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THE CASE FOR LABOR DEMAND POLICIES

How can public policy in the United States be most effective in helping low-income Americans increase their employment and earnings? Current U.S. antipoverty policies emphasize "labor supply policies." Labor supply policies are characterized by direct interactions with the poor to increase the quantity or quality of their labor supply or the wages they receive. Labor supply policies include welfare reform policies that make welfare benefits more difficult to receive as well as job training and education programs.

Current U.S. antipoverty policies place little emphasis on "labor demand policies." Labor demand policies are characterized by direct interactions with employers to provide more of the poor with jobs or to increase the quality of their jobs. Labor demand policies include public-service employment, wage subsidies to private employers, and economic development programs.

This book's main argument is that U.S. antipoverty policy would be more effective if it made greater use of labor demand policies. Using empirical evidence, this book argues that labor supply policies alone have significant limitations, and that labor demand policies can be effective. I also discuss how labor demand policies can be best designed to enhance their effectiveness in increasing earnings and to minimize their negative side effects.

The empirical evidence suggests that labor supply policies are limited because they have only modest effects in helping low-income Americans increase their employment. Even when welfare reform or job training programs help participants obtain jobs, those jobs are no longer available to other low-income Americans who are nonparticipants, thus "displacing" others from jobs. Some education policies may significantly increase participants' earnings but are very expensive. Job training and other labor supply policies also are more effective when overall labor demand is strong and the policies have strong ties to employers.

Labor demand policies are needed because even when overall U.S.

unemployment is low, jobs are in short supply for many groups, such as those with less education, racial minorities, and residents of high-unemployment cities. Increases in aggregate demand in the U.S. economy do significantly help the poor. However, the effects of those increases are not strong enough to come close to "solving" poverty. More targeted labor demand policies are also needed. Such targeted programs would directly induce either public employers or private employers to hire more low-income Americans. Empirical evidence suggests that public-service employment programs or wage subsidy programs for private employers can be effective in increasing the employment and earnings of low-income Americans.

An important point is that labor demand programs can have long-term effects on employment and earnings. How can a program that provides temporary subsidies for employing a low-income individual have long-term effects? The work experience provided during the subsidy period increases the job skills of the participant, particularly the "soft skills" of being able to reliably show up for work and deal effectively with coworkers and supervisors. Work experience also helps a worker build self-confidence, which also increases future employability. Finally, work experience gives a worker a better reputation with employers, who have only very imperfect information about which prospective workers will be most productive.

Targeted demand programs should be designed with features that reduce their displacement and inflation effects, increase the program's attractiveness to employers, and increase the program's long-run political support. To reduce displacement and inflation effects, targeted demand programs should emphasize creating new jobs, target individuals who currently are out of the labor force, and provide only temporary employment opportunities. If programs are also designed to make sure that participants can be productive on the job, private employers will be less likely to "stigmatize" the participants in the targeted demand program as unproductive.

Labor demand policies have usually faced strong political opposition in the United States. To reduce such opposition, targeted demand policies should emphasize subsidies to nonprofit employers and small business employers. This strategy would not invoke the American fear of augmenting the power of big government and big business, a fear that has often motivated opposition to public-service employment or wage subsidies to employers. In addition, labor demand policies should be managed locally by organizations that encompass one local labor market, such as a metropolitan area, to make sure that the design of the targeted labor demand programs matches the labor market conditions and institutions of that local market.

Based on the findings of this book, I would advocate a labor demand program for the United States with two components. First, the United States should increase aggregate labor demand by providing wage subsidies to employers who increase their overall employment. This wage subsidy program should be expanded during recessions and restricted during boom periods to high-unemployment local labor markets. Second, a large-scale labor demand program should be developed that targets those who are outside of the labor force or otherwise unlikely to be employed in regular jobs. When necessary, the targeted demand subsidies should be supplemented by supply-side programs to provide counseling or training to some individuals in the target group. Under the targeted demand program, short-term wage subsidies should be provided to selected public and private employers, particularly small businesses and nonprofits, for newly created jobs that go to selected persons in the target groups. Local agencies familiar with the local labor market should manage the targeted demand program, selecting members of the target group and employers who will be a good match, in that the match will create the largest short-run and long-run effects on employment and earnings. Over time a combined program of aggregate labor demand subsidies and a targeted labor demand program, with complementary supply-side programs, could significantly improve the permanent employment and earnings position of low-income Americans.

