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THE WHITE HOUSE

WASHINGTON

DATE: 13 APR 78

FOR ACTION: STU ELZENSTAT

JACK WATSON NC

CHARLIE SCHULTZE

FRANK MOORE (LES FRANCIS)

JIM MCINTYRE - attached

Bhumantlal - attached

~~Bhumantlal will comment - expected Wed eve~~

INFO ONLY: THE VICE PRESIDENT

HAMILTON JORDAN NC

JODY POWELL

*Treat with  
new provision  
with cost book*

*down*

SUBJECT: MARSHALL MEMO RE RECONSIDERATION OF THE EMPLOYMENT TAX  
CREDIT PROPOSAL

\*\*\*\*\*  
+ RESPONSE DUE TO RICK HUTCHESON STAFF SECRETARY (456-7052) +  
+ BY: 1100 AM MONDAY 17 APR 78 +  
\*\*\*\*\*

ACTION REQUESTED:

STAFF RESPONSE: ( ) I CONCUR. ( ) NO COMMENT. ( ) HOLD.

PLEASE NOTE OTHER COMMENTS BELOW:

*5/10  
Will not go  
to Pres - pm  
to one who says  
Marshall knows  
Bull*

THE WHITE HOUSE  
WASHINGTON

4/20/78

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TO. RICK HUTCHESON

For Your Information: \_\_\_\_\_

For Appropriate Handling:  X

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Robert D. Linder

U. S. DEPARTMENT OF LABOR  
OFFICE OF THE SECRETARY  
WASHINGTON

APR 13 1978

MEMORANDUM FOR: THE PRESIDENT  
FROM: THE SECRETARY OF LABOR *Ray Marshall*  
SUBJECT: Reconsideration of the Employment  
Tax Credit Proposal

Summary

The current specification of the Administration's Employment Tax Credit (ETC) proposal provides credits to firms for each disadvantaged youth they hire. This form of ETC would permit firms to fire and layoff existing workers to receive credits for hiring CETA-eligible youth, would involve high costs per new job for disadvantaged workers, and would help disadvantaged youth often at the expense of disadvantaged adults. These problems guarantee political opposition from organized labor and groups like the National League of Cities.

Adopting an incremental feature--in which firms receive credits only when they expand employment beyond some share of normal employment--would lessen the political opposition to the ETC and would improve the equity and economic impact of the ETC. Thus, I believe it is important that the Administration adopt an incremental feature before the proposal reaches Congress.

1. Status of the ETC Proposal

On the basis of a March 24 memo, you approved a tax credit for firms hiring disadvantaged youth, age 18-24. You decided to:

- restrict the credit to youth instead of all disadvantaged workers,

- allow firms to claim the credit for each eligible worker employed instead of for increases in the firm's employment of eligible workers;
- limit the credit to a firm's income tax liability instead of permitting refundable credits to those firms with zero tax liability.

Although the Urban Policy statement indicated the credit would cost up to \$1.5 billion, Treasury has estimated the proposal's actual cost at about \$.3 billion in FY 1979, \$.8 billion in FY 1980, rising gradually to \$1.3 billion in FY 1983.

The Ways and Means Committee will be ready to take up ETC proposals in about two weeks. Thus, the Administration will have to send up the details of its proposal soon. So far, only the outline of the proposal that appeared in the Urban Policy Message has been made public.

## 2. Difficulties with the Current ETC Proposal

### a. The Equity Issue

The current proposal does not build in safeguards against the layoff and firing of existing workers to open places for credit-eligible workers. Such substitution could even cause some disadvantaged youth to lose jobs to other disadvantaged youth, since the youth who is laid off may become disadvantaged by virtue of the layoff itself. The ETC could certainly cause firms to lay off disadvantaged adults and hire disadvantaged youth.

### b. Expansions in Coverage

The Congress is likely to expand eligibility of workers who would be credit-eligible. At a minimum, Ways and Means will probably extend coverage to welfare recipients and fold the current WIN and welfare credits into the new ETC. Unions and other groups oppose the youth limitation and see the proposal as similar to a subminimum wage for youth.

