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ABSTRACT

Utilizing data collected through a national survey of employers, the impact of federal tax credit programs for employers of Work Incentive Program (WIN) participants and Aid to Families with Dependent Children (AFDC) recipients was assessed. Six major questions were addressed: (1) What differences there were in the use of the WIN and welfare tax credits? (2) To what degree were employment tax credits a factor in employer decisions to hire WIN and welfare participants? (3) What features of each tax credit either contributed to or inhibited its use? (4) Was the program cost beneficial? (5) What are the implications of the study findings for legislation, policy, program design and operation? and (6) How can the program be changed to increase its use and make it more cost beneficial? The findings include the following: neither employment tax credit is extensively used but, of the two, the WIN tax credit is used more frequently; only eleven percent of the respondents who received tax credit certifications stated that the WIN tax credit was an important factor in their hiring decisions; the degree of tax credit utilization was often related to the overall economic health of the community; businesses became informed of the tax credit primarily through local WIN and Employment Service efforts; the emphasis which WIN job developers placed on the tax credit influenced how often it was utilized; and the WIN tax credit is a cost-effective approach for promoting WIN hires among employers who are aware of their eligibility for a tax credit. (EM)

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EMPLOYMENT TAX CREDIT UTILIZATION

To

Employment and Training Administration
U.S. Department of Labor
Washington, DC 20213

By

Jan Parkinson

February 1978

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This monograph summarizes the findings of studies conducted by IMPACT concerning an assessment of the Work Incentive (WIN) and Aid to Families with Dependent Children (AFDC) tax credit programs. The project sought answers to the following questions: (1) To what degree are tax credits a factor in employer decisions to hire WIN registrants and welfare recipients? (2) What are the differences in usage of the WIN and the welfare tax credits? (3) What provisions or features of the tax credits contribute to or inhibit their use and effectiveness? (4) How do costs of the program (especially tax revenue decreases) compare with savings generated by the program (especially welfare savings, wages and/or taxes, and social security revenue increases)? (5) What are the implications of the findings for legislation, policy, program design, and operation? (6) How can the program be changed to increase its use and to make it more cost beneficial?

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TABLE OF CONTENTS

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INTRODUCTION

This monograph is concerned with recent research findings related to the employment tax credits to businesses commonly referred to as the WIN and welfare tax credits, which were legislated in 1971 and 1975.

The text is divided into four chapters. The first is a brief discussion of the economic and political contexts from which employment tax credit legislation arose. Chapter II is a brief description of the scope and methodologies of two of the employment tax credit utilization studies which were funded by the Department of Labor. Chapter III was written to present a succinct distilliation of the salient findings presented in the more lengthy reports of the DOL contractors.

In addition, I believe there is a need to explicitly identify the basic issues surrounding employment tax credit legislation, and to integrate the research findings into the national employment policy mosaic. Chapter IV may be viewed as an executive summary which incorporates this intention.

Chapter I

THE ECONOMIC AND POLITICAL CONTEXTS OF EMPLOYMENT TAX CREDIT LEGISLATION

Introduction

Modern national economies have been undergoing considerable and rapid structural changes during the past 30 to 40 years. The development of new technologies has done much to bring about these changes; indeed, some observers speak of a 'new industrial revolution'. Although these new technologies have been developed to provide solutions to many of society's problems, the solutions themselves have often created new and more complex problems. The process of automation is a good example. In forecasting the impact of automation on the national economy, one if its developers, Norbert Wiener, had the following concern about its impact:

> The industrial revolution has. . .displaced man and the beast as a source of power. . . . The factory of the future. . .will be controlled by something like a modern high-speed computing machine. . . . We can expect an abrupt and final cessation of the demand for the type of factory labor performing repetitive tasks. . .an intermediate transitional period of disastrous confusion. . . . Industry will be flooded with the new tools to the extent that they appear to yield immediate profits, irrespective of what long-term damage they can do. . . . It is perfectly clear that this will produce an unemployment situation, in comparison with which the present recession and even the depression of the thirties will seem a pleasant joke.[1]

[1]N. Wiener, The Human Use of Human Beings (Houghton Mifflin, Boston, 1950), pp. 180-189.

Fortunately, while great advances were being made in scientific technology, significant breakthroughs in the science of economics also occurred. A new paradigm was developed by John Maynard Keynes which has completely changed modern economic thinking, and considerably lessened the destructive consequences of automation which were feared by Wiener. Because this development has important implications for national employment policy, as well as the creation and use of employment tax credits, it will be briefly described here.

During the 1930s it was widely believed that increases in productivity would only result in unemployment, because total output would remain essentially unchanged. Modern Keynsian economics, however, took a more dynamic view of national economies. It prescribed a careful coordination of monetary and fiscal policies which would result in the creation of new purchasing power, subsequently increased production of new and existing products and ultimately, new jobs.