What Are Labor Supply and Demand Policies? How Are They Used Today in the United States Compared to Other Countries and the United States in the Past?

The distinction between labor supply and demand policies is fundamental. Each type of policy intervenes on a different side of the labor market. An increase in employment for low-income Americans requires changes on both sides of the labor market: on the supply side, additional persons must be able and willing to work; on the demand side, employers must be willing to hire additional labor.

As discussed in more detail in chapter 2, however, there are many different ways in which each type of policy can be implemented that make a major difference to their effectiveness. Labor demand and supply policies may differ in the instruments used to affect demand and supply, the particular types of labor suppliers and demanders targeted by the policy, the agency that administers the policy, and the degree of administrative discretion of that agency. Among the instruments used by labor demand and supply policies are "carrots" such as wage subsidies to workers or employers. But labor demand and supply policies may also influence the behavior of employers and workers through "sticks"—penalties for not behaving in a certain way, such as cutting off welfare benefits to welfare recipients who do not search for or accept jobs, or imposing legal penalties on firms that engage in racially discriminatory practices in hiring. Supply and demand policies can also influence behavior through information provision, such as providing employers with better information on the productivity of some workers, or providing workers with leads to better jobs.

Labor supply and demand programs may also differ in the workers or firms they target. They may focus on individuals below a certain income level, from a particular racial group, or at a particular stage of the life cycle. For example, U.S. educational and training programs to help the disadvantaged have traditionally devoted most of their resources to education programs for young persons, particularly K-12 programs, though extra attention is also focused on preschoolers and college students. These school and preschool programs are sometimes called "first-chance" programs, in contrast to job training and other postschool educational programs, which are called "second-chance" programs. Programs may also target a particular type of employer, such as public versus private employers, and, within those categories, employers below or above a certain size.

Labor supply and demand programs may also differ in the level of government and type of agency that is responsible for funding and administration. Some programs are administered at the federal level, such as the Earned Income Tax Credit (EITC), which subsidizes earnings for low-income families, and others are run at the state and local levels, such as economic development programs and welfare reform programs.

Finally, programs may be designed with more or less administrative discretion. The program's efforts to influence supply and demand behavior may tend toward automatically subsidizing or penalizing anyone who takes certain actions, on the one hand, or toward allowing the agency administering the program to award subsidies or impose penalties in a discretionary manner, on the other. For example, subsidies to firms for hiring the disadvantaged may be awarded either to any firm that does such hiring or only to firms that apply for such subsidies and are awarded one of a limited number of such subsidies at the discretion of the agency.

All of these different characteristics of supply and demand programs clearly can make a difference in program effectiveness. Although each program is unique and should be judged separately, this book concludes that programs tend to be more effective if they focus on "carrots" such as subsidies and information provision, are targeted at particular groups of interest, are locally administered to take account of the peculiarities of the local labor market, and allow for administrative discretion in handing out program benefits and sanctions.

Overall, the United States devotes far more resources to labor supply than to labor demand policies to reduce poverty, as shown in more detail in chapter 2. This great emphasis on labor supply approaches in the United States is particularly marked if we include first-chance programs that aid low-income Americans from preschool through college.

The U.S. underemphasis on labor demand programs is unusual among Western industrial countries. As shown in chapter 2, the United States devotes a far lower percentage of its economy to labor demand programs than do most other Western industrial countries. The United States also tends to devote fewer resources to labor supply policies to help the disadvantaged, but the differences in labor supply programs between the United States and other Western industrial countries are not as great.

This underemphasis on labor demand programs is also unusual compared to past U.S. policy. Historically the United States has occasionally undertaken labor demand policies that were quite large, such as the Works Progress Administration (WPA) program of the 1930s and early 1940s and the public-service jobs programs under the Comprehensive Employment and Training Act (CETA) in the mid-1970s. The U.S. historical experience with WPA and CETA is discussed in chapters 2 and 7.

Why does the United States devote unusually low levels of resources to labor demand policies? Labor demand policies tend to lack an enthusiastic political base, while arousing fears of big government or big business power. Labor demand policies to create public-service jobs arouse opposition from conservatives opposed to an expansion of big government, as well as from some public-sector labor unions concerned about their members losing jobs because of the new subsidized workers. Labor demand policies that subsidize private employers to create jobs arouse opposition from some liberals as "corporate welfare" and from some businesses and conservatives as an unwarranted interference in the private market. As suggested throughout the book, labor demand policies that focus on encouraging job creation at small nonprofits and small businesses may find more political support.

