 could be claimed against current year tax liability; for 1978, the corresponding figure was 62 percent. (Table 4.5). For these corporations as a whole, therefore, the present value of each $1 of NJTC earned in 1977 was 84 cents; a dollar credit earned in 1978 was worth 85 cents. Adjusting the previous estimates of the cost impact of the credit accordingly, the credit appears to have yielded roughly a 25 percent reduction in the 1977 cost of an additional worker hired in June 1977 by an eligible firm that was unaffected by the three limitations. The corresponding reduction in 1978 costs was 14 percent.

10/ Any 1977 change in employment would increase the FUTA base threshold by 2 percent so a $4,200 FUTA increase in 1978 would be worth $84 less than if there had been no change in 1977 employment. With a 50% credit on FUTA wage growth in excess of the threshold, the $84 increase in the threshold would cost $42 in credits.

11/ Based upon the average time patterns over which delayed credits are claimed, it is possible to calculate how delays reduce the value of "unused" credits. It is estimated that about 6 percent of "unused" credits can be obtained immediately with carrybacks, 45 percent are obtained within two years after they are earned, and another 13 percent are received between 2 and 7 years after they are earned. Based on this pattern, unused credits are 50 percent less valuable at a 20 percent interest rate, and 40 percent less valuable at a 10 percent interest rate. Thus a typical firm limited only by tax liability would only be able to claim 26 percent of its credits currently and the remaining 74 percent would be reduced in value by 40 percent because of delays, making the typical credit worth only 70 percent = $(0.70 = 0.26 + 0.74 \times 0.60)$ of the credit actually earned.

The NJTC reduced the first-year cost of an additional worker hired in 1977 or 1978 by 50 percent for all firms affected only by the wage bill limit. Among firms affected by this limit, the ratio of credits claimed against current-year tax liability to credits earned was 52 percent in both 1977 and 1978. Adjusting for the tax liability limit and for non-wage compensation in the same manner as before, the NJTC reduced the first (calendar)-year cost of an additional worker by an estimated 37 percent for hires made in 1977 or 1978 by firms affected by the wage bill limit.

With a similar adjustment for the tax liability limit, the NJTC reduced the first year cost of an additional position by an estimated 14 percent in 1977 and 8 percent in 1978 for firms affected by the new business limit.

The NJTC provided no incentive to hire additional workers for firms limited by the $100,000 credit cap.

Among firms unaffected by the small business limit, the proportion of employment growth that occurred in firms affected by the wage bill limit was 20 percent in 1977 and 28 percent in 1978 (see Table 4.5). For the new business limit, the corresponding proportion was 22 percent in 1977 and 26 percent in 1978 (Table 4.5). These proportions may be used to weight the three sets of estimates of reductions in marginal labor cost among firms unaffected by the small business limit--those for firms unaffected by any of the limits on credits earned, those for firms that were affected by the wage bill limit, and those for firms affected by the new business limit. Overall, for NJTC claimants that were not constrained by the small business limit, the NJTC reduced the 1977 cost of an additional position established in June 1977 by 26 percent; for an additional position established at the beginning of 1978, the reduction in first-year costs was 20 percent.

The discussion in this section has thus far focused on changes in the cost of an additional position. The changes in the average labor costs of firms claiming the credit are also relevant. For instance, the availability of the credit may have been responsible for some firms staying in business or starting business. Nevertheless, it is unlikely that much of the credit's employment stimulus was channelled through firm entry and exit decisions. For most NJTC claimants the credit reduced average labor cost by less than one percent (see the last column of Table 4.8), due to the credit's incremental feature and the several credit limitations. Furthermore, the incremental feature effectively precluded most financially ailing firms from receiving any credits.

The NJTC could have provided some potential entrepreneurs with a small incentive to start a new business. A new business affected only by the new business limit would have been entitled to a credit equal to 25 percent of its FUTA wage bill. For a new business starting at the beginning of 1978, a credit of this amount corresponds to about a 10 percent reduction in first year wage costs, since in the aggregate the FUTA wage bill was roughly 40 percent of the total wage bill. The incentive provided to new companies was in most cases reduced by the tax liability limit--in 1977, 82 percent of the corporations affected by the new business limit were also affected by the tax liability limit. In addition, new businesses tend to be relatively small and, as is pointed out in the next section, small businesses were unlikely to know of the credit.

3. Evaluation of the NJTC as an Employment Incentive

Chapter 1 developed the theoretical framework necessary to evaluate temporary and incremental credits such as the NJTC. This section analyzes the evidence that pertains to two questions:

(1) What portion of 1977 and 1978 employment growth in the private for-profit sector occurred in firms for which the credit could have offered an incentive?

(2) Did the credit produce any increases in employment in at least certain types of firms or industries?

The discussion of the former question combines the evidence from the tax returns of corporations claiming the credit and from an employer survey of use of the credit. Data from the employer survey were used in two studies funded by the Labor Department which provide evidence pertaining to the second question.

a. The Impact of the Credit Limits, Qualification Requirements, and Imperfect Knowledge of the Credit

To evaluate employer reaction to the NJTC, the Bureau of Census conducted a mail-survey of employers in February 1978 for the Department of Labor. The survey was sent to a stratified random sample of business employers. A partially successful attempt was made to exclude non-profit employers. The response rate was about 71 percent; approximately 2,500 useable responses were obtained. In presenting the results of the survey, the Census Bureau gave firms their appropriate sampling weights. Firms that were no longer in business at the time of the survey were not represented and there was also some underrepresentation of firms that started business in 1977.

Employers knowledgeable of the credit in February 1978 comprised only about one-third of all respondents, but they accounted for 77 percent of employees and 72 percent of 1976-1977 employment growth. "Employment growth" as used here and in the following discussion is defined in the gross sense--i.e., employment growth in those firms actually experiencing increases in employment (not counting negative growth in firms experiencing employment declines.) The proportion of employers who knew of the credit rose sharply with employment size, from 31 percent of firms with fewer than 10 employees to 89 percent of those with at least 500 employees. The survey asked employers, "Does your firm qualify for the New Jobs Tax Credit?" Since the time period to which this question relates is unspecified, a firm could have answered "yes" if it had qualified for the credit on its 1977 return or if it expected to qualify for the credit on its 1978 return. Twenty percent of the respondents reported both knowing of the credit and qualifying for it; these firms had 58 percent of employment and 64 percent of employment growth.

Few of the respondents to the Census survey--2.4 percent--answered that they had made a conscious effort to increase employment as a result of the credit; these respondents accounted for approximately 7 percent of the employment growth reported by all respondents. Comparable information is available from a sample of the membership of the National Federation of Independent Businesses (NFIB). In comparison with the respondents to the Census survey, the NFIB firms were more aware of the credit's existence, but apparently no more likely to respond that the credit induced them to increase employment. In January 1978, 1.4 percent of the NFIB firms reported that the credit had caused them to increase employment. In April 1978, the survey showed 2.4 percent of respondents claiming to have increased employment in response to the credit; the average increase among these employers was 2.3 employees. Unfortunately, information was not available on the size of the respondent firms in the NFIB survey. Therefore, it is impossible to say whether this constitutes a relatively large or small employment effect. By July 1978, 4.1 percent reported increasing employment as a result of the credit.

An estimated 53 percent of the employment growth in corporations claiming the NJTC occurred in corporations for which the small business limit was binding (Table 4.5). Corporations affected by the small business limit were not eligible to earn more credits if they employed more workers than they actually employed. Consequently, with few exceptions, the NJTC could not have induced these corporations to increase employment. Thus the NJTC could have been a contributing factor in about 47 percent of the employment growth among corporations claiming the credit. The corresponding percentage for all NJTC claimants--both corporate and non-corporate--may be higher because unincorporated firms are typically much smaller than corporations. The difference is probably small, however, since the non-corporate sector accounted for a small proportion of employment growth among NJTC claimants.12/

Together, the evidence from corporate returns and the Census survey yield a rough estimate that 30 percent of aggregate employment growth among private for-profit firms with some employment growth occurred in firms for which the NJTC offered an employment incentive. This estimate is obtained by multiplying two estimates together:

(1) The estimate of the proportion of employment growth among NJTC claimants that occurred in firms for which the credit could have offered an employment incentive (47 percent); and

(2) The estimate of the proportion of employment growth that occurred in firms which knew of and qualified for the NJTC (64 percent).

The estimate of the proportion of employment growth occurring in firms for which the NJTC provided an employment incentive should by no means be construed as an estimate of the proportion of employment growth which was caused by the credit.

b. Labor Department Studies

Two studies sponsored by the Department of Labor attempted to estimate the impact of the NJTC on employment.13/ Both use information obtained from the Census survey.

Perloff and Wachter used the data from the Census survey to estimate the effect of knowledge of the NJTC on firms' 1976-77 employment growth rate. The employment levels were those that

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12/ Corporations produced about 89 percent of the 1976-77 employment growth reported by respondents to the Census survey who said that they knew of and qualified for the NJTC. Thus, even if none of the unincorporated claimants were affected by the small business limit, this estimate would imply that only 53 percent of the employment growth among all claimants occurred in firms for which the small business limit was not effective.

13/ Perloff, J.M. and Michael L. Wachter, "The New Jobs Tax Credit: An Evaluation of the 1977-78 Wage Subsidy Program," American Economic Association Proceedings, Vol. 69, No. 2, May 1979, 173-179. A longer unpublished version is "A Re-evaluation of the New Jobs Tax Credit," November 1979. Bishop, J., "Employment in Construction and Distribution Industries: The Impact of the New Jobs Tax Credit," Institute for Research on Poverty Discussion Paper, April 1980.

firms reported to be their average levels for 1976 and 1977. In the comparison between firms which knew of the NJTC and other firms, firm employment size, industry, type of tax form, region, and growth rate in sales were held constant. The growth rate of employment was found to be substantially higher for knowledgeable firms. The authors caution that this difference cannot necessarily be viewed as having been caused by the NJTC: "It is possible that a variable such as entrepreneurial skill is responsible for both knowing about the program and rapid growth." The likelihood of spurious correlation between knowledge of the credit and the employment growth rate is suggested by two considerations.14/ First, only 7 percent of respondents to the Census survey who knew of the credit answered that the credit had caused them to increase employment. Second, since the NJTC was not enacted until May 1977, there is reason to doubt that it could have had a very large effect on the firm's average level of employment in 1977.

A study by Bishop relates growth in knowledge about the NJTC to employment growth in the construction and distribution (retailing and wholesaling) industries. Bishop estimates that the NJTC was responsible for a significant share of the increase in employment in these industries that occurred between mid-1977 and mid-1978. Since knowledge of the NJTC grew steadily over this period, however, it is possible that the increase in employment that Bishop attributes to the credit reflected a shift in the trend rate of growth that was due to other factors.15/

The credit's impact on aggregate employment cannot be inferred from either the Perloff-Wachter or Bishop studies. Any employment gains induced by the credit in eligible firms may have been offset by slower rates of growth (or declines) in employment in other firms. Thus, the Perloff-Wachter study "could not conclude that the NJTC expanded total employment" although the credit "had a clear impact in expanding employment in some firms

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14/ Additional causes of bias which are cited by Perloff and Wachter are specification error and the limited nature of the dependent variable.

15/ There are other problems in the interpretation of Bishop's results. Bishop estimated employment demand equations with contemporaneous and lagged values of measures of factor prices, output, and the variable measuring knowledge of NJTC. To be consistent with a finding that knowledge of the NJTC had a positive impact on employment in some industry, the estimated employment impact of increases in the wage rate would have to be significantly negative. This consistency test cannot be made, however, since Bishop did not perform tests of significance for the coefficients of the wage measures. Bishop's results are also rendered suspect by his finding that for many industries an increase in the cost of capital results in a decrease in relative employment, which counters the general presumption that capital and labor are substitutes.

relative to others." Similarly, Bishop's study does not rule out the possibility that any induced employment growth in the industries he studied was offset by reduced employment growth in other industries.

Another unknown is the extent to which employers exploited the credit through increases in employee turnover and/or decreases in weekly hours per worker. These responses would have enabled employers to increase their credits earned without accompanying increases in the total number of manhours employed. Such windfall gains would have reduced any net gain in aggregate manhours per dollar of subsidy. In addition, a NJTC-induced increase in turnover would have entailed higher training, hiring, and separation costs (such as unemployment insurance payments). The hypothesis that the NJTC caused increases in employee turnover rates was supported by anecdotal evidence that Tannenwald obtained from a small-scale 1979 employer survey.16/ Tannenwald attempted to corroborate this finding through an econometric analysis of the variation in turnover rates among the firms in his sample. Using the ratio of the firm's annual FUTA wage bill to its average employment level over the year as a proxy for turnover, Tannenwald found that turnover was positively related to measures of the firm's responsiveness to the NJTC. The correlation may be partly spurious, however, since the reduction in the cost of new eligible positions due to the credit varied directly with the turnover rate.

B. Effects of the New Jobs Tax Credit on Small Businesses

The New Jobs Tax Credit was intended to assist small businesses in particular. This was to be accomplished by the annual $100,000 limit on the amount of credit that could be claimed by employers. This small business limit targeted the credit's employment incentive to smaller businesses. Large employers who reached the $100,000 limit obtained no additional credits for expanding employment. In this respect, the credit discriminated in favor of small employers. Table 4.11 shows that the small business feature of the credit worked as expected. The percentage of corporations whose credit was reduced by this provision in 1977 increased with asset size. For example, only 0.4 percent of the smallest companies were affected by this limit in 1977, whereas 65 percent of the largest companies were affected.

The proportion of respondents to the Census survey who reported knowing of and qualifying for the credit increased steadily with firm size, from 4.4 percent of firms with fewer

16/ Tannenwald, R., "The Economic Impact of the Federal New Jobs Tax Credit" report prepared for the Employment and Training Administration, U.S. Department of Labor, 1982. The survey universe was limited to single-establishment firms within 20 selected 3-digit industries in Wisconsin.

Table 4.11

Impact of Small Business Limit by Size of Firm -1977

Total Assets ($000)	Percent of Corporations Affected by the Small Business Limit
0 - 250	0.4%
250 - 1,000	0.9
1,000 - 5,000	4.8
5,000 - 10,000	15.5
10,000 - 25,000	18.6
25,000 - 50,000	18.5
50,000 - 100,000	24.0
100,000 - 250,000	34.6
250,000 or more	65.1
All Corporations	2.6

1/ Does not include Subchapter S and DISC corporations. Figures may not add to total because of rounding.

Note: See note to Table 4.5

Source: Department of the Treasury.

than 10 employers to 47.8 percent of firms with at least 500 employees. From Table 4.2 it can be seen that the proportion of corporations that were eligible for the credit increased from 24 percent of those with 1977 receipts of under $1 million to 54 percent of those with 1977 receipts of $1 million or more.

The available evidence suggests that the NJTC provided the smallest employment incentive for very small and very large firms and the largest incentive for medium size firms. Very small firms were less likely to know of and qualify for the credit, while the small business limit removed any employment incentive for large firms.

C. Assistance to the Handicapped

A secondary objective of the New Jobs Tax Credit was to provide a special incentive to hire disabled workers. Employers could claim extra credits of up to 10 percent of the FUTA wages paid to such workers. Corporations claimed the extra credit on about $4.2 million of FUTA wages paid to disabled workers. Assuming a one to one correspondence between the number of employees and each $4,200 of FUTA wages, corporations claimed the extra credit for about 1,000 disabled workers in 1977.

D. Summary

The available evidence has not been sufficient to measure the impact of the New Jobs Tax Credit on the growth of aggregate employment and output. Due to the credit's eligibility requirements and limitations, 30 percent of the for-profit business employment growth that took place during the credit's lifetime occurred in firms for which the credit provided an incentive to increase employment. Among these firms, the 1977 wage cost of creating a new job at the beginning of June 1977--just after the credit's enactment--was typically reduced by 26 percent; for a new job created at the beginning of 1978, the typical reduction in the first-year cost was approximately 20 percent. The employment response elicited by these incentives is unknown. The fact that it subsidized only the first year wage cost of a new position limited its employment incentive, especially for firms where hiring and training costs account for a relatively large portion of total labor costs.