The 'new economics' became a reality during the Kennedy Administration, when a $10 billion tax cut was proposed to stimulate a stagnant economy. The successful result dramatically changed the economic attitudes of policy makers, and professional economists were flushed with the tax cut's success. When discussing Wiener's dreary forecast, Paul Samuelson, a prominant 'new economist' exulted:

> . . .This approach means you do not have to decide whether the pessimists are right who argue that inventions will kill off more jobs than they create. Why care? In every

> case we know that high employment without inflation will require monetary and fiscal policies of the correct magnitudes and mixed economies know what needs doing.[1]

Although the 1960s and early 1970s have not witnessed the cataclysmic unemployment which pessimists had forecast, high employment without inflation proved elusive and it became increasingly clear that the high aggregate demand produced by the new economics was a necessary, but not sufficient condition for eliminating unemployment in the nation's economy.

Policy makers were continually frustrated by large pockets of unemployment among many unskilled and semiskilled workers. Two categories of unemployment (which are not necessarily mutually exclusive) were grappled with: Structural unemployment, where large numbers of minority group members remained unemployed despite generally high aggregate demand; and frictional unemployment, perceived as a temporary labor market dislocation resulting from new and/or changing technologies. Because there were thousands of highly skilled jobs available, it was assumed that the public and private markets could absorb everyone ready and willing to work once they had been properly trained. Therefore, policy makers began to focus on training as a means of improving employment problems, and it was felt that government had an important role and responsibility to coordinate and provide opportunities for such training.

[1] P. Samuelson, Economics (McGraw-Hill, New York, New York, 1970), p. 319.

The Work Incentive Program (WIN)

During that period, Congress was also developing programs for segments of the welfare population who were considered to be employable. These programs also relied heavily on institutional training and general education. The 1967 Amendments to Title IV of the Social Security Act established the Work Incentive Program (WIN). This program was designed by Congress to assist parents or other caretaker relatives receiving Aid to Families with Dependent Children (AFDC) to become employable and obtain jobs.[1] The aforementioned view of training as a solution to the unemployment of the 1960s was incorporated into the WIN program, which attempted to increase individual job readiness through training, counseling and other employment and supportive services.

However, during the next few years the emphasis on training began to erode as thousands of people who were being trained under manpower programs were not finding employment. During the 1960s there had also been some opinion that although government could provide a blueprint for the future and offer seed money for training, private employers themselves should be the prime contractors in meeting the manpower needs of a rapidly changing technology through such measures as sponsoring their own training programs. As the shortcomings of government training programs became more apparent, this opinion gained a considerable following which affected the WIN program. Support began to

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[1] In 1961, legislation had been passed which allowed that children could be included in the Aid to Dependent Children program when their need was due to the unemployment of parents. Thus, the program's responsibilities became ever more dependent upon the general health of the economy.

develop for emphasizing immediate employment of eligible AFDC recipients rather than training whenever possible, with the hope that the recipients could then acquire the necessary skills and training on the job. In 1971, amendments to Title IV of the Social Security Act significantly changed the emphasis of the WIN program from training to direct obtainment of employment. Registration of all employable AFDC adult individuals for available work or training for work was mandated as a condition for eligibility of AFDC benefits. The amendments also required that at least one-third of WIN manpower funds be spent for on-the-job training (OJT) and public service employment to reverse the pattern of overwhelming reliance on institutional training.[1]

Employment Tax Credit Legislation

The WIN Tax Credit

In 1968, the National Advisory Commission on Civil Disorders recommended the following means of improving the situation of the hard-core unemployed:

> We are convinced that large numbers and many different types of business and industrial companies will participate in hiring and training the hard-core unemployed only if an incentive technique is devised which is as simple and automatic as possible.

And,

> We believe that the single most powerful inducement for broad involvement of private enterprise in job training

[1] U.S. Department of Labor, U.S. Department of Health, Education and Welfare, WIN Handbook (Handbook No. 318), 2nd ed. (Washington, D.C.: Work Incentive Program, National Coordination Committee, 1976), p. I-2.

> and job development lies in the use of a tax incentive. Neither a guarantee technique nor a contracting mechanism offers the same appeal to businessmen in enterprises of all sizes as does the tax incentive.[1]

Senator Herman Talmadge voiced the same concerns in 1971:

> We know that many welfare recipients will be very poor employment risks, requiring special training before they can achieve full productivity. It is unrealistic to expect that the business community will un[illegible] this kind of new responsibility without some [illegible] extra financial help in the initial stages.[2]

The form of financial help chosen was an employment tax credit, patterned after the Revenue Act of 1962 which offered businesses a tax credit on their investments in machinery and equipment. The employment tax credit, however, was for businesses that hired welfare recipients who were participating in the WIN program. For this reason it was referred to as the WIN tax credit.

The WIN tax credit passed by Congress under the Revenue Act of 1971 (Senate Report 92-437 to accompany H.R. 10947, 92nd Congress, pp. 129-130), provided a tax credit of 20 percent of the wages of WIN participants for the first 12 months of work. The 12 months did not have to be consecutive; although they had to be within 24 months after such employment began. This credit was in addition to tax credits on wages paid under a WIN/OJT contract. In a given year employers

[1] Report of the National Advisory Commission on Civil Disorders (New York: New York Times Company, Bantam Books, 1968), p. 564.

[2] U.S. Congress, Senate, Senator Talmadge speaking for improving the Work Incentive Program, S. 1019, 92nd Congress, 1st sess., March 1, 1971, Congressional Record, 117:4, p. 4379.

could claim WIN tax credits up to $25,000 plus 50 percent of the tax liability over $25,000 on each return. In October 1976, the ceiling was raised to $50,000 plus 50 percent of the tax liability over $50,000.

