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BTC Brief

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CREATING JOBS IN THE PRIVATE SECTOR: A Comparison of the NC Senate and House Proposals

Key Findings:

1 - North Carolina policymakers should be offering bold proposals to create jobs to replace the 6.4 percent of total non-farm employment lost since the start of the recession.

2 - Proposals in the Senate and House to stimulate growth by targeting small business will do little to create jobs because of fundamental problems with their design. Across the board tax cuts are very unlikely to generate new investments especially in the form of expanded payroll. And while tax credits provide a more targeted tax cut, the limited size of the credit and caps on available funds for the program are unlikely to motivate firms to expand.

3 - Growth of our state's workforce has continued at a steady clip. Without the implementation of policies to address the demand-side of the labor equation, long-term unemployment will continue to be a drag on our economic recovery.

4 - Lawmakers should consider effective direct job creation tools, such as a Small Business Job Growth grant program.

Overview

If the economic recovery is to continue and provide for widely shared prosperity, North Carolina must replace the jobs lost during this recession and meet the growing demand from the expanding workforce. Jobs have been front-and-center in the development of budget proposals from the Governor, Senate and House but conflicting approaches to job-creation remain. This raises the question: what is the best way to create jobs in the private sector through public policy? Luckily, recent experience and a whole host of economic research provide us with a guide to evaluating proposals that aim to get North Carolinians to work.

North Carolina's policymakers are proposing tax cuts and job-creation tax credits that will, unfortunately, have limited impact on the state's jobs gap and nascent economic growth. Fundamentally, the requirement that states balance their budgets means that

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both broad-based and targeted tax cuts will require reductions in programming or services in order to achieve fiscal balance.[1]

These reductions in programs and services could result in negative job growth despite promises of gross job creation from tax proposals. Budget cuts will require job losses for public employees and private-sector firms will face declines in consumer spending as families face unemployment, shortened work hours and loss of public benefits.

Policymakers' efforts to address the depressed job market should be commended. And there remain several demonstrated tools at their disposal to preserve and directly create jobs in the immediate- and long-term that should be considered instead of the current proposals. Such proposals will require a willingness to identify ineffective tax expenditures or raise new revenues in order to ensure positive net job creation.

Public Investment and Job Creation

The Senate and House budget proposals both recognize that government action is needed to spur job creation at a time when businesses remain reticent to expand and credit markets are tight. This is a welcome agreement on an approach that, if implemented effectively, can support a more robust economic recovery. Indeed, while reports on the implementation of the American Recovery and Reinvestment Act nationwide suggest that 1.8 million jobs have been created in the first quarter of 2010 alone, direct job creation strategies and not just fiscal stimulus are needed.[2]

The size of the jobs gap nationwide, and in North Carolina, as well as the long-term social costs of a lack of employment opportunities for those willing to work are particularly compelling reasons for public investment. At the national level in May, temporary Census jobs accounted for nearly 95 percent of employment growth reported over the month eclipsing private sector job creation.[3] Meanwhile, in North Carolina, just 7,500 jobs were created in the private sector in May 2010.[4] At that rate, it will take nearly five years for North Carolina to create the number of jobs needed to replace those lost and provide opportunities to the growing workforce.

The Proposals: Tax Cuts vs. Tax Credits

The Senate and House have set forth two distinct strategies for how to encourage growth in the small business sector. The Senate's budget would reduce the marginal tax rate on unincorporated small businesses from 7.5 percent to 6.9 percent resulting in a loss of $39,700,000 in state revenue. The House's budget proposal would target small businesses that add employees by providing a tax credit of $1,000 for each new full-time job created and maintained for three years.

The across-the-board tax cut proposed by the Senate is by far the least effective tool to stimulate growth. Since the proposed tax cut applies to corporate income tax liability, businesses are not required to spend these newly available dollars and generate economic development outcomes let alone increase wages or employment. Especially in the current environment where demand for products and services has not increased appreciably, business owners will be more likely to save this money rather than ramp up production immediately or hire new workers.[5] Moody's economist Mark Zandi found that across-the-board tax cuts generated $1.03 for every $1 in reduced federal tax.[6]

Evidence from the last economic cycle, when the Bush Administration established so-called "jobs and growth" tax cuts, demonstrates that across-the-board tax cuts fail to deliver. Estimates suggest tax cuts intended to create jobs fell short of projections by as much as 3.1 million jobs and what jobs were created could not be directly attributed to the tax cut.[8] The Senate proposal, like these previous federal tax cuts, represent an ineffective use of taxpayer dollars that will take money away from other proven strategies and fail to distribute benefits equitably.

The House proposal aims to overcome some of the identified challenges to the broad-based tax cut by ensuring that small businesses engage in hiring. But the structure of the tax credit applies to small businesses that are profitable, or that will be profitable in the next three years, thus limiting its usefulness to a broad range of potential employers.

