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In this issue . . .

*Timothy J. Bartik and
Kevin M. Hollenbeck*

Employment Effects of
the Washington High
Technology Business and
Occupation Tax Credit

Françoise Carré and Chris Tilly
Part-Time and Short Hours
in Retail in the United States,
Canada, and Mexico:
How Institutions Matter

Books on Current Policy Issues

Vol. 19, No. 4

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Employment Effects of the Washington High Technology Business and Occupation Tax Credit

This article summarizes findings from Upjohn Institute Working Paper No. 12-187. Visit www.upjohn.org to read the paper.

Washington State has a High Technology Business and Occupation Tax Credit that allows a credit against the state's gross receipts tax for firms that exceed a certain threshold of qualified research and development (R&D) spending. A major purpose of this credit is to stimulate employment growth. In spring 2012, the Joint Legislative Audit and Review Committee of the state legislature contracted with the Upjohn Institute to conduct a study that would estimate the extent to which the High Tech Tax Credit does, in fact, stimulate employment growth.

To address this question, we used tax return data from firms that claimed a tax credit on their business and occupation tax returns between 2004 and 2009. Companies that claim the credit must also file the state's Annual Tax Incentive Survey, and we used that survey data as well.

Self-Reported Employment Creation

One question on the Tax Incentive Survey asks firms to report "the amount of credit claimed for the calendar year," and another question asks "how many

new employment positions did your firm create in Washington State during the calendar year?" Table 1 summarizes these survey data by year.

Interpreted naively, these data might seem to indicate that the credit is very cost-effective in creating jobs. If one assumes that all the employment created in these firms was due to the credit, then the credit cost per job created is low, averaging less than \$2,000 annually per job-year (for example, the total credit cost over all years of about \$123 million divided by about 74,000 jobs yields a cost per job-year of \$1,662).

Models

Table 1 does not reveal, however, whether the tax credit created the reported employment. Does causality run from the credit to employment growth or from growth to more credits claimed? Firms that are expanding may choose to spend some of their additional revenue on R&D, thereby increasing credits claimed. Alternatively, the tax credit may incent firms to invest in R&D, which increases employment. Without further evidence, we cannot determine the direction of causation.

Unraveling the direction of causality is the key to estimating the effect of the tax

Table 1 Self-Reported Employment Creation and Tax Credit, by Year

Year	Average employment created	Total employment created	Average credit (\$)	Total credits taken (\$, millions)
2004	5.39	3,223	39,611	23.687
2005	31.07	16,622	31,003	16.587
2006	27.49	13,937	34,229	17.354
2007	27.05	14,309	37,499	19.837
2008	33.17	16,885	43,599	22.192
2009	18.25	9,305	46,696	23.815
All years	23.30	74,281	38,730	123.472

SOURCE: Washington Tax Incentive Survey.

credit on employment. In this study we identified causation through instrumental variables, which cause shifts in R&D credits for the firms that are unrelated to the firm's own decisions.

Our model assumes that a firm's hiring decisions are based on its profits. Profits are negatively related to costs, so hiring is negatively related to a firm's costs. The high tech tax credit influences a firm's decision making by reducing the cost of R&D. We assume that the effect of the R&D subsidy on business location and expansion decisions is proportional to this subsidy's effects on business costs.

The outcomes that we have analyzed include employment and overall wages paid at the firm. We examined how changes in the credit subsidy affect the firm's growth in employment or wages, and we estimated our model using firms' average credit ratios and marginal credit ratios. The latter is the additional tax credit that would be earned by spending one additional dollar on R&D. For many firms, these two ratios are the same—equal to the credit subsidy rate for that industry and year. However, because the credit is nonrefundable, the marginal credit ratio drops to 0 if the amount of the credit for which the firm is eligible exceeds its tax liability, or if the firm's computed tax credit exceeds \$2 million.

Hypotheses

We structure our empirical model around how the R&D credit lowers a business's costs. The research literature on state and local business taxes suggests that the long-run effects of a 10 percent increase in all state and local business

taxes is to reduce a location's business activity by between 1 and 6 percent (Bartik 1991). Because state and local business taxes have usually averaged around 5 percent of business costs in the United States, this implies that a one-half of a 1 percent increase in business costs (a 10 percent increase in business taxes when business taxes are 5 percent of overall costs) will reduce business activity by between 1 and 6 percent, and therefore a 1 percent increase in business costs will reduce business activity by between 2 and 12 percent. Our model is structured so that the R&D credit variable is scaled by its effects on business costs, so we would expect the credit variable to have a coefficient of between -2 and -12 . Scaling the credit by effects on business costs means that the credit price is scaled by the firm's R&D spending as a share of total costs, which is what economists call R&D's "factor share."

