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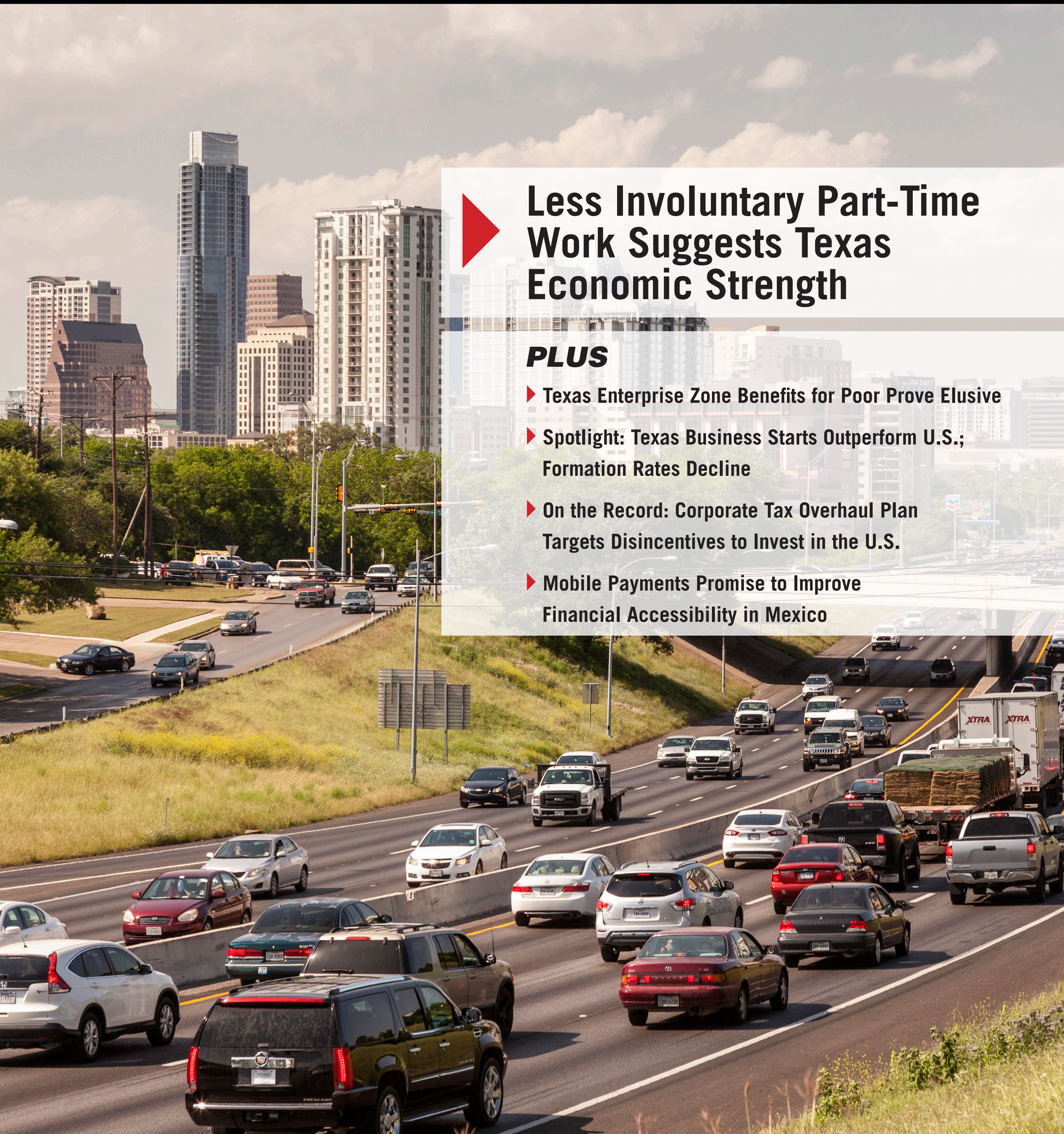
Southwest Economy



Less Involuntary Part-Time Work Suggests Texas Economic Strength

PLUS

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The Federal Reserve has a "dual mandate" of achieving full employment as well as price stability. Regarding our full employment objective, the U.S. economy has made good progress since the Great Recession, with the unemployment rate now standing at 4.9 percent.

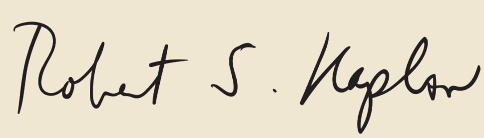
In the Eleventh District, we all know the economy has faced headwinds from weak energy prices as well as a stronger dollar. Despite these challenges, the Texas unemployment rate, as well as other measures of labor market slack, have remained below those of the nation. In this issue of *Southwest Economy*, Anil Kumar and Michael Weiss write about the reasons for this in their article, "Less Involuntary Part-Time Work Suggests Texas Economic Strength." They argue that involuntary part-time employment—the number of people settling for part-time work while wanting full-time employment—is lower in Texas than in the rest of the nation largely due to more flexible labor markets and less regulation, factors that have contributed to a greater relative availability of full-time positions.

While Texas has generally had a hands-off policy regarding state labor markets, it has created targeted exceptions. One example is the Texas Enterprise Zone program, which funnels tax breaks to businesses in economically challenged areas in order to spur greater economic development and job growth. While studies suggest that enterprise zone programs spur job creation, their impact on the financial health of residents is less clear.

Our research is critical to helping the Federal Reserve better understand labor markets and underlying economic conditions so we can more effectively achieve our dual-mandate objectives.

In their article, "Texas Enterprise Zone Benefits for Poor Prove Elusive," Wenhua Di and Daniel Millimet examine the program's impact on financial health of residents in and around designated zones. They find that this program tends to improve the ability of residents to repay retail loans, while increasing the incidence of mortgage delinquencies and bankruptcy filings. Their article suggests that more could be done to examine the design and impact of this program.

As this issue of *Southwest Economy* makes clear, Dallas Fed research is intended to inform decision-making by policymakers at the local, state and federal levels. Our research is critical to helping the Federal Reserve better understand labor markets and underlying economic conditions so we can more effectively achieve our dual-mandate objectives.



Robert S. Kaplan
President and Chief Executive Officer
Federal Reserve Bank of Dallas

Texas Enterprise Zone Benefits for Poor Prove Elusive

By Wenhua Di and Daniel Millimet

ABSTRACT: The Texas Enterprise Zone Program does not appear to benefit the financial well-being of residents. An examination of the state program suggests that at best, there is a modest positive impact on the repayment of retail loans.

The Texas Enterprise Zone Program, established in the late 1980s, is intended to aid economic development and create and retain jobs in impoverished locations. Projects in designated areas receive tax breaks and other assistance intended to help businesses expand and increase employment.

Ultimately, it is expected that the additional jobs will raise household income and improve residents' financial well-being.

The actual results are mixed. One independent, academic study of the Texas Enterprise Zone Program found that in areas with a roughly 20 percent poverty rate, five to six resident jobs were added annually per designated census block group—a cluster of blocks with 600 to 3,000 people within a census tract.[1] Employment effects were greater for lower-paying jobs in construction, manufacturing, retail and wholesale trade industries. Median house values in the zones also increased, while home vacancies decreased.

Another study, written by the authors of this article, asked whether enterprise zone improvements in labor and housing markets resulted in better financial outcomes for residents.[2] It found little evidence of a beneficial effect on measures such as residents' credit scores, bankruptcy filings and consumer loan performance.

The Texas Economic Development Bank administers and monitors the state enterprise zone program, providing loans and tax incentives to communities and businesses. In the bank's annual reports, the program is said to have created 40,248 jobs and retained 219,860 jobs since 2006. Capital investment in enterprise zones by business totaled $7.3 billion in fiscal 2014 and $9 billion last year.[3]

The state's estimated subsidies—in the form of refunds of sales and use taxes—were $42.2 million in fiscal 2014 and $30.3 million last year. Support from local jurisdictions—principally municipalities and counties—provides other incentives as well as favorable rules and regulations for qualified projects.

Texas Zones and Incentives

Forty-four U.S. states have implemented enterprise zone programs. These place-based programs generally provide incentives by subsidizing distressed areas in the hope of creating jobs for residents and reducing geographical economic inequality. Place-based programs are often criticized because they can be more successful in simply moving economic activity from one locale to another rather than increasing overall economic activity.

A census block group in Texas qualifies as an enterprise zone if it has a poverty rate exceeding 20 percent in the latest decennial census.[4] In addition, areas designated as a federal empowerment zone, renewal community or enterprise community also qualify.[5] As of 2005, a census block group can also gain the designation under the program if it is located in a distressed county.[6] An amendment of the Texas Enterprise Act in 2015 added qualified military installations and facilities.[7]

The 2014–15 zone designation was based on the 2010 census (*Chart 1*). The areas in blue are in the program solely because their poverty rates exceed 20 percent.

Once a census block group is a designated enterprise zone, the local government may nominate businesses as enterprise projects for state approval. State incentives depend on the capital investment in the businesses and the number of full-time-equivalent jobs projected to be created or retained.[8] Qualifying projects are entitled to tax benefits for up to five years. The state approves a maximum of 105 projects per two-year period.

