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Hiring Tax Credit Will Not Create Long-Term Jobs

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President Obama is proposing, and Congress is considering, a temporary tax credit to encourage businesses to hire new workers. Given that 7.2 million workers that have lost their jobs since the recession began in December 2007, efforts to reduce government-imposed obstacles to hiring are commendable. The proposed tax credit, however, will not create the sustainable jobs needed for long-term recovery and will likely create no jobs on net.

Congress and the President should instead focus on lifting the burden of uncertainty off businesses by dropping their business-threatening agenda and permanently extending the 2001 and 2003 tax cuts.

Small Bang for the Buck. The credit proposed by President Obama pays $5,000 for each new hire a business makes in 2010. Businesses would also get refunds on their Social Security taxes if they increase wages or expand hours for existing-workers. The credit would be capped at $500,000 per business.

Congress tried a similar credit in the 1970s. It failed to create jobs, however,[1] because much like today, policymakers ignored the jobs the credit would destroy since it had to be funded by government borrowing. Therefore, the current proposal must be evaluated by its net job creation—a standard that requires looking at the jobs created by the credit *and* the jobs lost because the government has to finance the proposal.

On the positive side, according to the Congressional Budget Office (CBO), the credit would create five to nine years of full time employment for every million dollars of credits businesses take.[2] The White House estimates that the credit will reduce tax revenue by $33 billion.[3] Combining these two estimates shows that before offsetting effects, the credit might create between 165,000 and 297,000 jobs in 2010. This works out to a cost of $111,000 to $200,000 per job created.[4]

Unfortunately, the jobs that are created will have to be funded by borrowing, since there are no plans to reduce spending to fund the $33 billion cost of the credit. Government borrowing takes purchasing power out of private hands, and as a result, jobs that would have been sustained by that money disappear.

It is hard to predict how many jobs all the borrowing will scuttle, but a rough estimate can be made simply by comparing the ratio of total GDP to total employment. Using CBO's data on GDP for 2010 puts the ratio at about $106,000 per job. (This is less expensive than the cost of credit-financed jobs because the efficiency of the private sector enables it to support a job for less money.) Thus, the financing of the credit would reduce employment by about 311,000 jobs—a net employment decline of as many as 146,000 jobs.

The credit could actually end up reducing employment, because many of the jobs for which an employer would receive the credit would have been

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created without the credit in the normal dynamics of the labor market. The designers of the credit have no way to distinguish between jobs that would have been created without the credit and jobs created specifically due to the credit. Consequently, the overall impact of the credit is lessened, but the job destruction effects of all the borrowing are felt in full.

No Long-Term Jobs. Holding all else constant, the only way for the President's proposed credit to be a net jobs creator is if it is funded by spending reductions on other programs. But even if the credit does end up creating jobs on net, it is very likely those jobs will be temporary.

The credit will not encourage businesses to create the long-term jobs the economy needs for a robust recovery. Businesses that provide lasting jobs hire new workers on a permanent basis only when they expect that those employees will increase future profitability, which requires a reasonable expectation that the economy to be on a sustained, upward path for some other reason. There is nothing a tax credit can do to get businesses to hire as long as they expect sales to remain sluggish.

The temporary jobs that the credit would create would likely be in industries with high worker turnover or businesses willing to take on temporary workers that they can let go after the credit expires. When the credit expires, the additional worker will be long gone and the business will not fill the vacated position because the extra worker would no longer be profitable without the credit. The businesses create no new long-term job while maximizing the benefit of the credit.

It is a no-lose situation for these businesses because they can increase their profitability in the short term without worrying about the long-term impact of the extra worker. The credit will end up being a government-funded reward to these businesses for doing something they were going to do anyway.

Remove Uncertainty. By completely dropping the big-government, anti-business agenda currently making its way through Washington, Congress can remove a major obstruction in the way of businesses that want to add lasting, secure jobs when the recovery picks up.

Before adding new workers for the long term, in addition to an expectation of higher future sales, businesses need to anticipate what their cost structure will look like when conditions do improve. Unfortunately, businesses are unable to confidently assess their bottom lines for the next few years in part because of legislation that is threatening to drive their costs higher. This includes:

- Higher taxes for businesses that operate internationally;
- Higher taxes on energy because of the cap-and-trade bill;
- Higher taxes and costly regulations as part of health care reform; and
- Stricter regulations in a variety of other areas.

As long as these cost-raisers hang over them, businesses will be hesitant to add new workers. After all, employers could end up making investments and adding new workers that would become unaffordable if these bills become law. Therefore, Congress should immediately announce that it will not pass any of this legislation until the economy moves significantly toward full employment. This would give businesses some breathing room and the sense of certainty they need to grow—thereby accelerating the move toward full employment.

A Better Solution. Congress should go one step further and remove the uncertainty created by the

1. Robert Tannenwald, "Are Wage and Training Subsidies Cost-Effective—Some Evidence from the New Jobs Tax Credit," Federal Reserve Bank of Boston Economic Review, September/October 1982.
2. Congressional Budget Office, "Policies for Increasing Economic Growth and Employment in 2010 and 2011," January 2010, p. 18, at *http://www.cbo.gov/ftpdocs/108xx/doc10803/01-14-Employment.pdf* (January 29, 2010).
3. The White House, "Fact Sheet: Small Business Jobs and Wages Tax Cut," January 28, 2010, at *http://www.whitehouse.gov/sites/default/files/FACT_SHEET_Small_Business%20_jobs_and_Wages_Tax_Cut.pdf* (January 29, 2010).
4. Keith Hennessey, "What Does It Mean to Focus on Jobs?," January 29, 2010, at *http://keithhennessey.com/2010/01/29/focus-on-jobs* (January 29, 2010).

impending expiration of the 2001 and 2003 tax cuts at the end of this year. Their expiration would be a huge tax increase for all taxpayers and a tremendous weight on the struggling economy.

Despite President Obama's insistence that the cuts should expire for those making over $250,000 a year, Congress should permanently extend the cuts for all taxpayers—or at least through 2013 when full recovery will hopefully be at hand. Congress should pass on engaging in this class warfare because higher taxes on the rich not only hurt the well-off; they also hurt low- and middle-income workers because these taxes effect many small businesses and reduce investment, which in turn leads to fewer jobs and lower wages for workers at all income levels. Creating the right incentives to work, save, and invest is a much better solution to create jobs than this flawed and costly credit.

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