Widening coverage could add substantially to the ETC's cost. Covering all welfare recipients could increase budget costs from about \$1.3 billion to \$1.8 billion. Including all workers receiving food stamps or welfare could raise the ETC's cost to \$3.0-3.5 billion; including all disadvantaged could involve a cost of over \$4.5 billion. (These are all annual tax expenditures after the ETC is fully implemented).

### c. Windfalls for Existing Firms

Unions are likely to oppose the current ETC not only because of the layoff problem but also because too much of the credits will be windfalls to employers who tend to hire disadvantaged even without the credit. Any ETC proposal would result in some windfalls, but under the current Administration version, the windfalls are especially large and obvious.

### d. High Cost Per Job

Treasury estimates that under the current specification, the tax loss per new job for disadvantaged will be about \$13,000. Many of these jobs will come at the expense of other workers, including disadvantaged adults. Thus, the cost for each new job to the economy would substantially exceed \$13,000, perhaps rising to \$26,000.

## 3. The Incremental Feature

We believe that adding an incremental feature will increase the ETC's chances to pass Congress and, once passed, will enhance the equity and economic impact of the ETC. The incremental feature we propose would limit the credit to:

- increases in a firm's total employment beyond 90% of its last year's employment, as well as
- the number of disadvantaged workers hired by the firm.

As long as the firm increased its total employment (over 90% of last year's employment) by the number of disadvantaged workers hired, the firm could claim the credit for each disadvantaged worker. However, if a nonexpanding firm's share of disadvantaged workers normally exceeded 10%, it would not receive full credits for following its normal employment policy. The ETC would act as a premium, providing extra benefits only for extra effort. Adding the incremental feature would:

- virtually eliminate the problem of encouraging firms to lay off or fire existing workers to qualify for tax credits;
- lessen the windfalls to low wage firms;
- provide budget room for increases in the number of workers covered without substantial additional costs;

- increase the number of jobs created per dollar of tax expenditure; and
- do more to help disadvantaged workers move into growing firms, where advancement opportunities are better.

The addition of an incremental feature could have some disadvantages. It would add complexity but little compared to that already embodied in the current proposal. We would have to alter somewhat the ETC already announced. This should not be a serious problem because we have not yet sent specifications to Congress. Another concern is that too much of the ETC will flow to growing areas. In fact, regional effects would not be adverse to urban firms because the credits would be concentrated in areas with many disadvantaged workers. Firms in these areas will gain new growth incentives.

#### 4. Conclusions

We believe the advantages of the incremental feature far outweigh its disadvantages. By adopting this feature, the Administration could:

- make it easier to attain agreement with the Congress; and
- make the credit more equitable and more efficient than the current proposal.

WASHINGTON

DATE: 13 APR 78

FOR ACTION: STU EIZENSTAT

FRANK MOORE (LES FRANCIS)

JACK WATSON

JIM MCINTYRE

CHARLIE SCHULTZE

INFO ONLY: THE VICE PRESIDENT

HAMILTON JORDAN

JODY POWELL

SUBJECT: MARSHALL MEMO RE RECONSIDERATION OF THE EMPLOYMENT TAX  
CREDIT PROPOSAL

++++  
+ RESPONSE DUE TO RICK HUTCHESON STAFF SECRETARY (456-7052) +  
+ BY: 1100 AM MONDAY 17 APR 78 +  
++++

ACTION REQUESTED:

STAFF RESPONSE: ( ) I CONCUR. (  ) NO COMMENT. ( ) HOLD.

PLEASE NOTE OTHER COMMENTS BELOW:





EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D.C. 20503

April 21, 1978

MEMORANDUM FOR: RICK HUTCHESON

FROM: Suzanne H. Woolsey *SW*

SUBJECT: Secretary Marshall's Appeal on Targeted  
Employment Tax Credit

Secretary Marshall would substitute an incremental mechanism for the non-incremental targeted employment tax credit (TETC) selected by the President as part of the Urban Policy.

All the flaws of the non-incremental approach - high windfall profits, cost per job, the opposition of the unions, narrowness of targeting, the substitution of young for older workers - were well known and discussed by all agencies during preparation of the initial decision memo for the President.

The greater net effect for youth and reduced administrative burden were judged to outweigh the flaws.

