How Can California Spur Job Creation?

David Neumark

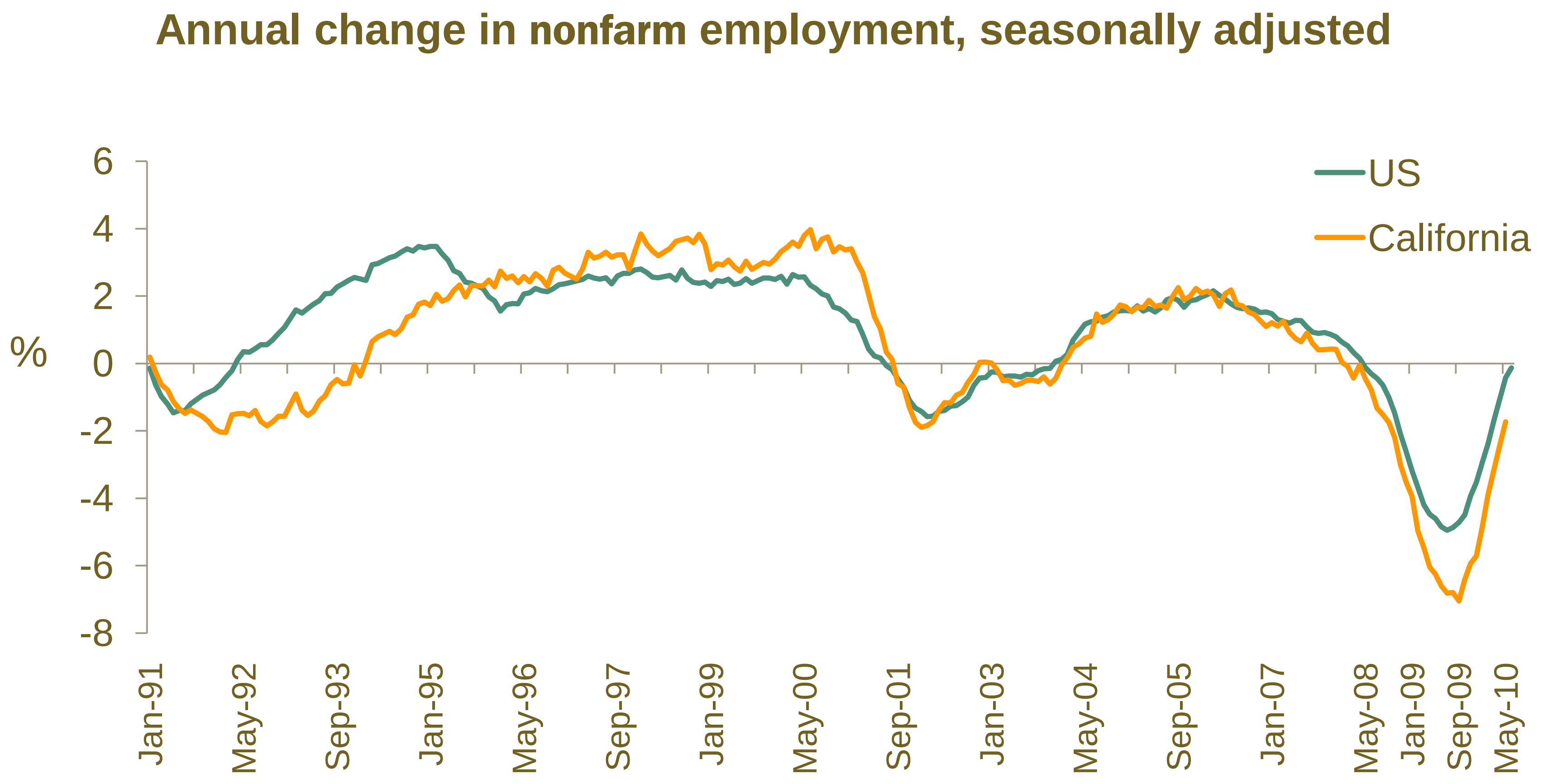
PPIC

Outline

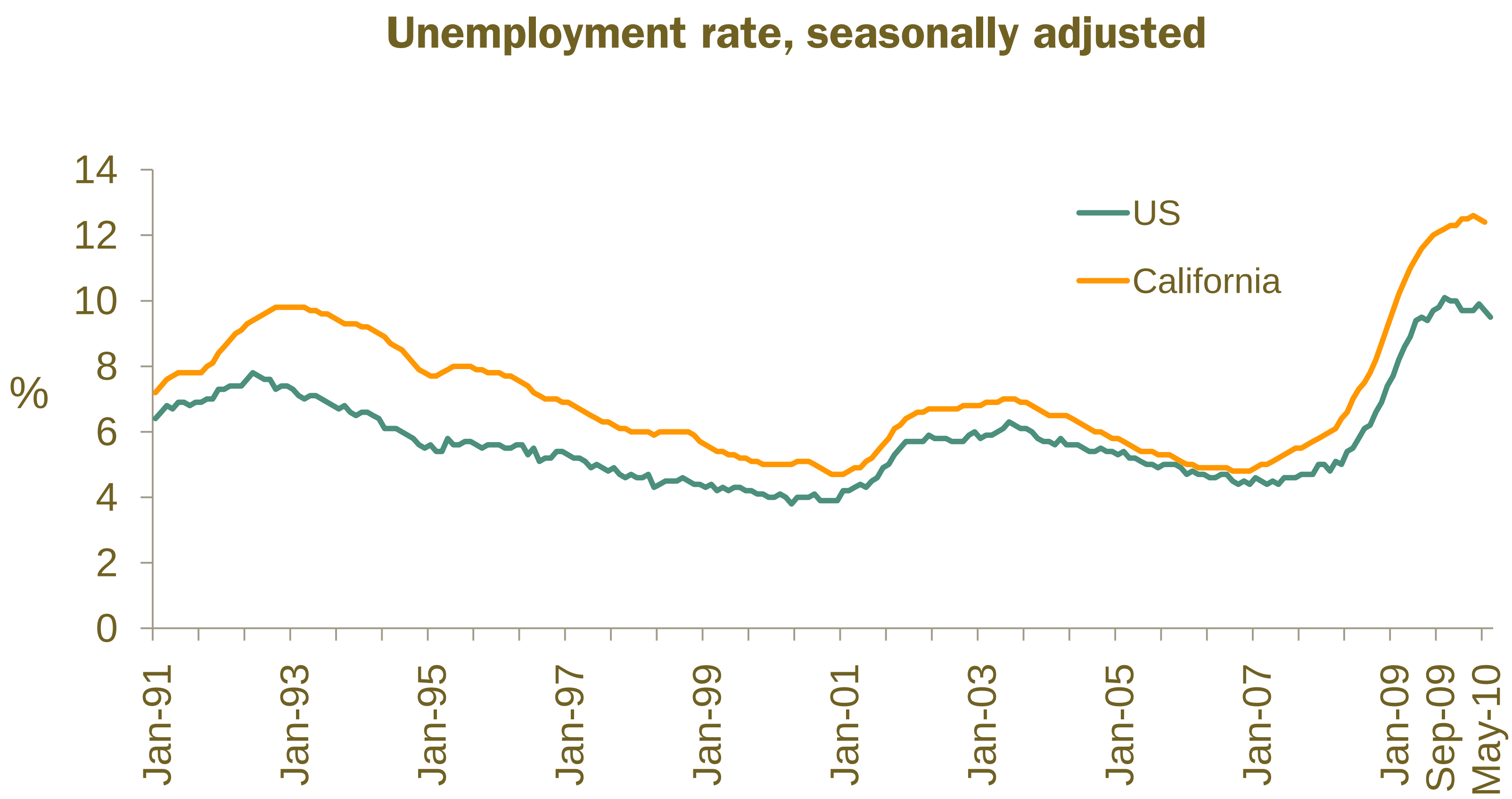
- Unemployment and job creation
- Hiring credits
- Worker subsidies
- Which is more effective?
- Policy recommendations

PPIC

California Has Recently Seen Steep Declines in Job Creation, But…



…Unemployment Is Persistently Higher in California



Direct Job Creation Tools: Hiring Credits and Worker Subsidies

- **Hiring credits:** Subsidies to employers to hire workers
  - Intended to increase demand for labor
- **Worker subsidies:** Subsidies to individuals to enter the labor market
  - Intended to increase supply of labor
- Under normal circumstances, increasing demand <u>or</u> supply will increase number of people employed
- Many other “indirect” policies

PPIC

Short- and Long-term Policy Recommendations May Differ

- Hiring credits
  - Address business cycle
  - Best option for short-term job creation problem
- Worker subsidies
  - Do not address business cycle
  - Increase employment in longer term
- Different dynamics affect policy preferences

Outline

- Unemployment and job creation
- Hiring credits
- Worker subsidies
- Which is more effective?
- Policy recommendations

PPIC

Hiring Credits Target Specific Workers

- Federal programs have tended to target the disadvantaged
  - Recent HIRE Act an exception—targets unemployed
- States programs vary widely
  - Many focus on recently unemployed
  - Fewer focus on disadvantaged
- California’s current program: New Jobs Credit
  - Enacted 2009
  - Targets small businesses generally

Hiring Credits for the Disadvantaged Are Ineffective

- Stigma effects
  - Eligibility for credit sends negative signals to employers
- Large administrative costs
  - May explain low participation rate
- Employer windfalls
  - Pay for hiring that would have occurred anyway
  - Need to create incentives for *new* hiring
  - *Always* a problem with hiring credits

But Credits Targeting the Unemployed May Work Better

- Mid-1970s program a model (New Jobs Tax Credit)
  - General, did not target disadvantaged workers
  - But created greater incentives to hire low-skill workers
  - Incentivized net job creation (firms had to grow by 2% or more)
  - Temporary
- Evidence indicates NJTC may have created more than 500,000 jobs

PPIC

How Does California's Current Program Stack Up?