The Welfare Tax Credit

In 1975, the Tax Reduction Act was passed creating the welfare tax credit. This credit allowed employers to claim a tax credit on virtually any type of employment of AFDC recipients, including temporary and seasonal workers as well as domestic workers in private homes. There was a ceiling of $25,000 plus 50 percent of the tax liability over $25,000 per tax year (except for domestic workers where the ceiling was set at $1,000). This ceiling was subsequently increased to $50,000. The Act also contained carry-over and carry-back provisions. Under this Act, an eligible welfare employee was defined as any AFDC recipient who had been certified by the appropriate state or local agency as having received public assistance for 90 days prior to the date of employment. Unlike the WIN tax credit, the employer could claim a welfare tax credit for any eligible employee who worked in excess of 30 days on a substantially full-time basis (75 percent or more of the customary work week). There was no retention requirement beyond the 30 days.

Initially, the credit could only be applied to wages paid after March 29, 1975, and before July 1, 1976. However, revisions enacted as of October 4, 1976, extended the expiration date to January 1, 1981.

Chapter II

DESCRIPTION OF EMPLOYMENT TAX CREDIT STUDIES

In 1975, Midwest Reserach Institute in Minneapolis, Minnesota, subcontracted with the University of Minnesota to complete a follow-up survey of the employers of WIN program participants. The follow-up survey was limited to two states, Illinois and Texas, and addressed the questions:

1) What factors affect WIN tax credit usage, and more specifically, what factors inhibit such usage?

2) What are the implications of the findings for WIN program operation?

The survey was mailed to employers and telephone interviews were conducted with those who did not respond to the mailed questionnaires. The survey yielded 569 usable responses.

A second study was conducted by the Institute for Manpower Program Analysis, Consultation and Training, Inc. (IMPACT) in Minneapolis, Minnesota. This study extended the research of the Illinois-Texas study into the national arena and studied the impact of the newly legislated welfare tax credit as well. Six major questions were addressed:

1) What differences were there in the use of the WIN and welfare tax credits?

2) To what degree were employment tax credits a factor in employer decisions to hire WIN and welfare participants?

3) What provisions or features of each tax credit either contributed to or inhibited its use and effectiveness?

4) Was the program cost beneficial?

5) What are the implications of the study findings for legislation, policy, program design and operation?

6) How can the program be changed to increase its use and make it more cost beneficial?

Information on employers in 22 states was collected concerning their knowledge, attitudes and usage of the WIN/welfare tax credits. This information was obtained through a telephone survey of employers who hired 709 AFDC recipients (557 WIN tax credits, 152 welfare tax credits). An additional 403 employers were surveyed who had not received certification for either tax credit. In addition to this survey, a series of seminars was held with employers to develop an understanding of the organizational impediments to the use of the tax credits; information campaigns were conducted in four cities to assess the impact of increased employer awareness on the utilization of the tax credits; a telephone survey of 32 WIN offices was conducted to determine the importance of these offices in promoting the tax credits; and a correlation analysis relating community economic variables to the tax credit utilization was conducted.

A more extensive discussion of each study's methodology may be found in their final reports.[1]

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[1] Sheryl Grams and D.L. Thompson, Follow-up Study of Tax Credit Users in Illinois and Texas, Minneapolis: Midwest Research Institute, North Star Division, June 1975, Contract No. PL 42-27-73-07.

David Thompson, Jan Parkinson and Dorothy Bonnallie, An Assessment of WIN and Welfare Tax Credits, Institute for Manpower Program Analysis, Consultation and Training, Inc., Minneapolis, March 1977, Contract No. DOL: 51-27-75-03.

Chapter III

EMPLOYMENT TAX CREDIT FINDINGS

The research generated a voluminous amount of information on various facets of the WIN program, characteristics of AFDC recipients hired by businesses, and factors influencing employment tax credit utilization by employers. The intent of this monograph is to generalize these findings rather than provide intricate documentation. To accomplish this, the first four questions posed by the national study will be addressed in this chapter, and the answers to the remaining two questions will be incorporated into the summary in Chapter IV.

Question 1: What Differences Were There in the Use of the WIN and Welfare Tax Credits?

Neither employment tax credit is extensively used. Of the two, the WIN tax credit is used much more frequently. The numbers of WIN tax credit certifications for the 1973 through 1976 fiscal years are shown in Table 1.

Table 1

WIN JOB ENTRIES AND TAX CREDIT CERTIFICATIONS
FY 1973 THROUGH FY 1976

Fiscal Year	Individual Job Entries	Tax Credit Certifications Per Year	Certifications as Percentage of Job Entries
1973	136,783	24,853	18.2%
1974	177,271	39,788	22.4%
1975	170,641	26,042	15.3%
1976	186,062	28,215	15.2%

SOURCES: WIN Reporting System, MA5-98 Reports 08 and 11, June 30 of each fiscal year for 1973, 1974, and 1975; ESARS, Table 30, June 30, 1976.

The Institute was unable to determine how many of the certifications were actually used to claim tax credits. This was because the Internal Revenue Service corporate income tax returns statistics were only available for the years prior to 1973.