What Does Our Understanding of the Low-Wage Labor Market Suggest About the Likely Effects of Supply and Demand Policies?

As reviewed in chapter 3, economists and other social scientists already have considerable knowledge about the functioning of low-wage labor markets. Much of this knowledge is quite relevant to understanding the effectiveness of different labor supply and demand policies, including: evidence on the need for and effectiveness of jobs in the low-wage labor market; the responsiveness of labor supply in the low-wage labor market to increased demand; the responsiveness of labor demand for low-wage workers to increased labor supply; the likely displacement and wage effects of labor supply and demand policies; and the geographic scope of low-wage labor markets.

Even though the U.S. economy is currently strong, there are still many low-income Americans who need a job. Compared to past employment rates for some groups, or compared to the need for income, the United States probably needs at least three million to nine million additional jobs for low-income Americans, according to estimates presented in chapter 3. Furthermore, contrary to popular myth, having a full-time full-year worker in each American family would have sizable effects on reducing U.S. poverty rates, cutting the number of persons in poverty by more than 70 percent. Earnings supplements such as the EITC are extensive enough in the United States today that even relatively low-wage jobs can help reduce poverty.

As shown in chapter 3, many of the U.S. poor could work more under the right labor demand conditions. Many Americans in poverty already work, although not always full-time and full-year. Improved demand conditions, which would increase wage rates and lower unemployment rates, have been shown by empirical studies to cause a significant labor supply response, increasing the labor force participation and employment rates of low-income Americans.

Furthermore, as mentioned earlier, the work experience brought about by increased employment can significantly increase the long-run employment and earnings of the poor, according to the research reviewed in chapter 3. Improved job skills, self-image, and reputation with employers all increase a worker's long-run employability and wages. As a result, full-time full-year work increases the long-run earnings of different educational groups in the United States by the same percentage.

As shown in chapter 3, even in today's strong economy, the labor demand for low-income Americans is for many groups and in many areas short of labor supply. For example, though the overall U.S. unemployment rate was 4.5 percent in 1998, unemployment was still 8.9 percent among blacks, and 7.3 percent in the New York metropolitan area. Labor demand for low-income Americans does respond to increased labor supply, but the most plausible estimates suggest that this response is modest and probably considerably less than the increase in labor supply.

One reason that labor demand for low-income Americans may not fully respond to increased labor supply is the poor information that employers have about the productivity of job seekers. Because of poor information, new hires in the low-wage labor market frequently do not work out well and employers become more reluctant to hire in response to increased labor supply. Furthermore, because employers have great difficulty finding productive workers, they often adopt practices that may put many low-income Americans at a disadvantage, such as hiring through referrals from current employees or refusing to hire welfare recipients. In the absence of reliable information on job seekers' productivity, some employers may rationalize their own racial prejudices against minority job seekers. Empirical studies show that racial discrimination in hiring is still common.

The modest responsiveness in low-wage labor markets of both labor supply and demand means that both labor supply and demand policies can increase employment but may also cause displacement. According to estimates presented in appendices 1 and 2, employment increases in response to increased labor supply, but by perhaps one-third to two-thirds of the employment obtained by those persons added to labor supply. This implies that other persons lose their jobs, because of the increased labor supply, or are "displaced" from employment owing to the policy. Similarly, employment increases in response to increased labor demand, but also by perhaps one-third to two-thirds of the employment of those directly employed in subsidized jobs. Other persons lose their jobs because of the increased labor demand or are "displaced."

The appropriate design of labor supply and demand policies depends on the economic conditions, labor market institutions, and mix of businesses in the labor market for low-wage labor. What is the geographic scope of the low-wage labor market? As shown in chapter 3, the available evidence suggests that the relevant labor market is best defined as the area within which most commuting flows are contained, such as a metropolitan area. Within such an area there is sufficient commuting that changes in labor market conditions for similar individuals tend to be transmitted fairly rapidly across the metropolitan area. In larger metropolitan areas labor market conditions for somewhat smaller areas may also be relevant, owing to problems in efficiently transmitting information about job openings and job seekers throughout a large metropolitan area.

Metropolitan areas and other similar labor market areas are relevant to labor supply and demand policies because each labor market area has a particular character of its local labor market institutions, such as local job training agencies, local schools and community colleges, local economic development agencies, and local business groups. The character of these local institutions, and their interrelationships, may influence the types of labor supply and labor demand policies that are most effective in a particular local labor market.

