A Job Creation Tax

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Abstract

A number of well-publicised submissions advocating a 'Job Creation Levy' were made to the Committee. In its report, however, the Committee is lukewarm in relation to this option. The case for a levy in the form of an income tax surcharge can be made in terms of conventional welfare economics criteria and considerations of equity. The main case against the levy is that it will merely reshuffle the dole queue and, at the same time, create 'artificial' jobs at the expense of 'real' jobs. Moreover, there may be some undesirable implications for aggregate labour supply.

1. Introduction

In a number of submissions to the Committee on Employment Opportunities, a 'jobs levy' [in the form of an income tax surcharge] was proposed as a means of raising revenue to fund various (usually unspecified) schemes to reduce long-term unemployment. The most vociferous advocates of the levy were the Australian Council of Social Services (ACOSS), the ACTU and the Labour Left. In addition, however, the press gave extensive coverage to the proposal to the point where it emerged as a central issue in the run-up to the publication of the Committee's report. In the event, the report itself is somewhat muted and vague on the issue. It is considered only in the penultimate section of the Conclusions chapter and is given about a page and a half of space. One cannot help feeling that the Committee felt bound to acknowledge the head of steam that had been built up around the idea of a jobs levy but did not want to be seen to endorse it. Accordingly, the Committee's discussion of the issue is perfunctory, unenthusiastic and non-committal.

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A jobs levy is novel only in that it proposes a new means of raising funds for job creation programmes. Specific new programmes for creating jobs were not proposed in association with the proposed tax by its original proponents. However, the 'job compact' and other measures proposed by the Committee were estimated to cost a maximum of $2 billion in a full year. The question which arises here, therefore, is simply which method of funding these programmes is to be preferred. Instead of a jobs levy the programmes could be funded, for example, by reducing outlays on other programmes, either within the existing employment budget or from the wider expenditure programme of the Government or by raising indirect taxes or borrowing. Moreover, in a period of rapid economic growth, of the kind presently being forecast by Government and private sources, buoyancy in tax revenues might provide the resources to finance a job creation programme without recourse to any of these methods. There are, of course, other alternatives for addressing the problem of long-term unemployment, such as reductions in real wages, but these are not considered here.

2. The Case for a Job Creation Tax

One basis for the job levy would be a psuedomoralistic one. It can be argued that the recent recession has been a consequence of structural adjustment which is (or will be) of general benefit to the Australian community but the burden of the recession has fallen quite disproportionately on the unemployed. Those who have remained in employment have suffered only small reductions in their living standards while those who have lost their jobs have suffered severe reductions in living standards. On this basis, it may be argued that the fortunate [the still employed] should accept further modest reductions in their standard of living in order to assist the less fortunate [the unemployed] to obtain work. The argument may be extended in two ways. First, in the course of the recession, the distribution of income has become less equal so that equity might suggest that the tax need be levied only on the better off, say those earning incomes in excess of the national average. Second, those who have suffered most from the unemployment induced by the recession are the long-term unemployed. Hence equity might be further invoked to support the notion that the revenue raised by the jobs tax might be reserved for programmes to assist the long-term unemployed.

A jobs levy would meet these requirements much more precisely than, say, increased indirect taxation, which is levied on the unemployed as well as the employed, or a redistribution of existing Government outlays which

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could scarcely be tailored to reduce outlays on programmes of benefit only to the employed.

A more formal argument along these lines could be mounted in terms of the principles of welfare economics. Hence, it might be argued that the structural changes which brought about the unemployment were in pursuit of welfare gains to society as a whole. These gains would include reduced inflation, the increased efficiency resulting from microeconomic reform, improvements in the balance of payments position etc. The costs of change include unemployment, reduced real wages, high interest rates etc. Those made unemployed for some period of time by the policies designed to secure the structural changes have borne a very large part of the total costs compared to those who have remained in employment throughout. Economic change may be justified if it secures a net improvement in economic welfare and still permits the gainers to compensate the losers.[1]

It is arguable that this is probably true of the structural changes undertaken during the last decade in a long-run sense. On this basis it might be argued that expenditure funded by a job creation tax is a form of compensation [together with unemployment compensation] to the losers from the gainers.

This framework may give even more force to the argument that those who have benefited from the redistribution of income which has accompanied the recession should pay all or most of the job creation tax. If we decide that the redistribution of income that has occurred is not a good one, in terms of society's judgment of it, then it is reasonable to argue that compensation which partially reverses that redistribution is desirable. This would probably be the case in terms of the current situation, given the much talked about Australian egalitarian ethic. Similarly, it may be argued that the redistribution of income will be most desirably changed in the process of compensation by directing the compensation most fully towards those who have lost most, the long-term unemployed.

As a practical matter, and following the general principles derived above, a job creation tax would probably be most effectively levied as a percentage surcharge on incomes. The tax could be restricted to those incomes in excess of the average or to the upper-quartile or some such other category. The revenues so raised could then be specifically directed to providing additional services to the long-term unemployed as additional compensation for their suffering and in a special effort to return them to paid employment.

As will be argued below, a consequence of using a jobs levy to attack the problem of long-term unemployment is that some workers presently in jobs will be displaced from employment and become unemployed. Hence

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a significant element in the jobs levy strategy will be to reshuffle the faces in the dole queue. Total unemployment would probably fall but its composition would change as the proportion of long-term unemployed was reduced and the proportion of short-term unemployed increased. This would, as argued in the Committee's report, reduce the natural rate of unemployment with beneficial effects on economic growth.