The welfare tax credit was hardly used at all during the period of time which pertained to the study (15 months). It was estimated that during this period not more than 1,500 welfare tax credit certifications were issued. The provision for a tax credit to employers of domestic workers was largely ignored. Fewer than 200 such certifications were issued during the first phase.

Question 2: To What Extent Were the Tax Credits a Factor in Employer Decisions to Hire WIN and Welfare Participants?

As shown in Table 2, only 11.1 percent of the employers in the Institute's national sample who received tax credit certifications stated that the

WIN tax credit was at least a significant factor in their hiring decisions. Approximately 32 percent responded that it had been a contributing factor, but not a major consideration; and approximately 57 percent said that is was either a remote consideration or no consideration in hiring decisions. These findings are consistent with the Illinois-Texas follow-up study.

Table 2

EFFECT OF WIN TAX CREDIT ON HIRING DECISIONS

	WIN Tax Credit Certified Employers		
Importance of Tax Credit	Total Sample	Sample Follow-up	Not in Follow-up
Requisite Condition	1.5%	1.7%	1.3%
Significant Factor	9.6	9.7	9.6
Contributing Element	31.5	31.1	31.9
Remote Consideration	10.5	11.1	9.7
Not Considered	46.9	46.4	47.5
TOTAL	100% (527)	100% (289)	100% (238)

NOTE: Responses of the follow-up sample compared with the responses of employers not in the follow-up. $X^2 = 0.49$; df = 8; p .10.

As Table 3 shows, approximately 34 percent of the employers were unaware of the WIN tax credit's existence.

Table 3

KNOWLEDGE OF THE WIN AND WELFARE TAX CREDITS AMONG EMPLOYERS IN THE INSTITUTE'S NATIONAL SAMPLE

Knowledge of Tax Credit	WIN Tax Credit Certified Employer	Employers Not Certified for Tax Credit	Total
WIN Tax Credit			
Aware	77%	51%	66%
Not Aware	23	49	34
TOTAL	100% (545)	100% (393)	100% (938)
Welfare Tax Credit			
Aware	14%	17%	15%
Not Aware	86	83	85
TOTAL	100% (545)	100% (393)	100% (938)

Question 3: What Factors Contributed to or Inhibited the Use and Effectiveness of the Employment Tax Credits?

Provisions of the Tax Credits

The Amount of Credit Allowed

The percentage of employers (both 'tax credit certified' and 'not tax credit certified' employers) in the national survey who felt the tax credit should be increased was approximately the same as the percentage who felt it should not be increased (Table 4). Although it is possible that increasing the amount of the credit might encourage employers to use it more often, most employers in both groups either replied that the amount of the credit should not be increased or did not answer. It is, therefore, unlikely that moderate increases in the amount of the employment tax credits would encourage significant increases in utilization.

Table 4

PROPORTION OF WAGES ALLOWED TO BE CLAIMED AS AN EMPLOYMENT TAX CREDIT

Should the Tax Credit be a Greater Proportion?	Tax Credit Certified Employer	Employers not Certified for Tax Credit
Yes	15%	25%
No	15	28
Don't Know/No Answer	70	47
TOTAL	100% (557)	100% (395)

The Retention Requirement

Although retention rates for WIN employees are low, employers did not consider the retention requirements in the Act to be a negative factor. It is possible that many employers remained eligible for the tax credit even though the WIN hire was employed only a short time. Employers in the national study indicated that approximately 70 percent of the time the employee quit or was fired. In most of these cases, the employer still remained eligible for the tax credit, despite the fact that the employee was not retained for 12 months.

The welfare tax credit reduced the retention period to only 30 days, but this had little, if any, positive effect on hiring.

The Recapture Provision

It was indicated in group seminars with employers that although the portion of the claimed WIN tax credits which are recaptured is negligible, the recapture clause is still perceived as an obstacle by employers. In many cases employers do not attempt to locate employees who would qualify them for the tax credit because they feel that the turnover in the job categories for which they are hiring is too rapid to make a tax credit realistic. In other cases, employers may hire a qualified applicant but not apply for the tax credit because they do not want to be burdened with keeping the necessary records. At other times the employee has terminated employment before the tax filing date. Thus, the seminars concluded that the recapture clause does discourage use of the tax credit and reduces its incentive value.

The very term 'recapture' is misleading. It implies that the IRS will make a careful effort to recover claims which turn out to be unsupportable in the light of subsequent events. In fact, the IRS rarely audits for this tax credit. The recapture is really a recalculation by the employer. The term 'recapture' appears to have been taken from the context of the investment tax credit. In <u>investment</u> tax credit legislation, it is necessary to have a recapture clause because firms often replace equipment sooner than they had anticipated. When this is done, there is a tax credit on the new equipment and a termination of the credit on the old equipment. The <u>recapture</u> is, in fact, a <u>recalculation</u> of the new claim based on adjustments for prior claims. When such a recalculation is made, the amounts claimed in the past are not canceled out entirely, but merely reduced on the basis of the actual life of the equipment.

With <u>employment</u> tax credits, on the other hand, the terminating employee may not be replaced by another employee who qualifies for the tax credit, and, further, the prior claims are not adjusted in the light of subsequent events but instead are completely canceled. Therefore the consequences for the firm when employment tax credits are recaptured may be more severe than when the investment tax credit is recaptured.

