Time for New Jobs Tax Credit 2.0 For This Even-Numbered Year?

To the Editor:

1. An aside: Just before my May 2020 final exam, one of my graduate tele-students expressed some frustration at the federal largesse that promised her a Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136) rebate of $1,200, and nothing to her fiancé, who was phased out. She opined that she really didn't need the money, as her company, which provides campaign financing services to those seeking elected office, had been quite prosperous over the years, but she could use it to pay off some outstanding bills.

Since she was an undergraduate political science and economics major, and neither politically nor economically naive, I simply asked: "Is this an even-numbered year?" To which she promptly replied, "Yes." And I followed up with: "Is this year divisible by 4?" She laughed, and answered, "Yes, of course." OK, so readers are forewarned that what follows, on the subject of how to fuss with the payroll tax, is a combination of economic reasoning in the midst of the pandemic and conditioned by the realities of the political season of 2020.

2. Main theme: A few assumptions. Historically, economic and political conservatives found it morally compelling to argue for smaller government, not resorting to debt financing, free trade, and leaving social welfare to the states in accordance with what the Constitution seemed to say. Over time, various theories and political exigencies have led to a new kind of consensus across the spectrum of political thought that argues that debt does not matter, followed by the corollary that spending without regard to financing is an acceptable form of governance.

Until. Until something unexpected could happen? Those who resent, worry, or are outraged that the federal government was less prepared for a pandemic than it should have been might wonder if the debt overhang could be the next unexpected shoe to drop. For me, my reasoning leads me to believe this is going to happen as trust and patience diminish, and fear for one's life increases.

Facing a choice of federal default, partial default/restructuring, inflating oneself out of a bad economic corner, or long-term austerity, I surmise that our elected representatives will be forced to conclude austerity, or at least some limits on what can be spent this year, is the only option they can reasonably pursue. I thus assume that the size of deficits and the debt matter, and that more care will be needed as federal policy gets fashioned.

3. The analysis: So, given that the deficit and debt do matter, what is the problem to solve, preferably by recorded, rather than voice, votes in the U.S. House and U.S. Senate?

3a. Problem definition 1: Are we concerned that people not working do not have enough income to get by until the health risks subside? This is an income maintenance or safety net issue, and is the subject of things like short-term federal payments — perhaps more targeted than what the CARES Act managed to accomplish — along with appropriate financing of unemployment insurance, food stamps, temporary assistance to needy families, public assistance, and the earned income tax credit. (I leave the matter of further monies to state and local governments to be the subject of a follow-up article.)

The term "appropriate" here means policy should maintain targeted assistance to those who need it, on a pretax, pre-transfer basis, and provide it in a way that the incentive to work remains in place. Note: It would help to know what the relative cost of living around the United States really is, by the way. As a starting point, one can use something like 20 or 25 percent of median private sector income by state to be what post-transfer, post-tax income should look like.[1]

---

[1] *See, e.g.*, Robert P. Strauss, "A Targeted Household Stimulus Demi-Grant Based on Each State's AGI Distribution," available at https://bit.ly/2ClIiUX.

3b. Problem definition 2: Or are we concerned that employers who have been hammered by the absence of customers just need to face a reduced cost of labor to encourage them to hire? With something like 17.9 million Americans out of work, is the problem the *total* cost of labor or the absence of cash flow to employers to warrant hiring back furloughed employees? Arguably, if the income maintenance system works, then as the risk of getting sick from purchasing goods and services subsides, employers will be able to recall former employees, recall those working part-time, or advertise to find new employees.

I don't think the definition of the current labor market problem as the *total* cost of labor being somehow *too high* passes the straight face test. Another way to think about this is to wonder if giving employers more cash by forgoing their FICA contribution is going to result in the money going to workers or employers? Are they really the same? How can the federal government be sure about what retention really means?

3c. Problem definition 3 (mine): But given that 17.9 million are out of work, with more likely to follow, given it is a very political year, and given that much of the monies given directly out to business have yet to make it to the small business community, let's suppose that something needs to be done. Further, suppose we agree that federal tax policy should seek to encourage hiring at the *margin*, or, as I like to put it, "encourage an employer to do something he/she would otherwise not do."