In addition, each metropolitan area has its own mix of industries and sizes of businesses. This business mix affects business hiring, training, and job retention policies. These business policies must be taken into account in designing appropriate labor supply and demand policies.

What Is the Evidence on the Effects of Labor Supply Policies?

Labor supply policies to increase the employment, earnings, and income of low-income Americans include welfare reform, earnings supplements to workers, education policies, and job training. As shown in chapter 4, such labor supply policies can do much good but have significant limitations. It is difficult for labor supply policies to increase significantly *both* the employment and the income of the poor without huge costs. In addition, the significant displacement effects of many labor supply policies can adversely affect employment prospects for low-income Americans who do not participate in labor supply programs.

Welfare reform can significantly increase employment for welfare recipients by making it more difficult to receive adequate welfare benefits, thereby forcing many welfare recipients into the labor force. However, such welfare reform does significantly reduce family income for a sizable proportion of those pushed into the labor force. Under a philosophy of "sink or swim," some sink. Welfare reform also causes significant displacement effects: perhaps half of the new jobs for welfare recipients represent reduced employment for other low-income persons.

"Carrot" approaches seek to increase the labor supply of low-income Americans by providing them with earnings supplements; for example, the Earned Income Tax Credit provides refundable tax credits for extra earnings for low-income families. Such earnings supplements can significantly increase income for many low-income Americans but generally appear to have only modest effects on employment, as reviewed in chapter 4. Supplements have a modest effect on employment in part because the apparent stigma attached to receiving most income-tied earnings supplements may reduce somewhat a family's incentive to alter its work behavior because of the supplement. In addition, those earnings supplements may cause displacement: to the extent to which the earnings supplements encourage some of those receiving supplements to get jobs they otherwise would not obtain, these jobs are unavailable to others.

Education policies can significantly increase both the employment and the income of disadvantaged persons who successfully complete education programs. Any displacement effects of the extra employment of the newly educated tend to be felt by more highly educated persons, and in fact, education may open up some job opportunities for individuals left behind in the low-education job market. However, education programs can be very expensive, particularly considering how many extra jobs are needed (three million to nine million) and the enormous costs of making additional education available to millions of people. Furthermore, any enormous expansion of education levels would require some significant reforms if it is to be accomplished without some diminishment of educational quality.

The enormous costs of significantly expanding the regular first-chance education system increases the interest in perhaps improving job skills more cheaply through more focused job training programs. On the whole, the performance of the average job training program has been disappointing to many social scientists and policymakers. As reviewed in chapter 4, the programs on average increase earnings of training participants by only perhaps $1,000 per year, although this average probably conceals that these earnings benefits are concentrated among the relatively few trainees who gain much more in an annual earnings boost. Furthermore, most training programs in practice have not significantly improved wage rates, so the new trainees are competing for jobs with others who also have modest incomes. Training programs probably have significant displacement effects, so a significant portion of the added jobs for trainees represent reduced employment for others who also have quite moderate to low incomes.

Some training programs have been considerably more effective. Such successful programs tend, like the Center for Employment Training (CET) program, to be located in local labor markets with relatively strong employment growth. In addition, successful programs like CET typically have strong ties to individual local employers; the programs involve these employers in training design and aggressively market program graduates to them. Therefore, labor supply programs such as job training are most successful when labor demand is strong and when the programs make some effort to affect the behavior of employers—that is, when the program adopts some of the characteristics of a labor demand policy.

What Is the Evidence on the Effects of Increased Labor Demand?

As reviewed in chapter 5, a considerable amount of empirical research has estimated the effects of increased labor demand on the employment and earnings of low-income persons. This research suggests that increases in labor demand can make a significant difference to the employment and earnings of low-income Americans, particularly if the increase in labor demand is somehow targeted at low-income Americans who are originally out of the labor force. (Later chapters consider the issues of designing labor demand programs that can actually do this.) Empirical research also suggests that targeted labor demand increases can result in long-term increases in employment and earnings for low-income Americans. Increases in high "wage premium" jobs—those jobs that pay well relative to the skills required—have greater benefits.

Despite the myth that a "rising tide no longer lifts all boats," the empirical work reviewed in chapter 5 shows that increases in overall labor demand still have progressive effects on the income distribution. Stronger overall labor demand and lower average unemployment increase the employment rates and labor force participation rates of those who originally were not employed and allow for occupational upgrading for many persons in lower-paid occupations. As a consequence, lower overall unemployment increases real earnings and income for all education and income groups, but by a higher percentage for those with less education or lower income.