Unlike other similar state and federal programs, Texas' program does not require enterprise zone projects to locate strictly inside the boundary of a zone. This likely reduces the displacement effect but makes the program's effects harder to measure. Moreover, more jobs must be filled by economically disadvantaged individuals at projects outside the zone for those projects to qualify.[9]

Fewer than half of enterprise zone projects were located within zones; the outsiders accounted for about 29 percent of total capital investment and 48 percent of estimated total maximum tax refunds from 2004 to 2014 (*Table 1*).

Residents' Debt Behavior

Enterprise zone residents' financial well-being can be measured by consumption and debt patterns. For example, if the program brings an expectation of improved earnings, residents may increase purchases of durable goods or take out retail or credit card loans. Higher land values can increase the demand for mortgages while boosting homeowner equity.

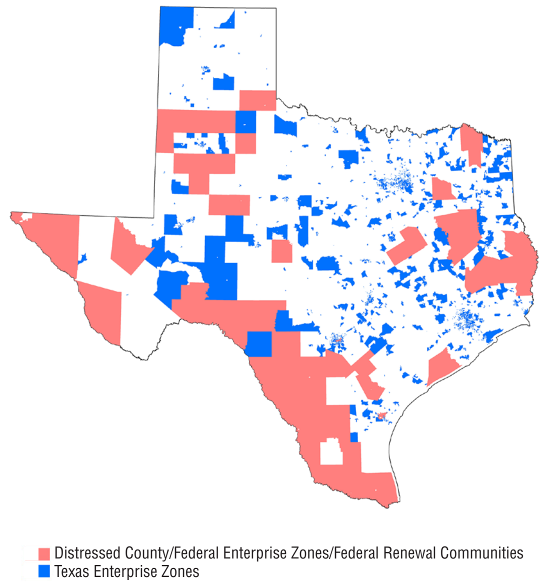
Jobs becoming available in or near the zones can alter residents' commuting situations, affecting their need for cars and car loans. And in an improving labor market, consumers are more likely to repay loans, resulting in fewer delinquencies and defaults. However, with higher incomes and more opportunities, residents may take more risk when borrowing, fail to repay loans and ultimately file for bankruptcy.

The direction and magnitude of the impact in designated enterprises zones can be assessed using data from the Federal Reserve Bank of New York Consumer Credit Panel/Equifax.[10]

Determining Program Impact

Individuals' consumer debt situations vary between areas with and without enterprise zone benefits. Differences, however, cannot all be attributed to the program. Prior to enterprise zone designation, Texas block groups in higher poverty areas contained larger shares of minority groups and smaller working-age populations. There were also lower homeownership rates, median incomes and home values (*Table 2*). Residents in these areas had lower credit scores, lower bankruptcy rates and higher delinquency rates. Residents were likely to make different consumption and debt decisions than people in less-poor areas.

Chart 1 Texas Enterprise Zones Reflect 2010 Census Data



NOTE: Zone designation for 2014–15.

SOURCES: Economic Development and Tourism Office, Texas Governor's Office; U.S. Department of Housing and Urban Development.

Table 1 Most Texas Enterprise Programs Outside Designated Areas

	Number of new projects			Capital investment by businesses		Estimated state maximum tax refund	
Year	Total	Located in zone	Number of announced new jobs	Total ($mil)	Located in zone ($mil)	Total ($mil)	Located in zone ($mil)
2004	41	28	4,904	2,549	2,108	11.8	8.5
2005	23	10	4,831	3,364	1,139	15.0	7.6
2006	44	20	8,717	3,779	661	19.1	10.8
2007	15	11	3,097	387	249	5.9	4.2
2008	36	15	7,746	2,277	752	15.0	5.2
2009	53	20	5,322	3,496	823	12.4	3.7
2010	70	26	6,167	13,557	1,847	13.6	8.3
2011	38	20	3,473	5,633	1,270	10.7	3.7
2012	38	13	2,286	5,858	2,028	9.4	4.6
2013	56	25	1,920	5,532	744	10.0	3.7
2014	48	24	3,087	7,283	4,193	23.1	9.5
Total	**462**	**212**	**51,550**	**53,714**	**15,815**	**146**	**70**

NOTE: It is unclear whether the state ensures that the number of announced new jobs are created and filled according to the guidelines.

SOURCES: Economic Development and Tourism Office, Texas Governor's Office; authors' calculations.

Table 2
Selected Census Block Group Characteristics in Texas

	Block groups with poverty rate between 18% and 22%		All block groups	
	Enterprise zones	Non-enterprise zones	Enterprise zones	Non-enterprise zones
2000 block group demographics				
Poverty rate (%)	20.9	19.0	30.8	7.8
Average population	1,659	1,632	1,653	2,171
White (%)	58.5	61.7	49.8	76.8
Black (%)	17.3	17.4	25.4	9.2
Hispanic (%)	39.7	32.7	42.3	18.5
Age 18–64 (%)	61.6	61.5	61.2	63.3
Owner occupied (%)	47.6	51.1	41.2	66.4
Renter occupied (%)	43.3	39.3	48.9	26.9
Median household income ($)	30,909	32,268	25,260	53,989
Median value of housing units ($)	59,563	62,700	53,492	107,098
2002 consumer finance measures				
Median Equifax risk score	625	631	611	675
Average Chapter 7 bankruptcy (%)	2.4	2.8	2.1	3.2
Average Chapter13 bankruptcy (%)	1.3	1.7	1.4	1.9
Average auto balance delinquent (%)	4.9	4.8	5.4	3.3
Average credit card balance delinquent (%)	22.1	21.7	25.6	15.2
Average mortgage balance delinquent (%)	8.3	7.4	9.4	5.8
Average retail loan balance delinquent (%)	37.5	35.2	40.3	31.1

NOTES: Data are weighted by number of individuals in the block group. There were 3,012 enterprise zones and 8,678 non-enterprise zones in all block groups in Texas and 445 enterprise zones and 555 non-enterprise zones in block groups with poverty rates between 18 percent and 22 percent. Chapter 7 eliminates unsecured debts; Chapter 13 reorganizes debts into a repayment plan.

SOURCES: 2000 census; Federal Reserve Bank of New York Consumer Credit Panel/Equifax.

If the program simply relocates existing economic activity from nearby areas to the zone, the spillover effect is negative—the improvement in the zone is offset by the loss in nearby areas.

Assessing zones and non-zones that are otherwise similar helps show how regions respond to the program's incentives. For example, consider two block groups prior to the designation of one as an enterprise zone. The poverty rate in one is just above the 20 percent poverty threshold; the other just below.[11] Demographics and consumer debt behaviors were similar prior to the zone designation.

Enterprise zones are supposed to improve conditions for residents. The comparison between areas with and without enterprise zones that are within a small window of the poverty threshold shows that improvement may not result.

From 2002 (prior to zone designation) to 2006 (before the economic downturn), mortgage and retail borrowing, Chapter 13 bankruptcy filings and auto loan delinquencies increased more in the census block groups with enterprise zones than those without them (*Table 3*).[12] A possible explanation is that personal earnings cannot keep up with the increase in financial demands or transportation needs among low-income workers in the zones who take new jobs.

Retail borrowing increased in enterprise zone areas when the comparison was extended to 2009. Retail loan delinquencies decreased but mortgage delinquencies increased in areas that qualified for enterprise zone designation. There was little difference between zones and non-zones in other measures, such as median Equifax risk score, Chapter 7 bankruptcy filings, number of borrowers and credit card performance.

Place-based programs such as the Texas Enterprise Zone Program can affect surrounding areas in various ways. If the program simply relocates existing economic activity from nearby areas to the zone, the spillover effect is negative—the improvement in the zone is offset by the loss in nearby areas.

Table 3
Texas Program Affects Resident Debt Behaviors Little; Minimal Impact Detected Before, After Recession

	Changes between 2002 and 2006	Changes between 2002 and 2009
Median Equifax risk score	0	0
Chapter 7 bankruptcy (pct. point change)	0	0
Chapter 13 bankruptcy (pct. point change)	1	0
Auto loans		
Balance delinquent (pct. point change)	3	0
Median balance ($)	0	0
Credit cards		
Balance delinquent (pct. point change)	0	0
Median balance ($)	0	0
Mortgage loans		
Balance delinquent (pct. point change)	0	9.7
Median balance ($)	255	0
Retail loans		
Balance delinquent (pct. point change)	0	–11.4
Median balance ($)	3	3

NOTES: Chapter 7 eliminates unsecured debts; Chapter 13 reorganizes debts into a repayment plan.
SOURCES: Federal Reserve Bank of New York Consumer Credit Panel/Equifax; authors' calculations.

If the program also improves the well-being of those living nearby but outside the target area, the spillover effect is positive. For example, workers commute from other places and still gain from the tax incentives, or economic activity improves near the zones because of the positive changes in the zones.

Taking out block groups adjacent to the zones in the comparison yields more Chapter 13 bankruptcy filings and improvement in retail loan performance in the zones, a mixed spillover effect.

Rethinking Place-Based Policies

Despite the long history of place-based policies playing a prominent role in regional economic development, the impact of such policies on welfare depends on their effects on investment and employment growth as well as labor mobility and the cost of living.