<u>Community Economic Activity Levels</u>

There are scores of hypotheses concerning what effect, if any, the general level of economic activity has on the level of tax credit utilization in a particular community. In the national study, fifty Standard Metropolitan Statistical Areas (SMSAs) were selected according to whether they were high or low tax credit utilization areas (25 in each category), and a number of hypotheses were tested. High or low tax credit utilization was defined as the number of WIN tax credit certifications divided by the total number of WIN job entrants during the fiscal year. (The average utilization was 3.7 percent and 37.5 percent for low and high utilization projects, respectively.) Various community variables (employment rates, types of industry in each area, etc.) were then correlated with the SMSAs utilization rates to determine which variables, if any, were strongly associated.

Four community variables were found to be significantly related to the utilization of tax credits: population density, level of AFDC benefits, quits, and layoffs (Table 5).

Table 5

COMMUNITY VARIABLES ASSOCIATED WITH
TAX CREDIT UTILIZATION RATES

Community Variable	Pearson's r	Significance
Population Density	-.18	p<.10
Level of AFDC Benefits	-.40	p<.01
Quits	.30	p<.07
Layoffs	-.27	p<.09

Surprisingly, there was no correlation between the rate of employment and the utilization of tax credits. (It was hypothesized that areas of high unemployment would offer fewer jobs and subsequently fewer certifications would be issued.) It is probably the case, however, that the overall employment rate was too gross a measure to be pertinent to the WIN population.

Looking instead at the statistics on quits per 100 employed and layoffs per 100 employed, a much different picture emerged. Areas typified by relatively high quit rates (possibly implying more economic opportunity) displayed significantly higher tax credit utilization rates. There was a symmetry with layoffs in this regard. Areas with high rates of layoffs had lower utilizations of tax credits. Interestingly this may also explain the negative association of tax credit utilization with population density. The Pearson correlation coefficient of layoffs with population density was .44 ($p<.01$); that is, higher population density areas in these SMSAs were generally areas with higher rates of layoffs, and areas with higher rates of layoffs were associated with lower utilization of tax credits. Thus, using the layoff rate as a general proxy measure of the health of a community's economic sector which is pertinent to WIN clients, it was found that tax credit utilization tends to be higher in communities with healthier economic activity levels.

Another interesting and significant association was found between the level of AFDC benefits per family and tax credit utilization: areas with lower AFDC benefits tended to have higher tax credit utilization. It may be that relatively low benefits force AFDC recipients to accept almost any job the WIN office finds rather than try to survive on welfare. (As will be explained later, a significantly higher level of certifications is associated with WIN office job placements.)

In summary, of all the possible community and industrial variables which were hypothesized to be related to tax credit utilization, the layoff rate and the level of AFDC benefits were most closely associated with tax credit utilization. Given these results, it seems safe to suggest that when an area has little economic vitality; it is more difficult to place WIN clients, regardless of whether or not an employment tax credit is available.

Promotion

Promotion in WIN Job Development

There was considerable evidence that employment tax credits are most often utilized by business when WIN personnel actively promote them in order to market their clients more aggressively.

The national study used two methods to analyze the impact of WIN personnel on employment tax credit utilization. First, a telephone interview with 32 WIN offices was undertaken to determine whether procedural variation affected the number of tax certifications issued. WIN office managers were asked about their attitude toward the WIN employment tax credit, its importance as a job development tool, their perceptions of employer interest in the credit, the means by which employers were informed of the credit, and the procedures used in reporting tax credit certifications.

The number of WIN offices in the telephone survey (32) was much too small to provide statistically significant inferences about the hundreds of WIN offices throughout the country. Yet, if one were to hypothesize that offices with high percentages of certifications were simply more aggressive sellers, one would find no responses to the questions posed in the survey which would contradict such a hypothesis. High certifications per entrant projects mentioned the tax credit more often, promoted the tax credit through job developers more often, more often perceived the qualifications of their client to be their most serious difficulty, and more often tended to obtain a confidentiality release than did offices with lower percentages of certifications. Taken together, these findings are compatible with, but not necessarily indicative of, a profile of WIN offices which more actively assert themselves in marketing their clients. This assertion is supported by findings on employment tax credit information dissemination: before an employment tax credit can be an incentive to businesses to hire AFDC participants, the businesses must be aware of it. The national study found that 89 percent of the businesses who used the tax credit became aware of it through the efforts of either the State Employment Service or the WIN office. The employer seminars also documented that tax credit certifications were often directly attributed to the active placement efforts of WIN office personnel.

The second approach to analyzing the role of the WIN office was to utilize some of the SMSA data collected for the community variables study and compare the percentage of WIN registrants placed by the WIN office with the percentage of tax credit certifications issued. This approach also provided evidence for the assertion that the extent of tax credit utilization is dependent upon the individual placement efforts of WIN office employees. In the sample of high and low certification SMSAs there was a strong positive correlation between the percentage of job entrants who received employment through WIN placement efforts and the percentage of tax credit certifications issued for all WIN job entrants (Pearson's r = .59, p<.001).[1]

One obvious conclusion which can be drawn from this statistic is that WIN clients who obtained their own jobs probably did not often indicate their WIN and/or AFDC status (which was verified in business firm surveys and seminars) nor did they use the tax credit advantage in promoting themselves. Hence, the tax credit was most effective in providing an incentive to businesses when it was combined with WIN office placement efforts.

