Statement of

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Mr. Chairman, Congressional concern about improving employment opportunities for disadvantaged groups is longstanding. Currently, the Congress authorizes both direct spending and tax expenditure programs to aid disadvantaged workers. One of these--the Targeted Jobs Tax Credit (TJTC, hereafter referred to as the tax credit)--is a tax expenditure that will expire at the end of 19S5, unless it is reauthorized by the Congress.

My remarks today cover three topics:

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

BACKGROUND

The jobs tax credit is a nonrefundable employer tax credit. The credit reduces the cost of hiring workers from certain disadvantaged groups relative to unsubsidized job seekers; it thereby seeks to induce private-sector employers to employ workers from some high-risk groups that they might not otherwise choose to hire. While there is no explicit training requirement under the credit, disadvantaged workers who receive jobs because of the credit may have an opportunity to demonstrate their competence and build work histories that will make it easier for them to find other jobs later. Beyond any gains from reducing barriers to the future employment of these workers, the effect on total employment is uncertain. Employers may shift the composition of their hiring toward targeted workers in response to the credit, whether or not they add to their overall work force.

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

The tax credit program has been changed substantially since its initial authorization in 1978, probably increasing its effect on employers' hiring decisions. In its early years, it was widely believed that the program was not providing the intended employment benefits for targeted groups. Instead, it seemed likely that most of the program's benefits accrued to

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1. The employer's tax deduction for wages also must be reduced by the amount of the credit. This keeps the rate of subsidy for wage costs constant at the stated rates--50 percent in the first year and 25 percent in the second year--regardless of the employer's tax bracket.

employers for whom the credit was a windfall benefit and did not alter their hiring decisions. There were two reasons for this belief. First, about half the workers certified for the credit were youth in cooperative education programs--a group that employers are generally willing to hire without the credit as an inducement. Second, two-thirds of other workers claimed for the credit were certified retroactively. That is, first they were hired and only later did their employers determine their eligibility for the credit.

To increase the effectiveness of the program, the Economic Recovery Tax Act of 1981 eliminated both retroactive certification and eligibility for cooperative education students, unless they were also economically disadvantaged. Following these changes, certifications declined in 1982 by about 40 percent, with three-quarters of the decline resulting from the restriction imposed on eligibility for cooperative education students. The rest of the decline resulted from a combination of two factors: the elimination of retroactive certification and the recession, which brought about lower overall demand for workers. (The contribution of each factor is unknown, however.) 3y 1983, use of the credit had returned to its 1981 level of more than 400,000 certifications, an increase that reflected renewed economic growth and greater efforts by the Employment Service to implement the program.

The Deficit Reduction Act of 1984 extended the credit for one year, permitting employers to claim a tax credit for eligible employees hired before January 1, 1986, and allowed employers five additional days to request certification. Use of the tax credit has continued to increase: in fiscal year 1984, more than 500,000 certifications were issued; in the first quarter of fiscal year 19S5, 140,000 were issued--an increase of more than 20 percent over the number in the corresponding quarter of the preceding year.

EVIDENCE ABOUT THE PROGRAM

Researchers have focused on two key questions about the tax credit. First, is it effective? That is, does it generate jobs for targeted workers that they would not have had without the subsidy at a reasonable cost? Second, if additional employer participation is desired, how could this be encouraged?

Effectiveness of the TJTC

The poor employment prospects for disadvantaged youth--the only group for which much is known about the credit's effects--have long been a major concern. Unemployment rates among minority youth are generally more than double the rates for white youth (see Table 1). For example, the unemployment rate for black teenagers averaged over 40 percent in 1984, while the jobless rate for white teenagers was 16 percent. 2/

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

TABLE 1. UNEMPLOYMENT AND EMPLOYMENT RATES FOR YOUTH, 1984 (In percents)

Category of Youth	Unemployment Rate	Employment in Group as a Percentage of Group Population
All Youth, aged:		
16-19	18.9	43.7
20-24	11.5	68.7
White Youth, aged:		
16-19	16.0	48.0
20-24	9.3	72.0
Black Youth, aged:		
16-19	42.7	21.9
20-24	26.1	51.1

SOURCE: Employment and Earnings, Bureau of Labor Statistics (January 1985).

Although the employment problem for youth in general will moderate in future years because of demographic trends, exceptionally high unemployment among disadvantaged youth is likely to continue. Because this problem has been so intractable, any approach that may help merits careful consideration if the Congress remains committed to assisting the disadvantaged to find employment. While I will review current evidence about the effectiveness of the tax credit in this testimony, some important questions about its effects remain unanswered at this time.

Based on evidence from an employer survey, it appears that from 19SO to 1982 the credit induced a shift in employers' hiring toward targeted young workers. In a 1982 survey, about 34 percent of employers who had used the credit said that it substantially influenced their choice of which workers to hire. Moreover, the proportion of workers who were under age 25 was at least 6 percent higher, on average, in firms that had used the credit over the previous two years compared with similar firms that had not used it.