Framing the policy design question in this way leads to something other than just cutting or suspending the FICA tax. Giving employers money without their actually doing anything in return for sure seems a little irresponsible to me.

This is not just wordsmithing, but turns out to be a meaningful distinction, and legislatively feasible. Such incremental thinking, for which I now take credit, was the underpinning of what others have concluded was the most effective federal job creation program in the 20th century, the new jobs tax credit (NJTC), which lowered the national unemployment rate in the late 1970s a full percentage point, accelerated hiring, and, because it was focused on low-wage workers who spent what they incrementally earned, had the desirable indirect effect of increasing aggregate consumption. Admittedly, this is not what Congress has done since then, but the independent evaluations are clear that subsequent efforts were both more expensive per job created and less effective.[2]

4. So what would a new jobs tax credit 2.0 (NJTC 2.0) look like? An updated NJTC would provide a 50 percent tax credit on the *growth* in *countable* wages, subject to some limitations, which would focus it on small businesses. It would provide a 50 percent credit for the growth in wages paid to incremental hires in the second half of 2020 compared to the first half of the 2020 base period. In 2021 it would provide the same incentive, but compare 2021 to the entirety of 2020 for the employer's hiring decision. It would require enacting again section 202 of the Tax Reduction and Simplification Act of 1977, and basically updating the nominal figures in the 1977 legislation by the increase in the cost of living. The price level has increased by 4.3. So the 1977 per-firm limit on the credit of $100,000 would become $427,000.

The table below compares the 1977 NJTC to an updated set of parameters. For each net new employee hired, the tax credit would be about half of the first $18,000 paid, or $9,000, with the total amount of credits being limited to $427,000/year. This works out to limiting the credit to around 47 new employees. The parameters below can easily be refashioned. For example, it might make sense for the rate of credit for the first six months to be limited to 25 percent, and then increased to 50 percent for tax year 2021, or the amount of credit limited to $427,000/2.[3]

Robert P. Strauss
Carnegie Mellon University
July 14, 2020

[2] *See* Daniel S. Hamermesh, *Labor Demand* 192-194 (1993); or Jeffrey M. Perloff and Michael L. Wachter, "The New Jobs Tax Credit: An Evaluation of the 1977-78 Wage Subsidy Program," 69(2) *Am. Econ. Rev.* 173-179.

[3] The views here are the sole responsibility of the author, and do not represent those of the Trustees of Carnegie Mellon or the university. The author can be found at www.andrew.cmu.edu/user/rs9f and reached at rpstrauss@gmail.com.

Comparison of 1977 New Jobs Tax Credit Parameters to a 2020 Updated Version

Comparison	Enacted New Jobs Tax Credit 1977[a]	Proposed New Jobs Tax Credit 2.0 2020
Definition of total wage base	Wages paid into FUTA w/o $4,200 limit	Employer federal hospital insurance contribution wage base
First period of credit	Tax year 1977	First six months of 2020
Comparison period 1	Tax year 1977/1976	Second half of 2020/first half of 2020
Second period of credit	Tax year 1978	Tax year 2021
Comparison period 2	Tax year 1978/1977	Tax year 2021/2020
Effective date of credit	Tax year 1977	July 1, 2020
Duration of credit	Two tax years	Through close of tax year 2021
Countable wage base	$4,200/employee	$18,000/employee
Rate of credit	50%	50%
Limitation: 1	Credit cannot exceed 1/2 of increase in total wages for period above 105% of base period total wages	Credit cannot exceed 1/2 of increase in total wages for period above 105% of base period total wages
Limitation: 2	Credit cannot exceed 25% of total wages	Credit cannot exceed 25% of total wages
Limitation: 3	Credit/firm cannot exceed $100,000	Credit/firm cannot exceed $427,000
Limitation: 4	Credit cannot exceed taxpayer's total tax liability. Net operating loss use of credit permitted	Credit cannot exceed taxpayer's total tax liability. NOL use of credit permitted

[a]Section 202 of Tax Reduction and Simplification Act of 1977 (H.R. 3477), May 23, 1977. *See* Joint Committee on Taxation, "Summary of H.R. 3477: The Tax Reduction and Simplification Act of 1977," JCS-18-77 (May 9, 1977).

■