Employer Knowledge of Job Applicants' Welfare Status and the Use of Tax Credits

Nearly 80 percent of the employers in the sample who had obtained tax credit certifications _had been aware_ of the tax credit before hiring an AFDC recipient. However, not all employers knew of the welfare status of prospective employees before the hire. In fact, only 57 percent of the employers who had obtained certifications knew about both the availability of the WIN tax credit _and_ the welfare status of the applicant at the time of hire. Therefore, in 43 percent of the certifications issued, the tax credit could not have been a factor in the hiring decision. Employers who may be interested in employment tax credits are reluctant to ask the welfare status of job applicants because of potential discrimination lawsuits. The incentive value of the

[1]Readers should not view placement/certification statistics as unambiguous measures of _individual_ WIN office effectiveness because many factors may be at work in a community making it more difficult for some WIN offices to place clients than others. In particular, it was found that the percentage of placements by the WIN office was negatively associated with the layoff rate in the community (r = -.35, p<.04); i.e., the higher the layoff rate, the lower the percentage of WIN placements.

WIN/welfare tax credits can certainly be improved by taking measures to increase employer awareness of the tax credit eligibility status of the job applicants.

Information Campaigns

When the national study was initiated, there was some concern that the number of employers who were aware of and using the credits might be inadequate for the study's purposes (especially in the case of the welfare tax credit). Accordingly, a technical assistance component for an information campaign in selected cities was included in the study. Inclusion of this component had the added benefit of allowing comparison of areas which had been subjected to an intensive tax credit information effort with the rest of the country. Using the criteria of optimal use of funds, labor market stability, availability of administrative machinery, and geographical distribution, four cities were selected: Atlanta, Georgia; Toledo, Ohio; Houston, Texas; and Minneapolis, Minneosta.

A target of informing 90 percent of the businesses of the existence, applicable conditions, and obtainment procedures for the two tax credits was chosen. A number of methods were used in trying to accomplish this goal including direct mail, personal contacts and speeches, public service announcements on radio and television and articles in newspapers. The actual campaign was conducted by the National Alliance of Businessmen (NAB), with the active cooperation of the local WIN and Employment Service offices. Ten newspaper articles appeared in the demonstration area; 925 television and 6,149 radio spots worth $273,000 were contributed; 67,101 letters were mailed; 10,497 telephone calls were made to employers; and 34 speeches were delivered.

Perhaps the best measure of the campaign's success is the level of awareness of the welfare tax credit. As shown in Table 3, two-thirds of the nation's employers were already aware of the WIN tax credit. However, only about 15 percent of the employers were aware of the welfare tax credit. After the information campaign, about 31 percent of all employers in the demonstration cities were aware of the welfare tax credit and its separateness from the WIN tax credit. The number of WIN/welfare job entries increased by 94.8 percent in the demonstration cities compared with 54 percent nationally during the same time period. Also, the number of WIN/welfare tax credit certifications increased 100 percent in the demonstration projects compared with 45 percent nationally.

Most of the inquiries generated by radio and television came from welfare recipients looking for work. Direct mailing was the most successful means of eliciting inquiries from employers. Speeches to employer groups and unsolicited phone calls to employers, albeit sometimes successful, generally did not merit the time and effort devoted to them.

The campaign once again underscored the finding that businesses have not been 'self-starters' in seeking out qualifying employment tax credit employees, but that when the tax credits are used in conjunction with a well-coordinated effort to place AFDC recipients, they can be a valuable resource.

Organizational Impediments

A series of seminars was conducted in the national study with several personnel from various departments within several large firms to:

1) Determine how the decision was made within the firms to use or not use the employment tax credits;

2) Examine the procedures used by firms to implement the employment tax credits when an affirmative decision was made;

3) Identify those aspects of the employment tax credit legislation which complicated procedures or made them more expensive; and

4) Obtain recommendations for changes which would make the tax credits easier to use.

A complete volume of the seminar questions and responses was produced as a separate publication by IMPACT.[1] The results of these interviews are summarized below:

> The employment tax credits were made available to employers as an incentive to hire persons who are on AFDC. The incentive was thought to be necessary because it was recognized that there is widespread bias toward persons who are on welfare or 'on relief'. The interviews produced ample evidence of this bias, and the preponderant attitude was that people on welfare are poorly motivated, unreliable, and unproductive. This attitude is the basis for the generally held opinion that hiring people on welfare is more risky than hiring people who are not. Ordinary business prudence operates on the side of minimizing risks to the extent that this is possible.[2]

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[1] Frederick Manzara, Organizational Impediments Within the Firm to the Uses of the Employment Tax Credits (Minneapolis: Institute for Manpower Program Analysis, Consultation and Training, Inc. [IMPACT], February 1977).

[2] Ibid., p. 59.