Consumer finance aspects of these policies have long been overlooked but represent an important measure of individual financial well-being and, thus, provide an additional measure of program effectiveness.

The Texas Enterprise Zone Program appears to have modestly improved residents' repayment of retail loans, though there is an increase in mortgage delinquencies and Chapter 13 bankruptcy filings in enterprise zones that just meet the zone designation threshold. There is no evidence of overall improvement in the financial well-being of the residents of targeted locations.

Even if jobs and wages increase, the additional economic activity increases land values where housing supply is limited, benefiting businesses and landowners who don't necessarily reside in the zones.

Di is a senior research economist in the Research Department of the Federal Reserve Bank of Dallas. Millimet is a professor in the Department of Economics at Southern Methodist University and was a visiting scholar at the Federal Reserve Bank of Dallas during this research.

Notes

[1] "Targeted Business Incentives and Local Labor Markets," by Matthew Freeman, *Journal of Human Resources*, vol. 48, no. 2, 2013, pp. 311–44.

[2] "Targeted Business Incentives and the Debt Behavior of Households," by Wenhua Di and Daniel Millimet, Federal Reserve Bank of Dallas, Working Paper no. 1602, 2016. Also, in *Empirical Economics* (forthcoming).

[3] Based on Texas Economic Development Bank Reports for fiscal 2015 and 2014, https://texaswideopenforbusiness.com/sites/default/files/bank_annual_report_fy2015.pdf and https://texaswideopenforbusiness.com/sites/default/files/bank_annual_report_fy2014.pdf. Fiscal years are the 12-month periods ended Aug. 31.

[4] The amendment of the Texas Enterprise Act in 2003 defined most of the zone designation rules in use. For more details, see Texas State Government Code, Title 10, Subtitle G, Chapter 2303, www.statutes.legis.state.tx.us/Docs/GV/htm/GV.2303.htm.

[5] The federal government introduced the empowerment zone, renewal community and enterprise community designations in 1993. The three are no longer in effect, though they affected the designation of earlier Texas enterprise zones. Enterprise community designations expired in 2004, while renewal community designations expired at year-end 2009. Empowerment zone designations received several extensions during the Great Recession but were allowed to expire on Dec. 31, 2014. For a Q&A on the tax incentives, see: http://portal.hud.gov/hudportal/documents/huddoc?id=19170_taxincentivesqa.pdf.

[6] A county is identified as distressed on an annual basis if its poverty rate exceeds 15.4 percent, more than 25.4 percent of the population has less than a high school education and the unemployment rate exceeds 4.9 percent in each of the five preceding years.

[7] The Defense Base Development Authorities are defined in Local Government Code, Title 12, Subtitle A, Chapter 379B, www.statutes.legis.state.tx.us/Docs/LG/htm/LG.379B.htm.

[8] The annual Texas state incentive schedule for enterprise projects is available at https://texaswideopenforbusiness.com/services/tax-incentives.

[9] See the definition for "economically disadvantaged individual" in Government Code, Title 10, Subtitle G, Sec 2303.402 (c), www.statutes.legis.state.tx.us/Docs/GV/htm/GV.2303.htm.

[10] The Federal Reserve Bank of New York Consumer Credit Panel/Equifax is a quarterly dataset that follows a representative sample of individuals with a credit report and Social Security number.

[11] Neither municipalities nor counties could manipulate the designation based on the single poverty threshold from the decennial census prior to the designation.

[12] Federal zones, or "distressed counties," are excluded from the comparison because of different qualification criteria. Chapter 7 eliminates unsecured debts; Chapter 13 reorganizes debts into a repayment plan.

Texas Business Starts Outperform U.S.; Formation Rates Decline

By Jack Wang and Michael Weiss

Small firms don't create the bulk of net new jobs, but young firms do. Thus, business formation is a closely watched gauge of economic health and future growth.[1]

Despite the attention given to start-ups and entrepreneurism, particularly in the high-tech sector, overall rates of business formation in the economy have been trending lower since the late 1970s. This pattern has also held in Texas, despite higher rates of overall activity here.

New businesses are important because they help fuel long-term economic growth. Businesses with fewer than 100 workers employed 32 percent of all workers in Texas in 2013 and play an outsized role in the development of new industry in the state, according to a recent study commissioned by the Texas governor's office.[2]

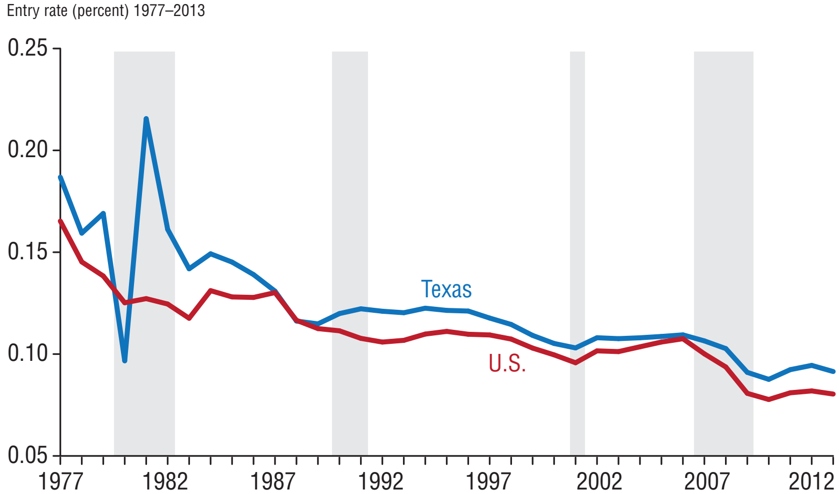
Annual firm entry rates illustrate the slipping rate of business formation nationally and in Texas (*see Chart 1*). The entry rate is the proportion of new firms less than 1 year old relative to the total.

Texas' entry rate has consistently exceeded the U.S. rate, except during years of sharp oil price declines in the early and late 1980s. The energy sector's share of the state economy was 19 percent at its peak, which meant oil busts wreaked havoc on the region's growth.

The state has diversified since 1990—dropping oil's share of gross domestic product to 14 percent in 2014 during the shale boom—with expanding high technology, business and financial services and transportation and logistics sectors making Texas economy more like that of the U.S.

Nonetheless, Texas provides a particularly welcoming business environment. The Vancouver, Canada-based Fraser Institute ranked Texas fifth among states and provinces in North America in terms of economic freedom—"the ability of individuals to act in the economic sphere free of undue restrictions."

Chart 1 Firm Entry Rate Trends Lower for Texas and the U.S.



NOTE: Shaded areas indicate U.S. recessions.
SOURCES: Census Bureau Business Dynamics Statistics; authors' calculations.

Texas secured second place for its business climate in the 2016 CNBC Global CFO Council measure of top states for business. It won top 10 grades for its economy, infrastructure, access to capital and workforce. Its worst grade was for education, ranking 40th.

The average annual firm entry rate for Texas was 14.1 percent from 1980 to 1989, falling to 11.9 percent in 1990–99, 10.5 percent in 2000–09 and 9.1 percent in 2013, the most recent year for which figures are available. Texas shared a falling rate of business formation with each of the other 49 states.[3]

The reasons for the decline are not known, but the same factors that contribute to large-scale business consolidation are the ones that benefit large, established firms and harm small, young enterprise. Retail trade is a powerful example—the replacement of mom-and-pop stores with single "big box" retailers, such as Walmart or Home Depot.

Technological advancement and increased globalization create economies of scale advantages for bigger, established companies that can more easily manage worldwide supply chains and shift resources in the face of adversity than start-ups. Increased regulation also helps drive up the costs of starting and running a business.[4]

To be sure, although the business formation rate has declined, the actual number of newly registered businesses in Texas has grown, increasing at a 4.6 percent annual rate from 2004 to 2015, according to the Texas secretary of state.

Notes

[1] "Who Creates Jobs? Small vs. Large vs. Young," by John C. Haltiwanger, Ron S. Jarmin and Javier Miranda, National Bureau of Economic Research, Working Paper no. 16300, August 2010.

[2] "Small Businesses and Their Impact on Texas," by Thomas Tunstall, Javier Oyakawa, Hisham Eid and Amanda Martinez, Center for Community and Business Research, University of Texas at San Antonio, April 2016.

[3] "Declining Business Dynamism in the United States: A Look at States and Metros," by Ian Hathaway and Robert E. Litan, *Economic Studies*, The Brookings Institution, May 2014.

[4] "The Role of Entrepreneurship in U.S. Job Creation and Economic Dynamism," by Ryan Decker, John Haltiwanger, Ron Jarmin and Javier Miranda, *The Journal of Economic Perspectives*, vol. 28, no. 3, 2014, pp. 3–24.

A Conversation with Alan D. Viard

Corporate Tax Overhaul Plan Targets Disincentives to Invest in the U.S.

Alan D. Viard is a resident scholar at the American Enterprise Institute, a nonprofit research organization, and an expert on tax policy. He outlines his plan, developed with Eric Toder of the Urban Institute, for revising the tax code to make it less attractive for U.S. companies to shelter profits abroad.