However, the progressive effects of stronger overall labor demand are clearly insufficient to be the only solution to the poverty problem. For example, numerous empirical studies suggest that a 1 percent lower overall U.S. unemployment rate would bring somewhere between one million and three million persons out of poverty. But with more than thirty million Americans in poverty, and a U.S. unemployment rate close to 4 percent, even reducing unemployment to zero would not solve all of the poverty problem, and clearly reducing overall unemployment a huge amount below the current level is infeasible.

As reviewed in chapter 5, the empirical evidence suggests that increases in labor demand targeted at lower-income groups can significantly increase employment and earnings. Studies using a variety of empirical approaches suggest that a targeted increase in labor demand, whether brought about by public policy or by the regular workings of the economy, will in the short run increase employment and earnings of the targeted group by about two-thirds of the initial shock to employment and earnings of that group, implying a "displacement" effect of about one-third. Displacement rates may be somewhat larger in the long run. However, simulations using estimated parameters suggest that long-run displacement rates can be reduced by targeting the increased demand on persons who originally were out of the labor force and by encouraging those targeted for increased labor demand to remain available for other jobs.

The empirical evidence also suggests that increases in labor demand cause long-run increases in employment and earnings. Empirical studies of individuals' earnings suggest that increased work experience for individuals causes increases in wages and employment rates many years later. In addition, empirical work on local labor markets suggests that an increase in labor demand at one point in time causes a local labor market to still have increased employment rates many years later.

The long-run effects of greater labor demand are somewhat higher for increased labor demand that is concentrated in high "wage premium" jobs. Empirical evidence suggests that such jobs tend to be characterized by greater job retention, which promotes greater long-run employment and earnings effects.

Will Increases in Labor Demand Inevitably Increase Inflation?

One argument against policies to increase labor demand for the poor is that such policies could increase inflation. Perhaps labor demand policies, if expanded until unemployment is dramatically reduced, could push unemployment low enough to initiate an upward spiral of accelerating inflation rates. This possibility is based on the theory that there is a level of unemployment below which inflation tends endlessly to accelerate the so-called non-accelerating inflation rate of unemployment (NAIRU).

As chapter 6 explains, potential problems with a NAIRU should not scare policymakers away from labor demand policies, although these problems might affect the design of labor demand policies, for several reasons. First, even in empirical models that estimate that there is a NAIRU, unemployment below the NAIRU only significantly accelerates inflation after a long time. In addition, there is much uncertainty about exactly what unemployment rate is the NAIRU, or indeed whether a NAIRU exists. Given the long-term nature of the potential NAIRU problem and this uncertainty, it may make sense to pursue labor demand policies and simply monitor these policies' possible effects on inflation.

Second, the inflationary effects of increasing labor demand are reduced if the increased labor demand is targeted at those out of the labor force—a sizable group of the adult U.S. poor. To put it another way, the inflationary effects of added labor demand are reduced if the increased labor demand is accompanied by an increase in labor supply. As discussed in chapter 6, empirical work also indicates lower inflationary effects of labor demand increases that are targeted at high-unemployment local labor markets.

Third, the inflationary effects of increasing labor demand are moderated if the newly employed are more readily available for hiring by private employers. For example, if the labor demand policy is to provide public-service jobs for the disadvantaged, these jobs could require periodic job search and be temporary by design, with time limits on how long someone could hold such a job. In addition, setting the wage rate on these special public-service jobs slightly below alternative wages in the private sector would tend to increase work search among the disadvantaged workers who get these jobs.

Finally, if some labor demand policies are implemented in a way that lowers marginal costs for businesses, inflationary pressures may be eased. For example, wage subsidy programs for the disadvantaged tend to lower business marginal costs. As reviewed in chapter 6, there is some empirical evidence that wage subsidies do lower the prices charged by employers.

What Is the Evidence on the Effects of Labor Demand Policies? The Case of Public-Service Employment Programs

Various labor demand programs to increase the employment and earnings of low-income Americans have been proposed or implemented over the years. Chapter 7 considers the most traditional type of labor demand program for the disadvantaged, public-service employment (PSE). Chapter 8 considers labor demand policies that provide wage subsidies to private for-profit employers for employing the disadvantaged. Finally, chapter 9 considers a wide variety of other labor demand programs, ranging from economic development programs to the minimum wage.

