Job Creation Tax Credits and Job Growth:
Evidence from U.S. States

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Abstract

An unemployment rate remaining unacceptably high and monthly job gains barely keeping pace with labor force growth have generated discussions about innovative fiscal policy instruments, such as job creation tax credits (JCTCs), to help stimulate labor demand. This paper studies the effects of JCTCs enacted by U.S. states over the past 20 years. Twenty-three states have adopted JCTCs, and their experiences provide a rich source of information for assessing the effectiveness of such policies. We investigate whether JCTCs affect employment growth before, at, and after the time they go into effect. These questions are investigated in an event study framework applied to monthly panel data on employment, the JCTC effective and legislative dates, and various controls. We find that the employment response to JCTCs depends importantly on whether the credit is anticipated in advance. Anticipated credits tend to have perverse negative effects during the anticipation period and then relatively large positive effects after the credit goes into effect. In contrast, unanticipated credits tend to have positive but relatively modest near-term effects. The response to either credit occurs over a long period of time (four years). Based on the sample of unanticipated credits, we find that the JCTC elasticity of employment is 0.28. This estimate suggests that President Obama’s proposed JCTC would create 280,000 more jobs and would lower the unemployment rate by only 0.1 percentage points.

Keywords: Job creation tax credits, state business tax incentives, spatial externalities, anticipation effects, fiscal foresight, implementation lags

JEL codes: H25, H3