Q. Why reform the U.S. corporate tax system?

The corporate income tax, in interaction with the individual income tax, has long-standing problems that would apply even if the U.S. economy were closed to international trade and investment. It penalizes equity-financed corporate investment relative to both debt-financed corporate investment and investment by flow-through business structures (such as sole proprietorships, partnerships, limited liability corporations and S corporations).

Corporate equity-financed corporate investments are penalized because their returns are taxed twice, with the corporation paying corporate income tax and the shareholders paying dividend and capital gains taxes. By comparison, interest income and income from flow-through businesses are taxed only once at the bondholder or business-owner level.

However, the corporate income tax has more serious shortcomings in today's globalized economy.

First, the corporate income tax discourages corporations from investing and booking profits in the United States. Foreign-chartered corporations pay U.S. corporate income tax on their U.S. profits, but not on their foreign profits. U.S.-chartered corporations immediately pay U.S. corporate income tax on their U.S. profits. They pay tax on their foreign profits only when the profits are brought back to the United States as dividends, and they are allowed to claim a credit for any foreign income taxes paid on the profits.

The U.S. tax system, therefore, gives both types of corporations an incentive to invest and book profits abroad rather than in the United States. By encouraging investment outside the United States, the corporate income tax reduces the U.S. capital stock, making workers less productive and driving down their wages.

Second, the corporate income tax discourages the use of U.S.-chartered corporations to invest abroad. As noted before, only U.S.-chartered corporations pay U.S. corporate income tax on their foreign profits. The U.S. tax system, therefore, creates an incentive to invest abroad through foreign-chartered rather than U.S.-chartered corporations.

Corporations have wide flexibility to act on the current tax system's perverse incentives, as they easily change where they book their profits and where they are chartered. For example, corporations can use a variety of accounting gimmicks to book profits abroad, and they can use "inversion" transactions to effectively swap a U.S. charter for a foreign charter.

Q. What are the limitations of the leading corporate tax reform proposals now being considered?

Although the leading proposals mitigate some of the current tax system's problems, they aggravate other problems.

For example, some proposals call for higher taxes on the foreign profits of U.S.-chartered corporations. That would reduce the incentive for U.S.-chartered corporations to invest and book profits abroad. But it would not change the incentive for foreign-chartered corporations to do so and it would increase the incentive to do foreign investment through foreign-chartered corporations.

Other proposals go in the opposite direction, calling for lower taxes on the foreign profits of U.S.-chartered corporations. That would reduce the incentive to do foreign investment through foreign-chartered corporations. But it would increase the incentive for U.S.-chartered corporations to invest and book profits abroad.

Trade-offs are unavoidable so long as the tax system gives such large weight to where profits are booked and where corporations are chartered.

Q. What is your plan and how would it solve the problems of the current system?

The plan would reduce the federal corporate tax rate from 35 percent to 15 percent. To ensure that the shareholders who receive corporate income continue to bear their fair share of the U.S. tax burden, the plan would increase the taxes collected from American shareholders.

American individual shareholders of publicly traded companies would be taxed on their dividends and capital gains at ordinary income tax rates (with a top rate of 43.4 percent) rather than the current preferential rates (with a top rate of 23.8 percent). Also, accrued capital gains would be taxed, and accrued capital losses would be deducted, each year as stock values rise and fall, even if the stock is not sold.

American individual shareholders would be allowed to claim credit against their taxes for their share of the corporate income taxes paid by the companies whose stocks they own. No similar credit would be provided to foreign shareholders or to nonprofit organizations and pension and retirement plans holding corporate stock.

The plan would dramatically reduce corporate income taxes, which are

> Trade-offs are unavoidable so long as the tax system gives such large weight to where profits are booked and where corporations are chartered.

based on where profits are booked and corporations are chartered, and would increase shareholder taxes, which are based on where shareholders live.

Q. What economic benefits would your plan have?

The tax penalty on corporate equity-financed investment would be greatly reduced by lowering the corporate income tax rate and allowing American individual shareholders to claim a credit for their share of corporate taxes paid by companies.

The incentive to invest and book profits abroad would be greatly reduced because the tax rate on U.S. profits would be 15 percent rather than 35 percent. The inflow of investment into the U.S. would expand the U.S. capital stock.

The incentive to do foreign investment through foreign-chartered corporations would be largely eliminated. U.S.-chartered corporations would owe little or no U.S. corporate income tax on their foreign profits because the U.S. tax rate would be reduced to 15 percent, against which they would still claim credit for foreign income taxes (which would often be larger than 15 percent of profits). U.S.-chartered corporations would therefore be much less disadvantaged relative to foreign-chartered corporations that do not pay U.S. corporate income tax on their foreign profits.

Americans owning shares of a corporation's stock would pay U.S. income tax on their dividends and accrued capital gains, regardless of where the corporation invested, booked profits or was chartered.

Q. Why doesn't the plan repeal the corporate income tax entirely, which would eliminate the problems you've discussed?

An April 2014 version of the plan repealed the corporate income tax. However, the new version maintains a 15 percent corporate income tax in order to attain revenue neutrality, providing government the same total revenue as the current system. Keeping the corporate income tax would also ensure that some U.S. tax is imposed on foreigners who hold shares in companies investing in the United States, as the foreign shareholders would bear part of the burden of the companies' corporate income tax payments and, unlike American shareholders, would not be allowed to claim a credit for those tax payments.

Q. Your plan would tax capital gains as they accrue, even if the shares had not been sold. How would shareholders pay tax on income they haven't realized?

Gains and losses on corporate stock would be averaged over many years, thereby protecting shareholders from facing large tax liabilities in any particular year. In most cases, shareholders should be able to pay their tax liabilities from dividends and other income, without selling any of their shares.

Also, the plan would exempt from tax the first $500 ($1,000 for married couples) of dividends and accrued capital gains each year, thereby helping small shareholders avoid potential problems posed by accrual taxation.

Q. How would your plan affect government revenue? How would the plan affect the taxes paid by various income groups?

Estimates by the Urban-Brookings Tax Policy Center show that the plan would be approximately revenue-neutral, after including the taxes that would be paid on the additional profits that corporations would likely be induced to book into the United States. The estimates also show that the highest-income taxpayers would pay slightly more tax than they do today and that all other income groups would pay slightly less tax.

Q. Won't moving the bulk of the tax burden from corporations onto individual shareholders be politically unpopular?

In reality, the plan moves tax collection, not tax burdens, from corporations to shareholders. Tax burdens can be borne only by people, not corporations and other artificial entities. The taxes now collected from corporations are presumably intended to impose a tax burden on the shareholders who own the corporations. Why not pursue that goal more openly by directly collecting the tax from shareholders, particularly if that approach avoids creating incentives to invest, book profits and charter abroad?

The plan actually moves tax burdens from *workers* to shareholders. Because the current corporate income tax encourages companies to invest abroad, thereby reducing the U.S. capital stock and making workers less productive, part of the corporate tax burden is currently shifted to workers in the form of lower wages. In contrast, because the increased taxes collected from shareholders under our plan would not encourage companies to invest abroad, the burden of those taxes is less likely to be shifted to workers.

Nevertheless, the perceived shift of the tax burden away from corporations (and the taxation of accrued capital gains) may make the plan unpopular in many circles. We do not expect the plan to be adopted in the near term. However, we believe that Congress, the president and the public will eventually recognize that some reform of this kind is necessary.

For a more complete description of the plan, including its transition rules and other provisions, please see www.aei.org/publication/a-proposal-to-reform-the-taxation-of-corporate-income.

EDUCATION: Bilingual Programs Still Important in Texas

A total of 980,487 students—18.5 percent of Texas public schools enrollment—are not proficient in English. Texas trails only California in the number of so-called English Language Learners (ELLs), with the great majority speaking Spanish at home.

Texas requires that elementary schools with more than 20 ELLs in one grade provide bilingual programs, which include instruction in the native language at least 50 percent of the time for two to seven years. By comparison, a 1998 California referendum limited bilingual education, reducing the share of students receiving such instruction to 8 percent from 30 percent.

Texas law describes four models of bilingual education, which vary in the number of years and amount of English allowed. A 2002 study funded by the U.S. Department of Education compared programs for ELLs in the Houston Independent School District.

The study found that among secondary students, former ELL students who had always been in mainstream classes fared worse than the average student, as did ELL students who had been in English-only classes; those who were in bilingual programs performed as well as native English speakers. Top achievers were in two-way dual-language immersion programs—ELL and native English speakers taught in both Spanish and English for six to seven years. By the fifth grade, these students scored above grade level on English and Spanish tests.

—Stephanie Gullo

ENERGY: Louisiana Slips into Recession amid Oil Bust

Louisiana slipped into recession in 2015, following the oil industry bust that began with plummeting prices in 2014. Employment decreased 1.1 percent while real (inflation-adjusted) gross domestic product (GDP) growth stagnated in 2015.

Employment was down 0.2 percent through June while the unemployment rate stood at 6.2 percent in June, up from 5.8 percent in December. The Louisiana labor force is 1.4 percent smaller than at its peak in December 2014.

