How Can California Spur Job Creation?

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David Neumark

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SUMMARY

California has short- and long-term labor market problems—there were steep employment declines during the recent recession, and the state's unemployment rate is persistently higher than the national average. Recent job losses have led to proposals for state policies to spur job creation. This report examines two "direct" job creation policies: subsidies to employers to hire workers ("hiring credits") and subsidies to individuals to enter the labor market ("worker subsidies"). Hiring credits act to increase the demand for labor, and worker subsidies aim to increase labor supply. Under normal circumstances, either policy should lead to higher employment. However, short- and long-term goals turn out to be of critical concern when considering the effectiveness of each policy.

In the short term, when recovery from the recession is the paramount goal, hiring credits are likely to be the better policy response. To be most effective, hiring credits should focus broadly on the recently unemployed and establish incentives for new hires rather than increases in the work hours of existing employees. In the longer term, when the labor market has recovered more fully from the recession and the focus can shift to the persistently higher unemployment in California, greater reliance on worker subsidies—most likely in the form of a state Earned Income Tax Credit (EITC)—would prove beneficial.

Either program would be costly to implement. Rough calculations suggest that the cost per job created using worker subsidies would be $12,000 to $207,000, and the cost for hir-

ing credits would be $9,100 to $75,000. These cost ranges do not take into account other fiscal or macroeconomic benefits associated with these policies, including such difficult-to-measure effects as reducing expenditures on unemployment insurance and welfare payments, increasing tax receipts, or stimulating the economy—all of which could lower the ultimate costs of these programs. But even if program costs were lower, feasible levels of state funding would at best contribute only modestly toward helping California's labor market recover from the recession.

Still, there may be good reason to pursue these policies, with short- and long-term goals in mind. If policymakers want to confront the aftermath of the recent recession, hiring credits can be made more cost-effective by using simple program rules and setting a relatively low hurdle for employers to claim the credit. When the state's economy and budget situation improve, the beneficial effects of a state EITC for low-income families might offset the EITC's greater cost per job produced. California might best follow other states and specify the EITC as an add-on to the federal EITC.

When the economy is strong, the state may want to rely less on hiring credits and more on worker subsidies to spur job creation. But to prepare for future recessions, a flexible approach may be best. California could create a hiring credit program that remains on the books permanently—one that aggressively rewards the hiring of unemployed workers during economic downturns but "turns off" during better economic times.

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