The complexity of the NJTC probably limited its employment impact. At the time hiring decisions were made, many employers were uncertain whether they would ultimately qualify for a full credit, a partial credit, or no credit.

Two studies sponsored by the Labor Department provide support for the hypothesis that the NJTC stimulated employment growth among certain firms or industries. The first study found that among surveyed employers, 2.4 percent reported having made a conscious effort to increase employment as a result of the NJTC, and that employers which knew of the credit had substantially higher 1976-77 employment growth rates than otherwise similar employers. The other study found that over the credit's duration, employment growth in the construction and distribution industries was positively related to growth in knowledge of the NJTC.

The results of these studies do not imply that the NJTC increased aggregate employment. While it was in effect, the credit could have reduced the workforce of ineligible employers (or of employers for whom the credit's employment incentive was relatively small). The employment losses could have resulted from: (1) consumer substitution away from products made by these employers toward products of employers for whom the credit's direct employment stimulus was greatest, (2) increased wage costs, or (3) the cost of financing the subsidy. Similarly, it cannot be concluded that the NJTC stimulated growth in aggregate output.

As designed, the NJTC directed a disproportionate share of the benefits to small businesses. However, very small firms were less likely to know of or qualify for the credit.

Finally, the additional credit available for hiring handicapped workers was rarely used. Only 1,000 claims of the additional credit were made for hiring handicapped workers.

Chapter 5

THE TARGETED JOBS TAX CREDIT

This chapter deals with the administration and effectiveness of the Targeted Jobs Tax Credit, during its initial phase (January 1979-September 1981). The credit was intended as an incentive for employers to hire members of seven targeted groups. The chapter is divided into three sections. The first section describes the actual administration and operation of the tax credit program. The second section presents statistical data on the use of the TJTC by the eligible individuals and employers. The final section evaluates the effectiveness of the TJTC. The legislative history and description of the credit are in Chapter 3, Section III.

I. Administrative Aspects of the TJTC Program

The design of TJTC was similar to an expenditure program, with administration of the program assigned to the Department of Labor. The actual implementation of the TJTC program differed from the intended operation due to several factors described in this section, including a lack of funding for administration, the slow start-up of the certification process, and retroactive certifications.

A. The TJTC Certification System

An administrative system was required to certify that TJTC credits were taken only for wages paid to qualified workers. The Revenue Act of 1978 required the Department of Treasury and the Department of Labor to specify local agencies that would be responsible for certifying eligible individuals. An administrative decision was made to give the Department of Labor official responsibility for managing the certification system. The State Employment Security Agencies (SESAs) were designated as the local administering agencies. The IRS was responsible for auditing tax returns to ensure that correct amounts of credit were taken and for issuing income tax regulations to enable taxpayers to understand the conditions under which the credit could be claimed. Both Departments shared responsibility for informing taxpayers of the program's existence.

The House and Senate Committee Reports on their respective TJTC bills present a common description of the intended operation of the certification system. The basic reason for having an agency certify eligible individuals was to encourage employers to participate by relieving them of "responsibility for proving to the Internal Revenue Service that an individual is a member of a target group". A certification of eligibility from the Secretary of Labor was also thought to be more likely to assist an individual job seeker than one identifying the worker as a welfare or food stamp recipient.

The Congress envisioned that there would be a single designated employment agency which would issue the certifications in each locality. This was expected to strengthen the agency's labor market information exchange role, and to relieve other agencies (which were in a position to verify an individual's eligibility) of the burden of inquiries from employers. Thus, the Committees believed that the credit would be used both by public employment agencies in their attempts to place target group members, and by targeted individuals in their own job search. Further they believed that aggressive promotion by the Department of Labor and local employment and training agencies was essential to the success of the credit. Both Committee reports state "The Committee believes that only through such publicity, and through the resulting interchange between employers and public employment agencies, will the intended results be achieved."1/

1. The Certification System - For Groups Other Than Cooperative Education Students

The State Employment Service Agencies (SESAs) of the Department of Labor were given primary responsibility for certifying TJTC eligibility for target group members other than cooperative education students. For eligible persons other than cooperative education students, a two-stage certification system was adopted. In the first stage, called "vouchering", the certifying agency would determine whether individuals were members of targeted groups and issue vouchers to employers who hired eligible individuals. Alternatively, the voucher could be issued directly to target group members for use in their search for employment.

The second stage, called "certification", would be initiated when an employer signed the voucher form and sent it to the SESA office. By signing the form, the employer indicated that the vourchered individual either had been hired or would be hired. Certification would be concluded after SESA personnel reviewed the voucher and issued a certificate to the employer that could be used to substantiate TJTCs claimed on the tax return. If the vouchers were in order, the SESA offices were required by the Department of Labor to issue certificates within 72 hours after receiving the vouchers.

1/ U.S. House of Representatives, Committee on Ways and Means, Revenue Act of 1978, Report No. 95-1445, p. 92. U.S. Senate, Committee on Finance, Revenue Act of 1978, Report No. 95-1263.

The two-stage certification system was based on a similar system developed in California for administering the WIN-Welfare Tax Credit. The system was chosen to enable eligible individuals to use TJTC vouchers in their job searches. The SESAs were responsible for the certifications, but due to lack of administrative funding, other agencies were permitted to voucher their client populations. The other agencies involved included the Comprehensive Employment and Training Act (CETA) prime sponsors2/ which vouchered only the three economically disadvantaged groups), vocational rehabilitation agencies, Social Security offices, Veterans Administration offices, ex-offender agencies, and state and local welfare agencies. Many of these agencies were reluctant to enter into "cooperative agreements" with the SESAs to issue vouchers because no additional funding was provided for this work.

Through September 30, 1981, nearly 1,030,000 vouchers were issued to TJTC eligibles other than cooperative education students. Sixty-two percent were issued by the SESA's, 25 percent by CETA prime sponsors, and another 12 percent by vocational rehabilitation and state and local welfare agencies combined.

2. The Certification System for Cooperative Education Students

The Revenue Act of 1978 required the cooperative education schools to operate the certification system for cooperative education students. Since cooperative education students must be placed in specific jobs in order to participate in a "qualified" cooperative education program, only one form is used for this group and it serves the purposes of both a voucher and a certificate. Certifications are provided for these students by the schools rather than the SESAs. Through September 30, 1981, 317,000 cooperative education students were certified.

The eligibility of cooperative education students is documented by a single form, IRS Form 6199, which is signed by the student, the employer, and a representative of the school. This form serves as a certificate for employers of cooperative education students.

2/ CETA prime sponsors are defined as state governments and other political jurisdictions with populations of 100,000 or more persons. CETA prime sponsors were eligible for direct CETA grants.

B. Major Factors Shaping Administration of the Credit

1. Establishment of Certification Targets

Initially, TJTC certifications proceeded at a slower rate than expected. By August 1979, Department of Labor reports indicated that about 58,000 persons had been vouchered for the TJTC, and 23,000 certified. An in-house Employment and Training Administration (ETA) evaluation of the TJTC certification system at nine sites found that one reason for the slow start was a reluctance on the part of vouchering agency staff to promote the credit. The reluctance on the part of the administering agency staff was cited as being due to a staff perception that employers were skeptical about the TJTC program. The evaluation concluded, however, that much of the staff attitude stemmed from personal assumptions rather than actual TJTC experience.3/

To help give direction to the TJTC effort and to increase use of the credit, ETA established certification goals in late 1979. The national goals were 250,000 certifications from the beginning of the program through the end of September 1980, and an additional 300,000 certifications during FY 1981. These goals were apportioned among the states by a formula based on estimates of the size of the resident target population.

2. Provisions for Verifying the Eligibility of Economically Disadvantaged Individuals

Of the seven target groups, vouchering the three economically disadvantaged groups required the greatest administrative effort. According to the TJTC statute, an individual is economically disadvantaged if his annualized family income during the six-months immediately preceeding the month in which he was hired was less than 70 percent of the Bureau of Labor Statistics lower living standard. The determination that an individual is economically disadvantaged involves a time-consuming examination of various income records. In addition, the experience with similar determinations for the CETA program indicated that the process involved frequent errors. Congress had recently taken steps to reduce such errors by provisions in the 1978 amendments to CETA, leading to DOL administrative procedures to verify CETA eligibility determinations. The same procedures were mandated for the TJTC.

An additional complication in the case of the TJTC was that the statute required these determinations to be based on income in the "six months immediately preceding the month in which the

3/ Employment and Training Administration, Office of Program Policy, Evaluation, and Research, "Evaluation Study of the Early Implementation of the Targeted Jobs Tax Credit Program" (Report No. 51, December 1979), p. viii. Additional information about the study is in Appendix B.

hiring date occurs". This meant that vouchers needed to be revalidated at the end of the month in which they were issued. Thus, a voucher issed to an eligible job applicant on April 29 expired the next day and required revalidation in two days. Local administering agencies were reluctant to issue vouchers toward the end of the month. (This problem was eliminated by the 1981 amendments to the TJTC.)

For the three economically-disadvantaged target groups, a voucher life of one month or less meant that: (1) some vouchers expired unused and (2) some individuals were vouchered more than once. From the standpoint of a local administering agency, the high resource cost of unused vouchers or revalidations of expired vouchers reduced the attractiveness of large-scale vouchering, relative to issuing retroactive certifications, as a means of reaching the certification targets set by ETA.

3. Retroactive Certifications

The most controversial aspect of the TJTC program involved retroactive certifications. In its recordkeeping, the Department of Labor (DOL) counted as retroactive any certification in which the eligible individual was vouchered 15 or more days after the employee started work. Retroactive certification for the jobs credit is similar to the substantiation tests for all other tax credits that are claimed at the end of the tax year or several years later by amended return. According to DOL data (described below), nearly two-thirds of all targeted individuals (other than cooperative education students) certified during the first three quarters of FY 1981 were certified retroactively. A Mershon Center study4/ surveyed the certification procedures at four different times in 1980 and 1981. Their surveys, which counted as retroactive any voucher and certification issued after an employee was hired, found that between two-thirds and four-fifths of all certifications issued in the areas studied were retroactive.

Retroactive certifications were necessary initially in order to compensate employers of workers hired before the certification system was established. The law allowed the credit to be claimed for wages incurred or paid after December 31, 1978 to employees hired after September 26, 1978. This necessitated retroactive certifications for workers hired before January 1, 1979, even if the certification system was operative on November 6, 1978, the date the TJTC was enacted. Furthermore, since many designated

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4/ Ohio State University, Mershon Center, The Implementation of the Targeted Jobs Credit, Report No. 2 (January 1981), Report No. 3 (May 1981), Final Report (January 1982). Additional information about the study is in Appendix B.

agencies were unable to certify individuals until the summer of 1979, many employers could not obtain certifications for employees hired during part of 1979.

In order to avoid penalizing employers of these workers, the Internal Revenue Service took the position, announced in a March 21, 1979, news release, that the certifications could be completed after employees were hired, but not later than the due date, including extensions, of the employer's tax return on which the credit was claimed. This interpretation was consistent with the statutory provision that allowed employers to claim the credit for wages paid after December 31, 1978, for employees first hired after September 26, 1978, a date preceding enactment of the statute. Otherwise, the statute did not specify when the certifications may be made.

Retroactive certifications could conceivably have been restricted administratively after a transition period which allowed for the late start of the program. However, this was not done. By the time the Internal Revenue Service became aware of the retroactive certification issue, legislation concerning the TJTC was already pending. A legislative solution to the issue was chosen.

According to a study of TJTC administration, the establishment of certification targets by DOL provided considerable stimulus to the practice of retroactive certifications. In their efforts to reach their targets, many SESAs found that certifications could be achieved at the lowest administrative cost by assisting employers to identify eligible workers already on their payrolls.

4. Funding for Administration

The Department of Labor initially estimated that it would cost about $70 million annually to properly operate the certification system, but no funds were approved for this purpose. Congress did not specifically authorize appropriations for administering the TJTC. However, DOL reprogrammed $10 million from Title III, of the Comprehensive Employment and Training Act (CETA) for FY 1979, and in subsequent years earmarked $14 million from CETA Title VII, to administer the TJTC certification system. The funds were to be used for recordkeeping, reporting, and promoting the credit.

As noted above, the lack of funding required the use of several cooperating agencies to voucher groups other than cooperative education students. In addition, the lack of funding for eligibility determinations caused most cooperating agencies to maintain only modest vouchering efforts.5/

C. Other Aspects of TJTC Program Administration

1. Promotion and Information

TJTC promotional activities were undertaken by both the Department of Labor and the Department of the Treasury. These included the development and distribution of brochures, flyers, and other materials providing information on the TJTC to the employer community, to organizations serving various target groups, and to vouchering agencies. Promotional packages and standard radio spots, for use in local areas, were also developed. Many SESAs developed their own promotional materials and conducted extensive marketing campaigns.

2. Treasury Regulations

Proposed regulations for the Targeted Jobs Tax Credit were published December 28, 1979, in the Federal Register, Volume 44, Number 250. The regulations covered the definition of qualified cooperative education programs, the apportionment of the credit among a group of businesses under common control, and the carryback and carryover provisions for unused credits. The proposed regulations also dealt with some aspects of the New Jobs Tax Credit.

Public response to the new regulations primarily concerned the definition of a qualified cooperative education program. The proposed regulations defined the term "program of vocational education" as an "organized educational program which is directly related to the preparation for a career requiring other than a baccalaureate or advanced degree." The "organized education program" was defined to be "only instructions related to the occupation or occupations for which the students are in training."

Several service industry associations responded that the proposed regulations interpreted the statute too narrowly. They stated that students should be eligible for the TJTC regardless of whether or not the job was specifically related to the course of study or career goal. Several State Education Department officials and cooperative education program directors argued, on the other side, that the regulations were too broad. They stressed that the statute requires a written agreement between the school and employer(s) that plans the alternation of study and school with a job that "contributes to the students' education and employability."

5/ Ohio State University, Mershon Center, Report No. 1, p. 11.

Final regulations were issued on November 6, 1985.

II. Statistical Summary

Information on the use of the Targeted Jobs Tax Credit is available from two sources: certification data collected by SESAs and a sample of corporate income tax returns.

A. Certification Data

1. The Initial TJTC Program

Since the inception of the TJTC program, the SESAs have collected data on individuals vouchered and certified. State reports are sent to Department of Labor regional offices, and the regional summaries are sent to the National Office where they are compiled. The reports contain certain demographic information--age, sex, race or ethnic group--and the occupations and wages of those certified.

The data in Table 5.1 show that through September 30, 1981, 1.35 million vouchers had been issued, including 318,000 for cooperative education students. More than two vouchers were issued for every certification for individuals in the non-cooperative education groups. Vouchers were often issued several times to the same person. The SESAs and CETA prime sponsors issued nearly seven out of every eight vouchers for the target groups other than cooperative education students. Vocational rehabilitation and welfare agencies accounted for most of the remainder.

Certifications issued through September 30, 1981, totalled about 717,000. The largest shares of total certifications went to cooperative education students (44 percent) and economically disadvantaged youth (40 percent).

Overall TJTC certification activity has varied over time (see Table 5.2), with the trend line dominated primarily by the variability of cooperative education certifications which are strongly tied to the school cycle. Within the general trend, several patterns emerge. On a quarterly basis, certifications for economically disadvantaged youth increased steadily since the beginning of 1980. Certifications for economically disadvantaged Vietnam veterans and vocational rehabilitation referrals increased since the July-September 1980 and October-December 1980 quarters, respectively, while certifications for the other groups have fluctuated over time.