The Secretary's incremental design would cut out many firms that now hire a large number of disadvantaged youth. This is supported by calling such firms "low wage" and therefore somehow unattractive. The possibility that some firms will expand low-wage forces, even at the expense of hiring some higher wage workers, is advantageous for our goal of aiding youth. Young workers cannot command higher salaries without some period of employment experience which the tax credit is designed to help them acquire.

The Secretary's further concern over the potential for multi-billion dollar budget costs if the Congress seeks to expand eligibility to all welfare recipients cannot be dealt with in isolation of our overall strategy for welfare reform and tax cuts. (Note that the current AFDC-WIN tax credit is costing only \$20 million per year.) Those strategies have not yet been formed, nor has there been an opportunity to evaluate the seriousness of the threat posed by widened eligibility.

Recommendation

1. Before going in to the President, Treasury views should also be obtained.
2. Retain the non-incremental approach. The Secretary's proposal does not add enough new arguments to support seeking Presidential review. The political issue of Congressional and union support may deserve more thorough evaluation. However, the President is being asked to sacrifice the program goal of aiding youth in return for the benefit of avoiding antagonizing unions and perhaps disagreements with some members of Congress over the extent of targeting. We feel the initial policy is sufficiently strong and publicly defensible as to outweigh these risks.

THE CHAIRMAN OF THE  
COUNCIL OF ECONOMIC ADVISERS  
WASHINGTON

April 29, 1978

MEMORANDUM FOR THE PRESIDENT

FROM: Charlie Schultze <sup>CLS</sup>

SUBJECT: Reconsideration of the Employment Tax Credit

Background

In devising the Administration's proposed Employment Tax Credit, many variations were thoroughly discussed by the participating agencies -- DPS, OMB, DOL, Treasury, and CEA. There was early general agreement that an employment tax credit targeted to those who suffer severe labor market obstacles was preferable to the general employment tax credit presently in operation. The major decisions which remained were:

- o whether the credit should be incremental (firms would receive credits only when employment is expanded beyond some benchmark level) or categorical (firms would receive credits for all employed persons from the targeted population group); and
- o whether the credits should be targeted to disadvantaged youth or to all disadvantaged persons.

DPS, OMB, Treasury, and CEA favored the categorical approach, with the targeted population defined to be disadvantaged youth. You originally approved this position. However, Secretary Marshall has asked you to reconsider your decisions on these two features of the credit. I believe you should not change your decisions for several reasons.

An Incremental versus a Categorical Credit

Secretary Marshall argues that an incremental credit would create more new jobs per dollar of revenue foregone than would a categorical program. The AFL-CIO strongly favors such a program. I do not think the arguments are persuasive.

An incremental employment tax credit would be only slightly more efficient, in terms of job creation per dollar of tax expenditures, than a categorical program.

The categorical credit would be available for the first two years for each disadvantaged youth employed by a firm. By contrast, an incremental credit would be available only for the number of disadvantaged persons employed by a firm each year in excess of a base number of regular employees in the firm. That base is a fixed proportion of the previous year's total employment. For example:

Total employment in 1978.....	100
Base (90 percent).....	90
Total employment in 1979.....	110
Maximum number of disadvantaged employees eligible for credit in 1979.....	20

If total employment in a firm increased, and then stabilized, the base would increase and so reduce the number of workers eligible for the credit. For example: (same firm as earlier example)

Total employment in 1979.....	110
Base (90 percent).....	99
Total employment in 1980.....	110
Maximum number of employees eligible for credit in 1980.....	11
Number of disadvantaged persons for whom the firm could <u>lose</u> eligibility in 1980.....	9 (20 minus 11)

Analysis by my staff demonstrates that under these conditions, the categorical and incremental credit approaches are likely to create essentially the same number of job opportunities for disadvantaged workers per dollar of revenue loss.

The incremental credit is considerably less appealing than a categorical credit when another feature of the scheme is considered. A firm will not know with certainty what its total employment will be at the end of each year. But the number of workers eligible for subsidy depends on end-of-year total employment. Hence, the extent of the firm's subsidy for the year is unknown until year end, and

this uncertainty will discourage full use of the subsidy. Firms face the risk that they will hire more disadvantaged workers than qualify for an incremental tax credit -- diluting the total value of the subsidy to the firm. Under those circumstances, I believe that the number of jobs established under this program would be reduced.