Often in discussions of employment tax credit utilization, a simple one-man entrepreneur profit maximizing model is implicitly or explicitly assumed. The assertion is that tax credits make the labor inputs cheaper; hence, firms will rationally strive to fill all available openings with AFDC clients. The interviews indicated, however, that firms are large, complex organizations with complicated internal bureaucracies and that use of the employment tax credits require changes in virtually every phase of the hiring process, from the placement of the job order to the maintenance of records in order to prepare IRS Form 4874-FY and claim the tax credit. Where a procedural change or innovation is required, a decision is necessary; and the greater the perceived risk in making the change, the more pronounced is the tendency to involve more people in the decision. When the job description of any functionary in the firm does not contain the full authority to make the decision, the usual procedure is to pass the decision on or to shelve it.

Also, there was often some question about who in the firm must be involved to make the program function. Personnel was usually involved, but personnel does not usually keep the tax data or file the tax returns. Accounting may have been involved if payroll was a responsibility of accounting; but accounting did not know how to obtain WIN/welfare people, or how to identify them in the firm. The tax department was involved, but it did not keep payroll records in a form which permitted extraction of the WIN/welfare employees, nor did it know what was involved in seeking to hire WIN/welfare people. Supervisory personnel were involved because they were often the ones who made the final hiring decision, as well as the ones who worked with the new employees. Usually supervisory personnel were more concerned with getting the job done than with obtaining the tax credit, but where they were concerned with the tax credit, they did not know what kind of documentation was required or who was to receive it.

Hence, implementation of the employment tax credit program requires the efforts ~~of~~ more than one person in the firm, especially in the larger firms. Even in the smaller firms, personnel do not usually act without clearance from the president. There are instances where one person will implement the program; but on the basis of the interview data, when this does occur very little hiring is done anyway. Thus, as a result of a general tendency to minimize risks, the routine decision processes in the firm appear to be relied upon and it is rare when one invididual has the information, the authority and the incentive to implement the program.

Question 4: Is the Employment Tax Credit Program Cost Beneficial?

A cost-benefit formula was derived on the basis of employers who knew about the tax credit program <u>and</u> the AFDC status of the individual job applicants prior to hiring them (Thompson, Parkinson, Bonnallie, pp. 78-83). This formula assessed the value of the WIN tax credit program as a job development tool by comparing the program costs (lost corporate tax revenues) with the savings generated (welfare grant reductions, increased social security and personal income tax collections). It was estimated from this analysis that it cost approximately $.53 in lost tax revenue to stimulate a WIN hire resulting in $1.00 of potential welfare savings; therefore, the WIN tax credit is a cost-effective approach for promoting

WIN hires among employers who are aware of their eligibility for an employment tax credit.

It is important to understand that to the extent that employers do not know of the AFDC status of the job applicant and the availability of employment tax credits at the time of hire, the cost beneficiality of the program is reduced. Unless they are viewed as necessary steps to encouraging businesses to use the tax credits, efforts to get tax credit certifications to employers who do not request them, i.e., routine mailing of certifications after hiring, encouragement of employers to go through their records and claim credits, etc., reduce the cost-effectiveness of the program and simply provide a windfall to businesses.

Chapter IV

SUMMARY AND CONCLUSIONS

The intent of this monograph is to summarize the key findings of recent research concerning the utilization of employment tax credits. For the sake of brevity, a considerable amount of incidental and supporting documentation has not been included; readers desiring more extensive detail are advised to refer to the final reports of the investigations. The purpose of this chapter is to provide some perspective and make some inferences concerning the basic issues pertaining to the use of the two employment tax credits.

Review of Findings

The research discovered that an average of approximately 30,000 WIN tax credit certifications were issued for each of the four fiscal years from 1973 to 1976. (This was about 18 percent of the WIN job entries during this period.) It also found that the degree of tax credit utilization was often positively correlated to the overall economic health of local communities; that businesses became informed of the employment tax credit primarily through the efforts of the local WIN and Employment Service offices, and that the emphasis which WIN job developers placed on the WIN tax credit influenced how often it was utilized.

The research also found that the welfare tax credit was hardly used at all. Businesses remained passive to this legislation as they had earlier to the WIN tax credit, although the length-of-retention requirement was much lower (30 days). The low utilization of this credit probably reflects the fact that most AFDC recipients who are classified as employable are already in the WIN program. In addition, the WIN tax credit has a strong advocate and promoter through the WIN program which the welfare tax credit lacks. Welfare clients who secure employment on their own are not likely to mention their welfare status nor are they likely to mention the advantage of obtaining a tax credit to potential employers.

The study also found that there are complex organizational impediments within the business firms which militate against easy and automatic utilization of the employment tax credits.

A Comparison of Employment and Investment Tax Credits

As indicated above, the employment tax credits were not extensively utilized by businesses. Rather than actively seeking out qualifying AFDC clients, businesses remained rather passive to the program, utilizing it primarily in response to WIN office placement efforts. Many proponents of the employment tax credit legislation were disappointed that it had not enjoyed the same success as the investment tax credit program, after which it was patterned. However, to hope for such success is ~~almost to~~ assume that capital and labor are perfect substitutes for one another. Furthermore, while the investment tax credit applied to all new capital equipment, the employment tax credit applies only to AFDC recipients. The differences between the two types of productive inputs are marked: striking technological advances in capital resources have occurred during the past few decades which are making substantial contributions to increased productivity and subsequent profitability. Furthermore, these products have been aggressively marketed with award-winning advertising and articulate commission-basis salesmen. By contrast, many employable AFDC persons are unskilled or semi-skilled workers with only entry level abilities, and they cannot be as effectively marketed. Therefore, an assessment of the employment tax credit program cannot be made by comparing it with the investment tax credit program.