Table 5.1

Targeted Jobs Tax Credit Vouchers and Certifications
Issued by Target Group
(Cumulative through September 30, 1981)

Target Group	Vouchers	Certifications
Youth, Economically Disadvantaged	647,378	289,814
Vietnam Veterans, Economically Disadvantaged	84,728	29,847
Ex-Convicts, Economically Disadvantaged	90,511	30,015
Vocational Rehabilitation - Handicapped	75,945	33,609
Cooperative Education Students	317,901	317,901
General Assistance Recipients	129,867	14,481
Supplemental Security Income Recipients	4,284	1,657
Total	1,350,614	717,324

Source: U.S. Department of Labor.

Table 5.2

Certifications for Target Groups Per Quarter Through September 30, 1981 1/

	Disadvantaged Youth	Cooperative Education	Other	Total
January - March 1980	22,739	52,015	12,049	86,803
April - June 1980	24,585	20,613	12,203	57,401
July - September 1980	29,585	11,525	11,699	52,809
October - December 1980	35,834	53,301	12,654	101,789
January - March 1981	41,921	53,320	14,847	110,088
April - June 1981	46,946	25,693	14,732	87,371
July - September 1981	51,430	46,670	14,233	112,333

1/ Data problems preclude use of quarterly data prior to January 1980.

Source: U.S. Department of Labor.

Data on demographic characteristics, occupations, and wages are collected for certified individuals in all the target groups except cooperative education students.6/ Data in Table 5.3 show that about three-fifths of the certifications issued were for males, three-fourths for individuals under age 25, about one-half for whites, one-third for blacks, and one-tenth for Hispanics.

As of June 30, 1981, certifications (excluding cooperative education students) have been concentrated in the services, benchwork occupations, machine trades, and clerical and sales (Table 5.4). Service occupations have accounted for nearly one-fourth of all certifications. About three-fourths of TJTC certifications for all groups except cooperative education students were for jobs with wages below $4.00 per hour (Table 5.5).

In the first three quarters of fiscal year 1981, 63 percent of all vouchers for noncooperative education students were issued 15 or more days after the individual began employment, based on reports from 44 states. An earlier Mershon Center report7/ estimated that 80 percent of the certifications in the area they studied were issued after the individual's employment starting date.

2. Vouchering and Certification Activity Since the 1981 Amendments

The 1981 amendments restricted the issuance of retroactive certifications. The effect of this change can be roughly gauged from Table 5.6, which compares certification levels during the first half of FY 1981 with the levels during the first half of 1982. Excluding the cooperative education group, certifications issued for the original TJTC target groups declined by 32 percent, from 105,256 in the first half of FY 1981 to 71,936 in the first half of FY 1982. It should be noted that the 1981 amendments to the TJTC coincided with two other changes of major

6/ Data on the number of certifications for cooperative education students generally are sent by the schools to the SESAs, but data on demographic characteristics, wages, and occupations are not compiled for cooperative education students. Data are not collected on retroactive certifications for this group either.

7/ Mershon Center Report No. 1.

Table 5.3

Demographic Characteristics of Certified Individuals
(Excluding Cooperative Education Students)
(Cumulative through June 30, 1981)

Demographic Characteristics	Number	Percent
Males	206,634	62.0%
Female	126,885	38.0
16-18 Years Old	34,339	10.3
19-24 Years Old	227,588	68.2
25-34 Years Old	54,050	16.2
35 Years Old or Over	17,542	5.3
White, Not Hispanic	182,337	54.7
Black, Not Hispanic	108,673	32.6
Hispanic	33,786	10.1
American Indian/Alaskan Native	2,203	0.7
Asian or Pacific Islander	6,106	1.8%

Source: U.S. Department of Labor.

Table 5.4

Occupations of Certified Individuals
(Excluding Cooperative Education Students)
(Cumulative through June 30, 1981)

	Number	Percent
Professional, Technical, Managerial	14,852	4.4%
Clerical and Sales	39,952	12.0
Service	81,394	24.4
Farming, Forestry, Fishery	8,780	2.6
Processing	33,201	9.9
Machine Trades	35,526	10.6
Benchwork 1/	40,437	12.1
Structural	30,400	9.1
Miscellaneous	49,252	14.8
Total	333,794	99.9 2/

1/ Includes assembling, grinding, and drilling.

2/ Does not add to 100 percent due to rounding.

Source: U.S. Department of Labor

Table 5.5

Starting Wage Rates for Certified Individuals
(Excluding Cooperative Education Students)
(Cumulative through June 30, 1981)

Wage Rate	Number	Percent
Up to $3.99	248,024	74.6%
$4.00 - $4.99	47,578	14.3
$5.00 - $5.99	18,326	5.5
$6.00 and Over	18,558	5.6
Total	332,486	100.0%

Source: U.S. Department of Labor.

Table 5.6

Certifications by Target Group Before and After the 1981 Amendments to the TJTC 1/

Target Group	Certifications Issued 10/1/80 to 3/31/81	Certifications Issued 10/1/81 to 3/31/82
Youth, Economically-Disadvantaged	77,755	51,170
Vietnam Veterans, Economically Disadvantaged	7,415	5,241
Ex-convicts, Economically Disadvantaged	7,702	5,871
Vocational Rehabilitation	7,875	6,034
General Assistance	4,048	3,315
Supplemental Security Income Recipients	461	305
Total 2/	105,256	71,936

1/ Certification data for cooperative education students are unavailable after FY 1981.

2/ The total does not include certifications for three target groups: cooperative education students; ex-CETA participants, and the AFDC/WIN group.

Source: U.S. Department of Labor.

importance to the TJTC program: a worsening in overall economic conditions and reductions in the staff of the Job Service.8/

The requirement that cooperative education students be economically disadvantaged did not take effect until January 1, 1982. After that date, the schools issued certifications only after a student was determined to be economically disadvantaged by the Job Service. To examine the effect of the 1981 amendments on the use of the TJTC by the cooperative education system, appropriate comparison periods would be the second halves of fiscal years 1981 and 1982. Cooperative education certifications during the second half of FY 1981 totalled 72,363. During FY 1982 the schools ceased reporting to the Job Service the number of certifications issued for cooperative education students. However, Job Service records show that approximately 8,435 cooperative education students were determined to be TJTC-eligible during the second half of FY 1982.

The Economic Recovery Tax Act incorporated the WIN/Welfare credit into the TJTC. WIN/Welfare certifications decreased from 65,700 in 1980 to 31,090 in 1982. The WIN/Welfare credit was also modified in two ways that discouraged its use: the issuance of retroactive certification was restricted and employer eligibility was limited to business employers. The economic downturn and administrative changes in the WIN program also contributed to the decline in WIN/Welfare certifications. WIN administrative funds in FY 1982 were 25 percent less than in FY 1981. In addition, the 1981 Omnibus Budget Reconciliation Act allowed states to opt for their own alternatives to the WIN program, called WIN demonstration project (demos). By the end of FY 1982, 16 states had implemented WIN demonstration projects.

8/ Certifications for all target groups, with the exception of cooperative education students, have increased from 202,261 in FY 1982 to 563,381 in FY 1984. The Department of Education provides technical assistance to state education agencies which certify cooperative education students. DOL performs "economic determinations" for cooperative education students, i.e., DOL determines whether these students are economically disadvantaged. The number of "economic determinations" provides an upper bound on the number of certifications for cooperative education students. There were 8,324 "economic determinations" for cooperative education students in FY 1984. A comparable number is unavailable for 1982. Certifications for AFDC recipients/WIN program eligibles have grown more rapidly than certifications for any target group, increasing from 18,503 in FY 1982 to 84,769 in FY 1984.

The transition from the regular WIN program is believed to have inhibited use of the TJTC, especially since there was some uncertainty as to the eligibility of WIN demo registrants.

The 1981 amendments created a new TJTC target group: individuals involuntarily terminated from CETA public service employment programs. During FY 1982, 1,285 certifications were issued for members of this group.

B. Employer Income Tax Return Data

1. Description of the Data

Additional information about the use of the Targeted Jobs Tax Credit is available from a sample of early corporate income tax returns for 1979 on which jobs credits were claimed. Corporations that claimed jobs credits in 1979 reported the total amount of the credit earned and additional information: the number and type of targeted workers hired, the total qualified wages paid to each type of worker, the amount of credit claimed in the current year, and information on the company's tax liability limitation worksheet.

The data from the 1979 corporate income tax returns can only provide limited information for the analysis of the effectiveness of the TJTC program. Nonetheless, the sample provides relevant information on characteristics of employers claiming the credit.

2. Limitations of the Data

Complete information from employer tax returns is generally not available until two years after the end of a tax year. For some businesses, the 1979 fiscal tax year lasted through June 1980. Given that the completion date for this report was originally anticipated to be June 30, 1981, it was not possible to use employer tax return data to analyze the pattern of TJTC use for tax years after 1979. Even for the 1979 tax year, it was not possible to obtain a representative sample of all tax returns. The last of the 1979 tax year returns were being filed in March 1981 due to the three-month filing period and two automatic filing extensions. In addition, transcribing, assembling, processing, and verifying the data take several months.

The analysis in this section is based on a sample of early 1979 corporate income tax returns. The sample was limited to corporations filing calendar year or early fiscal year returns; corporations with 1979 fiscal years ending after December 1979 were not included.9/ The vast majority of the returns in the sample were calendar year returns; few were early fiscal year returns. The sample was also limited to returns filed before November 1, 1980.

The data from the corporate tax return sample indicated that the TJTC was claimed for an estimated 33,000 employees by corporations which filed calendar year or early fiscal year returns for 1979 prior to November 1, 1980. The Department of Labor reported a total of 108,000 certifications in 1979. The difference mostly reflects certifications of workers employed by unincorporated businesses and by corporations whose fiscal years ended after December 1979.10/ In addition, some certifications may never have been claimed as tax credits on income tax returns because the eligible employees never started work or they worked for only a very short time. Despite their differences about the total size of the progam, the Treasury and Labor Department data show a similar pattern of credit use by target group.

It is important to note that the tax return data provided only information needed for calculation of tax liability which is not sufficient to evaluate the TJTC's effectiveness. In addition, the tax return data pertain to the first year of the TJTC program, during which use of the TJTC was lower than in subsequent years. The TJTC administrative system was implemented slowly and it is likely that employer awareness of the credit began at a low level. The TJTC program did not issue its first certification until April 1979 and few workers were certified before September 1979.

3. The Results

a. Use of the Targeted Jobs Tax Credit

Few corporations with early returns (calendar year or early fiscal year) claimed the TJTC in 1979. Table 5.7 shows that the estimated 12,000 such corporations accounted for less than one percent of the more than 1.4 million corporations with early returns.

Use of the credit varied greatly by industry classification. Table 5.7 shows that manufacturing and retail trade industries made the most intensive use of the credit.

9/ The distributions by industry and firm size do not differ greatly between the corporations with calendar or early fiscal year returns and those with late fiscal year returns.

10/ It is unlikely that much of the difference was due to credits claimed on calendar year or early fiscal year returns which were filed after November 1, 1980. Few calendar year or early fiscal year returns are filed after November 1.

Table 5.7

Number of Corporations with Early Income Tax Returns Claiming the Targeted Jobs Tax Credit, by Industry - 1979

Industrial Classification	Corporations Claiming: TJTC - 1979		Estimated 1979 Early Returns		Percent Claiming TJTC
	Number	Percent	Number	Percent	
Agriculture	36	0.3%	46,840	3.0%	0.08%
Mining	44	0.4	12,110	0.8	0.36
Construction	516	4.3	143,210	9.2	0.36
Manufacturing	3,072	25.7	159,440	10.2	1.93
Transportation, Communication, and Utilities	90	0.8	66,260	4.2	0.14
Wholesale Trade	907	7.6	161,760	10.4	0.56
Retail Trade	3,768	31.5	301.360	19.3	1.25
Finance, Banking	1,940	16.2	320,390	20.5	0.61
Services	1,168	9.8	282,740	18.1	0.41
Other	421	3.5	65,890	4.0	0.64
All Corporations	11,963	100.0%	1,560,000	100.0%	0.77%

Note: Early 1979 tax returns are mostly calendar year returns; they also include fiscal year returns with accounting periods ending in calendar year 1979. The number of early tax returns on which the TJTC was claimed was underestimated to the extent that returns filed after November 1, 1980 were not counted. However, the degree of underestimation is slight since few early returns are filed after November 1.

Source: Department of the Treasury.

However, the jobs credit was only claimed by 1.9 percent of all manufacturing firms and 1.3 percent of all retail trade firms. Less than 0.7 percent of firms in all other industries claimed the credit.

The TJTC was used more often by larger firms than by smaller firms. Table 5.8 shows the percent of firms claiming the credit by size of firm. Seven percent of firms with assets totaling $10 million or more claimed the credit while less than one percent of firms with total assets below $500,000 claimed the credit.

Table 5.9 shows the number of jobs credits claimed (i.e., the number of employees for whom the credit was claimed) by firm size and industry. An estimated 33,000 jobs credits were claimed by firms filing 1979 calendar year returns. Within both industrial and commercial industries, firms with assets totaling one million dollars or more claimed over three-quarters of the jobs credits.

The average number of jobs credits claimed increased with firm size. Firms with total assets below $500,000 claimed, on average, less than two jobs credits, while firms with total assets above $10 million claimed an average 5.4 credits. The average number of credits claimed increased with firm size within each of the industrial classifications. The higher average number of credits claimed by larger firms is not unexpected, since a large firm employs more workers.

b. Patterns of TJTC Use

The jobs tax credit Form 5884 contained information on the number of targeted workers and the amount of wages paid to each target group. For firms in the Treasury sample, qualified wages paid totalled $70 million and the credit earned equalled $35 million.

Table 5.10 shows the number of credits claimed for each target group. More credits were claimed for hiring cooperative education students than any other targeted group. Three-eighths of the credits claimed, or 12,000 credits, were for students participating in a qualified cooperative education program. Economically disadvantaged youth were the next largest target group, for whom one-quarter of the credits were claimed. Table 4.10 also shows the distribution of credits claimed by target group when an adjustment was made for a possible incorrect transcription of certain certifications.11/ After adjustment, the distribution of credits is quite similar to the DOL certifi-

11/ The adjustment is described in Appendix B.

Table 5.8

Number of Corporations with Early Income Tax Returns Claiming the Targeted Jobs Tax Credit, by Size of Firm - 1979

Total Assets ($000)	Claiming TJTC - 1979		Estimated 1979 Early Returns		Percent Claiming TJTC
	Number	Percent	Number	Percent	
0 - 100	2,204	18.4	877,000	56.2	0.25
100 - 500	3,263	27.3	449,000	28.8	0.73
500 - 1,000	1,682	14.1	101,000	6.5	1.67
1,000 - 10,000	2,957	24.7	107,000	6.8	2.76
10,000 or more	1,857	15.5	26,000	7.1	8.14
All Corporations	11,963	100.0	1,560,000	100.0	0.77

Note: See note to Table 5.7.

Source: Department of the Treasury.

Table 5.9

Number of Credits Claimed by Industry by Size of Firm - 1979

Industry Classification	Total Assets ($000) 0 - 100	100 - 500	500 - 1,000	1,000 - 10,000	10,000 or more	Total	Average Number of Credits Claimed Per Return
Manufacturing	1,126	1,453	633	5,254	4,476	12,942	4.21
Construction and Wholesale Trade	280	3,988	2,089	2,657	1,147	10,161	7.14
"Commercial"							
Retail Trade, Finance and Services	5	535	487	1,550	4,081	6,658	2.17
Other	1,611	136	484	807	403	3,441	1.96
All Corporations	3,022	6,112	3,693	10,268	10,107	33,202	2.78
Average Number of Credits Per Return	1.37	1.90	2.20	3.47	5.44	2.78	--

Source: Department of the Treasury.

