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# Countercyclical Job Creation Programs of the Post-World War II Era

Linda Levine

*Congressional Research Service*

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# Countercyclical Job Creation Programs of the Post-World War II Era

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# Report for Congress

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## Countercyclical Job Creation Programs of the Post-World War II Era

Updated January 14, 2003

Linda Levine  
Specialist in Labor Economics  
Domestic Social Policy Division

# Countercyclical Job Creation Programs of the Post-World War II Era

## Summary

For months before the terrorist attacks of September 11, 2001, analysts were debating whether the longest economic expansion in U.S. history had come to an end. The National Bureau of Economic Research officially declared that the longest-running expansion in the postwar period ended in March 2001. The labor market situation deteriorated further between 2001 and 2002, with the unemployment rate averaging 5.8% in 2002 compared to 4.8% in 2001. Nonfarm employment at private firms fell by 1.5 million between the 2 years. One bright spot was that the number of workers separated in announced layoffs in 2002, 1.47 million, receded from the record high in 2001 of just under 2.0 million.

The federal-state Unemployment Compensation (UC) program provides a financial cushion for involuntarily unemployed workers who recently held jobs and helps stabilize the economy during recessions. Typically in response to recessions, the Congress has enacted measures to supplement the regular UC program. The 107<sup>th</sup> Congress, in March 2002, passed legislation that gave additional weeks of jobless benefits to workers who exhausted their regular benefits. After the measure expired in December 2002, its extension was the first order of business in the 108<sup>th</sup> Congress.

During several downturns in the business cycle, the Congress also has passed legislation to directly create jobs so that people moved more quickly than they otherwise might have from unemployment rolls to employer payrolls. At present, a variety of proposals are being advanced to spur economic growth and to create jobs given what is viewed as a lackluster and “jobless” recovery. The proposals include a variety of measures, such as providing tax relief to individuals and providing states with financial assistance so that they do not enact procyclical legislation (i.e., tax increases and spending cutbacks).

Four *direct* approaches — public works, public service, revenue-sharing, and employment tax credits — were utilized to create jobs in the public or private sectors during earlier recessionary periods. The latest major measure was the Emergency Jobs Appropriations Act of 1983, an amalgam of public works and public service job creation. It provided about \$9 billion to 77 programs administered by 18 federal departments and agencies. About \$7.8 billion (86%) went to 55 programs and activities that fund public works functions (e.g., construction, repair, and maintenance of buildings and facilities including roads, libraries, and schools). The remainder went to 22 programs and activities that perform public service functions, such as block grant programs (i.e., the maternal and child care block services grant and the social services block grant) and programs that provide income support and employment/training assistance. The nation has had only one experience with a countercyclical tax credit (the New Jobs Tax Credit) and a countercyclical revenue-sharing program (the Anti-Recession Fiscal Assistance program). Both were enacted in response to the 1973-1975 recession.

This report will be updated as legislative activity warrants.

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## Countercyclical Job Creation Programs of the Post-World War II Era

The National Bureau of Economic Research belatedly declared that the longest economic expansion in the postwar period officially ended in March 2001.<sup>1</sup> By year's end, the unemployment rate had risen to 5.8% from its monthly low in 2000 of 3.9%.<sup>2</sup> Employment in the private nonfarm sector fell by 1.9 million jobs between December 2001 and the cyclical peak. Moreover, the number of workers involved in layoff actions that either took place or were announced in 2001 was the highest on record; estimates ranged from about 1.75 million to just shy of 2.0 million.<sup>3</sup>

The events of September 11, 2001 further disrupted activity in some sectors of the economy — most notably, travel-related enterprises. Domestic air carriers and aircraft manufacturers quickly announced that they were laying off tens of thousands of employees. Hoteliers in New York City and elsewhere (e.g., Washington, D.C., and Las Vegas) laid off or scaled back employees' hours as a result of reduced leisure and business travel, the latter having fallen off before the attacks. Although persons whose work hours are shortened or who depend heavily on tips (e.g., wait-staff and cabdrivers) may not be unemployed, their incomes — and presumably their spending — would nonetheless decrease.