3. The Case Against a Job Creation Tax

There does not appear to be any difference economically between the proposed job creation tax and normal income tax. Income tax levies tax progressively so that, as well as simply raising revenues, it also has some redistributional effects. Accordingly, all of the welfare criteria which would be met by a separate, dedicated, job creation tax could be met by income tax. Moreover, there would be administrative simplicity and greater efficiency in simply raising income tax rates than levying a new tax. It is also necessary to recall that a dedicated tax is less efficient than a general tax.

It might be argued that a dedicated job creation tax will ensure that the revenue raised will be used to assist the long-term unemployed rather than to meet other Government spending requirements. However, there is no guarantee that Government will not simply reduce existing or projected spending from general revenue on the long-term unemployed by an amount equivalent to the revenue raised by the new tax.

There may be some political appeal in using a job creation tax rather than a straightforward increase in income tax to raise the required revenue. This is particularly so in view of the fact that the budget delivered reductions in income tax and it might appear perverse to reverse this partially so soon after the budget. However, whatever the political or economic logic in the decision to reduce income tax, that logic is defeated by the imposition of a new income tax levy.

A jobs tax will remove income from private hands and place it in Government hands. Hence there will be some reduction in private expenditure at the same time as there is a rise in Government expenditure. However, on the usual assumption that the marginal propensity of Government to spend tax money is higher than that of taxpayers, and allowing for the effects of the multiplier, there will nevertheless be a net increase in aggregate expenditure.[2]

However, as a result of the redistribution of demand, some jobs will be lost in some areas of the [private] economy at the same time as others may be created in other areas by Government. Moreover, the jobs that will lost

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will be 'real' jobs [relatively high marginal product] while those that are created by Government may be largely artificial, makework type jobs [relatively low marginal product]. Hence a number of workers previously employed in relatively high productivity activities will join the pool of unemployment while a [probably greater] number of long-term unemployed workers will find work in relatively low productivity activities. Hence, as well as changing the faces in the dole queue and reducing that queue a little, labour productivity will tend to fall on average.

Since the 'Job Compact' envisages that wage subsidies to private employers will form part of the programme of measures to tackle long-term unemployment, some of the funds raised by a jobs levy would find their way back into the private sector. Accordingly, the wage subsidy programme would have the effect of creating jobs in the private sector – perhaps even restoring some of the same jobs that had been lost as a result of the fall in private sector demand due to the jobs levy – as well as in the public sector. However, those who filled the jobs would not be the same as those who had lost them; the long-term unemployed would be placed in work at the expense of those who previously held jobs and who would now become short-term unemployed. Hence a disproportionate part of the burden in creating jobs for the long-term unemployed through the jobs levy would be borne by those who lost their jobs as a result of the initial reduction in private expenditure and these are likely to be low-income workers.

The jobs levy is, in effect, an income tax surcharge and, as such, may have some effect on the supply of labour. In the standard model of short-run labour supply an increase in the rate of income tax is similar to a reduction in the wage rate. Theoretically, the aggregate supply of labour hours may be either a positive or negative function of the real wage. This will depend on the relative magnitude of the income and substitution effects at different levels of the real wage. While it is normally assumed that the supply of hours depends positively on the real wage the net impact of a reduction in the wage rate on labour supply cannot be predicted on the basis of theoretical considerations alone and the issue can be resolved only with the aid of empirical evidence. Unfortunately, the empirical evidence is not entirely conclusive either so that, while the jobs levy may affect labour supply, it is not clear what the effects may be.

Finally, there are welfare costs involved in any tax on labour income. Accordingly, for an expenditure programme to be efficient, it must yield benefits which exceed the direct and welfare costs of acquiring the revenues which fund it. [See Findlay and Jones (1982)] While no data on the relevant variables are presently available, this is a consideration which ought to be

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taken into account in estimating the value of a jobs levy as the chosen means of raising the required funds.

4. Conclusion

If there exist worthwhile initiatives or programmes to deal with long-term unemployment, that is, initiatives which would yield marginal social rates of return comparable with funded programmes in other areas, the Government must make a political decision as to whether or not they will proceed. If the decision is that they are to proceed, it must then be decided how they are to be funded. The options are to raise taxes [or to not reduce taxes where revenues increase due to economic growth], to increase the budget deficit or to redistribute exiting outlays. The Government appears to wish to avoid increasing the budget deficit. In this case it does not appear to matter a great deal whether or not revenues are raised through increased income tax or through some separate job creation tax – although the former is more efficient but the latter could be made more progressive. However, it should also be understood that a jobs levy, because it transfers expenditure from the private to Government sectors, will involve a significant element of reshuffling the faces in the dole queue as the long-term unemployed are placed in jobs and other workers are displaced from jobs into unemployment. This is, however, likely to reduce the natural rate of unemployment with beneficial consequences for the prospects for economic growth. In addition, it is possible that a reduction in the aggregate supply of labour may result from the reduction in the post-tax real wage implied by the jobs levy.

Notes

1. The argument is non-rigorous and ignores whether or not the change under consideration was optimal and whether or not the Kaldo/Hicks criterion [that the redistribution implied by compensation may affect the optimality of the initial change] is likely to be satisfied.
2. $\Delta Y = \beta T/w$ where Y is income, β is the sum of the marginal propensities to import and save out of income, T is the sum raised by the levy and w is the marginal propensity to withdraw.

Reference

Findlay, C.C. and Jones, R.L. (1982) 'The Marginal Cost of Australian Income Taxation' *Economic Record*, 58:162, 253-262.

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