Table 5.10

Number and Percentage Distribution of Credits
Claimed and Certifications - 1979

Target Groups	TJTC Claimed or 1979 Early Corporate Tax Returns		Department of Labor Certifications in 1979		TJTC Claimed Correcting for Possible Transcription Errors	
	Number	Percent	Number	Percent	Number	Percent
Economically Disadvantaged Youth	8,261	24.8	36,774	33.8	8,261	24.8
Economically Disadvantaged Vietnam Veterans	1,846	5.5	4,330	4.0	1,846	5.5
Economically Disadvantaged Ex-Convicts	1,269	3.8	4,768	4.4	1,269	3.8
Handicapped	1,603	4.8	6,119	5.6	1,603	4.8
Cooperative Education Students	12,593	37.8	54,764	50.4	18,705	56.2
SSI Recipients	6,372	19.1	390	0.4	261	0.8
General Assistance Welfare	1,358	4.1	1,585	1.5	1,358	4.1
Total	33,302	100.0	108,730	100.0	33,302	100.0

Note: See note to Table 5.7

Source: Department of the Treasury.

cation data. Cooperative education students account for 56 percent of all credits claimed, while SSI recipients account for approximately one percent. All other tables in the text, however, report the unadjusted data.

The type of targeted worker most often hired differed considerably by industry. Table 5.11 shows the proportion of all jobs credits claimed for each target group within a particular industry. Employers in the retail trade, finance, and service industries claimed the jobs credit primarily for cooperative education students. Twelve percent or less of their jobs credits were claimed for economically disadvantaged youth age 18-24. By contrast, corporations in the construction, manufacturing, and wholesale trade industries claimed the jobs credit most frequently for disadvantaged youth.

Table 5.12 shows the same pattern of industry hiring from an alternative perspective. The last column shows that construction, manfacturing, and wholesale trade--which might be called "industrial"--firms, claimed approximately one-half of all jobs credits and firms in the retail trade, finance, and the service industries--or the "commercial" sector--claimed roughly the other half. However, the pattern changes for particular target groups. Industrial firms claimed 83 percent of credits for economically disadvantaged youth compared with 16 percent by commercial firms. Industrial firms were also more likely to claim jobs credits for Vietnam veterans, ex-convicts, general assistance recipients, and handicapped individuals than were commercial firms. Seventy-one percent of the credits for hiring cooperative education students were claimed by commercial firms compared with 24 percent by industrial firms.

c. Impact of the TJTC Limitations

The amount of TJTC claimed in any given year was limited by two provisions. Qualified first-year wages could not exceed 30 percent of a firm's aggregate FUTA payroll. This limitation was intended to prevent large scale replacements of non-eligible labor with workers for whom the TJTC could be claimed. In addition, total jobs credits could not be claimed for more than 90 percent of a firm's tax liability in the current year after all other credits were claimed. The tax liability ceiling affected one-third of the firms claiming the TJTC, and reduced by two-thirds the amount of the credit claimed in the current year by those firms. The amount of the credit exceeding the tax liability limitation could still benefit the employer, as the credit could be either carried back three years for refund of past tax liability, or carried forward up to seven years to

Table 5.11

Type of Targeted Worker Hired within Industries - 1979
(Percentage Distribution of Jobs Credits Claimed)

Industry Classification	Targeted Groups: Economically Disadvantaged: Youth	Vietnam Veterans	Ex-Convicts	Handicapped	Coop. Education Students	SSI Recipients	General Assistance Welfare	Total
"Industrial"	42.3%	8.9%	4.9%	8.6%	18.7%	11.7%	4.9%	100.0%
Construction	45.2	7.0	*	*	32.4	4.8	*	100.0
Manufacturing	41.6	9.2	5.9	9.7	18.3	11.6	3.7	100.0
Wholesale Trade	44.8	2.8	*	6.3	14.6	15.8	14.3	100.0
"Commercial"	8.3	2.0	2.4	1.3	55.7	26.7	1.6	100.0
Retail Trade	7.4	2.1	2.9	1.7	57.1	24.4	4.4	100.0
Finance, Banking	7.7	1.1	1.4	1.1	52.4	33.4	2.9	100.0
Services	12.5	3.2	3.2	*	56.7	23.2	*	100.0
Other	7.3	9.0	6.0	*	60.0	16.4	*	100.0
Total	24.8	5.5	3.8	4.8	37.8	19.1	4.1	100.0

*Less than 40 cases.

Note: The data in the table pertain only to corporations with early income tax returns.

See note to Table 5.7.

Source: Department of the Treasury.

Table 5.12

Percentage Distribution of Credits Claim by Industry, for Each Targeted Group - 1979

Industry Classification	Targeted Groups							
	Economically Disadvantaged							
	Youth	Vietnam Veterans	Ex. Convicts	Handi-capped	Coop. Education Students	SSI Recipients	General Assistance Welfare	Total
"Industrial"								
Construction	5.9%	10.0%	*	*	2.8%	0.8%	*	3.3%
Manufacturing	65.2	64.6	59.8%	78.5%	18.8	23.5	35.6%	38.9
Wholesale Trade	11.8	3.3	*	8.5	2.5	5.4	22.9	6.5
Subtotal	82.9	77.9	59.8	87.1	24.1	29.7	58.5	48.7
"Commercial"								
Retail Trade	8.2	10.5	21.0	9.5	41.1	34.7	29.4	27.3
Finance, Banking	4.3	2.7	5.2	3.0	19.0	24.0	9.9	13.7
Services	3.7	4.2	6.2	*	11.1	9.0	*	7.4
Subtotal	16.2	17.4	32.4	12.5	71.2	67.7	39.3	48.4
Other	*	4.3	*	*	4.6	2.3	*	2.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

*Less than 40 cases.

Note: The data in this table pertain only to corporations with early income tax returns. See Note to Table 5.7.

Source: Department of the Treasury.

reduce future tax liabilities. For firms affected by the tax liability limit, the expected present value of the credit was, on average, reduced by about one-quarter.12/

The 30 percent FUTA limitation affected only 7 percent of the corporations in the sample. Qualified wages eligible for the credit were reduced by approximately 3 percent because of this provision. The limitation most likely affected new firms, firms that had very high turnover rates, or firms that were expanding very rapidly. Nearly one-half of the firms affected by the FUTA limitation were also affected by the tax liability limitation.

III. Evaluation of Effectiveness

The purpose of this section is to evaluate the effectiveness of the Targeted Jobs Tax Credit in achieving the objectives of Congress. Congress intended the credit to increase the employment of eligible individuals in the private sector and to promote the growth of cooperative education programs.13/

This section is divided into three parts. The first part describes the unexpectedly low use of the TJTC by both employers and target group members and presents reasons for the limited use of the tax credit. The second part evaluates the hiring incentive provided by the credit and the possible induced targeted employment effect. The third part analyzes the impact of the TJTC on the economy's total employment, on participating workers' wages, and the long-term benefits of the program to participating workers.

A. Utilization of the Targeted Jobs Tax Credit

The original Carter Administration TJTC proposal was intended to benefit disadvantaged youth aged 18-24, who numbered roughly four million at that time. During the first two years of the TJTC program, less than 200,000 disadvantaged youth were certified as qualifying employers for the credit.14/ Reasons for low certification rates for target groups are discussed in this section.

12/ Expected value of credit earned = [0.32 claimed in current year] + 0.68 not "used" in current x 0.60 expected value of "unused" credits] = 0.73. An estimate of the expected value of "unused" credits is given in footnote 11, of Section III, Chapter 4.

13/ U.S. House of Representatives, Committee on Ways and Means, Report on the Revenue Act of 1978, No. 95-1455, p. 90.

14/ In FY 1984, there were 328,213 certifications of economically disadvantaged youth.

1. <u>The TJTC Penetration Rate</u>

One important aspect of the assessment of the credit is measuring the extent to which the TJTC reached the population potentially eligible for it. This will be called the "penetration rate," the degree to which TJTC reached the potential, eligible, working, population. It is defined as the fraction of eligible hires who were hired with the jobs credit. Since many eligible individuals are unemployed and do not find work, the proportion of the total eligible population affected by the credit is even lower.

Although precise data on the penetration rate are unavailable, estimates have been made for several target groups.15/ The estimates in Table 5.13 indicate that, during FY 1981, TJTC certifications were issued for 21 to 23 percent of cooperative education student placements. For the other target group, the penetration rate was lower: in the 5 to 10 percent range. Thus, in FY 1981, except for cooperative education students, in less than 1 out of 10 instances was the credit claimed for persons eligible for TJTC by firms that could use the credit.16/ Most eligible employees are hired without the credit.

Estimated Penetration Rates, for Selected TJTC Target Groups, Fiscal Year 1981*
(Percentage of Eligible Working Population)

Cooperative Education Students	21-23%
Economically Disadvantaged Youth Aged 18-24	6-8
Economically Disadvantaged Vietnam Veterans	9-10
SSI Recipients	4-5

*See Appendix B for explanation of how the estimates were made.

15/ See Appendix B for a detailed discussion of the methods used to estimate the penetration rates.

16/ This estimate corresponds closely to an estimate made by the General Accounting Office. General Accounting Office, Letter Report to Senator Heinz, "Comments on Employment Tax Credits" (PAD-81-730), June 5, 1981.

2. The TJTC Take Up Rate: A DOL Employer Survey

An employer survey was conducted in the spring of 1980 by WESTAT Inc. under a contract with the U.S. Department of Labor. Data were obtained from a stratified random sample of 4,832 establishments that pay unemployment insurance taxes in 30 sites around the country. Respondents were questioned in detail about their knowledge and use of four employment subsidies; the TJTC, the WIN tax credit, CETA's On the Job Training (OJT) contracts, and WIN-OJT contracts. Research projects analyzing the survey data were awarded by the U.S. Department of Labor to the Institute for Research on Poverty and the National Center for Research in Vocational Education. As part of this research effort, Bishop and Montgomery studied the factors which determined employer participation in each of the subsidy programs.17/ Participation was modeled as the outcome of two conditions--familiarity with the subsidy program and a decision to participate given familiarity. Bishop and Montgomery estimated the individual effect of each of several variables on the likelihood that both conditions would obtain. The effect of each variable was estimated holding constant the other variables included in the analysis.

Seventeen percent of the respondents to the survey claimed "familiarity" with the TJTC; these employers accounted for 33 percent of the employment of survey respondents. Bishop and Montgomery found that the establishments which were most likely to be familar with the TJTC were large, belonged to a business organization, had a predominately blue-collar workforce, and had claimed the New Jobs Tax Credit. Familiarity was also found to be positively related to a measure representing government activity to promote the subsidy programs. (The government promotion measure was the proportion of respondents in the survey site who learned of the WIN program from a government representative.) Across regions, employers in the Northwest were least likely to be familiar with the TJTC; those in the Southwest were the most likely to be familiar with the TJTC. Across industries, familiarity was highest in manufacturing and lowest in construction, wholesaling, and retailing.

Among the 901 surveyed employers who were familiar with the TJTC, 15 percent had claimed the credit. The results of the statistical analysis by Bishop and Montgomery indicate that the establishments most likely to participate were large establishments which had been responsive to the WIN credit and the NJTC and which had learned of the WIN credit from a government

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17/ John H. Bishop and Mark Montgomery, Chapters 2 and 3 in Subsidizing On-The-Job-Training, editor, John Bishop, National Center for Research in Vocational Education, Ohio State University, 1982.

representative. The probability of participation was lower among establishments in the Northwest and higher in finance and service establishments.

3. Reasons for the Low Penetration and Take-up Rates

This section attempts to explain why the utilization of the TJTC was far below the expected level. A number of reasons for employers' low use of the credit are examined. Certainly, no single explanation accounts for the entire difference between the actual and expected use of the credit.

a. Knowledge of the Credit

The General Accounting Office (GAO) conducted a survey on the TJTC in January 1980, after the TJTC had been in existence for about one year.18/ Nearly two-thirds of the firms in the survey knew about (had heard of) the TJTC. Knowledge of the credit varied with the size of firm, ranging from about 50 percent of firms with 20 or fewer employees to 75 percent of firms employing 100 or more workers. More than two-thirds of the employment among surveyed firms was in knowledgeable firms.19/

Knowledge of the credit was not the sole factor explaining the low usage by employers. About 15 percent of the firms in the GAO sample that indicated awareness of the TJTC had actually used it. However, many employers who were aware of the credit may not have understood its provisions or may not have known which employees were eligible. Knowledge of the credit may have been limited to a vague idea that it was targeted to disadvantaged workers. The difference between "knowledge" of the TJTC and familiarity with it is suggested by the results of the WESTAT employer survey. In contrast with the results of the GAO survey in which over 66 percent of employers in the knew of the TJTC, 17 percent of employers in the WESTAT survey claimed to be

18/ General Accounting Office, letter report to Senator Heinz.

19/ The GAO survey estimate of the knowledge rates were probably biased upward by the exclusion from the survey universe of firms that had both fewer than 50 employees and assets under $500,000. The excluded firms employ only about 17 percent of all workers in the private business sector. Therefore, the proportion of private sector employment that was in knowledgeable firms would probably not be much overestimated by the results of the GAO survey. (Dave M. O'Neill, "Employment Tax Credit Programs: The Effects of Socio-economic Targeting-Provisions", Journal of Human Resources XVII (3) 1982, p. 455).

with the TJTC.20/ The extent to which employers are familiar with the TJTC has undoubtedly increased substantially since the spring of 1980, when the WESTAT survey was conducted.

A mid-1980 study on the use of employment tax credits in Wisconsin provides some evidence on employer familiarity with the specifics of the TJTC. Of the 169 firms surveyed during the first phase of the study, 60 percent claimed familiarity with the WIN/Welfare credit or the TJTC.21/ Of those claiming familiarity, however, less than 20 percent could identify the amount of the subsidy, and only 25 percent could identify any of the target groups.

In the second phase of the Wisconsin study a promotional marketing experiment was undertaken during March-July 1981 in three counties. Over 800 employers received information promoting the TJTC, either through a mailed brochure alone or through the brochure plus a telephone call. An approximately equal number of employers comprised the control group. Initially, about 300 firms were selected for inclusion in the mail plus phone group. Of these firms, 87 could not be contacted and another 80 refused to complete the telephone interview or to participate at all. The study's investigators argue that the loss of the latter group of 80 firms probably biased the experiment's results toward positive promotional effects, since they believe that the firms in this group were likely to have been uninterested in the TJTC.

20/ John H. Bishop, Chapter 1 in Subsidizing On-The-Job-Training, Editor, John Bishop, National Center for Research in Vocational Education, Ohio State University, 1982. It should be noted that apart from the distinct meanings attached to "know about" vs. "familiar with", there is an alternative explanation of the difference in the results of the GAO and WESTAT surveys. The WESTAT survey utilized a sample of establishments from the unemployment insurance files, whereas the firm was the sampling unit in the GAO survey. If the central decision-makers of a multi-establishment firm were familiar with the TJTC but not interested in using it, they would be unlikely to pass on their knowledge to establishment staff.

21/ Thomas Corbett, et al., "Tax Credits to Stimulate the Employment of Disadvantanged Workers", University of Wisconsin-Madison, Institute for Research of Poverty, Special Report No. 31 (April 1981). A report on Phase I of the Wisconsin Wage Bill Subsidy Research Project, funded by the Governor's Employment and Training Office, State of Wisconsin, Wisconsin Department of Health and Social Services, Division of Policy and Budget, and the Institute for Research on Poverty, January 1982.

The investigators attempted to estimate the effect of the experimental treatment on the number of certified hires. There was no evidence of any experimental effect for the mail-only group. For the mail plus phone group the TJTC participation rate during the experimental period was 9 percent, as compared with 4.5 percent for the control group. The difference was close to statistical significance at the 10 percent level. In addition, when the investigators controlled for differences among firms in characteristics other than experimental status (via a logit regression), the experimental effect became statistically significant at the 5 percent level. Nevertheless, the investigators concluded that the results of the mail plus phone promotion "did not represent a major improvement given the present low level of tax credit usage" and that the promotion efforts were not "cost effective". It was also concluded that lack of knowledge was not the main causal factor in the underutilization of the TJTC.