The federal-state Unemployment Compensation (UC) program, which has been in place since 1935, provides a financial cushion for involuntarily unemployed workers who recently held jobs and helps stabilize the economy during recessions. Typically in response to recessions, the Congress has enacted measures to supplement the regular UC program. As the airline industry was the most adversely and immediately affected by the terrorist attacks, the Congress passed legislation to help the carriers.<sup>4</sup> In addition, it passed the Temporary Extended Unemployment Compensation (TEUC) program in March 2002 — regardless of the industry which had employed them (P.L. 107-147). After the legislation expired at the end of the

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<sup>1</sup> The Business Cycle Dating Committee of the National Bureau of Economic Research is the official arbiter of dating recessions. The Committee declares peaks and troughs in the business cycle several months after they have occurred when a trend in various statistical series (e.g., employment) has emerged. Additional information is available at [<http://www.nber.org/cycles.html>].

<sup>2</sup> The peak unemployment rate of the 1948-1949 recession was 7.9%; of the 1953-1954 recession, 5.9%; of the 1957-1958 recession, 7.4%; of the 1960-1961 recession, 6.9%; of the 1969-1970 recession, 5.9%; of the 1973-1975 recession, 8.6%; of the January-July 1980 recession, 7.8%; of the 1981-1982 recession, 10.8%; and of the 1990-1991 recession, 6.8%.

<sup>3</sup> CRS Report RL30799, *Corporate Downsizing and Other Layoffs*, by Linda Levine.

<sup>4</sup> CRS Report RL31617, *The Economic Effects of 9/11: A Retrospective Assessment*, coordinated by Gail Makinen.

year, its extension was the first order of business taken up by the newly installed 108<sup>th</sup> Congress (P.L. 108-1).<sup>5</sup>

At the present time, the Administration and some Members of Congress are advancing a variety of proposals to spur economic growth and to create jobs, given what is viewed as a lackluster and “jobless” recovery. The unemployment rate moved erratically within a narrow range (5.5% and 6.0%) during 2002, and averaged 5.8% for the year. Nonfarm payroll jobs dropped by 1.5 million between 2001 and 2002. In contrast, the number of announced layoffs improved over 2001's total, decreasing by about one-quarter to 1.47 million.<sup>6</sup> The proposals include a variety of measures, such as providing tax relief to individuals and providing states with financial assistance so that they do not enact procyclical legislation (i.e., tax increases and spending cutbacks).

During several earlier downturns in the business cycle, the Congress has passed legislation to directly create jobs so that people moved more quickly than they otherwise might have from unemployment rolls to employer payrolls. This report presents a brief comparison of the four *direct* approaches — public works, public service, revenue-sharing, and employment tax credits — that were utilized to create jobs in the public or private sectors during recessionary periods. (Measures that could indirectly create jobs are not discussed in this report.)<sup>7</sup> It then describes the specific, major countercyclical job creation activities that were initiated during the post-World War II period and includes a discussion of program evaluations. The report will be updated if the Congress pursues one of these strategies.

## A Comparison of Direct Job Creation Approaches

**Public Works Programs.** It has been argued that federal spending on public works jobs projects (e.g., highways; water and sewer facilities; hospitals and libraries) both creates worthwhile, tangible outputs and teaches workers marketable skills. If program funds mainly are devoted to construction projects that require costly materials and equipment as well as highly skilled workers, then public works projects might be considered a fairly expensive way to create jobs. Alternatively, if funds are devoted to more labor-intensive endeavors, such as those involved in

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<sup>5</sup> CRS Report RL31277, *Temporary Programs to Extend Unemployment Compensation*, by Jennifer Lake.

<sup>6</sup> The mass layoff statistics program of the U.S. Bureau of Labor Statistics ended before it issued data for the fourth quarter of 2002. Based upon the trend in workers separated during the first three quarters of the year, it is likely that the series also would have shown an improvement over its record high year of 2001.

<sup>7</sup> An example of an indirect job creation measure is a personal income or payroll tax cut. If the taxes of individuals are cut, they might spend the money that would otherwise have gone toward funding government activities. Producers, in turn, might hire more workers in response to a tax-cut-induced increase in consumer demand for goods and services.

infrastructure maintenance and repair, more jobs would be created per dollar of spending.

