Innovations for Poverty Action

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Timeline
2015 -

Sample Size
10,000 firms

Research Implemented by IPA
No

Do investment tax credits stimulate investment? Evidence from tax reform in Chile

Abstract

Governments often implement a number of policies intended to support small and medium size enterprises (SMEs) to grow and expand. One such government tool is to use tax breaks to reward small and medium-sized firms for investing. While such investment tax credits are widely practiced, there is limited evidence on the effectiveness of these policies in promoting firm investment, employment, or growth. This study exploits a size cutoff in the eligibility rule of an expanded investment tax credit enacted by the Chilean government during the 2007 financial crisis, to analyze its effects on firm behavior.

Policy Issue

Investment Tax Credits (ITCs) are a frequently employed policy tool in both developing and developed countries. They offer tax incentives to firms for investing in their businesses and are thereby thought to encourage investment and growth. Knowing the degree to which ITCs are taken up by firms and are effective in promoting investment could help decision-makers design more effective policies to help firms expand.

Note: This is not a randomized controlled trial

Context of the Evaluation

In 2007, the government of Chile enacted a series of measures to reduce the cost of investment with the goal of expanding SME growth. One of these was temporarily expanding the ITC to stimulate capital expenditure by SMEs. This change allowed SMEs with less than about 4 million USD in average annual sales over the previous two years to deduct a higher percent of their investments from taxes. For SMEs with positive taxable profits, this is thought to be equivalent to a reduction in the cost of financing such investments.

Details of the Intervention

Researchers will use this natural experiment to estimate the effects of the ITC using a regression discontinuity design: comparing firms just above the eligibility cutoff (with more than $4 million USD in average annual sales) to those below the threshold and therefore affected by the policy change. Researchers will take advantage of the administrative tax data to measure take-up of the investment tax credit, as well as impacts on tax payments, investment, sales and other firm outcomes.

Results and Policy Lessons

Project ongoing, results forthcoming.

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