Since the Wisconsin study did not attempt to quantify in money equivalents the social cost and benefits of the mail plus telephone promotion, the basis for the conclusion that it was not cost-effective is unclear. A cost-benefit calculation would have to take into account the effect of the credit's promotion on employer participation beyond the limited experimental period. A cost-benefit calculation would also be necessary to justify the conclusion that the mail plus phone promotion did not effect a "major improvement". Finally, it is possible that a TJTC promotional campaign could be more successful if it was directed to employers who are relatively likely to be responsive, such as employers who list job openings with the Employment Service.

The results of a 1977 demonstration project conducted by IMPACT were more encouraging than those of the Wisconsin experiment.22/ The project tested the effect of intensive marketing of the WIN/Welfare tax credit. The information campaign was undertaken in four cities. The report on the IMPACT study summarized the results of the project:

> "Briefly, at the end of an eight month period, about 31 percent of all employers in the demonstration cities claimed to know about the WIN/Welfare tax credits, compared with 15 percent of the employers nationally. The number of WIN/Welfare job entries increased by 78 percent in the demonstration cities, as compared with a 46 percent increase for the nation. The number of WIN/Welfare tax credit certifications increased 236 percent in the demonstration

22/ David Thompson, Jan Parkinson, and Dorothy Bonnallie. An Assessment of WIN and Welfare Tax Credits. (Minneapolis: Institute for Manpower Program Analysis, Consultation and Training, March 1977).

cities as compared with 49 percent nationally. The ratio of certifications to job entries increased from 14.9 percent to 28.1 percent, or 89 percent, while this ratio remained unchanged throughout the nation in general."

b. Insufficient Value of the Credit

For firms aware of the credit, use of the credit also depends on the amount and terms of the subsidy. The gross value of the subsidy is the amount of credit claimed. The credit equals 50 percent of the first $6,000 of wages in the first year of employment ($3,000) and 25 percent in the second year of employment ($1,500).23/ For example, for an eligible worker earning the minimum wage of $3.35 and working up to 1,800 hours, the credit reduces wage costs by 50 percent in the first year and by 25 percent in the second year. The wages of workers with higher earnings would be reduced by smaller fractions. In practice, it appears the percentage wage reductions approached the maximum, because eligible workers' wages were generally low: in FY 1980, 78 percent of TJTC- certified hires had starting wages under $4 per hour.

As discussed in Chapter 2, factor adjustment costs may be a major impediment to the use of a temporary tax credit. Hiring additional eligible workers will normally entail costs in searching for and/or screening job applicants, as well as training costs and paperwork. If the additional workers are to be retained only for the duration of the credit, there could also be additional costs in contributions for unemployment insurance. Similar costs can also deter employers from substituting eligible labor for other inputs in order to take advantage of the credit.

23/ Employers must reduce their wage deduction by the amount of the credit. This requirement makes the net tax savings from the credit vary inversely with the employer's marginal tax rate. On the other hand, the requirement tends to equalize the percentage reduction in the net (after-tax) wage cost of targeted workers. For example, suppose an employer pays $6,000 in wages to a targeted worker during the first-year of employment. If the employer does not claim the credit for this worker, the after-tax first-year cost would be $3,240 at a 46 percent marginal tax rate and $4,800 at a 20 percent marginal tax rate. If the employer does claim the credit, his wage deduction is reduced by $3,000, the amount of the credit. The decrease in the wage deduction increases tax liability by $1,380 at a 46 percent marginal tax rate and by $600 at a 20 percent rate. Thus, the net tax savings from claiming the credit at these two marginal tax rates would be respectively $1,620 and $2,400. The net tax saving is larger at the lower marginal tax rate, but the percentage reduction in the after-tax wage cost is 50 percent at either rate.

There is some weak evidence on the responsiveness of employers' take-up rate to the size of a subsidy. In the private sector wage subsidy experiments which were conducted as part of the Youth Incentive Employment Pilot Projects (YIEPP), employers were offered differing rates of subsidy for hiring economically disadvantaged youths. Estimates by the Manpower Demonstration Research Corporation showed five percent participation for employers receiving a 50 percent subsidy, ten percent with a subsidy of 75 percent, and 18 percent with a 100 percent subsidy. There were several considerations which suggest that the results understated the potential effectiveness of employment subsidies for the disadvantaged: (1) in one experiment site the economy was depressed; (2) participating employers could claim the subsidy only for youths referred through the YIEPP program; (3) the hours of work on subsidized jobs had to conform to the school schedule; (4) the experiment lasted only five-months; and (5) employers who had previously provided YIEPP positions were not contacted.

c. Low Level of Administrative Activity

It is estimated that approximately 10 percent of the eligible clients served by the local administering agencies were vouchered.24/ Two reasons for the low level of administrative activity on the part of the local agencies are the lack of administrative funding and the process for certifying economically-disadvantaged groups.

During the first three years of its existence, funds were not appropriated specifically for administering the TJTC. The Department of Labor did shift limited funds from the CETA program

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24/ The level of TJTC vouchering can be gauged by comparing non-retroactive vouchers with estimates of the potentially eligible population served by the SESA and CETA systems. During calendar 1980, CETA prime sponsors and SESAs issued approximately 305,000 vouchers (including an unknown number of multiple vouchers issued to the same persons) to persons, who were not vouchered retroactively. This is approximately ten percent of the approximately 3.1 million SESA new applicants and renewals plus persons terminated from CETA training programs who were either economically disadvantaged youths 18-24, Vietnam veterans, or handicapped persons. There is probably some overlap between the 2.2 million such persons entering the SESA system and 900,000 persons terminated from CETA training and employment programs.

for use by SESAs to administer the TJTC certification system. The incentive for the administering agencies to undertake vouchering was reduced by the absence of any funds earmarked for that activity.25/

Vouchering activity was also reduced by the statutory requirement that economically-disadvantaged eligibles be certified as to their family income in the six months immediately preceding the month of hire. This statutory provision was interpreted to mean calendar months, rather than 30 days, so the vouchers issued were valid only until the end of the month. Eligible individuals had to be recertified at the beginning of each month. This requirement reduced the advantage of vouchering for the administering agencies as well as for the eligible individuals.

d. Acceptance and Knowledge of TJTC by the Certifying Agencies

Agencies with certification authority were also responsible for disseminating information on the existence of the credit and its basic features as well as administering other labor market programs. Through their regular contacts with both eligible individuals and employers, these agencies were in a position to influence employers' use of the credit and the costs incurred by using the credit. Through contacts, they could explain the steps necessary for certification and the dollar benefits to a particular employer, and allay fears about "red tape", fair hiring practices, and the quality of workers who might be certifiable. Large-scale vouchering could also have provided a means of spreading awareness by encouraging eligible workers to use the vouchers in their own job search.

However, the Mershon Center's evaluation of 25 sites concluded that the main vouchering agencies--CETA prime sponsors and state ES local offices--generally did not consider the credit sufficiently useful as a way to increase employer contacts to actively promote it.26/ Nor did the agencies generally accept

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25/ In Wisconsin, TJTC certifications dropped to almost zero in the last three months of 1979, after federal funds for administration were exhausted (Bishop p. 32).

26/ Mershon Center, Report No. 2.

the concept that "blanket vouchering" was a cost-effective means of increasing certifications.27/ The study found that in many sites the staff of CETA Prime Sponsors attempted to avoid involvement with TJTC. In a large number of sites, CETA administrators objected to TJTC on the grounds that it did not remedy the root cause--low productivity--of the employment difficulties of TJTC eligibles. The administrators argued for the CETA approach of providing training. Jobs tax credits were also seen as competing with CETA programs in attracting participants. The Mershon Center Study found that response to TJTC was somewhat more positive at ES offices than at CETA Prime Sponsors. There was considerable variation in the response of ES offices across the study sites, ranging from active promotion to slight involvement. The administrative response was clearly a barrier to full utilization of the credit in several areas where retroactive certifications were discouraged.

The Mershon Center Study found that the cooperative education agencies, vocational rehabilitation agencies, and agencies placing ex-offenders responded much more favorably to TJTC than did either the CETA Prime Sponsors or the ES offices. Officials in vocational rehabilitation agencies and in agencies placing ex-offenders were often of the belief that the credit had significantly assisted their job placement efforts.

Insufficient familiarity with the TJTC on the part the implementing staff appears to have been a factor inhibiting its use, at least initially. A report on the early (1979) implementation of the TJTC noted that "employment and training agencies...are at least at the outset, uncomfortable with or unable to explain authoritatively detailed aspects of the credit."28/ During the first phase (mid-1980) of the Wisconsin jobs credits study, interviews were conducted with members of the field placement staff in the Division of Vocational Rehabilitation and the Division of Corrections (serving ex-offenders) in

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27/ Cost-effective from the perspective of the local Job Service often means the extent to which an action generates final placements, not whether it is likely to increase eligible employment by affecting the hiring decision. Mershon Center, Report No. 3, p. 58 suggests that eligible individuals often did not use the voucher in their job search, frequently discarding the vouchers outside the office of the vouchering agency.

28/ Employment and Training Administration, Office of Program Policy, Evaluation and Research, "Evaluation Study of the Early Implementation of the Targeted Job Tax Credit Program" (Report No. 51, December 1979), p. iii.

the Department of Health and Social Services. Nearly two-thirds of the responding staff indicated that their lack of knowledge about the TJTC was a factor in its underutilization.29/

e. Search Costs

The design of the TJTC was intended to minimize the costs to employers of screening job applicants for TJTC eligibility. Ideally, eligible job applicants would come to the employers already vouchered. In practice, however, this was generally not the case. Many TJTC-implementing agencies did not actively initiate vouchering of their clients who were seeking jobs. In addition, a large proportion of TJTC eligibles seeking jobs did not turn for assistance to the agencies that could have vouchered them. Thus, employers commonly incurred costs in attempting to screen job applicants for TJTC eligibility. Employers also incurred costs in obtaining retroactive certifications. This was reflected in the emergence of several private "third-party vendors"--firms that would check the eligibility of firms' employees in return for a percentage of the tax credits earned.

f. Disadvantages of the Tax Credit Approach

Providing the wage subsidy through the tax system resulted in additional complications for employers and for the agency staff asked to administer the TJTC. The requirement that the credit be subtracted from wages allowable as a business deduction--which equalizes the percentage reduction in wage costs for employers of different tax brackets--has been cited as making the ultimate dollar value of the credit difficult to grasp. Some employers might have preferred a wage subsidy that took the form of a direct grant rather than a tax credit since the value of the credit was reduced for employers affected by the tax liability limitation. Finally, some employers cited the fear that claiming the TJTC would increase the likelihood of an Internal Revenue Service audit, although the IRS informed employers that this would not be the case.30/ Nevertheless, the relatively high-take-up rate among corporations eligible for the New Jobs Tax Credit (43 percent in 1977 and considerably higher in 1978) shows that employment subsidies which take the form of tax credits can be widely utilized.

A recent experiment provides evidence on whether employers respond differently to direct subsidies as compared to tax credits. The experiment was conducted between December 1980 and

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29/ Corbett, *et al.*, *op. cit.*, p. 35.

30/ Mershon Center Report No. 2., p. 49.

May 1981 by the local CETA Prime Sponsor in Montgomery County (Dayton), Ohio. Over 800 welfare recipients who were enrolled in a job search assistance program participated.31/ During their first two weeks in the program, enrollees were trained in job search skills, such as preparing resumes and rehearsing for job interviews. The training provided to participants was varied to some extent, in order to assess its interaction with of wage subsidies. Participants were randomly assigned to one of three groups. One experimental group was given TJTC or WIN/Welfare tax credit vouchers. An alternative experimental group was given vouchers entitling employers to direct subsidy payments. Both experimental groups were instructed in the use of their vouchers and given explanatory materials for employers. A "control" group was not given vouchers but instead was instructed in the use of the resources of the Employment Service. After completing the job search training, program participants engaged in up to six weeks of structured job finding activities in groups.

The results of the experiment were consistent with the hypothesis that the employer take-up rate will be higher for direct subsidies than for tax credits. The job placement rates of the two subsidy groups were equal: 13 percent of participants found jobs within the six weeks following the completion of job search training. However, even though the two types of subsidies were designed to be equivalent in value for all employers with positive tax liability, only 16 percent of the job placements for the tax credit vouchered groups resulted in certifications as compared with 37 percent for the direct subsidy voucher group.

g. Negative Stereotyping of TJTC Eligibles

One of the main reasons for tying the TJTC administration to the employment and training community was to avoid the potentially stigmatizing effect of associating the jobs credit with the welfare system.32/ Nonetheless, the Mershon Center cites some employers' perceptions that TJTC eligibles are less productive than other workers as a possible explanation of the low take-up rate.33/

31/ See Gary Burtless and John Cheston, "The Montgomery County (Dayton) Ohio Wage-Subsidy Voucher Experimental: Initial Findings", U.S. Department of Labor ASPER, June 1981, Draft.

32/ House Report 95-1445, p. 92.

33/ Mershon Center, Report No. 3, p. 86.

The results of the Dayton Wage-Subsidy Voucher Experiment and the Wisconsin study of wage bill subsidies are consistent with the hypothesis that TJTC eligibility carries a stigma. Participants in the Dayton experiment who were instructed to use their jobs credit (TJTC or WIN/Welfare) vouchers in job search were less successful in finding jobs than were members of the "control" group. Nearly one-third of the employers surveyed during the first phase of the Wisconsin study indicated that they harbored reservations about the quality of workers eligible for the TJTC.34/ In the second phase of the Wisconsin study an experiment similar to the Dayton experiment was conducted during the March-July 1981 period. A sample of 329 individuals who were actively seeking work was drawn from the current caseloads of the three state agencies which served, respectively, Work Incentive Program eligibles (the WIN office), the handicapped (the state vocational rehabilitation agency), and ex-offenders (Division of Corrections). Participating agency staff instructed clients placed in the experimental group in using their jobs credit eligibility to their advantage in seeking a job. Experimental clients were encouraged to present prospective employers with a brochure on the jobs tax credit after telling the employer of their eligibility. The results of the experiment would appear to be even more striking than those of the Dayton experiment. The experimental WIN clients were found to be significantly less likely to obtain a certified job than were the WIN clients in the control group.35/ While this finding is not easy to interpret, it does suggest that individuals receiving any type of targeted government assistance may be stigmatized.

If jobs credit eligibility does carry a stigma, then it would not be surprising to find that some eligibles are reluctant to be vouchered and to use vouchers in their job search. Some evidence of such behavior was reported by the project staff in the Dayton experiment and by employment counselors (in WIN, vocational rehabilitation, and ex-offender programs) interviewed in the first phase of the Wisconsin study. More than one-third of the vocational rehabilitation and ex-offender counselers interviewed in the Wisconsin study felt that clients were (or believed that they would be) stigmatized by revealing their eligibility for a subsidy. This finding is perhaps surprising given that the characteristics which might stigmatize vocational rehabilitation participants and ex-offenders should in most cases be fairly apparent to employers, even if the employer does not know of the job applicant's eligibility for the subsidy. The Mershon Center study found very few reported instances of handicapped persons or ex-offenders refusing to be vouchered.36/

34/ Corbett, et al., op. cit.

35/ Wisconsin Department of Health and Social Services, "Job Tax Credit - Wage Bill Subsidy Research Project - Phase II", January 1982.

36/ Burtless and Cheston, op. cit., p. 12; Corbett, et al., pp 41-42; Mershon Center, op. cit., 44-45.

h. Fear of Violating Fair Hiring or Privacy Laws

Some concern was expressed that, in attempting to identify eligible individuals, regulations covering fair hiring or privacy might be violated. Congress intended that the administering agencies, not the employer, to be responsible for checking worker eligibility. It was intended that workers would bring the voucher to the job interviews, so employers would not have to ask about their eligibility. However, employers frequently became involved in determining applicants' eligibility and this factor might have inhibited use of the credit.