- Appears to avoid retroactive crediting
- Requires employment growth
  - Makes sense but is limiting during severe recession
- May be underused
  - 2010 credits claimed only about 10% of total allocated ($400 million)
- Focus on very small businesses may be limiting
  - Firms with 0-19 workers are about 9% of CA employment

PPIC

Outline

- Unemployment and job creation
- Hiring credits
- Worker subsidies
- Which is more effective?
- Policy recommendations

EITC Is Primary Example of Worker Subsidy

- Federal EITC provides incentives to enter the workforce
  - Offers wage supplements based on family size
  - Phases out as earnings increase
- Many states have own EITC as add-on to federal program
- California has proposed but never enacted its own EITC

EITC Increases Employment, But…

- EITC boosts employment among single mothers
  - 18-23% increase for low-skill single mothers after federal expansion
  - State programs also show strong gains
- Small reduction in hours worked among other groups
- Overall hours increases well offset any hours reductions
- Effective at targeting low-income families

PPIC

…Also Has Some Drawbacks

- May encourage some to reduce hours or leave labor market
- Wages and employment may decline for low-skill workers ineligible for EITC
  - Childless, male, minority workers

PPIC

Outline

- Unemployment and job creation
- Hiring credits
- Worker subsidies
- Which is more effective?
- Policy recommendations

Hiring Credits May Be More Useful in Combating Recession

- Stigma reduced if hiring credit focuses on recently unemployed
- Little job growth means
  - Incentives for new job creation can be simpler (and likely stronger)
  - Administrative burden can be lower
- Problem is likely insufficient labor demand
- Hiring credits likely cheaper per job created

PPIC

But Worker Subsidies Preferable in Many Ways…

- EITC avoids stigma effects
  - Employer doesn't know who gets it
- Administrative and compliance costs low

…Especially for Longer-Term Problems

- Hiring credits less effective when labor markets tighter
- But EITC more effective in those times

PPIC

In Long Term, Concern for Disadvantaged More Prominent

- EITC better targets low-income families, especially single mothers
  - And hiring credits do not work well for disadvantaged
- Underlies common argument for EITC over hiring credits
- But in short term, distributional priorities may be different, given effects of recession on men

Recent Recession Hit Men Harder

Annual change in employment by gender, California

Unemployment rate by gender, California

PPIC

What Are the Costs?

- "Windfalls" or "wastage" difficult to estimate
- Benefits also hard to measure
  - Reduced expenditures on unemployment insurance and welfare, increased tax receipts
- But evidence suggests:
  - Hiring credits: $9,100-$75,000 per job created
  - Worker subsidies: $12,000-$207,000
  - Estimates do not account for indirect effects

PPIC

Potential Hiring Credits Program: Positive but Limited Effects

- Federal stimulus package
  - $150,000-$470,000 per job created
  - Likely created 168,000-396,000 jobs in CA
  - Unemployment rate lowered by about 1.6 percentage points
- State would have to spend $9.9 billion on hiring credits for equivalent impact
- If state spent $1 billion
  - 24,000 more jobs
  - 0.1 to 0.2 percentage point lower unemployment rate

Outline

- Unemployment and job creation
- Hiring credits
- Worker subsidies
- Which is more effective?
- Policy recommendations

PPIC

Making the Most of Hiring Credits

- Concentrate spending during recessions, to reduce windfalls
- Make credits short-term and temporary, to counter business cycle
- Avoid retroactive credits, to induce new hiring
- Create incentives for growth in *employment* not hours
- Don’t expand eligibility
  – Credit should not become general tax relief

Making the Most of Worker Subsidies

- Piggyback on federal EITC
  - Simplifies administration
  - May encourage federal take-up
- Minimum hours constraints (or “wage-based”)
  - Discourages labor supply reductions
  - Improves targeting

PPIC

Overall Recommendations

- Hiring credit is better short-term response
  - Target unemployed, keep it simple, and focus on job growth
  - Current program (NJC) may be too limiting
    - Doesn’t focus on unemployed, applies only to small firms, and credit is small
- In longer term, consider state EITC
- Prepare better for *future* recessions
  - Hiring credit should kick in when economy slows, fade out when economy recovers

PPIC

Notes on the use of these slides

These slides were created to accompany a presentation. They do not include full documentation of sources, data samples, methods, and interpretations. To avoid misinterpretations, please contact:

David Neumark: 949-824-8496, 415-291-4476,
dneumark@uci.edu

Thank you for your interest in this work.

How Can California Spur Job Creation?

David Neumark

PPIC