While service sector employment held steady last year, the goods-producing sector shrank 4.4 percent, cutting 15,000 positions during 2015. Mining (which includes the oil and gas industry) and durable goods manufacturing were hardest hit, declining faster than other industries in Louisiana. Other oil-dependent states, such as Texas and North Dakota, experienced a similar pattern of job loss. Meanwhile, Louisiana's health and education services and retail trade continued healthy growth.

Louisiana's economy was particularly exposed to the oil downturn because of its high dependency on mining and manufacturing, which at their 2014 peak made up about 30 percent of state GDP. That declined to 25.5 percent by year-end 2015. By comparison, those industries in Texas contributed 21.4 percent to state GDP last year.

—Justin Lee

TRADE: Brexit May Harm Texas Exports; Other Impacts Unclear

The United Kingdom's decision to leave the European Union won't noticeably affect the overall Texas economy, though some export activities may weaken.

The U.K. ranks 10th among Texas' trading partners—accounting for about 2 percent, or $9.1 billion, of the state's imports and exports. When the British pound depreciated against the dollar following the Brexit referendum on June 23, U.S. exports, including those from Texas, became relatively more expensive. Imports from the U.K. grew cheaper. Transportation equipment comprises the largest share of Texas' U.K. exports, 19 percent in 2015, while machinery products made up the largest share of imports from the U.K., according to the International Trade Administration.

U.K. investment is also important. Since 2011, U.K. investors have funded hundreds of foreign direct investment (FDI) projects in Texas, totaling $2.3 billion, according to the Texas governor's office. In a post-Brexit world, the weaker pound will increase costs of new FDI projects while boosting the value of any future revenue streams. Thus, Brexit's net effect on U.K. FDI in Texas is unclear. Of course, better relative growth prospects in Texas may also encourage more investment.

Ultimately, commerce and investment effects will also depend on the nature of trade agreements and the new regulatory environment in place once the U.K. officially leaves the European Union.

—Sarah Greer

Mobile Payments Promise to Improve Financial Accessibility in Mexico

By Michael Perez

ABSTRACT: Mobile phone-based financial services and other new technologies may hold the key to converting more of Mexico's "unbanked" residents, most of whom have traditionally operated outside the formal economy. Regulatory oversight of the new services is slowly evolving.

A majority of Mexican adults remain outside the country's financial system. The proportion is greatest in rural areas, where 71 percent of those 15 and older lack access to formal financial services, far exceeding figures for Mexico's Latin American peers. Mexico also trails in personal and business loan issuance, deposit rates and debit and credit card penetration (*Chart 1*).

An estimated 90 percent of transactions in Mexico are settled in cash, indicative of formal finance's poor reach in the world's 15th-largest economy.[1] A deep distrust of banks persists, which has contributed to low bank-account ownership, along with unstable employment prospects and a large informal economic sector operating outside government oversight and tax law.

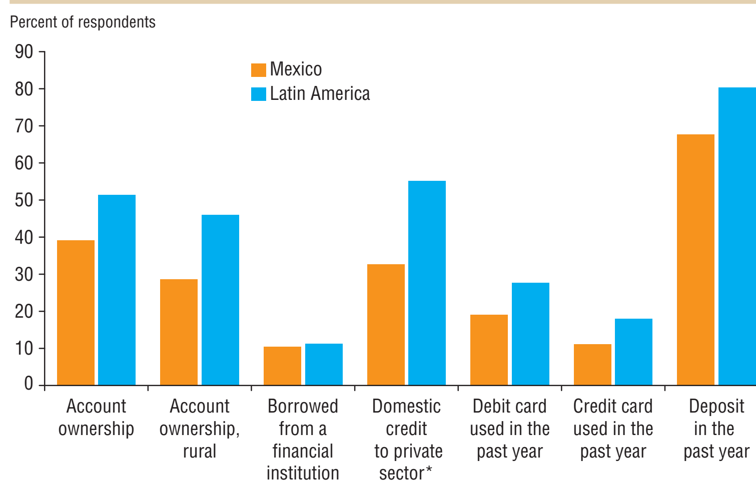
The high fees and minimum balance requirements at Mexico's commercial banks contribute to the problem. The banks also have traditionally failed to address the payment needs of low-income, unbanked populations.

Consequently, many Mexicans form communal savings and lending arrangements, known as *tandas*, though these can be expensive and unreliable.[2] Inadequate financial consumer protection laws, frequent instances of payment fraud and low levels of financial literacy also persist.[3]

The economic and commercial consequences are considerable. The most affected—small businesses and poor households—often can't take advantage of growth opportunities or absorb financial shocks.[4]

Accessible systems, via technologies such as mobile phone networks, could more widely make available savings, payment, credit and risk-management products, aiding growth and efficiency by narrowing financial in-

Chart 1 Financial Inclusion in Mexico Below Latin America Average



*"Domestic credit" depicted as percent of gross domestic product.

NOTE: Countries in Latin America are Argentina, Belize, Bolivia, Brazil, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Peru and Venezuela.

SOURCES: World Bank Global Findex 2014; International Monetary Fund, International Financial Statistics and data files; World Bank and Organization for Economic Cooperation and Development gross domestic product estimates.

frastructure gaps.[5] Such improvements would boost credit supply and investor confidence, encouraging business formation while discouraging reliance on often costly and unreliable informal alternatives.[6]

Mobile Remedy

Mexico's regulators are slowly progressing toward a more inclusive financial system. The country's banking and financial market regulator has endorsed the Maya Declaration, an initiative supported by 58 regulatory agencies around the world to encourage financial inclusion. Authorities had aimed to have a banking agent or branch in every Mexican municipality but failed to reach the goal by their original 2014 target date. Officials have since begun recalibrating objectives in light of technological advances.

Presently, there are 1,685 communities in Mexico with 10 or fewer banking access points per 10,000 people—a limited number of bank branches, ATMs and banking agents that can process client transactions.[7]

The Bank of National Savings and Financial Services, one of the nation's development banks, in 2011 recommitted to a program seeking to link rural residents to 36 formal financial institutions through technology, including mobile point-of-sale locations and mobile devices.[8] The Rural Microfinance Technical Assistance Program has served 245,000 rural clients and provided the equivalent of $114 million in loans over the five-year period ended last March.[9]

President Enrique Peña Nieto unveiled a six-point National Financial Inclusion Strategy in June that seeks to further improve financial service access and education for the unbanked. Mexico's telecommunications infrastructure and technology are central to the effort, particularly the expansion of Mexico's mobile payment network.

Mobile payments are financial technologies that facilitate delivery of payments through mobile devices and networks (*see box*). They allow users to make proximate or remote purchases from retail points-of-sale and remit funds user-to-user. Typically, payments are funded via credit or debit cards, prepaid accounts, bank accounts or a charge to consumers' mobile phone bills.

Phones serve the dual purpose of securely storing users' methods of payment and transmitting funds digitally between them. Middlemen operating between users and enterprises receive small commissions for handling cash and electronic currency.

Mobile payments improve payments process efficiency by simultaneously lowering costs and increasing security. Because mobile payments are processed online through automated systems, they require less manpower than paper checks and are usually deposited more quickly. At the same time, they use multifactor authentication and tokens, reducing the chances of fraud.

These payments reduce overall transaction time, particularly for customers in rural areas. Remote payment transfers previously required travel over long distances to designated locations such as bank branches, money transfer operators or government offices. Mobile money can be received and sent from a mobile device or dedicated cash-in/cash-out points in rural communities.[10]

The Growing Role of Financial Technology

Financial technology is the use of online, mobile and information technologies to deliver financial services. Fintechs are companies or applications that compete with commercial banks and incumbent financial institutions by making financial services quicker, cheaper and easier to use.[1] They do so by using advanced data analytics, computing power and cloud-based systems that reduce banks' role in the financial services supply chain. Examples in the U.S. include online lenders like Lending Club, crowdfunding platforms such as Kickstarter, and payment applications like Google Wallet, PayPal and Apple Pay.

In the industrialized world, Fintechs owe their success to convenience. In Mexico, the sector caters to low-income individuals and small- and medium-sized enterprises—entities traditional banks have overlooked. Remittance technologies, for example, allow users to electronically send payments anywhere in the world. Mexico receives about $25 billion in remittances annually, mostly from the U.S., particularly California and Texas.

However, traditional institutions confront high regulatory costs, largely due to anti-money-laundering measures. The average cost of sending $500 between the two countries by traditional means is $16.44.[2] However, the cost of an immediate $500 transfer through applications such as Remitly and Xoom, which aren't subject to such regulatory costs, is $3.99. For Mexicans working in the U.S., the applications lower costs and expedite the process of sending funds to family back home.

While the Fintech sector is still small, the high interconnectivity, diversity, anonymity and speed of these technologies make them cause for concern not only with regard to money laundering, but also law enforcement concerns more broadly. As a result, heightened government scrutiny, tighter regulation and increased security costs are likely in the near future. Fintech startups, lacking the resources to meet such compliance costs, could be particularly affected.

Mexico's regulatory authorities have yet to reveal plans for Fintech, though the finance ministry has indicated that a regulatory regime is in development.

Notes

[1] See "The FinTech Opportunity," by Thomas Philippon, National Bureau of Economic Research, NBER Working Paper no. 22476, August 2016.