IV. Summary

No single reason can entirely explain the low take-up and low penetration rates of the TJTC. Although many employers knew of the credit by the end of the first year, it was rarely claimed.37/ The main factors inhibiting use of the credit seem to have been lack of knowledge by employers, the costs to employers of identifying target group members, and the small size of the credit relative to the costs of identifying and employing target group members. Finally, providing hiring incentives to employers via the tax system seems to have inhibited their use somewhat.

A. The Targeted Jobs Tax Credit as an Employment Incentive

1. The Effect of the TJTC on Targeted Employment

The number of targeted individuals who gained employment as a result of the TJTC is not known. Prior to late 1981, most certificates were issued retroactively, which typically meant that the employers' hiring decision was unaffected by the applicants' eligibility for the credit. And, even among workers whose eligibility was apparent to the employer at the time of hire, not all would in fact be induced by the credit.

Department of Labor data for the first three quarters of Fiscal Year 1981 indicate that, for target groups other than cooperative education students, approximately 63 percent of all certifications were "retroactive" (based on eligibility determinations done 15 or more days after the individual had begun work). At the time that the decision was made to hire a worker who was later retroactively certified, the employer was often totally unaware of the worker's eligibility for the TJTC. In these cases, the TJTC would have played no role in the employer's selection of the new employee. In at least some cases, however, the retroactive certification may have resulted from delays by the employer or the certifying agency even though the employer might have been aware of the individual's eligibility. Further-

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37/ Use of the credit has increased since 1982. See footnote 8 of this chapter.

more an employer aware of the TJTC may have hired a worker he felt might be eligible for the TJTC, only to find out later that the worker was indeed eligible.

Among those hires for which an employer was aware of eligibility, not all can be considered induced. The proportion of subsidized hires that are in fact induced will depend on the net value of the subsidy and on market conditions. The higher the net subsidy value, the greater will be the incentive to hire targeted workers. As described earlier, the incentive value of the credit was less than the nominal 50 percent wage reduction in the first year for a number of reasons.

The effectiveness of the credit in inducing additional targeted workers will also depend positively on the responsiveness of the demand for and supply of target group labor to wages. Both the demand for and the supply of targeted workers may be fairly responsive to changes in wage rates. The TJTC target groups are defined quite narrowly, so that they are close substitutes for nontargeted low-skill workers. This would imply that the demand for targeted labor is highly responsive to the relative cost of employing targeted workers, but any induced gains in targeted employment may occur largely at the expense of nontargeted low-skill labor. The high unemployment rate of the TJTC target groups suggests a willingness to work at prevailing wage rates, which would translate into an increase in employment of targeted workers if there is an increase in their demand. Thus, the TJTC has at least some potential for increasing employment of the targeted groups.

Several other factors must also be considered in evaluating the effectiveness of the TJTC. First, there is some evidence that in cases where an employer was aware of an applicant's eligibility, the credit may have worked to the applicant's disadvantage. The results of the experiments in Dayton, Ohio and Wisconsin suggest that individuals who use wage subsidy vouchers in independent job search may be less likely to find work than similar individuals without vouchers. The results of these experiments may indicate negative sterotyping by employers of vouchered TJTC eligibles, which might offset the intended incentive for employers to increase targeted employment.

Second, the total impact of the TJTC on target group employment is channeled through the employment experiences of both vouchered and nonvouchered target group members. To the extent that employment gained by vouchered TJTC individuals came at the expense of nonvouchered TJTC eligibles, the effectiveness of the program is reduced.

Third, the credit could have some effect on targeted employment even if employers do not substitute targeted for nontargeted workers. The subsidy provided to firms employing targeted workers could lead to an expansion of those firms' production, and thus targeted employment. The scale effect of the subsidy is undoubtedly small in the aggregate due to the low utilization and small size of the TJTC program. Nevertheless, the scale effect could have been significant for firms that were heavy users of the credit, especially after 1981 when the 30 percent ceiling on the share of FUTA wages that could be subsidized was removed.

Fourth, because the agency responsible for certifying cooperative education students--the school system--was invariably involved in placing the students in jobs, the impact of the TJTC on cooperative education employment may have differed from the TJTC's impact on the employment of other target groups. On the basis of interviews with the cooperative education staff, an April 1980 study by the Employment and Training Administration concluded that the TJTC did little to induce additional employer participation in cooperative education programs during the 1979 academic year.

Finally, there are the responses to survey questions which directly ask TJTC users about the impact of the credit on their employment and hiring patterns. Bishop reports some empirical evidence that is relevant to the credit's overall impact on targeted employment. Respondents to the 1980 WESTAT Survey who indicated having used at least one targeted employment subsidy (TJTC, the WIN credit, or CETA-OJT) were asked whether their participation in these programs had influenced their establishment to "expand total employment by more than might otherwise have been done." Respondents answering this question affirmatively were then asked to estimate for the most recent year that the establishment participated in one of the programs: (1) the number of "additional employees that were hired that wouldn't have been hired otherwise"; and (2) the total number of employees for which a tax credit or a subsidy was received. It is unclear whether in providing the former estimate respondents had in mind the net increase in total hires, as was intended, or the number of subsidized hires that were induced hires.

Assuming that respondents understood the question correctly to refer to net changes in total hires, Bishop reports that among all respondents who used solely the TJTC, the 1979 ratio of the net increase in total hires to the number of subsidized hires was 22 percent.38/ (In forming this estimate, respondents who

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38/ John H. Bishop and Mark Montgomery, Chapter 4 Subsidizing On-the-Job-Training, Editor, John Bishop, National Center for Research in Vocational Education, Ohio State University, 1982.

reported no net increase in total employment were included.) Since Bishop's finding relates to total hires, it is possible that some nontargeted workers were displaced by targeted workers such that the net increase in targeted group hires to subsidized hires may have exceeded 22 percent. However, the reliability of Bishop's findings may be questioned, since the number of respondents was small, and many respondents may have misinterpreted the questions or have been unable to answer them with resaonable accuracy. In addition, the responses pertain to the first year of the TJTC program, a year which probably was not typical of later experience.

Although Bishop finds a modest employment effect, it is contrary to the conclusion of the Mershon Center study which finds that "Employer hiring and firing practices do not appear to be significantly influenced by TJTC, even in those cases where they are applying for current rather than retroactive certification."39/ However, this finding, like Bishop's, is based on the survey responses of a small sample of employers which may not be representative of all employees using the credit.

Until more is known about labor market behavior, the total induced employment effect for targeted workers will not be known. Employer questionnaires, certification data, and tax return information are not sufficient for an analysis of the effect of the subsidy on targeted employment. The information that is known about the credit during its first three years of operation would suggest that some fraction of workers who were hired with the credit actually gained employment as a result of the credit's availability.

2. Budgetary Cost of the TJTC

The benefits of the TJTC must be measured relative of the cost of the program, since the Federal government could have chosen alternative employment programs with the same budgetary cost. The direct budgetary costs of the TJTC amounted to $730 million in Fiscal Years 1979-1981. In addition, employers could claim credits in FY 1982 and FY 1983 for workers certified during FY 1979-1981, because the credit was available for the first two years of employment. There are also costs of administering the credit by the Departments of Labor and Treasury, and the other agencies involved in TJTC vouchering. In evaluating the cost of the TJTC, it would also be necessary to account for any impact which the credit might have had on government welfare payments.

39/ Mershon Center, Report No. 2, p. 29.

B. Other Effects of the Targeted Jobs Tax Credit

1. Effects on Employment of Noneligible Workers and on Total Employment

The TJTC could have adversely affected employment opportunities for ineligible individuals by giving employers an incentive to favor target group members in their hiring decisions. It is unlikely that employers directly replaced ineligible workers hired before the TJTC was available with eligible workers. Instead, the displacement of ineligibles was more likely to have resulted from hiring a credit-eligibile worker rather than an ineligible worker when positions became available due to company expansion or regular turnover.

The only direct evidence that pertains to the displacement effect of the TJTC comes from the GAO employer survey. Among employers who used (or intended to use) the credit, 25 percent indicated that their use of the credit had led (or would lead) to an increase in their employment. Among actual and prospective users responding to a separate question, however, 40 percent indicated that they had "used some target groups workers in place of workers with similar skills but who were not members of a target group". Moreover, although users of the TJTC may have increased their total employment as a result of the credit, it cannot be concluded that the credit increased aggregate employment (see the discussion in Chapter 1).

2. Effect on Target Group Wages

The TJTC could increase the wages of participating workers in either of two ways. First, by providing additional employment, the TJTC may boost the earning power of participating workers through increased experience and on-the-job training.

Second, even without such improvement in skills, employers desiring to take advantage of the subsidy may offer higher wages in order to attract and retain eligible workers. A rough assessment of the second effect can be made by comparing wages at placement of certain categories of individuals placed by the Employment Service nationwide during FY 1980 with the wages entered on completed TJTC certificates through FY 1980.

Comparison of TJTC placements with two other groups is made in Table 5.14. These groups are: (1) all economically disadvantaged ES applicants placed, aged 18 and over; and (2) the group closest in skill levels to the TJTC population, economically disadvantaged 18-24 years old, Vietnam-era veterans, and the handicapped. The TJTC group includes 270,000 individuals; the first group consisted of over 1.2 million individuals in FY 1980; the second totaled about 675,000. Table 5.14 shows a wage distribution for TJTC participants which is broadly similar to the wage distribution of the comparison

Table 5.14

Comparison of Hourly Wage Rate Distribution of TJTC Workers and Employment Service Placements - FY 1980

Hourly Wage Rates	Percent: TJTC Certifications 1/	Percent: ES Applicants 18 and Over 2/	Percent: ES Youth, Vets Handicapped 3/
Under $4.00	78.0	73.2	77.5
$4.00 - $4.99	12.3	15.0	13.7
$5.00 - $5.99	4.8	5.5	5.0
$6.00 and Over	4.9	4.3	3.8
Total	100.0	100.0	100.0

1/ Excludes cooperative education students.

2/ Economically-disadvantaged employment service (ES) placements, age 18 and older.

3/ Employment service placements of economically-disadvantaged youth age 18-24, Vietnam veterans, and handicapped individuals.

Source: U.S. Department of Labor.

groups, particularly that of the group which most closely matches the TJTC population. While this comparison suggests that the wages of TJTC participants do not differ from those of similar workers, the comparison suffers from inadequate detail. For each of the groups compared in Table 5.14 the bulk of the workers earn under $4.00, and the absence of any finer breakdown may obscure differences between the groups. In addition, the data shed no light on the effect of the TJTC on the future wages of participating workers.

More informative estimates of the wage effects of the TJTC were obtained by Bishop and Stephenson, using the data from the WESTAT survey.40/ Employers were asked to provide detailed information on their most recent subsidized and unsubsidized hires. The starting wages of subsidized workers were compared with those of unsubsidized workers, controlling for differences in measures of education, experience, age, sex, and employer characteristics. A similar comparison was made for percentage wage growth during the first year of the employee's tenure at the firm. Employees for whom the TJTC was received were not found to differ from otherwise similar employees with respect to the starting wage or wage growth.

3. Hours and Tenure

In Chapter 2 it was argued that a pure wage subsidy (especially a temporary one) would encourge employers to increase hours per employee, whereas a per worker subsidy of a fixed amount would provide the opposite incentive. The $6,000 ceiling on annual subsidized wages per employee made the TJTC a cross between a pure wage subsidy and a fixed per employee subsidy. The wage distribution shown in Table 4.14 suggests that the $6,000 ceiling may have been binding for a significant proportion of the positions subsidized by the TJTC.

The TJTC may not have had an effect on the job tenure of workers for whom the credit was claimed. The costs to the employers of identifying and certifying TJTC eligibles gave employers an incentive to retain certified employees. On the other hand, the limitation of the subsidy to an employee's initial two years on the job gave employers an incentive to limit job tenure to two years.

40/ John H. Bishop and Stanley Stephenson, Jr., Chapter 9, in Subsidizing On-the-Job Training, editor, John Bishop, National Center for Research in Vocational Education, Ohio State University, 1982.

C. Conclusion

Based on the initial Congressional projections of the tax expenditures for TJTC, the actual impact of the program fell short of Congressional expectations. For most target groups, the credit was claimed for only a fraction of eligible hires. Available evidence is not adequate to explain the underutilization of TJTC. It is likely, however, that both the design of the credit and the administrative procedures involved in certifying workers were major factors. Provision of the wage subsidy through the tax system reduced the possible incentive effect for many employers.

Appendix A

New Jobs Tax Credit Data

I. Description of the Data

A. Limitations of Data

The analysis of the distribution of NJTCs in this report was limited to corporations. Corporations claimed about 80 percent of the NJTCs taken in 1977 and 1978. The remaining credits were earned by proprietorships and partnerships and claimed on individual tax returns. The distributions of jobs credits earned by partnerships and proprietorships should be broadly similar to the patterns observed among corporations.

One systematic difference is likely to exist between the distributions of credits claimed by corporations and those claimed by proprietorships. Partnerships are more likely to be able to claim credits than corporations of the same size because their taxable income includes the labor income of their owners. However, including noncorporate businesses would be unlikely to significantly alter the finding that the NJTC was less likely to be used by small businesses.

The data presented in Chapter 4 are based largely on final Statistics of Income (SOI) corporate income tax returns for 1977 and 1978. Information contained in two early samples of corporate tax returns and a sample of income tax data matched with payroll tax data was used to estimate eligible corporations and the effects of the various credit limitations.

B. Corporate Income Tax Return Samples

The Internal Revenue Service's Statistics of Income (SOI) sample of 1977 corporate returns had 90,634 returns, of which 76,723 were included in the jobs credit sample. Firms filing 1120-S or 1120-DISC returns were not included in the jobs credit sample since the NJTC could not be claimed on those returns. Credits earned by Subchapter S corporations could only be claimed on the individual tax returns of the shareholders. Nor could the NJTC be earned by DISCs. The 1978 corporate SOI sample had 89,249 returns, of which 79,000 were included in the sample.

In the 1977 sample, 24,922 returns were filed with jobs credits claimed on either Schedule J of Form 1120 or on Form 5884. In the 1978 sample, 58,835 returns claimed a jobs credit.

The Treasury Department used information transcribed from the sample returns to recalculate the amount of credit each corporation could claim. If the calculated credit differed from the credit actually claimed by less than $500, the two credits were considered matches. In 1977, there were 21,322 "matches" out of a possible 24,922; in 1978 there were 54,070 "matches" out of a possible 58,835.

The text presents information on the number of firms using the credit based upon the number of returns that claimed the credit in each sample, regardless of whether or not the credit claimed and the calculated credit matched. The information on the credit limitations presented in the report, however, was based upon the matching cases in the sample. In 1977, the calculated credit exceeded the credit actually claimed by $106.9 million. In 1978, the calculated credit exceeded the amount of credit actually claimed on all returns by $205.7 million. These discrepancies represented 7 percent of the total dollar amount of credit claimed in 1977 and 8 percent in 1978.

C. Estimating FUTA Base Growth Rates

The effect of the two percent employment growth threshold on eligibility for the NJTC could not be determined from tax returns because not all corporations are required to report their Federal Unemployment Tax Act (FUTA) base on their income tax returns. Hence, only companies claiming the NJTC reported FUTA base information.

Growth in the FUTA base for all corporations was estimated by matching the Census Business Master File (BMF) for 1977 with the FUTA payroll tax returns (IRS Form 941). The BMF contains various data items, including corporate income tax return data, on approximately 2.5 million business entities. The payroll tax file contains FUTA base information for the same business taxpayers. About 1.5 million direct matches between these two files were achieved. These matched data were used in Chapter 4 to estimate FUTA base growth rates for the universe of corporations.

The approximately one million non-matches resulted from different filing periods for some firms, business consolidations, and different collection procedures. Distributions using BMF matched data assume that the excluded non-matched firms do not differ significantly with respect to payroll wage growth from the matched firms. There is no reason to expect that firms were more likely to be matched for reasons related to payroll wage growth.