We tried three different instrumental variables for the R&D factor share: 1) the average R&D factor share in Washington in an industry where the average was calculated by omitting the firm; 2) the national R&D factor share for the industry using data from the National Science Foundation; and 3) the firm's projected factor share in a year, in which the projection was accomplished by applying the national rate of R&D expenditure growth in the industry (from the National Science Foundation [NSF] data) to the firm's factor share in the first year of data.¹ All of these instrumental variables are designed to predict a firm's R&D spending and credit but be independent of the firm's own changing decisions. The third instrument has the

most variability because it incorporates the most firm-specific information, which should increase prediction in estimation.

In theory, average credit rates would be germane to a major location decision. If decision makers at a firm are trying to decide whether to locate in Washington, then they might compare the net tax rates from several jurisdictions as part of their decision-making process, and in Washington that would include the average credit rate. However, if they are making decisions at the margin, such as expanding R&D or employment, then they are going to respond to the marginal tax and credit rates.

Table 2 shows the estimation results for models in which employment growth and earnings growth are explained by changes in R&D costs, using the marginal credit ratio, for the three sets of instrumental variables. Our preferred specification is using the instrumental variable that is presented in the third column, that is, using a baseline R&D factor share and inflating it annually at the rate of growth of R&D in the industry, as these estimates are the most precise.

To estimate the job growth that resulted from the tax credit, we used the firms' data and the parameters from our preferred estimated model with the actual marginal credit ratio and with a marginal credit rate of 0 to predict employment growth with and without the credit.² We did a similar calculation for total wages at the firm. Table 3 presents these results.

As seen in the table, the number of jobs created by the tax credit annually ranged between about 380 and about 510, which represented a growth in jobs at these firms of between 0.53 and 0.62 percent. The amount of earnings generated in the state from these jobs ranges from about \$14.2 million to \$23.0 million. The levels of earnings represented a growth in earnings of between 0.20 and 0.25 percent.³ We calculate the average cost per job created by dividing the entries in the last column of Table 3 by the jobs created in the second column. These averages range from \$40,409 (2006) to \$50,291 (2009).

The job creation numbers reported in Table 3 are job-years created—they should not be interpreted as additional

Table 2 Effects of Changes in R&D Credit Subsidies on an Individual Firm's Growth

Dependent variable/model	Instrumental variable		
	Industry average (without firm)	National R&D factor share growth rate	Baseline factor share growing at national rate
Employment/growth	-10.44 (8.06)	-2.02 (6.32)	-4.94*** (1.92)
Earnings/growth	-13.14 (10.68)	-2.64 (8.21)	-2.90 (2.42)

NOTE: Entries are estimated effects of a credit subsidy on firm growth, scaled so that it shows the percentage effects on firm growth of an increase in the credit subsidy received of 1 percent of the firm's overall business costs. Robust standard errors are presented in parentheses.

***statistically significant at the 0.01 level.

permanent jobs created each year. Our model estimates that a change in the tax credit causes a once-and-for-all permanent change in the number of jobs in the state. Therefore, the job-years listed in the second column should not be summed to get a cumulative total of jobs created. In other words, our model estimates that if policymakers had eliminated the tax credit in 2009, the level of jobs in these firms would have been permanently lower by 484 jobs.

Furthermore, only about 40 percent of the employment creation in this study occurred in industries that would be expected to be "export-based" industries, that is, to primarily sell goods and services outside the state of Washington. For non-export-based firms, any expansion of the firms receiving the tax credit would likely reduce sales of other firms in that same industry in Washington, as they are competing for

the same Washington customers, with little net effects on state employment. If there is a multiplier of 2.0 for the export-based firms, and 0.0 for the non-export-based firms, the net employment creation would be approximately 80 percent as large as the numbers in Table 3.

Conclusion

Our analyses of tax credit data suggest that the Washington high tech R&D tax credit does increase employment to a very modest extent. The analyses suggest that, because of the tax credit, employment grew by between 0.5 and 0.6 percent at the firms that claimed credits. Our preferred specification suggests that firms respond to the marginal credit rate, which we should note is zero for slightly less than one-quarter of the sample.