[2] See Remittance Prices Worldwide data, World Bank, https://www.remittanceprices.worldbank.org.

More fundamentally, mobile payments cultivate financial inclusion and reduce reliance on informal arrangements. To that end, impoverished families taking part in *Prospera*, a government welfare program that provides mobile payments, rely less on *tandas*. Moreover, they are more likely to receive remittances and use their own savings to cope with financial stresses instead of taking out emergency loans or reducing consumption.[11]

Digital payments create opportunities for the unbanked to use automatic deposits, schedule text reminders and build emergency savings. Small "nudges," such as text-message reminders to save, may push households toward formal finance and away from informal alternatives.[12] Over time, greater use of traditional banking products can strengthen the financial system by, for example, enabling credit scoring based on broader payment and income histories than were previously available.

Despite its promise, mobile money faces significant barriers. Finance and telecommunications sectors have different priorities and objectives, making large-scale mobile payments a tricky and expensive exercise. One immediate challenge is the physical infrastructure necessary to process digital transfers.

Mobile phone subscriptions in Mexico have hovered around 85 per 100 Mexican residents, and prices have decreased 42 percent since the signing of telecommunications reform in June 2013 (*Charts 2 and 3*). But the country's service levels trail those of its Latin American peers. Even widespread mobile use by itself is an insufficient mobile banking catalyst.

Development of Mexico's mobile payment infrastructure involves numerous parties broadening poorer households' access to financial services, such as cash-in/cash-out points, and ensuring the ability of cash middlemen to maintain system liquidity. There are also significant challenges specific to rural areas. These include lack of electricity with which to power mobile phones and cell towers, limitations in mobile network coverage, and poor roads and transport networks.[13]

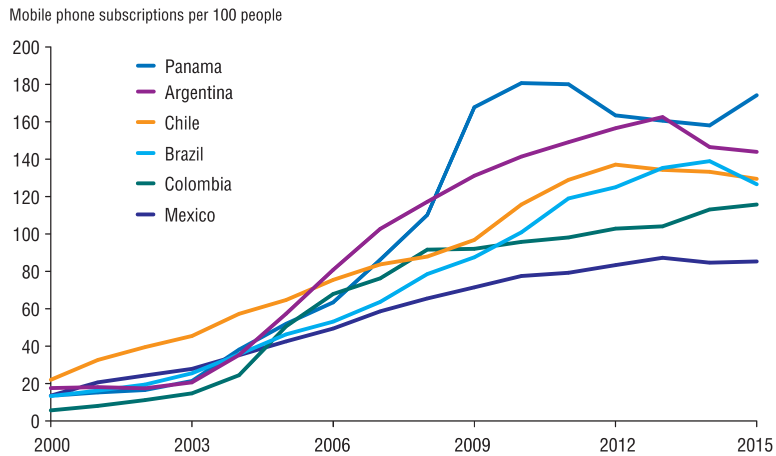
Once the network is established, its security and reliability must be sustained. Payment delays or illiquidity in agent networks can weaken an electronic transfer program by diminishing consumer trust. A reliable payment system requires not only safeguards against fraud and cyberattacks, but also contingency plans to ensure operation in an emergency.

Financial education is another concern. Users must feel comfortable and understand what recourse they have if something goes wrong. Understanding the basics of financial technology systems—PINs, cash-in/cash-out stations, ATMs and mobile applications—is important.[14]

Regulatory Scope

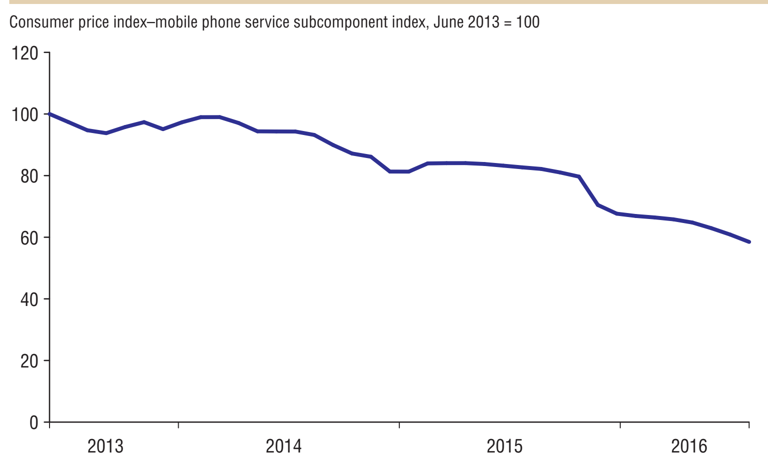
Mexico's government will have a significant role in mobile payment plan development. New regulations will need to balance innovation and consumer protection while also allowing the private sector room to create

Chart 2 Mexico's Mobile Subscriptions Rise, Still Lag Latin American Peers



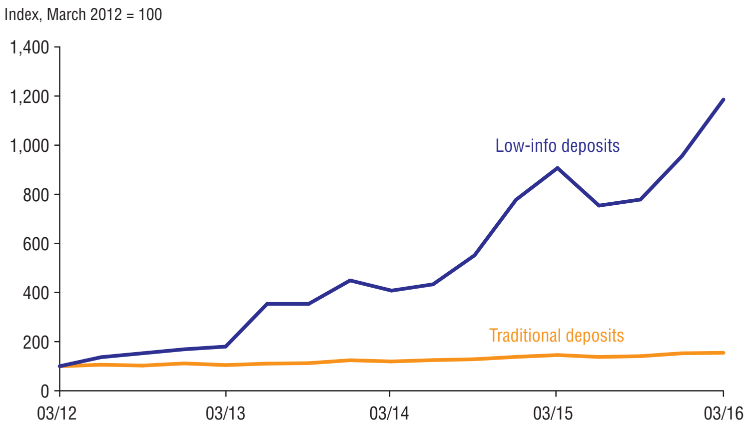
SOURCE: International Telecommunication Union.

Chart 3 Mexico's Telecom Reform Reduces Cost of Service



SOURCE: National Institute of Statistics and Geography (Instituto Nacional de Estadística y Geografía).

Chart 4 'Know Your Customer' Rules Aid Account Deposit Growth



SOURCE: National Banking and Securities Commission.

new products. And government agencies will need to coordinate with one another, especially across complementary sectors such as financial services and telecommunications, to ensure system stability.

Particular attention must be paid to money-laundering and identity-theft rules. Mexican regulators in 2011 implemented progressive "know your customer" requirements governing customers opening accounts and documentation requirements. The rules apply to commercial banks, insurance companies, remittance services and foreign-exchange houses. The rules restrict the size of account balances, the cumulative value of transactions and/or the channels to access funds for "low-information clients"—those without the background information or documentation necessary to open a traditional, unrestricted account.

As client information accumulates, the restrictions become less stringent. Under the plan, the number of low-information, low-value, peso-denominated accounts have markedly grown, along with their balances (*Chart 4*). Furthermore, biometric identification improvements have helped overcome difficulties with PIN and password-authentication methods. Adoption of new technologies has helped ensure the validity and taken the anonymity out of mobile payments.

Cash Preference

A large proportion of Mexico's population remains unbanked, but recent trends suggest that private and public sector efforts to encourage mobile payment networks are helping the country improve financial inclusion.

Many challenges remain, particularly as regulators and developers of the new systems work to ensure their sustainability and overcome a preference among the unbanked for traditional cash payments.

Perez is a financial industry analyst in the Financial Industry Studies Department at the Federal Reserve Bank of Dallas.

Notes

[1] See "Cash Outlook: Mexico," by Elisabeth Burgess et al., IBGC Working Paper no. 13-02, The Fletcher School, Tufts University, September 2013.

[2] See "Social Service Delivery and Access to Financial Innovation: The Impact of Oportunidades' Electronic Payment System in Mexico," by Serena Masino and Miguel Niño-Zarazúa, United Nations University, UNU-WIDER Working Paper 2014/034, 2014.

[3] See note 1.

[4] See "Measuring Financial Inclusion: Explaining Variation in Use of Financial Services Across and Within Countries," by Asli Demirguc-Kunt and Leora Klapper, Brookings Papers on Economic Activity, Spring 2013.

[5] See "ICT, Financial Inclusion, and Growth: Evidence from African Countries," by Mihasonirina Andrianaivo and Kangni Kpodar, International Monetary Fund, Working Paper no. 11/73, April 2011.

[6] See "A Study on the Effect of Financial Inclusion on the Relationship Between Income Inequality and Economic Growth," by Jong-Hee Kim, *Emerging Markets Finance and Trade*, vol. 52, no. 2, 2016, pp. 498–512.

[7] See "The Maya Declaration: Celebrating Five Years of Advancing Global Financial Inclusion," Alliance for Financial Inclusion, www.afi-global.org/sites/default/files/publications/2016-08/2016%20Maya%20Progress%20Report-2.pdf.

[8] Mexico's development banks are publicly owned institutions that serve economic sectors not normally reached by commercial banks. They are required to promote economic development in their areas of specialization, which include small and medium-sized enterprises, low-income households and housing development.

[9] See "PATMIR III," World Council of Credit Unions, www.woccu.org.mx/esp/index_esp.php?id_menu=22.