Appendix B

Targeted Jobs Tax Credit Data

I. Description of TJTC Employer Income Tax Return Data

The data for firms claiming the TJTC in 1979 were taken from a large sample of corporate income tax returns claiming a jobs credit in 1979. The entire sample contained firms whose accounting periods ended no later than December 31, 1979, which filed a return before November 1, 1980, and which either filed Form 5884 or reported a jobs credit on Form 1120. The sample was limited to corporations with early accounting periods in order to provide information for this congressionally mandated report prior to its July 1, 1981 deadline. Corporations with late fiscal year returns differ only slightly from corporations with early accounting periods with respect to industry and asset size.

The amounts of NJTC and TJTC claimed were combined on a single line on Form 1120. The fiscal year 1978-9 Form 5884 contained line items for both credits, while the 1979 calendar year Form 5884 included a line item for carryovers of the NJTC.

Thus, the TJTC had to be separated from the amount claimed for the NJTC. A tax calculator, replicating the calculations on Form 5884, was used to estimate the amount of the TJTC claimed on each return. The calculator assumed that the employment and wage data on Form 5884 were accurate. Any returns that contained no employment or wage data for the targeted groups were assumed to have claimed only the NJTC. Any returns that reported jobs credits totaling more than the calculated TJTC amount plus $500 were assumed to also claim the NJTC for the excess amount.

II. Adjustment for Potential Transcription Error

The eligibility certifications received by employers contained a letter-designation of the worker's target group, which was to be used in filling out the jobs credit tax form. The Tax Form 5884 listed seven letter-designated categories for the targeted groups rather than listing the specific types of eligible workers. This procedure was used to prevent employers from learning which target group an individual belonged to from the certification system.

The letter designations reported on the corporate tax return were used to estimate the number of tax credits claimed for each target group. However, the estimated number of credits taken for SSI recipients was 6,372, whereas according to DOL records only 390 members of this group were certified. This result was probably due to an incorrect transcription of the letter-designations for cooperative education students and for SSI recipients.

Some cooperative education students who were designated as letter 'E' appear to have been incorrectly classified as SSI recipients who were designated as letter 'F'. The distribution of credits claimed for the two groups was quite similiar by industry classification.

Some caution is necessary in interpreting the results by target group due to this inconsistency. Nevertheless, as Table 5.10 shows, among the five target groups other than the SSI and cooperative education groups, the distribution of tax credits was similar to that of Department of Labor certifications. It was not possible to check the reliability of the letter designations on Form 5884, since certifications were not required to accompany the tax form.

Table 5.10 also reports the number of jobs credits claimed for each target group when an adjustment for the possible incorrect transcription was made. The adjustment assumes that firms hired an SSI recipient only if they claimed credits for both cooperative education students and SSI recipients; otherwise only cooperative education students were assumed to have been hired. After the adjustment, the distribution of credits claimed for each of the targeted groups is more similar to that of the DOL certifications--cooperative education students and SSI recipients account for 56 percent and 1 percent respectively, of all credits claimed. All other tables in Chapter 5, however, report the unadjusted data.

III. <u>Summaries of Evaluations of TJTC Implementation</u>

The following summaries, except the description of the GAO survey, are based upon evaluations of the TJTC conducted internally or financed by the Department of Labor.

A. Ohio State University Research Foundation (Mershon Center Study), The Implementation of the Targeted Jobs Tax Credit, Report No. 1 (July 1980), Report No. 2 (January 1981), Report No. 3 (July 1981), Final Report (January 1982).

The TJTC evaluation project funded by DOL was intended to provide periodic feedback on the progress of the implementation of the TJTC at a sample of 25 areas chosen earlier for a study of the implementation of the Private Sector Initiatives Programs (PSIP). The 25 sites comprised about 5 percent of all CETA prime sponsors' areas and, since they were located in 17 States, involved contact with about one-third of State Employment Security Agencies (SESAs). A report was prepared after each of four waves of field visits. During the field visits, the evaluators contacted key individuals in the agencies involved in the TJTC implementation, reviewed reports, and observed operations. As part of the Fall 1980 field work, they also contacted a small sample of employers who were knowledgeable about the TJTC. In all, 47 employers were interviewed (about 2 per site), and the researchers referred to earlier employer surveys (such as a California survey of 620 employers) to confirm their findings. In addition, persons involved in the administration of the TJTC at the state, regional, and national levels were contacted.

The first report was based on field study in the 25 sample sites as of mid-1980. The principal finding of the report was that many local ES offices and CETA sponsors were skeptical about the tax credit approach and reluctant to use it extensively as a job placement aid. This attitude and the tendency to give TJTC a low priority were explained by several factors:

(1) The tax credit idea was new to the agencies. Key staff were not convinced of its "legitimacy" because it may provide financial gains to employers who do not alter their hiring practices.

(2) The TJTC certification system increased agency workloads, with what were seen to be little positive results. The small funding provided to administer the program suggested to local officials that the program was not important or that it was mistakenly seen at the national level as self-administering or readily absorbable by local agencies.

The second report in the series, based on a field study lasting through October 1980, indicated why employers responded only weakly to the tax credit incentive to hire from the targeted groups. Among its findings are:

(1) Many Employment Service offices and most CETA sponsors continued to be skeptical about the TJTC and reluctant to use it extensively as a placement tool. Employment Service offices in the selected sites were generally unable to meet their goals for certifications unless they actively promoted retroactive certifications, or at least responded to employer requests for assistance in obtaining them.

(2) Employer hiring practices did not appear to be significantly influenced by the TJTC. Most employers using the TJTC had already customarily been hiring from the eligible target groups.

(3) As to why more employers were not seeking TJTC hires, the principal reasons appeared to be "fear of government" and "hidden costs"--expressed as concern about "red tape", government intrusion into hiring, IRS audits, or being subject to requirements for Federal contractors.

The third report in the series was based on field studies and consultations in February and March 1981. It was primarily concerned with describing in detail the structure of the implementation of TJTC and how that structure evolved, and its effect on performance.

In addition to the findings presented in its first two reports--which were found to hold substantially in the areas studied in the third round of field studies--the report notes:

- Most ES offices vouchered selectively or in response to an employer's request.

- Over time, non-retroactive vouchering and marketing activity declined in the sites studied due to reduced resources and employers' emphasis on retroactive certifications.

- Agencies were generally more successful in meeting certification goals if they used a variety of marketing approaches, integrated TJTC with their other labor market programs and involved other agencies. Approaches involving direct contact with employers or accountants seemed to generate more certifications than approaches using the mass media.

- Despite the evidence suggesting that in some cases vouchered individuals did not use the TJTC voucher issued to them as a job search tool, the Center concluded that promotion of client-directed job search was the approach most likely to yield new--as opposed to retroactive--hires, although the volumn of certifications might not reach previous target levels.

The fourth and final report in the series updated the findings of the third report to July 1981. The most significant trends that were reported were a slight decline in the efforts of ES offices and CETA Prime Sponsors towards implementing TJTC, and a continued increase in activity by private "third-party" TJTC vendors.

B. Office of Program Evaluation, Employment and Training Administration, U.S. Department of Labor, Evaluation Study of the Early Implementation of the Targeted Jobs Tax Credit Program, December 1979.

The study of the early implementation of TJTC, done for internal Labor Department management purposes, was based on visits during the summer of 1979 to a major metropolitan area in each of nine ETA regions. Key staff of the agencies involved in TJTC implementation in each site were interviewed. In addition, about 200 employees who had been issued certifications or were known to be familiar with the TJTC were interviewed to obtain their opinions about the TJTC and to find out how they used the credit.

The major findings of the report are:

(1) Though it was generally assumed that the TJTC could be set up locally as a simple program, SESAs and CETA sponsors found it a rather complicated program to implement.

(2) Both SESAs and CETA sponsors were unhappy with ETA's assignment of exclusive responsibility to the CETA sponsors for eligibility determination and vouchering for the three income-targeted groups. The SESAs were concerned because this arrangement constrained the use of the TJTC in their regular labor exchange activities. CETA sponsors were concerned with the burden on them of arranging eligibility screening and vouchering of many persons they may not enroll in CETA programs.

(3) CETA sponsors generally considered the TJTC as a placement resource, much more suited to SESAs than to their own needs, and, therefore, generally did little to utilize it directly.

(4) There was evidence of skepticism about the TJTC and hesitation among many local agency staff actively to screen and voucher applicants or to promote TJTC use among employers.

C. Office of Program Evaluation, Employment and Training Administration, U.S. Department of Labor, Study of the Georgia TJTC Program, June 1980.

The Labor Department field evaluation of TJTC in Georgia was conducted to determine why and how Georgia (and more generally the States of DOL Region IV) had been attaining a high volume of tax credit certifications while most other areas had made relatively limited use of the TJTC. The study was based on visits to eight localities in Georgia in the spring of 1980, and on telephone contacts with a number of employers at those sites.

The major findings of the study are:

(1) The Georgia Job Service, with regional office support and with agreement of CETA sponsors and other agencies, had taken almost sole responsibility for the program, had assigned local office staff to work on it, and had actively sought to achieve relatively large numbers of certifications.

(2) Its efforts were primarily geared to helping employers identify previously hired workers who may be eligible, making eligibility determinations for such workers, and issuing retroactive certifications for them. As a result, it was estimated that about 80 percent of Georgia's certifications had been retroactive rather than involving workers hired by employers with the prior knowledge that they were eligible for the credit.

(3) The Georgia SESA officials saw this strategy as a way to get employers favorably oriented to using the tax credit, to get them to consider target groups more consciously in future hiring, and to make greater use of the Job Service generally.

(4) Neither Job Service nor CETA staff in Georgia were making any appreciable attempt to issue TJTC eligibility vouchers to applicants to help them in their job search. They doubted that workers could explain the TJTC or that employers would hire on the basis of a worker-presented voucher.

D. Office of Program Evaluation, Employment and Training Administration, U.S. Department of Labor, The Use of TJTC in Cooperative Education, December 1980.

This study of the use of the TJTC by instructors and coordinators of cooperative eductaion programs, done for internal Labor Department management purposes, was based on telephone interviews in the spring of 1980 with about 70 persons at the state, county, and local levels in a sample of nine States.

The study found that the TJTC was not used to any significant extent in the 1979-80 school year for lining up positions with new employers. It may have been of moderate value in increasing the retention of some students. On the basis of the limited sample of local experience in the survey, the study concluded the TJTC was not needed to obtain cooperative education placements in localities where the employment situation was not particularly depressed.

The principal role that school staff administering cooperative education saw for the TJTC, however, was as a means of rewarding employers already inclined to join with the schools in this activity. With only few exceptions, local school staff indicated they approached the credit as an entitlement of the employers they already work with, a sort of bonus for loyal support of the school-work program over the years.

E. U.S. General Accounting Office (GAO), Letter Report to Senator Heinz, "Comments on Employment Tax Credits" (PAD-81-73), June 5, 1981.

The GAO survey, taken in January 1980, was based on a stratified sample of 1,000 firms chosen from the Dun and Bradstreet Million Dollar and Middle Market files. These files cover almost the entire universe of firms employing 50 of more persons, as well as most firms employing less than 50 persons if they have a net worth of $500,000 or more. The major omission is very small firms (1-9 workers) with a low net worth. Such firms account for about 80 percent of all firms but less than 20 percent of aggregate employment. Seven hundred and twenty firms responded to the mail survey. The main findings of the survey are reported in the Chapter 5.

IV. Description of the Penetration Rate Calculations

This section describes the calculation of the TJTC penetration rate; i.e., the ratio of TJTC certifications to potential certifications. An employer in a "trade or business" who had newly hired a member of a TJTC target group since September 27, 1978 could claim the credit by having that person certified. The credit could only be applied against actual tax liabilities. The potential universe of TJTC certifications was thus all new hires of persons who were members of TJTC target groups by trade or business firms with past, present, or future federal income tax liabilities.

A full specification of this universe would require data on the number of individuals in each taraget group newly hired by trade or business firms with usable tax liabilities. While these data were not available, they were be estimated for certain target groups. Estimates of the numbers of economically disadvantaged Vietnam-era veterans and SSI recipients who work were available.

The calculation of the universe of one eligible group--economically disadvantaged youths--is described for 1981 in the following steps:

- o The 1981 population of 18-24 year-olds who were "economically disadvantaged" according to the TJTC definition was estimated to have been approximately 4 million.
- o According to Current Population Survey (CPS) data for 1981, about one half of that number were at work on an average day during the year.
- o CPS data also indicate that about 10 percent worked in sectors of the economy not covered by the credit (private homes; private nonprofit organizatons; unpaid family work; government; or self-employment).
- o Of the remaining 1.8 million, it was assumed that three-fourths worked for firms with enough residual income tax liability to use the credit.1/

1/ In any year, roughly one-half of all businesses have income tax liabilities. However, due to the carryover provisions of the law, TJTC could still be attractive to firms with no tax liability in the year of hire. An upper estimate of 25 precent was used for the percent of businesses that would have no "usable" tax liability after other nonrefundable credits during the 11 year period allowed for carrybacks and carryforwards of the credit.

- Based on CPS gross flow data, it is estimated that, on average, persons of this age group leave the state of employment (i.e., become unemployed or out of the labor force) at a rate of 9 percent per month.2/ To allow for the possibility that economically disadvantaged youths probably have higher than average job turnover and to allow for job changes with no intervening spell of unemployment or labor force withdrawal, a range of estimated monthly turnover rates of 15 to 18 percent is reasonable. This implies a range of 1.8 to 2.2 new hires per year per job to maintain the size of the employed population.

- Thus, the potential TJTC universe of economically disadvantaged youths is conservatively estimated at 2.4 to 3.0 million new hires during 1981.

- During fiscal year 1981, there were about 176,000 certifications of economically disadvantaged 18-24 year olds. This implies a penetration rate of 6 to 8 percent.

Similar calculations for other target groups include cooperative education youth, 21 to 23 percent; SSI recipients, 5 percent; and economically disadvantaged Vietnam-era veterans 9 to 10 percent.

The size of the universe of the remaining groups--ex-felons, vocational rehabilition referrals, and general assistance recipients--cannot be determined because the size of the populations is unknown. It is unlikely that the penetration rates for these groups differ significantly from the rates for economically disadvantaged youths or veterans. On the whole, for the TJTC groups other than cooperative education students, the penetration rate achieved during FY 1981 is estimated between 5 and 10 percent, and probably closer to the lower figure.

2/ See Stephen T. Marston, "Employment Instability and High Unemployment Rates" Brookings Papers on Economics Activity, 1: 1976 p. 175. The CPS data can only identify changes in labor market status (e.g., employment-to-unemployment); they do not identify job-to-job shifts involving no intervening spell of unemployment or labor force withdrawal.

Form **5884**
Department of the Treasury
Internal Revenue Service

New Jobs Credit

▶ See separate instructions.
▶ Attach to your tax return.

1978

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

Important—The employer's wage and salary deduction must be reduced by the new jobs credit on line 13. (See instruction G.)

If you are a small business corporation, partnership, estate, or trust which apportions the credit to shareholders, partners, or beneficiaries, complete only lines 1 through 13.

If you are an individual shareholder, partner, or beneficiary who receives the credit from the above entities and have no other jobs credit, complete only lines 16 through 19, enter the apportioned credit on line 20, 21, or 22, respectively and complete the balance of the form as applicable.

If you are an individual who has more than one new jobs credit, see instruction for line 13.

Note: *If you are a member of a group of trades or businesses that are under common control or if you are an estate or trust that apportions the new jobs credit between itself and its beneficiaries, please see instruction H and the instruction for line 13 before completing the form.*

1 Enter the total unemployment insurance wages (limited to $4,200 for each employee) paid during calendar year 1978 (see instruction for line 1) . . . . . .

2 Enter 102% of the total unemployment insurance wages (limited to $4,200 for each employee) paid during calendar year 1977 (see instruction for line 2) . . . . . .