The cost per job created implied by these estimates is relatively high. The

range in the above estimates is from just over \$40,000 to just over \$50,000 per job created. Although the jobs created may pay more than those figures, not all earnings generated are a pure benefit. We know from previous studies that only a portion of newly created jobs actually result in increased local employment rates and earnings per capita. Up to four-fifths of all new jobs in a state will end up being reflected in higher population rather than higher state employment rates. That is, a 1 percent increase in a state's employment is estimated to lead after 5 or more years to a 0.8 percent increase in state population, with a resulting increase of 0.2 percent in the state's employment to population ratio (Bartik 1991, 1993). Some of the new jobs will also help state residents advance to better-paying jobs than would have occurred otherwise, as the new jobs make it easier for them to be hired in better-paying occupations. Estimates suggest that a 1 percent increase in a state's employment leads to a 0.2 percent increase in earnings per capita due to state residents moving up to better-paying occupations (Bartik 1991).

Combining these two effects, a 1 percent increase in jobs, which would directly increase state earnings by 1 percent if the jobs pay similarly to the average state job, will actually lead to a somewhat lower 0.4 percent increase in state earnings per capita: 0.2 percent due to higher state employment rates, and 0.2 percent due to state residents moving up to better-paying occupations. The boost in state earnings of 0.4 percent is 40 percent of the 1 percent extra earnings directly associated with the new jobs. Therefore, in evaluating the benefits for state residents from new jobs, only about 40 percent of the earnings from the new jobs lead to higher earnings per capita for state residents.

Why is the cost per job created in this study relatively high? Four reasons seem most important. First, this study finds that, consistent with the research literature, state and local business activity is only modestly responsive to lower costs. Second, for the firms receiving this particular tax credit, the ratio of earnings and output to employment is relatively high, which implies that a given dollar tax credit has more modest percentage

Table 3 Estimated Employment and Earnings Creation, by Year

Year	Employment	Earnings (\$, millions)	Total credit taken (\$, millions)
2005	378 (84, 672)	14.244 (-9.528, 38.016)	18.541
2006	430 (96, 764)	18.988 (-12.702, 50.678)	17.376
2007	469 (117, 833)	21.114 (-14.125, 56.353)	19.487
2008	511 (114, 907)	23.019 (-15.399, 61.437)	22.672
2009	484 (108, 860)	20.728 (-13.866, 55.322)	24.341

NOTE: Table entries in the second and third columns are estimated jobs and earnings created as a result of the R&D tax credit. The entries in parentheses are the lower and upper bounds of a 95 percent confidence interval. The "credit taken" data are derived from tax return data, and hence differ slightly from the survey data reported in Table 1.

effects in lowering overall business costs. Third, a significant proportion of the tax credits are capped, which means that on the margin these tax credits do not lower the costs of expanding Washington employment. Fourth, a significant proportion of the tax credits are awarded to non-export-based firms, which will have lower effects on overall Washington employment.

These explanations point to ways to lower the cost per job created from this policy. In particular, targeting export-based firms with high multiplier effects, and making sure that incentives affect marginal costs to firms that are expanding, will help reduce the cost per job created. Higher multiplier effects will be more likely if firms have stronger local supplier links. Finally, if the goal is job creation, directly tying the magnitude of the incentive to job creation provides a greater reason for firms to respond to the incentive with job creation.

Notes

1. Dr. Raymond Wolfe of the NSF graciously assisted us in navigating the NSF data, and released the 2008 and 2009 data slightly early.

2. Note that many firms' marginal credit ratio is 0, so that no simulated job creation occurs at these firms.

3. The fact that wages increased less than employment suggests that the credit had a negative impact on wages per employee. This finding is not surprising because one would assume that new hires make, on average, less than incumbent workers. In addition, lower-wage firms may have higher percentage effects of the tax credit on costs.

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Françoise Carré and Chris Tilly

Part-Time and Short Hours in Retail in the United States, Canada, and Mexico

How Institutions Matter

In sectors where full-time schedules do not dominate, total hours matter greatly for job quality. We explore hour levels and trends in retail trade, which is known for part-time work. We compare the United States, Canada, and Mexico, taking advantage of the fact that work hours regulations vary cross-nationally. By comparing retail hour levels and trends, we contribute insights into policy and regulatory impacts on job quality. Our analysis draws mainly on publicly available data from national statistical offices in the three countries; from 419

U.S. retail relies heavily on part-time workers, who increasingly are guaranteed very few weekly hours, but are expected to “flex up” to 40 hours on demand.

field interviews with retail executives, managers, and workers in the United States and Mexico; and from secondary sources.