Additionally, certain elements of the policy affect whether it is bold enough to change employer behavior. The size of the credit for each job created as well as the cap on funds available for the program can effectively determine an employer's willingness to take on additional employees. For example, the modest success of the New Job Creation Tax Credit of the 1970s has been attributed in part to the fact that the $2100 credit equaled 22 percent of a full-time worker's annual salary. Not only would a credit of $12,000 be required in 2010 dollars to meet that level, the current House credit represents just 2.2% of the average North Carolina worker's salary.[8] The North Carolina House proposal is too small to incentivize employers to take on additional workers and available funds are capped at such a low level that the number of jobs created will be limited.

Finally, there is a question as to whether a tax credit will just benefit those businesses already planning expansion and thus fail to actually boost the number of new jobs created. As mentioned above, the private sector is already creating jobs at a rate of 7,500 per month, and so even in the simplest calculation of the highest potential impact of the overall investment was achieved, these jobs are already being created.[9] The Economic Policy Institute's evaluation of their own federal tax credit proposal found that for every job created "more than six jobs that would have already been created would benefit from the credit."[10] In a time of tight budgets, investments should be made that can provide a greater guarantee of motivating employers to expand.

FIGURE 1:

RETURN ON INVESTMENT IN JOB CREATION STRATEGIES		
	ANNUAL CHANGE IN GDP (FOR EVERY $1)	JOBS CREATED (FOR EVERY $1 MILLION)
Tax Cut to Small Business	1.03	n/a
Tax Credit to Small Business	1.28	8-18 jobs
Small Business Job Growth Grant	n/a	30 jobs

SOURCE: Annual Change in GDP reflect federal estimates from Zandi, Mark, January 21, 2009. The Economic Impact of the American Recovery and Reinvestment Act. Moody's Economy.com; Jobs Created for Tax Credit to Small Business are based on analysis of the various employer tax credit proposals by the Congressional Budget Office, January 2010. Policies for Increasing Economic Growth and Employment in 2010-2011 and for Small Business Job Growth Grant analysis found in the BTC Report, North Carolina Jobs Plan.

A Better Approach to Job Creation

There are better tools available to North Carolina policymakers that can stimulate demand for jobs and directly create jobs.

Preserving existing jobs in education, health and public safety by implementing already identified revenue-raising proposals to balance the state budget will allow public-sector workers to maintain their spending activities in local communities.[11] Strengthening the safety net and ensuring unemployed workers and working families can access work supports will provide a mechanism to maintain consumer spending as well and generate demand for private business goods and services.[12]

Finally, a promising direct job creation strategy previously recommended by the Budget and Tax Center is a Small Business Job Growth grant program. The program would provide a direct subsidy of $10 per hour to the wages and benefits for jobs newly created by employers. Benefits of such a program include not only creating temporary jobs where workers can gain experience but permanent ones where workers can build long-term connections to career pathways. Such a proposal would require an investment of public dollars to make a significant impact. Thus, freeing up money from job creation strategies that have proven ineffective, like the Article 3J tax credits, would be necessary to deliver on the promise of job creation.[13]

Conclusion

North Carolina policymakers are right to focus on supporting the creation of jobs. However, current strategies under consideration will be ineffective at generating jobs efficiently and at the level that is required. Instead, policymakers should focus on preserving jobs in education, health and public safety by taking a balanced approach to the budget and allocating funding away from ineffective tax expenditures toward a Small Business Job Creation grant program that can directly subsidize the wages of new hires and provide meaningful work experience.

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2 Congressional Budget Office, May 2010. Estimated Impact of the American Recovery and Reinvestment Action on Employment and Economic Output from January 2010 through March 2010. p. 2 and Bartik, Timothy J. January 2010. A Proposal for Early Impact, Persistent and Cost-Effective Job Creation Policies. Vol. 17, No.1. W.E. Upjohn Institute for Employment Research: Kalamazoo, MI.

3 Shierholz, Heidi, June 4, 2010. "Absent temporary employment, no job growth in May" Economic Policy Institute Jobs Picture.

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5 Congressional Budget Office, January 2008. "Options for Responding to Short-Term Economic Weakness."

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7 Economic Policy Institute. January 2005. "Final Grade on Bush Tax Cuts: Failure to produce jobs." Job Watch analysis accessed at: http://www.jobwatch.org/email/jobwatch_20050107.html

8 Thompson, Jeff and Heidi Garrett-Peltier, April 2010. "Generating Jobs through State Employer Tax Credits: Is there a Better Way?" Working Paper Series, Number 219. Political Economy Research Institute at University of Massachusetts Amherst: Amherst, MA.

9 The full impact of the credit will likely be much less than a simple division of the $7,500,000 by the value of the available credit but as an upper and unattainable limit suggests the failings of the proposal to add to employment in a significant way.

10 Thompson and Garrett-Peltier, April 2010. p. 6

11 Mishel, Lawrence, et al, December 2009 American Job Plan: A Five-Point Plan to Stem the U.S. Jobs Crisis. Economic Policy Institute: Washington, DC.

12 Lane, E. Brent and G. Jason Jolley. January 2008. An Evaluation of North Carolina's Economic Development Incentive Programs: A Summary of Findings. UNC Center for Competitive Economies

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