Public works jobs programs often are slow to start, which could cause them to increase the demand for labor when the economy already is expanding and thereby drive up wages and the inflation rate. The startup of a public works program can be delayed because of lags between the appropriation of federal funds and their allocation to state or local governments, between the allocation of funds to jurisdictions and their awarding of contracts, and between the awarding of contracts and the initiation of projects. Moreover, federal funds might be substituted for state or local funds that would have been spent on similar projects in the absence of the federal program — practice that diminishes the actual number of new jobs generated by the federal expenditure.

**Public Service Programs.** Countercyclical public service jobs programs typically have been quicker to startup than public works programs. In addition, relatively more federal expenditures on public service activities go toward wages. As a result, more jobs can be created per dollar of spending on public service as compared to public works projects. Public service jobs programs also tend to help a broader range of workers by employing more lower skilled and unemployed workers than public works programs.

It has been asserted that public service jobs programs impart few skills to participants and that the participants engage in “make-work” projects. In addition, participants hired through public service jobs programs might be substituted for regular government workers, thereby dampening the program’s net job-creating effect.

**Revenue-Sharing Programs.** These federal grants can stabilize state and local governments’ budgets by giving the governments funds to avoid cutbacks in services or increases in taxes due to recession-induced revenue shortfalls. Spending cuts or tax increases at the state or local level could exacerbate a recession’s effects and offset countercyclical measures initiated at the federal level.

Some observers think that revenue-sharing programs can produce jobs fairly quickly if the money is used for general purposes and if neither new regulations nor new administrative entities are required. By attaching few strings to the ways in which federal funds may be spent, there is a risk that states or localities might utilize the funds for purposes that create relatively few new jobs (e.g., building up cash balances or using federal for state/local funds that otherwise would have been spent).

**Employment Tax Credits.** As in the case of the aforementioned job creation approaches, some of the jobs created by employment tax credits likely would have been created in the absence of the program (i.e., employers could claim a credit for already anticipated hiring). The availability of a jobs tax credit during an economic recovery might accelerate the pace of hiring rather than create additional jobs. The failure of other direct job creation programs to end when an economic recovery begins means that private employers would have to compete with these programs for new workers, which in turn could drive up wages and the inflation rate.

Some analysts believe that an employment tax credit is superior to public service job creation because workers get jobs in the private sector under the tax credit approach, where they may learn skills that subsequently are readily transferable to unsubsidized jobs at private firms. Other benefits claimed for the tax credit approach are that it neither requires a new government program nor an administrative entity. Alternatively, the speed with which a tax credit generates employment depends on how and when individual employers respond to the subsidy's availability. Although a jobs tax credit lowers the cost of labor to firms, it might not cause them to hire more workers during a recession: unless businesses think that there is sufficient demand to warrant increased production, the relative change in input (labor and capital) prices might not entice them to expand employment much if at all. Moreover, faced with only temporary subsidization of their labor costs, firms might be unwilling to change their production techniques and shift their input mix toward greater use of the less expensive (labor) input.

## **Countercyclical Public Works Employment**

The Public Works Acceleration Act of 1962 (P.L. 87-658) created the Accelerated Public Works (APW) program, which was the first effort in the post-war period to create publicly funded jobs in construction and related private sector industries to combat rising national unemployment. In addition to redevelopment areas designated under the Area Redevelopment Act, localities eligible for assistance were those that the Secretary of Labor determined had experienced substantial unemployment (i.e., a jobless rate above 6%) for at least 9 of the preceding 12 months. The program was conducted through existing federal agencies and was coordinated by the Commerce Department. The APW program provided \$852 million for such projects as waste treatment, water and sewer facilities; hospitals and health facilities; and street construction and repair.

The APW program and subsequent countercyclical public works measures have been criticized for their delayed startup, which means that many projects were not completed until well after a recession's end. Some observers have suggested that if there were a program already in place with prescribed triggers for its initiation, the issue of timeliness would be resolved. Others have responded that even with an already existing program, the time needed to plan, obtain materials and hire workers as well as the time it takes to complete the projects themselves, still would make public works programs pro-cyclical rather than countercyclical; that is, by increasing the demand for labor when the economy is expanding, public works programs could drive up wages and consequently, the inflation rate.