Retail Hours—Cause for Policy Concern

The issue of insufficient hours is ubiquitous in U.S. retail. Schedules are driven by retailers' extension of opening hours, and by wide swings in shopping flows throughout the day and week, as well as seasonally. Retail in the United States relies heavily on part-time workers, who increasingly are guaranteed very few weekly hours, but are expected to “flex up” to 40 hours on demand. Moreover, today even the full-time-hours guarantee falls below 40 hours, and often below 35.

These patterns have significant implications for the workforce. Lower standard hours reduce the base level of weekly earnings that workers—full- and part-time—can rely upon. Additionally, retailers' scheduling practices generate variability and unpredictability in individuals' total hours and in the distribution of these hours. Part-timers receive few or no benefits and usually a lower hourly wage than full-time workers. For these reasons, retail work hours and the firm strategies and institutional factors that drive them warrant attention.

In each of the countries we examined, long and expanding hours of operation create two managerial goals: 1) control labor costs with lean staffing, and 2) closely match staffing levels to customer flow. However, in the United States and Canada, these twin goals lead retailers to shorten employee work hours and expand part-time jobs, whereas in Mexico they lead retailers to lengthen hours.

The three countries provide a useful comparison. They are neighbors and share many of the same retail chains—Wal-Mart is the largest retailer in both the United States and Mexico and is one of the top retailers in Canada as well. Yet the labor market and social protection institutions of the three countries are quite distinct, with important implications for hours of work.

Contrasting Hours in Canada, the United States, and Mexico

We find differing levels and trends in retail hours across the three countries in recent decades. Table 1 provides average weekly hours levels; data are broadly comparable multiyear averages (see

Carré and Tilly [2012a] for sources and definitions). Compared to the economy-wide average, U.S. and Canadian retail employees work shorter hours, while Mexican retail workers put in longer hours.

The United States has the shortest average hours—they are shorter than in Canada except in the grocery subsector. Mexico has the longest hours economy-wide, and even longer hours in retail. Mexican statistics must be seen within the national context: our fieldwork indicates that Mexican retailers press workers to work unpaid additional hours. In the United States, supervisors, who are not subject to the overtime premium, work much longer hours than nonsupervisory workers; in Mexico, the reverse is true, consistent with a management regime built on extending worker hours.

In Canada and the United States, 1987–2009 time trends for employee hours are negative for total, retail, and

In the United States, supervisors work much longer hours than nonsupervisory workers; in Mexico, the reverse is true.

grocery employment, but the negative time trend is more marked in Canada than in the United States: a loss of 1.8 hours over 20 years after controlling for cyclical effects, as compared to the 0.2 hour U.S. loss (see Carré and Tilly [2012b] for details).¹ We lack detailed time series data on Mexico and thus did not make a parallel estimate of trends.

How Institutional Environment Matters: Three Patterns

Patterns of hours reflect sector-specific strategies but also significant differences in institutional environments—notably between Mexico and its two northern neighbors, but also to some degree between the United States and Canada.

Retailers have parallel practices in Canada and the United States; they control unit labor costs by paying lower hourly wages and in most cases extending fewer benefits to part-time workers

than to full-time workers. Still, these practices take place against a backdrop of institutional characteristics with significantly different implications. The U.S. institutional environment for retail jobs is best characterized as regulatory “flexibility.” Retail hours of operation are not regulated at the federal and state levels; there are few (and diminishing) local statutory limits on opening hours. Retail entry-level wages are pegged at or slightly above the minimum wage, which is low relative to the economy-wide median and has declined in real terms. Collective bargaining, which historically has improved compensation, covers a declining share of workers (reaching 5 percent in retail and 17 percent in grocery in 2011).

Canada’s institutional environment represents a form of “constrained flexibility.” Its industry regulation is broadly similar to that of the United States, but it has different norms in regard to labor standards and social protection. As provinces have relaxed their restrictions on Sunday and holiday opening, legal regulation of opening hours has moved in the same direction as in the United States, but it has changed more recently in Canada. The steeper 1987–2009 decline in hours in Canada reflects adoption of these practices in

Canadian retail starting in the 1980s, then accelerating in the 1990s, whereas these same practices had been long-standing in the United States by the late 1980s. Furthermore, in grocery retail and general merchandise, severe price competition also hit later. When it did, in the early 1990s, management in Canadian unionized grocery chains sought to reopen contracts, dissolve pattern bargaining, and redesign jobs (Kainer 2002). These changes, entailing greater use of part-time workers, spread quickly. Today Canadian retail has high rates of

Retailers in Canada and the United States control unit labor costs by paying lower hourly wages and extending fewer benefits to part-time workers.

part-time workers (35.5 percent of wage employment in 2004, compared to 28 percent in the United States, although Canada uses a lower threshold, 30 hours).