Program Recommendations

Expand Employer Awareness

The employment tax credit program was found to be cost beneficial, returning $1.00 in potential welfare savings for a $.53 expenditure in lost revenue. The program implications, therefore, were to expand efforts to increase employer awareness of the WIN tax credit program and for WIN and ES job developers to more effectively communicate prospective employees' eligibility for tax credits.

Change Existing Legislation

Eliminate the Retention Provision of the WIN Tax Credit

It was judged that this would reduce some of the complexities and risks to businesses. Questions of seniority would be minimized in cases of termination, and there would be no undue burden on the employer to forecast needs for entry level employees. The 1976 legislative revisions reduced the length of the required retention time, but did not eliminate it entirely.

Eliminate the Recapture Provision

The group seminars indicated that the recapture provision is still perceived as an obstacle by employers and discourages the use of the tax credit. It was originally incorporated into the employment tax credit legislation because it was in the investment tax credit, but the reasons for its incorporation there do not apply to labor inputs.

Eliminate the Minimum AFDC Period

Eliminating the requirement that qualifying tax credit employees be receiving welfare assistance at least 90 days prior to hire would simplify identification procedures for employers.

Employment Policy Implications

As discussed in Chapter I, modern economies are often subject to rapid technological change. With the aid of modern economic science, monetary and fiscal policy tools have been developed which have helped to maintain reasonably high aggregate demand for labor in the face of such rapid changes. However, these changes sometimes result in temporary disequilibrium in labor markets which affect large numbers of unskilled and semi-skilled workers. The AFDC program is strongly affected in these situations, especially since 1961, when legislation was passed that children could qualify for aid when parents were unemployed. In addition to the AFDC recipients who have been temporarily displaced due to technological changes, there are also many who generally have difficulty competing in the labor market.

Employment tax credit legislation was passed to encourage businesses to hire AFDC recipients who are perceived as high risks because they lack the immediate necessary skills for employment. Thus, experience and training obtained on the job would smooth the economic transition problems and reduce welfare expenditures.

At this point it is necessary to clarify a basic issue. There had been discussion prior to the present employment tax credit legislation of allowing a general employment tax credit for all new hires as a means of creating new jobs.[1] That plan was rejected in favor of the current legislation which focuses on a specific target group (welfare recipients). Because of the association in many minds between employment tax credits and job creation, many people expected the new tax credits to create jobs. However, the research failed to discover any cases which indicated that additional hires were made, over and above those jobs which would normally have been filled. Obviously, some number of AFDC recipients obtained employment as a direct result of the employment tax credit (the study estimated this to be somewhere between 5,000 and 20,000 per year). But it cannot be argued that these jobs were additions to the total job pool.

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[1]U.S. Congress, Senate, Committee on Finance, The Revenue Act of 1971, Hearings before the Committee on Finance on H.R. 10947, 92nd Congress, 1st sess., October 14, 15 and 18, 1971.

The value of employment tax credits does not lie in their power to create new jobs; that requires a much larger effort involving the careful coordination of national monetary and fiscal policies. The WIN/welfare tax credits operate most effectively as structural remedies in high employment situations, providing incentives to employers to take risks hiring the "hard core" unemployed:

> Reaching a low rate of unemployment without initiating increases in the rate of inflation will require structural programs as well as overall monetary and fiscal policy. Programs that increase access to jobs for groups with high unemployment not only serve the interests of economic justice, but help us avoid the excessively tight labor markets and inflationary pressures that might otherwise arise in a period of high employment.
>
> Policies designed to alleviate structural unemployment include. . .incentives for private industry to hire the disadvantaged.[1]

In this regard, the timing of the creation of the employment tax credits was unfortunate. The Vietnam involvement and the international energy crisis combined to produce unacceptable levels of inflation requiring stern economic policy measures which, in turn, resulted in higher than usual levels of unemployment. (In the five-year period prior to 1971, the average rate of unemployment was only 3.9 percent. In the five years following 1971, the average unemployment rate had risen to 6.5 percent.)

In such situations when the economy is operating at levels below full employment, there are thousands of unemployed persons looking for work

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[1] Economic Report of the President (Washington, DC: Government Printing Office, 1977), p. 172.

who are not underqualified but overqualified for the positions available. In this case, there is less incentive for employers to hire high risk, entry level employees (i.e., AFDC recipients) and provide training, even though their employment qualifies the firm for a tax credit.

There is also a serious ethical question about whether less-qualified job seekers should be given a competitive advantage over more qualified job seekers. Clearly policy makers may decide such measures are socially desirable and necessary to reduce the number of hard-core (such as, second and third generation) welfare families, but that choice should be explicitly stated and its consequences fully understood.

The research concluded that the WIN and welfare tax credits are helpful, cost-effective tools for encouraging placement of AFDC recipients, and that with certain legislative and program modifications, their effectiveness can be increased. However, they do not create new jobs; and they are most useful in periods of generally high employment as a means to reducing frictional and structural unemployment. Unfortunately, they have not yet been used in that context.

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