By contrast, under the categorical approach, credits will be provided for any worker from the target group retained for three months or more.

Secretary Marshall also has argued that the incremental tax credit would involve lower windfall profit gains to businesses than would a categorical approach. In the short-run, firms that take advantage of the proposed tax credit will incur an increase in their profits. However, analysis by my staff again indicates that the potential "windfall," or subsidy, would be essentially equivalent under either approach.

#### Eligibility Criteria

The credit we have proposed would limit eligibility for the credit to young, disadvantaged workers. Secretary Marshall has proposed expanding eligibility to all disadvantaged workers, regardless of age. While there are many disadvantaged persons in the labor market, it is my judgment that youth, especially minority youth, suffer from the most serious structural obstacles to employment. Expanding eligibility would spread the limited dollars available for this credit too widely and would reduce its impact on youth, who need private sector experience most. The Administration proposal is designed to improve both the quantity and quality of employment opportunities for those who fare worst in the labor market. For this reason, I feel that the eligibility criteria should be held to the narrow bounds you originally approved.

4/21/78

Department  
of the Treasury

to: Mr. Rick Hutcheson

Office  
of the Secretary

Rick -

Attached is Mike's view on Secretary Marshall's proposal to alter the Employment Tax Credit.

The staff over here was upset that we were not directly asked to respond to the Marshall memo. Treasury runs the tax system and should be consulted on all proposals about that system.



Curt A. Hessler  
Executive Assistant  
to the Secretary

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room 3407  
phone 566-5901



THE SECRETARY OF THE TREASURY  
WASHINGTON 20220

April 21, 1978

MEMORANDUM FOR THE PRESIDENT

Subject: Labor Department proposal to alter the Employment Tax Credit

Secretary Marshall suggests limiting our Employment Tax Credit (ETC) to firms that increase employment over some base level. I recommend against this change.

Limiting the ETC to growing firms would not prevent substitution of ETC-eligible workers for other workers; nor would it reduce windfalls for firms that would have hired the disadvantaged "anyway":

. Substitution: The whole purpose of an ETC is to make disadvantaged workers more attractive relative to other workers and thus to narrow the disparity in unemployment rates between the two groups. In that sense, "substitution" is not only inevitable but desirable. What of course we do not want is an absolute reduction in the number of jobs available to non-eligible workers, but the only way to prevent that is to expand the labor market as a whole, through proper macroeconomic policies. Limiting the ETC itself to growing firms is not a solution. It would not expand the size of the labor market, and unless that happened, non-eligible workers would still suffer an absolute displacement by eligible workers.

. Windfalls: The only way to prevent windfalls is to identify those disadvantaged workers who would have been hired "anyway." This is impossible. Limiting the ETC to growing firms is no answer: Growing firms are no less likely than stagnant firms to have hired the disadvantaged "anyway."

Limiting the ETC to growing firms would have very serious disadvantages:

. Complexity: An incremental ETC would be much more complicated to claim and to administer. In addition, eligibility for many firms would not be known until the end of the tax year--too late to influence hiring practices. The ETC would become yet another source of uncertainty associated with hiring the disadvantaged. If it is to do any good, the ETC must be as simple and certain as possible.

. Discrimination: An incremental ETC would discriminate against non-growing firms, setting up a competitive distortion against businesses which are already struggling. Similarly, it would discriminate against disadvantaged workers seeking employment in non-growing firms, to no apparent social purpose.

It is true that limiting the ETC to growing firms would free up revenue for expanding the class of workers eligible for the credit. But our ETC is targeted on the class suffering most critically from high unemployment: CETA-eligible youth. We should resist a never-ending "Christmas tree" process of adding new eligible groups.

Finally, I strongly oppose making the ETC refundable. This would set a disastrous precedent for other tax credits.