The Local Public Works Capital Development and Investment Act of 1976 (Title I of P.L. 94-369, the Public Works Employment Act of 1976) and the Public Works Employment Act of 1977 (P.L. 95-28) appropriated \$6 billion for the Local Public Works (LPW) program. The Economic Development Administration allocated funds to states based on their unemployment levels and rates, and to substate areas based on a more complicated formula.

There was criticism that LPW funds were substituted for local funds which would have been spent on similar projects in the absence of the federal program. Analysts' differing assumptions about the extent of this practice, commonly referred to as fiscal substitution, resulted in markedly different estimates of the net number of jobs created by the program. (The net number of jobs attributable to any type of job creation measure will be smaller than the gross number to the extent that some of the subsidized jobs would have been created even without the program.)

Given the nature of public works programs, the LPW program did not help unemployed workers across a range of occupations. Instead, it largely provided jobs for already employed construction workers (who might otherwise have become unemployed). For the few unemployed persons who did get jobs on LPW projects, the experience and skills acquired probably were minimal as the average length of employment was short.

The Emergency Jobs Appropriations Act of 1983 (P.L. 98-8) was an amalgam of public works and public service job creation. It provided roughly \$9 billion to 77 programs administered by 18 federal departments and agencies. About 86% of the appropriations (\$7.8 billion) went to 55 programs and activities that fund public works functions (e.g., construction, repair and maintenance of buildings and facilities including roads, libraries, housing and schools). The remainder went to 22 programs and activities that perform public service functions, such as through the maternal and child care block services grant, the social services block grant and community centers (\$620 million); income support (\$400 million); and employment/training assistance (\$230 million).

P.L. 98-8 was designed to deal with some of the criticisms leveled at earlier job creation efforts. By appropriating additional funds to existing programs with projects already underway, the Congress expected that money would be spent and jobs would be created more quickly than in past job creation efforts. An evaluation of the program showed this was not the case, however. In addition, although the legislation required that funds be used as much as possible to create jobs for the unemployed, relatively few jobs went to unemployed workers. In response to this criticism, program officials suggested that this might have occurred because unemployed workers did not have the skills needed for some projects or because contractors were trying to provide jobs for their existing workforces.

## **Countercyclical Public Service Employment**

The Public Employment Program (PEP), authorized by the Emergency Employment Act of 1971 (P.L. 92-54), was the first sizeable (\$2.5 billion) anti-recessionary public service employment effort since the Great Depression. It was a temporary program that sought to provide public service jobs to unemployed and underemployed persons.

Funds were allocated to units of government based on the relative severity of unemployment. Program funds were spent quickly, which meant that jobs were created at a rapid rate. The program was labor-intensive, with a large share of the

funds going toward wages. However, several studies found that many of the jobs subsidized by the program would have existed in its absence and that the program “creamed” (i.e., took the best qualified of the eligible population).

Although PEP was a countercyclical tool, it also focused resources on those thought to be most in need. The law called for targeting assistance to such groups as veterans; young and older workers; the economically disadvantaged; welfare recipients; migrant workers; non-English speakers; and workers laid off due to cutbacks in the defense, aerospace and construction industries. In order to ensure that many different occupational groups benefitted from PEP, the legislation mandated that a maximum annual salary of \$12,000 per employee could come from federal funds and, excluding teaching positions, a maximum of one-third of the jobs created could be for professionals.

The Emergency Jobs and Unemployment Assistance Act of 1974 (P.L. 93-567) amended the Comprehensive Employment and Training Act (CETA) to add Title VI, Emergency Job Programs. It was established to mitigate cyclical unemployment by funding temporary positions in federal, state and local governments as well as in nonprofit organizations that provided public services. Title VI funds (about \$15 billion, 1975-1982) were allocated to prime sponsors based on measures of the relative severity of unemployment. The program created many jobs quickly.

Initially, to be eligible for jobs subsidized by Title VI funds, individuals had to have been unemployed for 30 days, or 15 days in areas where the unemployment rate exceeded 7%. In both the 1976 and 1978 amendments to CETA, the Title VI eligibility criteria were tightened to target funds to low-income, unemployed persons (e.g., the maximum annual federal wage subsidy per program participant was lowered to \$10,000). These changes were enacted to discourage what was perceived as a widespread practice by state and local governments that reduced the net number of jobs created: many state and local governments laid off current employees and then rehired them, using Title VI rather than state/local funds to pay them. CETA’s public service program also was criticized for creating “make-work, dead-end” jobs, which some believed neither provided society with worthwhile output nor CETA workers with useful skills.

