

October 7, 2009

Support Builds for Tax Credit to Help Hiring

By [CATHERINE RAMPELL](#)

The idea of a tax credit for companies that create new jobs, something the federal government has not tried since the 1970s, is gaining support among economists and Washington officials grappling with the highest unemployment in a generation.

The proposal has some bipartisan appeal among politicians eager both to help their unemployed constituents and to encourage small-business development. Legislators on Capitol Hill and [President Obama](#)'s economic team have been quietly researching the policy for several weeks.

"There is a lot of traction for this kind of idea," said Representative [Eric Cantor](#) of Virginia, the Republican whip. "If the White House will take the lead on this, I'm fairly positive it would be welcomed in a bipartisan fashion."

In addition to the economists working on the proposal, some heavyweights support the concept, including the Nobel laureate Edmund S. Phelps, Dani Rodrik of Harvard and former Labor Secretary [Robert B. Reich](#).

One version of the approach, to be unveiled next week by the [Economic Policy Institute](#), a labor-oriented research organization, would give employers a two-year tax credit if they increased the size of their work force or added significant hours of work (for example, making a part-time worker full time). Employers would receive a credit worth twice the first-year payroll tax for each new hire, amounting to several thousand dollars, depending on the new worker's salary.

"It's beautiful if it can be timed at a dire moment like this, when unemployment is way too high and appears to be going somewhat higher," said Mr. Phelps, an economics professor at Columbia, lamenting that the president dropped it from the \$787 billion [stimulus plan](#) approved in February. "But it's a pity that this wasn't done a year ago."

One of a number of ideas being discussed, the policy is intended to encourage companies to start hiring again by making it cheaper to add new workers. It has raised concerns, though, that employers might try to exploit the system.

States have dabbled with similar tax credits in recent years, with mixed results. The federal government last tried this measure in 1977-78. During that period, employment — which had been soft from the 1973-75 [recession](#) — climbed at a record pace. The creation of one out of three jobs that was awarded the credit then was attributed directly to the policy. But the permanence of those jobs was less clear, and some dispute how many of those positions would have been created eventually anyway.

Supporters say that improvements upon the 1970s policy would increase its potency. These include better publicizing the credit; making it available even to concerns that are not making money, in the form of a direct payout to nonprofits and companies in the red; and distributing the credit quarterly so that companies see it sooner.

Timothy J. Bartik, a senior economist at the Upjohn Institute for Employment Research who is working on the draft with John H. Bishop of [Cornell](#), estimates that it would cost about \$20,000 for each job created.

But some dismiss the idea as corporate welfare.

“Some bad ideas never go away,” said Howard Gleckman, a senior research associate at the Urban Institute. “It’s just providing incentives to lots of companies that probably aren’t going to make it in the end anyway.”

Under the proposal from Mr. Bartik and Mr. Bishop, the credit in the first year would equal 15.3 percent of the cost of adding an employee. In the second year, it would fall to about 10.2 percent.

For example, hiring a worker might cost a small business \$50,000 annually. But with the tax credit, the cost would fall to \$42,350 in the first year, and then be \$44,900 the next year. After that, the cost would return to \$50,000.

The credit would apply only to the portion of an employee's salary under \$106,800. Lowering the cap further, however, could provide an even greater benefit to low-wage, unskilled workers.

The authors estimate their proposal could create more than two million jobs in the first year.

“Businesses like those provisions that reduce the hurdle rate that you have to surmount in order to make an investment — like an employee — a profitable investment,” said Robert Willens, president of a tax and accounting advisory firm in New York.

Of course, even in recessionary times, some companies are [hiring without tax breaks](#). So a subsidy could merely benefit those businesses that already would have added new workers.

An [American Economic Review study](#) has suggested that the 1970s policy was responsible for adding about 700,000 of the 2.1 million jobs that were awarded the credit. This may sound modest, but if accurate, economists say it would make this proposal a successful and relatively cheap way of creating jobs.

Advocates argue that such incentives would be more effective this time around not only because of design, but also because of timing. In 1977, hiring was already on the upswing, whereas economists expect today's job market to decline a bit more and then stagnate for months.

“Now is a better time than '77 was because we're closer to the bottom of a recession,” said Daniel S. Hamermesh, an economics professor at the [University of Texas](#), Austin, who helped create the 1970s plan. “This could help an uptick proceed more rapidly.”

But critics of the idea argue that businesses hire based on actual demand for their products, and a minor subsidy for adding an employee will not make up for the collapse in demand across the broader economy.

“Why would a business hire a new worker?” Bill Rys, tax counsel to the National Federation of Independent Business, a small-business industry group, said. “They’re hiring because they need to do work. Unless you have work to do, it’s still an expense.”

[Barack Obama](#) — like Senator [John Kerry](#) before him — proposed a job creation tax credit during his presidential campaign, and then in discussions for the stimulus package. The proposal was eventually killed because of concerns that employers would exploit the tax credit. For example, companies might close and reopen, claiming credit for all their “new” employees.

Even advocates acknowledge that, as with any tax incentive, employers and their accountants will take advantage of loopholes. But they argue that with strong rules — possibly by reducing the credit for “new” companies, or by requiring a company’s overall wage bill to rise along with its work force — the proposal could minimize such abuse.

Deficit hawks still worry about the cost of the proposal, and whether it would be politically feasible for Congress to phase it out once businesses have grown used to it.

The biggest fear among some, though, is that the proposal might unintentionally reduce job opportunities if it sits in Washington too long without passing.

“Particularly for big employers, if they think a job creation tax credit is in the offing, it could certainly be an incentive to delay hiring,” said Lee E. Ohanian, an economics professor at the [University of California](#), Los Angeles. “That means it could have the perverse effect of actually prolonging the recession.”