As reviewed in chapter 7, public-service employment programs can be effective. The U.S. experience with PSE programs suggests that, if the PSE program is well administered, PSE jobs are productive, delivering valuable services and developing public works. Furthermore, administrative requirements that PSE jobs be new jobs and that existing workers not lose their jobs to PSE hires seem to be reasonably effective in minimizing the displacement of existing public-sector workers by the new subsidized workers.

Well-designed PSE programs can also reduce their effects on the labor market that might cause marketwide displacement and increase the long-run effects on participants' earnings of the PSE jobs, while keeping down the size and cost of the program. PSE programs should target disadvantaged persons who otherwise would be unlikely to get a job, such as persons who were originally out of the labor force and who then were unsuccessful in searching for a regular job. PSE jobs should be limited in the duration of the subsidy period and pay slightly below market wages; the limited duration and low wage will encourage PSE participants to transition to regular jobs. In addition to reducing the displacement effects of PSE, these policies of targeting PSE jobs and limiting their wages and duration also tend to hold down the size and cost of a PSE program.

What Is the Evidence on the Effects of Labor Demand Policies? The Case of Wage Subsidies to Private For-Profit Employers

Another commonly used labor demand policy to increase the earnings of low-income Americans is to give wage subsidies to private employers for hiring persons from various lower-income groups. As reviewed in chapter 8, the empirical evidence suggests that several varieties of wage subsidy programs for employers can be effective in increasing the employment and earnings of low-income Americans. Among the effective wage subsidy programs are general wage subsidies, such as the New Jobs Tax Credit (NJTC) of the mid-1970s, which provided corporate tax credits for employment expansion regardless of who was hired. Another type of effective wage subsidy program is a targeted entitlement wage subsidy, such as the Work Opportunities Tax Credit (WOTC), which provides tax credits to firms that hire individuals from particular disadvantaged target groups, such as welfare recipients. Finally, the type of wage subsidy that has been the most successful in increasing the earnings of the disadvantaged is a discretionary wage subsidy, in which local agencies distribute wage subsidies in a discretionary manner to selected employers for hiring selected disadvantaged individuals.

The type of wage subsidy program that does not work is a voucher program, under which low-income persons are given vouchers entitling their employer to a wage subsidy; the voucher program is then primarily marketed to employers by encouraging individual voucher holders to tell prospective employers of the voucher. This type of program is ineffective because of stigma effects. Some employers contacted by voucher holders appear to use the voucher as a signal that the voucher holder is likely to be less productive. As a result, as discussed in chapter 8, several studies show that voucher wage subsidy programs may actually reduce the hiring prospects of voucher holders.

However, most other forms of wage subsidy programs in practice operate in ways that reduce such stigma effects. General wage subsidy programs do not suffer from stigma effects because employers are not required to hire particular target groups. Because discretionary wage subsidy programs allow local agencies to screen local employers and disadvantaged job seekers, the agencies can screen out the local employers who would be most reluctant to hire disadvantaged job seekers because of stigma effects, and they can provide employers with disadvantaged job seekers for whom there is at least some information suggesting that they can be productive on the job. Finally, in practice entitlement wage subsidy programs seem to be used most heavily by larger low-wage employers who expect to hire many disadvantaged job seekers and are unlikely to use stigma issues arbitrarily to refuse to hire an entire disadvantaged group.

One serious problem in wage subsidy programs for employers is their generally low take-up rates. The reluctance of many employers to use these programs limits the number of additional jobs that they can help create. The low take-up rate appears to be based in part on employer ignorance of the programs, and in part on a reluctance to be too involved with government red tape. As reviewed in chapter 8, some empirical evidence suggests that aggressive marketing of wage subsidy programs to employers can significantly increase these programs' take-up rate.

Wage subsidies, PSE, and job training programs may be seen as complementary programs. Training programs can help disadvantaged persons whose greatest employment need is to improve skills that are best addressed through formal educational programs, whereas subsidized jobs programs can help disadvantaged persons whose greatest employment need is to gain more work experience, job contacts, and credentials. It is easier to target public-service employment programs than wage subsidy programs at more disadvantaged groups. On the other hand, wage subsidies to private employers are more likely to result in "rollover" of the subsidized employers to permanent private-sector jobs.

What Is the Evidence on the Effects of Labor Demand Policies? Other Labor Demand Policies

In addition to PSE and wage subsidies to employers, the United States also has a number of other labor demand policies that, if not primarily aimed at reducing poverty, can be used to increase significantly the employment and earnings of low-income Americans. Chapter 9 reviews the following labor demand policies: state and local economic development policies; labor market intermediary programs; antidiscrimination policies; and minimum-wage or living-wage regulations.