[10] See "Payment Mechanisms and Anti-Poverty Programs: Evidence from a Mobile Money Cash Transfer Experiment in Niger," by Jenny C. Aker, Rachid Boumnijel, Amanda McClelland and Niall Tierney, Tufts University Working Paper, August 2014.

[11] See note 2.

[12] See "Getting to the Top of Mind: How Reminders Increase Saving," by Dean Karlan, Margaret McConnell, Sendhil Mullainathan and Jonathan Zinman, National Bureau of Economic Research, NBER Working Paper no. 16205, updated Oct. 28, 2014.

[13] See "The Opportunities of Digitizing Payments," by World Bank, Better Than Cash Alliance and the Bill and Melinda Gates Foundation, Aug. 28, 2014.

[14] See "Working with The Poorest Women in Pakistan," by Harry West and Rachel Lehrer, Consultive Group to Assist the Poor, Jan. 16, 2014.

Less Involuntary Part-Time Work Suggests Texas Economic Strength

By Anil Kumar and Michael Weiss

ABSTRACT: Fed policymakers have closely watched part-time workers as an indicator of labor market health. While the ranks of involuntary part-timers have remained persistently high since the Great Recession—suggesting remaining labor market slack—the pattern has been less notable in Texas.

The labor market has steadily improved, albeit slowly, since the Great Recession ended in 2009. The national unemployment rate has declined from a postrecession high of 10 percent in October 2009 to 4.9 percent in July 2016—about where it stood before the downturn.

There was less economic contraction in Texas and a stronger recovery, with the unemployment rate falling from a postrecession high of 8.4 percent in July 2009 to 4.6 percent in July 2016.

Although such recent jobless rates suggest an economy close to full employment, widespread concern remains that the readings don't adequately capture the extent of labor market weakness, or "labor market slack." Another measure, the number of involuntary part-time workers, reflects labor market stress and remains an important concern for monetary policy.

During recent press conferences, Federal Reserve Chair Janet Yellen has often referenced elevated involuntary part-time employment—workers who report that they want full-time work but can only find part-time work for economic reasons, such as lack of full-time jobs.

Part-time workers, in general, earn less per hour and experience slower wage growth than full-time workers. This wage gap with full-time workers cannot entirely be explained by skills differences.[1] A combination of lower wages and fewer hours implies that part-time workers take home smaller paychecks than full-time workers and are less likely to be eligible for employer-provided benefits such as pension and health insurance.

Many workers prefer to work part time for a variety of reasons that make part-time work an optimal choice. While those working part time by choice are happy to trade lower paychecks for more flexibility and time for leisure or child care, the existence of *involuntary* part-time workers reduces overall economic well-being.

Involuntary part-time workers do not figure into unemployment rate calculations, which are simply a tally of the percent of workers without jobs who are actively searching for employment. The involuntary part-time rate—the number of workers involuntarily working fewer than 35 hours as a percent of the labor force—has been slow to improve, indicating pervasive labor slack, researchers have found.[2]

Nationally, the involuntary part-time rate remains about 0.9 percentage points higher than at the outset of the Great Recession in December 2007. In Texas, involuntary part-time work declined sharply until the oil bust began in 2015, though it remains about 0.8 percentage points above December 2007 levels (*Chart 1*).

Measuring Labor Market Slack

There are well-known limitations to judging overall economic conditions using the headline unemployment rate. First, it does not account for discouraged workers who give up their job search and drop out of the labor force. Second, it excludes individuals marginally attached to the labor force but not engaged in a job search due to a weak economy. Thirdly, there are the involuntary part-time employees.

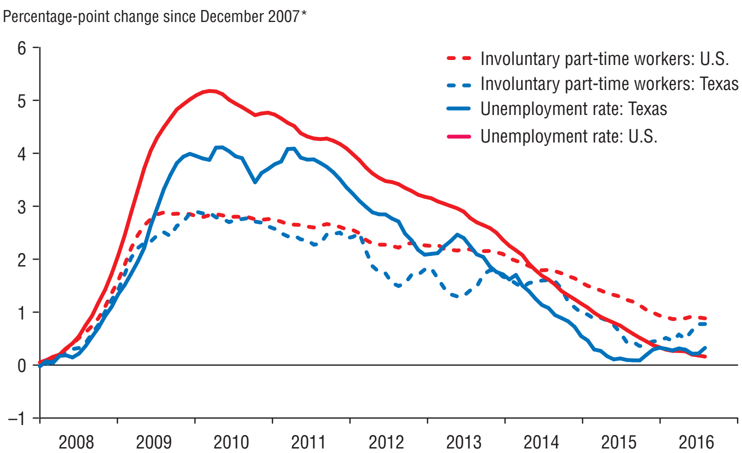
Adding these three kinds of workers to the number of "officially" unemployed, the six-month moving average of the broader national unemployment rate (also known by the Bureau of Labor Statistics (BLS) "U6 rate" designation) stood at 9.7 percent in July 2016. Reflecting a labor market that is tighter than the nation, Texas has a lower U6 unemployment rate; its six-month moving average was 8.7 percent in July 2016. However, the rate in both Texas and the nation remains above prerecession levels (*Chart 2*).

Household survey data from the BLS reveal that, starting from similar prerecession averages, involuntary part-time employment rose less sharply in Texas during the recession and improved more rapidly through the recovery for all major demographic groups.

Voluntary part-time employment, by comparison, has generally been lower in Texas, a difference that has largely remained stable since 2004.

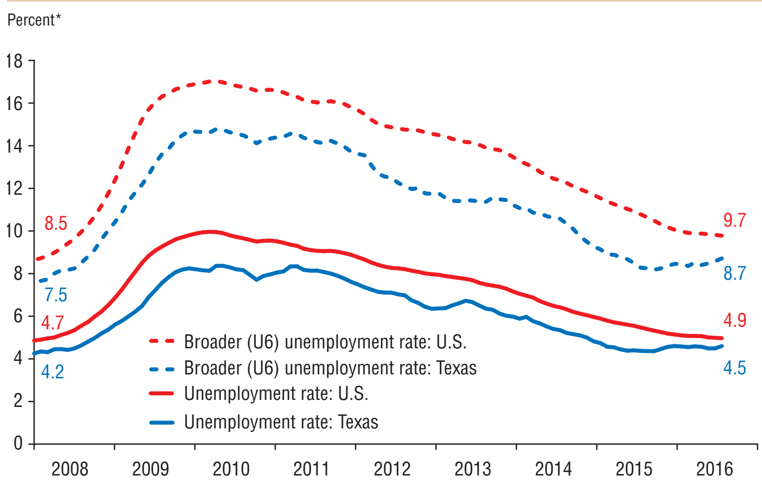
Several tendencies emerged following the Great Recession. Until 2015, the state's shale-oil boom helped support a cyclical expansion that extended well beyond the immediate energy sector. Legislative changes, most notably the Affordable Care Act (ACA), while expected to reduce employers' inclination to hire full-time workers, have had little impact so far. This may be the result of a relatively low minimum wage and substantial labor market flexibility that allows Texas employers to more easily manage compensation costs. The state's relatively light regulatory burden also likely contributed.

Chart 1 Reduction of Involuntary Part-Time Workers Trails Unemployment Rate Decline



*Seasonally adjusted, six-month moving average.
SOURCE: Bureau of Labor Statistics Current Population Survey.

Chart 2 Broad Unemployment Rate Remains Above Prerecession Levels



*Seasonally adjusted, six-month moving average.
SOURCE: Bureau of Labor Statistics Current Poplulation Survey.

Counting Part-Time Workers

On average, about 15 percent of workers in Texas worked fewer than 35 hours and, thus, were considered part-timers during the week of the BLS' household survey, between 2004 and 2007. That compared with 17 percent of workers nationally, with about 7 percent of those part-time workers holding multiple jobs (*Chart 3*).[3]

To facilitate precise comparisons between Texas and the rest of the nation, Chart 3 and subsequent charts depict household survey data from the BLS grouped into four time periods: prerecession (2004–07), recession (2008–09), recovery (2010–14) and the more recent period that includes the energy sector contraction (2015–16).

A vast majority of part-time workers opt for that employment arrangement. Not surprisingly, the incidence of such voluntary arrangement is high among women, teenagers and the elderly. Women with young children often prefer to work part time or stay out of the labor force to provide child care. Many teenagers and young adults voluntarily work part time because they are enrolled in school. Partially retired elderly or those on Social Security choose to work part time to supplement retirement income. Voluntary part-time workers are not looking for full-time work and, therefore, their presence doesn't indicate labor market slack.

Texas' smaller share of part-time employment relative to the nation largely stems from a lower incidence of voluntary part-time employment—a gap that has remained mostly stable over time, as Chart 3 shows. This gap exists primarily because fewer Texans than the rest of the nation find it optimal to work part time due to family commitments, schooling or retirement. Part of this gap may exist simply due to easier availability of full-time opportunities in Texas that make it less attractive to forego a full-time job for voluntary part-time work.

A relatively higher incidence of voluntary full-time workers (versus part-time) in Texas may also be due to the state's less-generous public assistance programs.[4] According to the Census Bureau, 1.8 percent of households in Texas received cash public assistance in 2012 compared with 2.9 percent nationally.