3 Subtract line 2 from line 1 . . . . . .

4 Enter 50% of line 1 . . . . . .

5 Enter the smaller of line 3 or line 4 . . . . . .

6 Enter total wages paid in calendar year 1978 (see instruction for line 6) . . . . . .

7 Enter 105% of total wages paid in calendar year 1977 (see instruction for line 6) . . . . . .

8 Subtract line 7 from line 6 . . . . . .

9 Enter 50% of the smaller of line 5 or line 8 . . . . . .

10 Enter the smaller of line 9 or $100,000 (married individuals filing separately, estates and trusts, see instruction for line 10) .

11 Enter the unemployment insurance wages (limited to $4,200 for each employee) paid to vocational rehabilitation referral employees during calendar year 1978 (see instruction E) . . . . . .

12 Enter the smaller of (a) 10% of line 11 or (b) 20% of line 9 . . . . . .

13 Current year new jobs credit—Add lines 10 and 12 (see instruction I for special limits). (Members of a group of trades or business under common control, small business corporations, partnerships, estates, and trusts, see instruction for line 13) . . .

14 Carryback and carryover of unused credit(s) (attach computation—see instruction F) . . . . . .

15 Tentative new jobs credit—Add lines 13 and 14 . . . . . .

Limitation

16 (a) Individuals—Enter amount from Form 1040, line 37, page 2 . . . . . .
(b) Estates and trusts—Enter amount from Form 1041, line 27 or 28, page 1 . . . .
(c) Corporations—Enter amount from Schedule J (Form 1120), line 9, page 3 . . . .

17 (a) Credit for the elderly (individuals only) . . . . . .
(b) Foreign tax credit . . . . . .
(c) Investment credit . . . . . .
(d) WIN credit . . . . . .
(e) Credit for political contributions (individuals only) . . . . . .
(f) Credit for child and dependent care expenses (individuals only) . . . . . .
(g) Possession tax credit (corporations only) . . . . . .
(h) Tax on lump-sum distributions (see instruction for line 17(h)) . . . . . .
(i) Section 72(m)(5) penalty tax (individuals only) . . . . . .

18 Total (add lines 17(a) through (i)) . . . . . .

19 Subtract line 18 from line 16. (All filers, other than shareholders, partners, or beneficiaries to which lines 20, 21, or 22 apply, are to skip lines 20 through 23; enter zero on line 24, and complete lines 25 through 27.) .

20 Shareholder's credit from Schedule K-1 (Form 1120S) plus unused new jobs credit (see instruction for line 13) .

21 Partner's credit from Schedule K-1 (Form 1065) plus unused new jobs credit (see instruction for line 13) . . .

22 Beneficiary's credit from Schedule K-1 (Form 1041) plus unused new jobs credit (see instruction for line 13) . .

23 Line 20, 21, and 22 limits:
(a) Enter the smaller of line 20 or the amount figured by using the formula in the line 23 instruction . .
(b) Enter the smaller of line 21 or the amount figured by using the formula in the line 23 instruction . .
(c) Enter the smaller of line 22 or the amount figured by using the formula in the line 23 instruction . .

24 Add lines 23(a), (b), and (c) . . . . . .

25 Subtract line 24 from line 19 . . . . . .

26 Enter the smaller of line 15 or line 25 (if there is no entry on line 15, enter zero) . . . . . .

27 Total allowable new jobs credit (add lines 24 and 26). Enter here and on Form 1040, line 44; Schedule J (Form 1120), line 10(d), page 3; or the appropriate line on other returns . . . . . .

1978 Department of the Treasury Internal Revenue Service

Instructions for Form 5884

(1978–79 Fiscal Year Filers See Instructions for Form 5884–FY)

New Jobs Credit

(References are to the Internal Revenue Code)

General Instructions

Generally, employers who hire additional workers may claim a new jobs credit for their tax years beginning in 1978. This credit is usually based upon the employer's total unemployment insurance (FUTA) wages (limited to $4,200 for each employee) paid during the 1978 calendar year. It is equal to 50% of the amount by which the employer's FUTA wages paid during 1978 exceeds the greater of:

(1) 102% of total FUTA wages paid during 1977; or

(2) 50% of total FUTA wages paid during 1978.

The credit is limited to the lesser of the following amounts:

(1) 50% of the excess of the total wages (determined without any dollar limitation) paid during 1978 over 105% of the total wages paid during 1977;

(2) $100,000—married persons filing separately and estates and trusts, see instruction for line 10 of this form (the total jobs credit of a taxpayer involved in more than one business enterprise may not exceed $100,000); or

(3) Tax liability as defined in section 53.

To figure the credit and the limitation in item (1), fiscal year taxpayers with tax years beginning in 1978 must use the wages paid during 1977 and 1978 and not during their fiscal year. For example, if your tax year began 12/1/78 you would figure your credit and limitation in (1) above by taking into account wages paid during the calendar years 1977 and 1978.

An employer also is allowed an additional credit that is equal to 10% of the FUTA wages paid to vocational rehabilitation referral employees during the calendar year. See instruction E for definitions and limitations concerning this credit.

A. Who Must File.—Any individual estate, trust, organization, or corporation entitled to a new jobs credit; or any small business corporation, partnership, estate, or trust that apportions the credit among its shareholders, partners, or beneficiaries must attach this form to its income tax return. A Schedule K–1 showing the allocation of the credit to each shareholder, partner, or beneficiary must also be attached to the income tax return.

For further details on allocation of the credit, see section 52(f) and (g).

B. New Employers.—Employers who started in business in 1978 can qualify for the new jobs tax credit. Generally, the new jobs credit for new employers is equal to 25% of the total FUTA wages (limited to $4,200 for each employee) paid during 1978.

C. Credit Not Allowed.—Generally, employers who are not subject to FUTA or who are tax-exempt organizations (other than a cooperative described in section 521) do not qualify for the credit. See instruction D below for special rules regarding agricultural and railroad employers.

D. Unemployment Insurance Wages.—Generally, unemployment insurance wages are FUTA wages up to $4,200 per employee. Agricultural employers are to use Federal Insurance Contribution Act (FICA) wages up to $4,200. Railroad employers not covered by FUTA use ⅞ of the Railroad Unemployment Insurance Act (RUIA) wages up to $4,200. See section 51(f)(1), (2) and (3).

E. Vocational Rehabilitation Referral Employees.—For 1978, employers may claim an additional credit of 10% of (1) the first $4,200 of FUTA wages paid in 1978 to each vocational rehabilitation referral employee reduced by (2) any FUTA wages paid to such employee in 1977. This additional credit is limited to 20% of the regular new jobs credit (line 9).

The wages to be taken into account for this type of employee are only those wages that are paid to the employee during a 1-year period. This period starts with the employee's first payment of wages after the start of the employee's rehabilitation plan. The first payment must have occurred after 1976. (See section 51(e).)

A vocational rehabilitation referral employee is a handicapped employee who has been referred to the employer upon completion of (or while receiving) rehabilitation services according to a written rehabilitation plan under a State plan for vocational rehabilitation services approved under the Rehabilitation Act of 1973, or a program of vocational rehabilitation carried out under Chapter 31 of title 38, United States Code. (See section 51(f)(4).)

F. Unused Credit.—If the amount of the credit determined under section 51 is more than the tax liability limitation of section 53, the excess (unused credit) may be carried back to each of the 3 tax years preceding the year of the unused credit and afterwards may be carried forward to each of the 7 years following the year of the unused credit. (See section 53(c).)

G. Employer's Deduction for Salaries and Wages.—No deduction is allowed to an employer for the part of salaries and wages paid or incurred for the tax year equal to the new jobs credit on line 13 of Form 5884. The salary and wage deduction is to be reduced even though the new jobs credit is not used for the current tax year. For example, an employer would be entitled to a $20,000 credit on line 13 but has tax liability of only $18,000. The employer must reduce the salary and wage deduction by $20,000 even though the allowable new jobs credit (line 27) is only $18,000. The unused credit of $2,000 may be used for carryback and carryforward purposes.

In most cases, employers must reduce the appropriate salary and wage deduction on their returns by the new jobs credit on line 13 of Form 5884. An employer that is a member of a group of trades or businesses under common control must reduce its salary and wage deduction by the amount of new jobs credit (line 13) apportioned to it from the group. (See instruction H(1) below.)

When salaries and wages are capitalized for depreciation, the amount subject to depreciation must be reduced by the part of the new jobs credit that applies to the salaries and wages being capitalized. For example, if the new jobs credit on line 13 of Form 5884 is $1,000 and $100 of this credit is attributable to salaries and wages being capitalized (which represent 10% of total wages), the amount subject to depreciation would be reduced by $100. The $900 balance ($1,000 less $100) would be entered on the appropriate salary and wage deduction line of your tax return (Form 1120, line 13; Form 1065, line 13; Schedule C (Form 1040), line 31; etc.). (See section 280C and 1.280C–1 of the regulations.)

Note: *Attach a schedule to Form 5884 (or use the back of the form) to reconcile any differences for cases in which the reduction of the appropriate salary and wage deduction is less than the new jobs credit on line 13 of Form 5884.*

H. Special Rules.—

(1) *Trades or Businesses that are Under Common Control.*—When there is a group of trades or businesses under common control, the new jobs credit according to section 51 is figured on the basis that all the organizations under common control are one trade or business. The new jobs credit for the group must be apportioned among the members of the group on the basis of each member's proportionate contribution to the increase in FUTA wages for the entire group. See section 52 and regulation 1.52–1 for definitions and other details.

(2) *Adjustments for Certain Acquisitions and Dispositions.*—See section 52(c) and regulation 1.52–2 concerning adjustments that are to be made when a major portion of a trade or business is acquired or disposed of after 1975.

(3) *Change in Status from Self-Employed to Employee.*—If during 1977 an individual has net earnings from self-employment in a trade or business, and during any portion of 1978 the individual is an employee of that trade or business, to determine the credit allowable for the succeeding tax year the employer's aggregate FUTA wages for 1977 must be increased by an amount equal to the self-employment net earnings but not more than $4,200.

(4) *Short Tax Year.*—If the employer has more than one tax year in 1978, the new jobs credit shall be determined from the employer's last tax year beginning in 1978.

(5) Wages paid by an employer to an employee during any calendar year is taken into account only if more than one-half of the wages paid is for services performed in the United States in a trade or business of the employer.

I. Mutual Savings Institutions, Regulated Investment Companies, Real Estate Investment Trusts, and Cooperatives.—These institutions are not allowed the full section 51 credit. See regulations 1.52–3 for the applicable limits.

Specific Instructions

Line 1.—Enter the total unemployment insurance wages (limited to $4,200 for each employee) paid during 1978. Generally, these wages would be reported on line 15(b) on the 1978 Form 940. Special rules apply to agricultural and railroad employees. (See section 51(f)(2) and (3).)

Line 2.—Generally, enter 102% of the total unemployment wages (line 15, 1977 Form 940) paid during calendar year 1977. Special rules apply to agricultural and railroad employees. (See section 51(f)(2) and (3).)

Line 6.—Enter total wages (disregarding any dollar limitation) paid in 1978. An employee's wages must be taken into account only if more than one-half of the wages paid during the calendar year are for services performed in a trade or business of the employer in the United States. Total wages include salaries, wages, commissions, fees, bonuses, vacation allowances and salaries and wages paid to temporary or part-time employees; and the value of goods, lodging, food, and clothing that are subject to the FUTA tax. For agricultural and railroad employers, total wages paid include the above except that generally only cash remuneration is subject to the FICA and RUIA taxes. The special rules contained in Instruction H also must be taken into account to figure these total wages.

Generally, for line 6, total wages would be reported on line 15(a) of the 1978 Form 940. For line 7, enter 105% of the sum of lines 13 and 15 of the 1977 Form 940.

Line 10.—If a husband and wife file separate returns, the $100,000 limitation must be reduced to $50,000 each. This does not apply if the one spouse has no interest in a trade or business for the tax year which ends within or with the other spouse's tax year.

For an estate or trust, the $100,000 amount must be reduced to an amount that has the same ratio to $100,000 as the portion of the new jobs credit allocable to the estate or trust has to the entire amount of such credit.

Line 13.—When a group of trades or businesses are under common control (see Instruction H(1)), the member of the group that made the greater proportionate contribution to the increase in FUTA wages of the group must report the computation of the group credit on lines 1 through 13 (ignoring lines 14 through 27) of Form 5884. In order for each member to determine its allowable new jobs credit, each member (including the above member) must enter its apportioned share of the current year's new jobs credit on line 13 and any unused credit from prior or subsequent years on line 14 of a separate Form 5884 (ignoring lines 1 through 12) and complete lines 15 through 27 as applicable. Each member must attach to its Form 5884 a schedule showing the apportionment of the total group credit to the members of the group.

If the new jobs credit figured by an estate or trust is to be apportioned to the estate or trust itself as well as to the beneficiaries, the credit on line 13 is apportioned between the estate or trust and the beneficiaries on the basis of the income of the estate or trust allocable to each. The estate or trust must attach to Form 5884 a schedule showing this apportionment and enter and identify the estate's or trust's portion and the beneficiaries' portion in the margin to the right of line 13. The estate or trust then will complete lines 14 through 27, as applicable, to determine its allowable new jobs credit to be claimed on Form 1041. The beneficiaries' shares will be apportioned to the individual beneficiaries and each beneficiary is to determine his or her allowable new jobs credit as explained below.

The credit figured on lines 1 through 13 by a small business corporation, partnership, or estate and trust is apportioned to the individual shareholders, partners, and beneficiaries, respectively. This apportioned credit and any unused credit from prior or subsequent years is entered on lines 20, 21, or 22 of a separate Form 5884 by these individuals. They must complete the limitation section of the separate Form 5884 to determine the allowable credit to be entered on Form 1040.

Note: *Where an individual shareholder, partner, or beneficiary is entitled to a new jobs credit from two sources, such as from a sole proprietorship and a partnership, the new jobs credit of the proprietorship would be figured on lines 1 through 15 of Form 5884. The new jobs credit arising from the partnership would be entered on line 21 of the same form. Lines 16 through 27 would be completed to determine the total allowable credit (proprietorship credit on line 15 plus the partnership credit on line 21) to be entered on the individual taxpayer's Form 1040.*

Line 17(h). Tax on lump-sum distributions.—Individuals, estates, or trusts which are recipients of lump-sum distributions from qualified employees' trusts or annuity plans are to enter the amount of partial tax included in line 16. This partial tax is computed on Form 4972 and Form 5544.

Line 23. Limits.—The new jobs credit entered on lines 20, 21, or 22 is limited to the proportionate part of the tax liability on line 19 that is attributable to the shareholder's, partner's, or beneficiary's interest in each small business corporation, partnership, estate, or trust from which the credit is derived.

The credit from each entity is limited to an amount computed in accordance with the following formula:

$$\text{Line 19} \times \frac{\text{Portion of person's taxable income attributable to the person's interest in each 1120S, 1065, or 1041 entity}}{\text{Person's taxable income for the year reduced by the person's zero bracket amount (section 63(d)), if any}}$$

See section 63 for a definition of taxable income and regulation 1.53–1 for further information and examples of the computation of the limitation.

Note: *The carryback or carryover of an unused new jobs credit resulting from the application of any of the limitations (line 23(a), 23(b), 23(c), or 25) is subject to these respective separate limitations as applicable in prior and subsequent years. (See instruction F.)*

Line 25.—Line 25 contains the tax liability limitation in excess of the separate limitation computed under section 53(b). This is the amount of the credit allowable from all sources, other than partnerships, estates and trusts, and small business corporations.

$100,000 Limitation.—The total new jobs credit to be entered on line 23(a); 23(b); 23(c); 24; or 27 may not exceed the sum of (1) $100,000, (2) the dollar amount of the credits earned by employers attributable to the hiring of vocational rehabilitation referral employees, and (3) any unused new jobs credit from prior or subsequent years.

Publication 902.—For more detailed information please get **Publication 902, Tax Information on Jobs Tax Credit,** from your local Internal Revenue office.

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