As reviewed in chapter 9, the empirical evidence suggests that state and local economic development policies can increase local employment growth and thereby increase the earnings of low-income local residents. However, for most typical economic development policies, these earnings effects on low-income groups are likely to be modest. Linking state and local economic development efforts with customized training programs that train disadvantaged persons, and with labor market intermediary programs (LMIs) that seek to identify productive workers among disadvantaged job seekers, helps increase the proportion of the earnings benefits of local job growth that accrue to the poor.

Labor market intermediary programs, such as the U.S. Employment Service, seek to increase and improve the matching between job seekers and available jobs. Under the recent Workforce Investment Act, the employment service is supposed to be integrated and coordinated with job training programs and welfare-to-work programs. At the same time, a number of neighborhood-based efforts around the United States have also sought to do a better job of linking the disadvantaged with available jobs. As reviewed in chapter 9, the available evidence suggests that LMIs can indeed result in better job matches. However, LMIs in the United States usually are poorly funded. In addition, by seeking to serve two very different clients, job seekers and employers, LMI services are complex and difficult to deliver consistently in a high-quality fashion. Chapter 9 suggests that perhaps political pressure to improve both the funding for and performance of LMI programs will increase if these programs are perceived as tied to economic development programs, which have greater local community support.

Although many white Americans believe otherwise, the empirical evidence shows that there is still significant hiring discrimination against blacks in the United States, as reviewed in chapter 9. Some evaluation studies suggest that antidiscrimination laws and affirmative action regulations do help to reduce employment discrimination. However, under current procedures, these laws and regulations are easier to enforce against discrimination in promotions than against discrimination in hiring. As suggested in chapter 9, perhaps political support for antidiscrimination efforts would be stronger if the existence of hiring discrimination were regularly demonstrated, perhaps by sending out matched employment testers of different races to apply for job openings in a variety of different occupations in different local job markets. Such employment testing could also be used to improve enforcement of antidiscrimination laws against discrimination in hiring. Firms might also be more willing to change discriminatory practices if testing were linked with assistance from LMI programs or others in improving the effectiveness of overall firm policies in hiring, training, and keeping productive workers.

Minimum-wage regulations are usually applied at the federal or state level to require minimum wages for most employees. A more recent trend is living-wage regulations, which are typically local regulations that require employers that receive contracts or economic development subsidies from the local government to pay “living wages” (higher than current federal minimum wages). As reviewed in chapter 9, most empirical studies suggest that minimum-wage and living-wage regulations have at best modest antipoverty effects. The earnings effects of higher wages for the poor are reduced for those many individuals who are not fully employed year-round, have wages above the minimum, or work for employers that are not covered by the minimum- or living-wage regulation. In addition, minimum wages may cause some employers to reduce employment of less-skilled workers, and living-wage regulations may cause some employers to change their location decisions in response to a city’s living-wage requirement for firms receiving economic development subsidies. However, higher minimum wages and living wages have great political popularity. Campaigns for higher minimum or living wages may be a useful organizing tool for getting many groups involved in thinking about the problems of poverty and low earnings. Such campaigns could lead to broader and more diversified efforts to reduce local poverty rates.

What Labor Demand Program Should Be Pursued to Increase the Employment and Earnings of Low-Income Americans?

Based on the findings of this book, what labor demand program makes the most sense to increase the employment and earnings of low-income Americans? As outlined in chapter 10, the most effective program would include two components, the first focusing on ensuring stronger aggregate labor demand in all local labor markets, the second on a large-scale targeted labor demand policy.

Ensuring stronger aggregate labor demand in all local labor markets in part rests on macroeconomic policies that minimize recessions and keep the U.S. economy operating at close to peak levels as much as possible. But stronger aggregate labor demand in all local labor markets would also be encouraged by adopting a revision of the New Jobs Tax Credit of 1976–1977. As outlined in chapter 10, in this modified NJTC all employers (private for-profit, nonprofit, and governmental) in high-unemployment local labor markets would receive refundable tax credits against social security payroll taxes for expanding employment above some base level. (The social security trust fund would be reimbursed for the forgone taxes from general revenues.) When the national unemployment rate is low, such a policy would target expanded labor demand in the local labor markets in which expanded aggregate demand is most likely to be effective in expanding employment, with the lowest inflationary consequences. When the national unemployment rate is high, such a policy would provide subsidies for expanded labor demand in virtually the entire nation. This policy would increase the automatic countercyclical effects of U.S. fiscal policy. This particular expansionary fiscal policy, compared to other types of tax reductions or spending expansions, would tend to increase employment more per dollar of resources, since the tax credits are targeted at employment expansions. Furthermore, it would be possible and desirable to design the refundable tax credits so that the program encourages the expansion of lower-skill jobs. For example, if the tax credit applies only on wages up to some proportion of the social security tax base, the incentive to expand employment would be somewhat greater for lower-wage jobs.