Still, even by 2007, the end of our study period, Canadian retail hours were on the whole higher than in the United States, and the implications for workers were mitigated. Very short-hour part-time work (less than 20 hours) appears to be less prevalent in Canada.

Table 1 Average Weekly Hours for the United States, Canada, and Mexico (multiyear averages)

	U.S.	Canada	Mexico
Total			
All private, nonsupervisory, 1987–2009	34.13		
Total, all employees, 1987–2009		36.69	
All private, all employees, 1998/2003/2008 (Economic Census)			47.66
Retail			
Nonsupervisory, 1987–2009	30.65		
All employees, 1987–2009		33.04	
All employees, 1998/2003/2008 (Economic Census)			51.57
Nonsupervisory, 1998/2003/2008 (Economic Census)			51.94
Grocery			
Nonsupervisory, 1990–2009	31.08		
All employees, 1990–2009		30.50	
All employees, 1998/2003/2008 (Economic Census)			54.88

NOTE: Hours from Mexico’s Economic Census imputed by assuming 52 weeks of work a year, thus weekly hours may be underestimated.

SOURCE: Carré and Tilly (2012b).

Moreover, the impacts of part-time work are buffered by nearly universal access to health insurance. Differential treatment does remain because several employer-based benefits are not readily available to part-time workers—namely employer pensions, paid time off, and supplemental health insurance—but the cost advantage to retailers of part-time employment is reduced in Canada. Finally, Canadian retail has retained significant rates of collective bargaining coverage, boosting compensation. In 2004, union coverage amounted to 15 percent of retail employment and 42 percent in grocery (compared to 6 and 18 percent, respectively, in the United States that year). In recent years, provincial minimum wage levels have remained higher, relative to the average wage, than the U.S. federal minimum wage.

In contrast, the institutional structure regulating Mexican retail jobs can be characterized as “unevenly regulated dualism.” While much of the retail industry in Mexico takes place in informal and family businesses, which typically evade regulation, the country has a growing number of modern retail outlets, including hypermarkets. Formal retail businesses face a regulatory regime quite distinct from that in the other two countries.

Mexican institutions motivate employers—especially retailers—to set longer hours. Four elements of the institutional environment of larger stores have a particular impact: 1) a long workweek, 2) the day-based minimum wage, 3) universal social insurance, and 4) weak unions and limited enforcement. Mexico’s full-time workweek is 48 hours (six days times eight hours), with overtime provisions only applying beyond this point. The minimum wage there is set by daily pay and not hourly pay. Mexican law also mandates universal social insurance (through employer contributions), though the level is low and workers with greater market power generally get plans above the minimum. The first three provisions weaken the incentive to use part-time employment: 1) the 48-hour workweek facilitates covering weekends without part-timers, 2) the minimum wage sets

a daily pay floor that vitiates the cost advantage of short-hour workers if the wage level is close to the minimum, and 3) universal social insurance bars (at least as a matter of law) a strategy of excluding part-timers from the most expensive benefits. The daily wage, however, also sets an economic incentive to push workers to work unpaid hours beyond the statutory eight hours. Finally, the bulk of retail unions negotiate so-called “protection” contracts (whereby corrupt union leadership colludes with management) that offer workers little if any representation or recourse against standards violations.

In short, national institutional environments can shape employer incentives and thus worker hours with significant job quality implications. The Canadian and Mexican examples suggest possible U.S. policy options to mitigate

The institutional structure regulating Mexican retail jobs can be characterized as “unevenly regulated dualism.”

the problems of short and variable hours—for example, instituting a daily as well as an hourly minimum wage would reduce employers’ incentives to create very short shifts (in a number of states, recently instituted “reporting pay” requirements that ensure a minimum pay when called into work should have similar effects); so would policies that reduce the cost differentials between full-time and part-time workers. Given the importance of work hours as a job quality indicator in retail and other service work, these possibilities merit further exploration.

Notes

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1. In the grocery subsector, time trend begins in 1990.

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