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How Washington Can Create Jobs

Despite their drawbacks, direct public-service employment and a tax credit for new workers would both help.

By [ALAN S. BLINDER](#)

These are the times that try men's and women's souls. After dropping for four consecutive quarters, GDP has at last begun to rise, signaling the end of the Great Recession. But employment continues to fall, and the unemployment rate recently hit 10%—a rate we haven't experienced in a generation. It's no wonder Americans seem to have only three things on their mind right now: jobs, jobs and jobs.

We've lived with this disjunction between rising output and falling employment for only a few months so far, but the consensus forecast sees it continuing for some time—a disturbing prospect. Hardship already abounds, and the current political atmosphere is ugly. Americans are justifiably angry to see their government committing trillions to get banks and Wall Street back on their feet while doing nothing, in their view, to create jobs. A long stretch of double-digit unemployment will deepen these sores.

Of course, it's not true that the government has done nothing about jobs. The \$787 billion stimulus has doubtless saved many jobs already, and will save many more. So have the numerous financial rescue programs that the electorate abhors.

But saying that it could have been worse doesn't inspire. And Americans take scant comfort that jobs are now disappearing at a slower pace.

All this creates a political imperative for action, and the president recently announced a "jobs forum" for next month. But what policies would be effective job creators?

I'd start with the Hippocratic oath: "First do no harm." A premature withdrawal of monetary and fiscal stimulus could pull the rug out from under the nascent recovery. Yes, the mammoth federal budget deficit is both appalling and unsustainable. But this is not the time to shrink it by raising taxes or cutting spending. Yes, the Federal Reserve must eventually "exit" from its hyper-expansionary monetary policy. But this is not the time to look for the door.

That said, "first do no harm" is not enough. What comes second?

Two big ideas for job creation are under active discussion: a tax credit for new jobs, and direct public-service employment. Were the unemployment rate at 5%, I would oppose both. The tax credit invites gaming, e.g., creating phantom jobs to grab the tax benefit; and we do not particularly want more people on the public payroll. But the unemployment rate is 10%. In deep recessions, sensible governments do things they

would never do at full employment. So let's consider the merits and demerits of the two ideas.

Direct public-service employment is straightforward. As long as the new government jobs do not compete with the private sector, the net job creation should be one-for-one. So hire people to repair parks, not shopping malls. And if we restrict ourselves to low-wage jobs, the cost will not do grievous harm to the budget. For example, at an average all-in cost of \$30,000 a year, one million new jobs would cost \$30 billion.

What's the downside? Well, any public expenditure does add to the deficit at a time when the deficit is already huge. Furthermore, despite much rhetoric to the contrary, the U.S. remains a "small government" country, especially at the federal level. With total federal civilian employment around 1.4 million, it is inconceivable that the federal government could find sensible uses for a million new workers. So, realistically, most of the program must be funneled through the states.

What about a tax credit for new jobs? That option has two obvious advantages. Every new job would be in the private sector, where at least some would become permanent. And since it's a tax cut, it might garner some votes from Republicans, who will shriek "socialism" at public-sector employment.

How many new jobs could such a tax credit actually create? And what is the jobs bang for the taxpayer buck? The answers depend on many factors, but two stand out: the response of private-sector hiring to a lower after-tax wage (what economists call the "elasticity of labor demand"), and the degree to which businesses can successfully game the system.

Economic research gives us a pretty good handle on the former. In normal times, a 10% reduction in after-tax wage costs, which is a reasonable benchmark figure to contemplate (e.g., a \$5,000 tax credit for a \$50,000 job), should boost employment by roughly 4%. That would amount to about 5.5 million net new jobs, which sounds great.

But hold on. First, lots of jobs that would have been created even without the tax credit would receive the credit anyway. For those jobs, there is no bang, only bucks. Second, by increasing the demand for labor, the tax credit will drive up wages (which is nice), which will in turn kill some jobs (not nice). All things considered, reasonable estimates of the budgetary cost per job created are comparable to the cost of public service employment. (And both are much lower than the cost per job of the big stimulus package.)

Unfortunately, we know much less about gaming the system. That worries me. Apart from outright fraud, there are three major ways (and many minor ones) for firms to exaggerate the number of new jobs created in order to receive the tax credit.

One is to fire Peter and hire Paul. This problem can be fixed by awarding the tax credit only for net increases in headcount above, say, last year's base. A second gimmick is replacing one full-time worker by two half-time workers. That loophole can be plugged

by applying the tax credit to total payroll costs, rather than to headcount. Both of those fixes should be made. But they will render the tax credit irrelevant to many firms that cut back their employment sharply during the recession.

And what about new firms, which have no "last-year's base"? Excluding them would make many of the economy's new jobs ineligible for the tax credit. But if we allow new firms to claim the credit, clever people will create new firms in droves—at least on paper. And that's the third big way to game the system: by turning the XYZ Company into the X Company, the Y Company, and the Z Company. Because of this concern, when Congress instituted a new jobs tax credit in 1977 it split the baby by giving new firms half the credit.

All this is a bit worrisome. Tax credits would require assiduous drafting (keep the lobbyists out of the room!) and extremely careful administration by the IRS. The more I dwell on these things, the better direct public-service employment sounds.

But as the jobless recovery drags on, two things have become clear: First, neither the tax credit nor public-service employment is a panacea. And second, with employment still declining and another massive stimulus package out of the question for budget and political reasons, we will probably have to choose one of these options soon.

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