Some rough estimates in chapter 10 suggest that during a recession a revised NJTC could create around two million jobs, about one-quarter of which would go to disadvantaged household heads. This would offset a significant portion—but not most—of the employment losses due to a recession. This revised NJTC might cost around $20 billion per year during recessions.

During a national labor market boom the NJTC subsidies for expansion of aggregate employment in high-unemployment local labor markets are estimated to increase the employment of disadvantaged household heads by around half a million in the long run. As discussed in chapter 3, disadvantaged Americans probably need from three million to nine million more jobs—or, to pick a middle number, about six million jobs. Therefore, although the revised NJTC would have important long-run effects on the employment of the poor, it would deal only with a small portion of their employment problems. During a boom NJTC subsidies would probably cost a little less than $5 billion annually.

As a second component of a labor demand program, I propose a large-scale targeted labor demand policy. This policy resembles a 1980s Minnesota program called MEED but is sufficiently revised that the program is renamed NEED (National Employment and Economic Development).

Under the NEED program, short-term wage subsidies would be provided to selected public and private employers for hiring into newly created jobs selected members of targeted disadvantaged groups. Local agencies familiar with the local labor market would administer the program and decide, within guidelines, which employers would receive wage subsidies and which disadvantaged persons would have their employment subsidized. The disadvantaged workers targeted would be low-income persons who are out of the labor force or otherwise unlikely to be employed in regular jobs. Whether participants are unlikely to receive a regular job would be decided in part by requiring them to undertake a job search before receiving a subsidized job slot. If necessary, an individual in the target group would receive supply-side services, such as counseling or training, before or during their period of subsidized employment.

Job developers would aggressively market the program to local employers. To increase political support, preference for subsidies would go to small businesses and small nonprofit agencies. Subsidized employment would last for up to six months. Preference in giving wage subsidies would go to employers that encourage the "rollover" of subsidized employees into regular jobs. Although firms would pay the market wage to subsidized workers, part of the worker's wages would be "taxed" by the program and paid as a bonus later if the worker meets certain goals for staying employed. This short-term reduction in the subsidized worker's net wage would encourage both long-term job retention and the transition to a regular job.

Empirical estimates suggest that it is feasible to operate a NEED program that, over a ten-year period, would create the five and a half million jobs needed by disadvantaged Americans (the assumed six million minus the half-million provided by the revised NJTC). Doing so would require a NEED program with about three million annual participants. Although such a large-scale program is unusual in the current U.S. policy environment, it is not out of line compared to past U.S. labor demand policies or policies in some Western European countries. The costs of the NEED program are estimated to be a little more than $40 billion per year.

In the end, finding resources for these programs will require a political coalition that is committed to government activism to increase the employment of low-income Americans. This book creates an intellectual case that an increased role for labor demand policies can significantly increase the employment of the poor. But these policies cannot be adopted without an active political coalition involving some combination of business groups, labor groups, community groups, and intellectual groups. Groups on the left must be willing to accept the idea that a key priority for helping the poor is increasing their employment. Groups on the right must be willing to accept the idea that increasing the employment of the poor may require some government activism.

Plan of the Book

Chapter 2 reviews the wide variety of labor demand and supply policies used in the United States and other industrial countries and describes their size and history. Chapter 3 goes on to discuss some features of the workings of the low-wage labor market and their relevance to understanding labor supply and demand policies. Chapter 4 reviews the evidence on the effectiveness of various labor supply policies. Chapter 5 examines the effects on the low-wage labor market of various types of shocks to labor demand, both aggregate and more targeted shocks to labor demand. Chapter 6 considers the effects on inflation of increases in labor demand. Chapters 7, 8, and 9 review the evidence on the effects of various specific labor demand policies, including public-service employment policies, wage subsidies to for-profit employers, and economic development policies. Chapter 10 makes the case for this book's policy recommendations.