W. Michael Blumenthal



ID 782337

THE WHITE HOUSE  
WASHINGTON

*W/SZK 5/10  
in Council / DF*

DATE: 05 MAY 78

FOR ACTION: STU EIZENSTAT

ZBIG BRZEZINSKI

*concur  
by plm*

JIM MCINTYRE

*amcr*

CHARLIE SCHULTZE

*by plm*

INFO ONLY: THE VICE PRESIDENT

FRANK MOORE (LES FRANCIS)

JACK WATSON

*will  
comment*

*should concur  
per J. Frank*

SUBJECT: KREPS MEMO RE US/UK TAX TREATY

++++  
+ RESPONSE DUE TO RICK HUTCHESON STAFF SECRETARY (456-7052) +  
+ BY: 1200 PM MONDAY 08 MAY 78 +  
++++

ACTION REQUESTED:

STAFF RESPONSE: ( ) I CONCUR. ( ) NO COMMENT. ( ) HOLD.

PLEASE NOTE OTHER COMMENTS BELOW:

*Withdrawn  
?*

LD 782337

THE WHITE HOUSE

WASHINGTON

DATE: 05 MAY 78

FOR ACTION: SECRETARY BLUMENTHAL

ATTACHED  
IDCT

*will recommend that it  
NOT go to the P at the  
time - exp Wed AM,  
get Don Lubick*

INFO ONLY:

SUBJECT: KREPS MEMO RE US/UK TREATY

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+ RESPONSE DUE TO RICK HUTCHESON STAFF SECRETARY (456-7052) +

+ BY: 1200 PM MONDAY 08 MAY 78 +

*Blumenthal 12:00 Wed 10 May 78*

ACTION REQUESTED:

STAFF RESPONSE: ( ) I CONCUR. ( ) NO COMMENT. ( ) HOLD.

PLEASE NOTE OTHER COMMENTS BELOW:

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MAY 01 1978

1978 MAY 1 PM 2 36

MEMORANDUM FOR THE PRESIDENT

SUBJECT: US/UK Tax Treaty

The United States-United Kingdom tax treaty, soon to be considered by the Senate, provides substantial benefits to American taxpayers, to the U.S. Government and, on balance, to most State taxing authorities. Failure to ratify the treaty in its entirety would require a renegotiation process, with the near certain result that the British Government would withdraw some of its more important concessions. There is already concern in Britain that the treaty, as now written, is too advantageous to the United States. Two "ground-breaking" concessions of major benefit to the United States are:

(1) Rebate of Advanced Corporation Tax (ACT) for U.S. Investors in British Companies

A rebate retroactive to 1973 of 100 percent of the ACT is provided for U.S. portfolio investors who received and will receive dividends from British corporations. In addition U.S. direct investors will get a rebate of 50 percent of the ACT retroactive to 1975. The U.S. balance of payments will likely receive a boost of \$381 million in retroactive payments through 1978, plus additional annual amounts thereafter in the neighborhood of \$85 million.

(2) Acceptance in Principle of Apportionment for Multinationals of Domestic Expense to Foreign Income

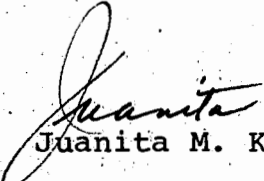
The U.K. has agreed in principle to compute U.K. tax liability of U.S. corporations taking into account appropriate expenses for stewardship research and development, and interest incurred in the U.S. but properly apportioned to U.S. profits.

Additionally the treaty would:

- o Add certainty to the availability of the U.S. foreign credit for oil investments subject to the U.K. Petroleum Revenue Tax.

- o Require a corresponding recognition by one country's taxing authority when the other country makes an adjustment or correction of income that is taxed by them both.
- o Clarify the treatment of containerization as it relates to shipping and air transport.

I believe that the treaty will make a major contribution to the U.S. economy and represents a positive step in our relations with the United Kingdom on outstanding tax issues. Moreover, its ratification might induce other countries (e.g. Germany, France) which have integrated their corporate tax systems for the benefit of only resident shareholders, to be more willing to accommodate this discrimination against U.S. shareholders on the basis of a tax treaty based on the U.K. model. I strongly recommend that you give this issue your personal attention.

  
Juanita M. Kreps

JUANITA KREPS

THE UNDER SECRETARY OF COMMERCE  
WASHINGTON, D. C. 20230

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