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Pay for Play? Tax Credits for Paid Time Off

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Economists are increasingly coming to the recognition that the current downturn is likely to be longer and more severe than they had expected at the time the last stimulus package was approved in February.[1] As a result, there is likely to be interest in additional stimulus in order to boost the economy and lower the unemployment rate.

This paper briefly outlines a method for Congress to quickly boost demand in the economy, while at the same time promoting important public ends: an employer tax credit for paid time off. This paid time off can take the form of paid family leave, paid sick days, paid vacation, or a shorter workweek. This tax credit can both provide short-term stimulus and also provide an incentive to restructure workplaces in ways that are more family friendly. It is possible that many workplaces may leave in place changes made to take advantage of this tax credit even after it has expired.

The Mechanics of a Tax Credit for Paid Time Off

The paid time off tax credit would give employers a tax credit for providing paid time off to workers of any type. The paid time off can take the form of paid family leave, paid sick days, paid vacations, shorter standard workweeks, or some combination. The amount for a credit should be a modest, but still enough to cover a substantial period of paid time off for typical workers.

A tax credit of up $2,500 per worker could cover a substantial period of paid time off for most workers. This would be sufficient to cover approximately 125 hours of compensation for a median wage earner, a bit more than 6 percent of the time of a worker employed for 2000 hours a year.[2] The credit should also be limited to not cover more than 10 percent of a worker's time in the interest of equity and to limit the opportunities for gaming. (The credit can also be limited by employer size, although the more firms who are eligible, the more stimulus it could provide.)

Not all employers will opt to take advantage of this tax credit, since it will require some restructuring of work arrangements. However, many employers will see it as an opportunity to provide valuable benefits to workers at little or no cost to themselves. If a substantial number of employers opt to take

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advantage of this tax credit, then the impact on employment could be dramatic.

The arithmetic on this is very straightforward. Suppose employers of 50 million workers reduced work time by 5 percent. Demand would be little changed, since most workers are still getting paid the same in spite of their shorter hours. With workers putting in 5 percent fewer hours, and demand unchanged, employers should want to hire roughly 5 percent more workers, or 2.5 million workers.

In addition, there will be a second round effect from the increased employment. Assuming that the net increase in wages is roughly equal to the money paid out for the tax credit, if the government pays out $125 billion (50 million workers at $2,500 each), then the wage bill will increase by $125 billion as a result of this policy. If workers spend 50 percent of this money on domestic products, this would lead to roughly $65 billion in additional demand. This would translate into an additional 500,000 jobs, for a total increase in employment of 3.0 million workers.[3]

The net cost per job on this policy ends up being considerably lower than other forms of stimulus. If the stimulus increases GDP by $190 billion (as discussed above), then this should lead to an increase in tax revenue and reduction of transfer payments (e.g. unemployment insurance) of approximately 25 percent of this amount, or $47 billion. This leaves a net cost of $78 billion ($125 billion minus $47 billion).

If the policy creates 3 million jobs at a cost of $78 billion, then the net cost per job is $26,000. This compares very well with other forms of stimulus being considered.

A paid time off tax credit also has the advantage that it can take effect almost immediately and would require very little bureaucracy or oversight. Direct government spending, for example on health care or infrastructure, directly increases employment and provides a boost to the economy. However, President Obama's stimulus package has already pressed the limits in expanding many areas of government services. It would not be easy to substantially increase spending beyond the amounts appropriated in the last stimulus.

By contrast, employers would have an incentive to move quickly to take advantage of a time-limited paid time off tax credit, since they would benefit more the sooner they acted. The enforcement should be relatively easy, since the government can require a public posting on the Internet for all employers who take advantage of the tax credit. This would mean that they would have to identify the paid time off that they were giving to workers.

The employees of any company receiving the credit would know whether they were getting the benefit indicated. In other words, if the employer claimed to be giving workers paid family leave, workers would know whether or not they were getting paid leave. Presumably workers would report employers that wrongly claimed the tax credit. This should substantially reduce the risk that employers would defraud the government.

Possible Long-term Benefits of the a Paid Time Off tax Credit

Labor practices in the United States have diverged sharply from those in other wealthy countries over the last three decades. While other countries have passed laws requiring that workers get several weeks of paid vacation each year, in addition to paid family leave and paid sick days, workers in the

United States have no such legal guarantees. Tens of millions of workers have no paid time off whatsoever.

A government tax credit that largely covers the cost for paid time off will allow employers to experiment with alternative work arrangements. While any tax credit will presumably be temporary (2 years would be a reasonable target, given the severity of the downturn), if the new arrangements prove better for workers and employers then many employers will opt to keep them even after the tax credit has expired. In this way, the tax credit may go far towards making benefits like paid family leave or paid sick days universal and moving the United States towards a shorter work year.

There have been examples in other countries that suggest that this sort of tax credit could lead to effective experimentation in work relations with lasting benefits. For example, the Netherlands reduced the standard workweek in the health care sector by 10 percent and found that it helped alleviate shortages of nurses. With a shorter standard workweek, nursing became a more desirable profession, attracting more workers. In this case, the increase in the number of workers more than offset the reduction in hours per worker. There could be similar experiences in many sectors in the United States.

Government policy in this area is especially appropriate since government policy has played an important role in pushing in the opposite direction. The vast majority of workers receive their health care insurance through their employer. Because health care insurance is typically paid as a per worker benefit (rather than a per hour benefit), employers have an incentive to try to get the most work out of each worker, rather than hiring more workers.

This pattern of health insurance provision is a direct outgrowth of a series of government policies beginning with wage controls in World War II and including the tax deductibility of employer provided health insurance. A paid time off tax credit would at least temporarily provide an offsetting incentive to push hours per worker in the opposite direction.

Conclusion

At this point, few people in Congress are actively discussing further stimulus. Of course, Congress has underestimated the severity of this downturn all along, passing a stimulus package in 2008 that everyone now concedes was inadequate. This will soon be the case with the more recent package. When Congress again realizes its mistake, there may be interest in a paid time off tax credit as the quickest and best way to get the economy back to full employment.

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[1] See Baker, Dean. 2009. "The Housing Crash Recession and the Case for a Third Stimulus," Center for Economic and Policy Research Briefing Paper. Available at http://www.cepr.net/documents/publications/housing-crash-recession-2009-03.pdf.

[2] The wage of the median worker in 2007 was $15.11 (Mishel,L., J. Bernstein, and H. Shierholz, *The State of Working America, 2007-2008*, Ithaca, NY: Cornell University Press, Table 3-5). If non-wage compensation is equal to 30 percent of the wage, then the hourly compensation of the median worker would be approximately $20.

[3] This applies the same rule of thumb as President Obama's economic team used in calculating the impact of their stimulus plan. They assumed that a 1.0 percent increase in GDP lead to 1 million addition jobs. A $65 billion increase in GDP would be a bit less than 0.5 percent of GDP (Romer, C. and J. Bernstein, 2009 "The Job Impact of the American Recovery and Reinvestment Plan," President's Council of Economic Advisors, available at http://otrans.3cdn.net/45593e8ecbd339d074_l3m6bt1te.pdf). Therefore, it should be expected to create approximately 500,000 additional jobs.