## **Countercyclical Revenue-Sharing Grants**

The Anti-Recession Fiscal Assistance (ARFA) program (Title II of P.L. 94-369, the Public Works Employment Act of 1976), which was amended and extended by the Tax Simplification and Adjustment Act of 1977 (Title VI of P.L. 95-30), operated from 1976 to late 1978. The legislation authorized appropriations of \$1.25 billion and \$2.25 billion, respectively, for a total of \$3.5 billion.

ARFA funds were to be released only if the national unemployment rate exceeded 6%. The allocation of funds to individual governments was determined by local unemployment rates over 4.5% and by their General Revenue Sharing

allocations.<sup>8</sup> By law, recipients of ARFA grants were required to spend, appropriate or obligate funds within 6 months of their receipt.

The use to which ARFA funds could be put were largely unrestricted (i.e., for the maintenance of basic services customarily provided by government such as public welfare, education and police protection). The funds generally could be used for employment and the acquisition of "normal" supplies or materials and for repairs, but not for construction or renovation.

A common criticism of the program's design was that it did not effectively target aid for countercyclical purposes. Some analysts thought ARFA assisted local economies undergoing long-run (secular) decline rather than focusing on those with short-run (cyclical) difficulties. It also was argued that the unemployment rate is not a good indicator of a recession's impact on a jurisdiction's financial condition. The allocation of funds between state and local governments was criticized as well: because recessions reportedly cause less budgetary disruption to local than state governments as state revenue sources and expenditures are more sensitive to economic conditions, some believed that state governments should have received more than one-third of the ARFA funds.

In order for countercyclical grants to promote economic stabilization, they must be spent rather than used to buildup state or local government surpluses. More particularly, they must be "additive" rather than used in place of local funds that otherwise would have been spent. Thus, revenue-sharing programs can suffer from fiscal substitution just as public works and public service job creation programs can. It was suggested that fiscal substitution in revenue-sharing programs might be minimized by earmarking the activities for which jurisdictions could use the grants.

## Countercyclical Employment Subsidies

The United States has had one experience with a tax credit intended to promote private sector job growth as an antidote to recession-induced unemployment. The New Jobs Tax Credit (NJTC) was enacted in 1977 (Title II of P.L. 95-30, Tax Reduction and Simplification Act of 1977). It ended in late 1978. The revenue loss to the government associated with the credit (less the required reduction by firms' deductions for wages and including carryovers for several years) was estimated by the Treasury Department to be \$5.7 billion.

The NJTC was a general subsidy meant to increase employment among all workers. It gave firms nonrefundable credits against corporate or personal income tax liabilities and thus, was only of value to for-profit employers.

The NJTC was an incremental or marginal subsidy, that is, employers could claim a credit only if their employment rose by a given amount above a specified threshold. In this case, the credit was equal to one-half of the increase above 2% in

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<sup>8</sup> General Revenue Sharing was a program established in the 1970s that provided largely unrestricted federal financial aid to states and localities.

an employer's Federal Unemployment Tax Act wage base between the base and current year. As a marginal credit, it tended to favor growing, labor-intensive firms and to help reduce "windfall gains" (i.e., paying employers for hiring that they would have undertaken in the absence of the program). Over time, however, it becomes increasingly difficult for firms to qualify for a marginal credit.

The NJTC was capped in three different ways. No firm could claim a credit in excess of: (1) \$100,000 annually, (2) 25% of its unemployment insurance (UI) wages in the current year, or (3) one-half of the difference in the firm's total wages for the year above 5% of the previous year's total wages. The reason for limiting the credit by relating it to the increase in total wages was to prevent employers from claiming credits by artificially increasing their UI wages (e.g., making full-time jobs into part-time jobs or substituting lower paid for higher paid workers). The reason for capping the credit at a certain percentage of a firm's UI wages was to try to limit the amount that new, expanding firms could claim.

Some observers faulted the NJTC for its complexity. One survey found that relatively few employers knew about the credit. And, of those firms that were aware of the NJTC, relatively few made a specific effort to increase employment because of its availability or thought they were eligible to claim it. In contrast, other analysts credited the NJTC with high employer use.