On the other hand, it is less clear that overall employment increased as a result of the credit. To the extent that job opportunities provided to targeted workers because of the credit were, in fact, new jobs, targeted workers benefited with no adverse effect on other workers. If overall employment increases were small, however, then gains for targeted workers were at the expense of other workers who were displaced.

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

Although the maximum annual credit is $3,000, the actual federal cost of a TJTC-subsidized job depends on the size of the credit taken and the employer's tax bracket. In fiscal year 1984, the average revenue loss per program participant was between $700 and $1,000. 3/ By way of

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3. Data from a 1981 survey indicated that the average TJTC-subsidized job held by youth lasted only 15 weeks and paid approximately the federal minimum wage.

comparison, the average cost per participant served in local training programs under the 3ob Training Partnership Act of 1982 (JTPA) in that same year was about $1,600. Although the two programs each include low-income youth as a target group, the approach taken is quite different--TJTC emphasizes immediate work experience, whereas 3TPA emphasizes training. At present, there is insufficient information to judge which is more cost-effective.

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

Employer Participation in the TJTC

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

A substantial proportion of employers are unlikely ever to use the credit. For example, employers who do not pay taxes—about 30 percent of firms--cannot benefit from the credit, nor can employers whose skill requirements do not broadly correspond to the qualifications of TJTC-eligible job-seekers. In addition, small firms may be reluctant to use the credit for at least two reasons. First, they are less able than larger firms to recover the fixed costs of participation, which include learning about the program and then modifying hiring practices to take advantage of it. Second, small firms are less able to absorb the additional costs that an unsuitable employee could impose on the firm.

Outreach efforts could, however, significantly increase the probability of employers participating in the tax credit program. If firms not now using the credit were contacted by the Employment Service, told about how the program works, and asked to accept program referrals, the Congressional Budget Office (CBO) estimates that up to a third of these firms could be

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

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

SOURCE: 1932 Employer Survey funded by the National Institute of Education and the National Center for Research in Vocational Education. This survey is not nationally representative, but is representative of both urban and rural sites in three regions--South, North Central, and West. In all, 3,710 employers responded to the survey.

persuaded to do so. For reasons already discussed, success rates would probably be highest in large firms with a high proportion of low-paid jobs, and lower in small firms or firms with few low-paid jobs. On the other hand, firms not now using the credit who already employ eligible workers might reduce their tax liabilities as turnover leads to hiring new employees, without expanding the number of jobs available to the target group.

OPTIONS

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

Allow the TJTC Program to Expire

One option is to allow the credit to expire as now scheduled at the end of 1985. This decision would contribute to simplifying the tax code; at the same time, federal programs to facilitate private-sector employment of disadvantaged groups would still exist under the Job Training Partnership Act. Costs can be tightly controlled under the latter program, whereas the Congress has less control over the costs of the tax credit since it is an entitlement. Allowing the program to end would avoid additional revenue losses of about $1 billion per year by the end of the decade.

Reauthorize the TJTC Program

Alternatively, the Congress could reauthorize the credit--either in its present form or with modifications--thereby continuing to encourage employers to hire eligible disadvantaged people. Since the Department of Labor is sponsoring a study of the tax credit, reauthorization would avoid disruption of the program, while providing the opportunity for better evaluation of its effectiveness.

A bill both to extend the tax credit for five years and to modify it (H.R. 983) was recently introduced by Representatives Rangel, Wheat, and

Campbell. One provision of this bill would increase annual eligible wages from $6,000 to $10,000. Doing so would make the tax credit more attractive to some employers by increasing its maximum value, and would roughly compensate for growth in earnings since the tax credit was first enacted in 1978. The larger maximum credit might not be used by many employers, however, because both average wages and employment durations in TJTC-supported jobs appear relatively low.

Another provision of this bill would expand program eligibility by changing the definition of "economically disadvantaged" from 70 percent of the Lower Living Standard Income Levels to 80 percent. When this modification was previously introduced, the Lower Living Standards had not been revised for several years. In late 1984, however, these standards were updated to reflect changes in the cost-of-living through December 19S3. Thus, eligibility has already been broadened somewhat. H.R. 933 would further expand eligibility, thereby reducing the extent to which the credit is targeted on the most disadvantaged. In total, H.R. 983 would reduce annual federal revenues by $100 million to $200 million by the end of the decade, compared with extending the current provisions.

CONCLUSION

Changes authorized by the Congress in 1981 probably increased the effectiveness of the tax credit program by reducing--but not eliminating—the potential for employers to benefit from the program without altering their hiring practices. In addition, use of the program is increasing as a result of growing familiarity with the credit, an improving economy, and more active marketing by the Employment Service. Available evidence suggests that the credit has increased employment of eligible disadvantaged people to some degree, but it may or may not have increased total employment. Reauthorization would allow time for further evaluation of the credit's effectiveness, but would increase the budget deficit.