More stringent Medicaid requirements may also explain the lower incidence of voluntary part-time workers in Texas. Texans whose income exceeds 18 percent of the federal poverty line are ineligible for Medicaid, the federally subsidized low-income health care coverage. In most other states, recipients are allowed to earn more and retain eligibility. Thus, the availability of employer-sponsored health insurance supports full-time work in Texas.

Chart 3 also reveals that, in contrast with the stability of voluntary part-time work, involuntary part-time employment is strongly counter-cyclical, rising during recessions and declining when the economy regains its footing.

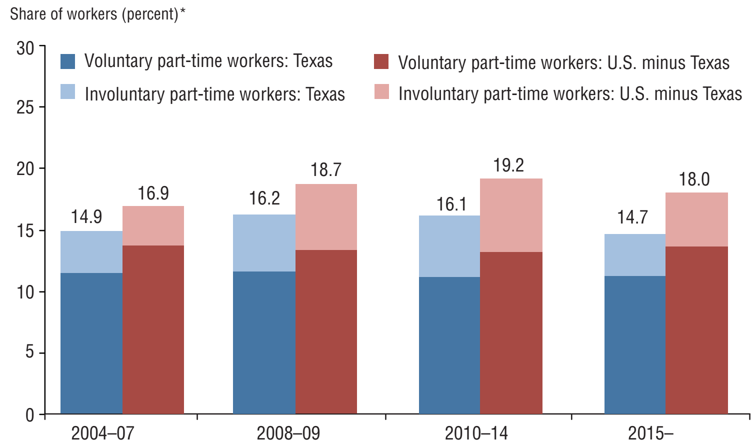
Involuntary Part-Time Work

During the 2004–07 prerecession period, about 3.4 percent of workers in Texas worked part time involuntarily, constituting about 23 percent of all part-time workers—larger than the 19 percent proportion in the rest of the U.S. The gap disappeared during the recession, thanks to a shorter and less severe downturn in Texas; involuntary part-time employment rose to 29 percent of all part-time workers in the state and in the rest of U.S.

Involuntary part-time employment continued rising between 2010 and 2014, with the national proportion of part-time employment climbing to 31 percent, slightly exceeding the share in Texas. Since 2015, the incidence of involuntary part-time work has declined more sharply in Texas than in other states. About 24 percent of all part-time workers are involuntarily part time in Texas—roughly 1 percentage point lower than the rest of the U.S.

The rate of involuntary part-time employment as a share of total Texas employment has averaged 3.5 percent since 2015, similar to the prerecession average of 2004–07. For the rest of the U.S., the average rate well exceeds prerecession levels.

Chart 3 Texas Has Smaller Share of Part-Time Workers than U.S.



*Excludes usually full-time workers who voluntarily worked fewer than 35 hours during the reference week.
SOURCE: Bureau of Labor Statistics Current Population Survey.

Differences Across Sectors

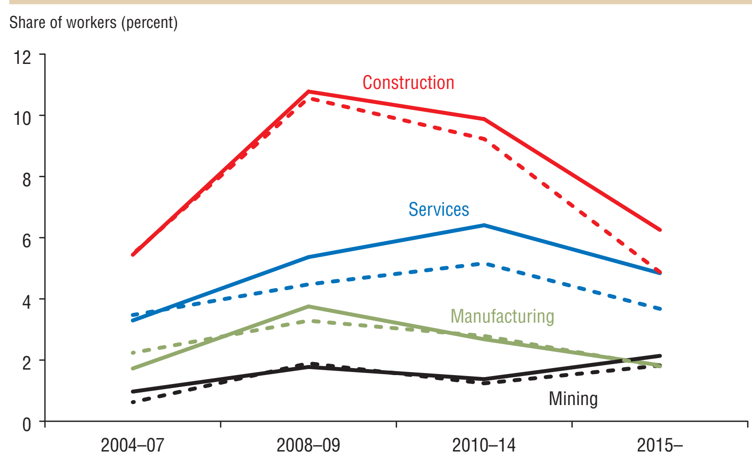
Involuntary part-time employment evolved differently in Texas than nationally. Construction and services, the two sectors with traditionally the highest incidence of involuntary part-time work, account for much of the differential movement (*Chart 4*).

Heading into the recession, the construction sector was hit hard across the country, but the impact lingered significantly longer outside Texas given the depth of the housing crisis in some other states. Texas' services sector also experienced a significantly stronger recovery after the Great Recession than the U.S.

Outside of Texas, involuntary part-time employment remains above prerecession averages in all key services subsectors. In Texas, it is below 2004–07 averages in financial activities, professional and business services, and education and health services.

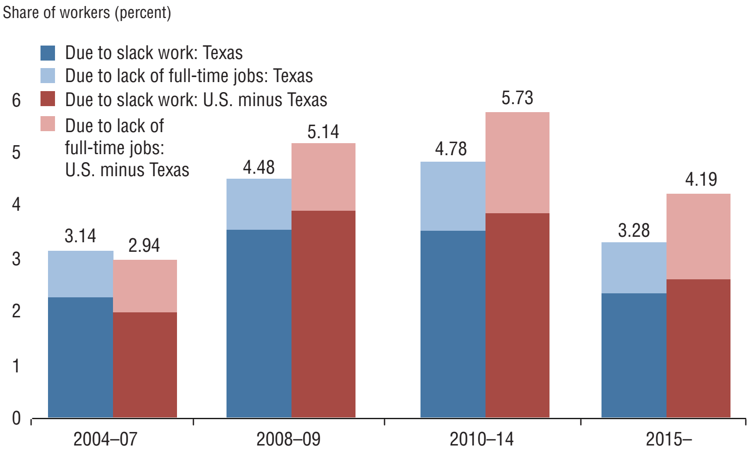
Incidence of part-time jobs in the service sector complicates assessment of labor market slack. For example, workers may routinely hold more than one part-time job to make ends meet—es-

Chart 4 Involuntary Part-Time Worker Share Lags Prerecession Levels in Most Texas Sectors



NOTES: Solid lines represent U.S. minus Texas; dashed lines represent Texas.
SOURCE: Bureau of Labor Statistics Current Population Survey.

Chart 5 Texas Has Lower Share of Involuntary Part-Time Workers than U.S.



SOURCE: Bureau of Labor Statistics Current Population Survey.

sentially becoming full-time, part-time workers. Still others find work essentially as contractors doing piecemeal labor, exemplified by the growth of Uber and other technology-enabled labor arrangements that blur the lines between employee and contractor relationships.

The manufacturing and mining sectors employ a relatively smaller share of part-time workers and, therefore, have on average a lower incidence of involuntary part-time employment than the services sector. Involuntary part-time employment in manufacturing followed a similar trend in Texas and the U.S. since the recession.

By comparison, the services sector in Texas experienced a significantly stronger recovery from the Great Recession than in the U.S.

Lack of Full-Time Jobs

The BLS asks survey respondents working fewer than 35 hours for the main reason why they're involuntarily part time. Two frequently mentioned reasons are a slack economy and availability of nothing but part-time work.[5] A closer examination sheds light on differences between Texas and the U.S. A slack economy is the most important reason for involuntary part-time work. But some workers involuntarily work part-time simply due to lack of full-time jobs, even while part-time jobs remain plentiful.

Structural changes in the economy can contribute to increased availability of part-time jobs, relative to full-time ones. Stronger growth in the retail and leisure and hospitality sectors that employ proportionately more part-time workers, for example, could lead to limited availability of full-time jobs even as the economy steadily expands.

A lack of full-time jobs relative to part-time positions widened slightly in Texas as the recession took hold (*Chart 5*). The share of workers citing a lack of full-time work for their part-time status increased from a prerecession rate of less than 1 percent to 1.3 percent, on average, between 2010 and 2014 in Texas.

Elsewhere in the U.S., the increase was significantly greater—almost doubling from the 1 percent share of workers citing lack of full-time work to 1.9 percent. Since 2015, involuntary part-time work due to lack of full-time jobs has edged down to 1.6 percent in the rest of U.S., while still accounting for 38 percent of all involuntary part-time employment. The involuntary share of part-time employment represents an almost 5 percentage-point rise since 2004–07.

By comparison, just about 29 percent of involuntary part-time workers in Texas cite lack of full-time jobs as the reason for working less than 35 hours a week—a share that has remained largely stable since before the recession.

Demographic Differences

Data since 2015 confirm that among most key demographic groups, involuntary part-time work increased less in Texas than the rest of the nation from similar prerecession levels (*Charts 6A, 6B*). Moreover, the recovery in the state occurred more rapidly.

Chart 6B suggests that the Texas–U.S. difference in involuntary part-time employment attributable to a lack of full-time jobs is significantly larger than the difference due to a slack economy, and that gap has widened since 2004–07. Clearly, differences in demographic characteristics cannot explain the differing pattern in involuntary part-time work between Texas and the nation. Nor can they account for a lack of full-time jobs being a lesser cause of involuntary part-time work in Texas.

Federal Health Law Impacts

Some ACA provisions may increase the incidence of involuntary part-time employment. Under the law, most workers not receiving qualified employer-provided health care coverage may purchase insurance through the ACA marketplace. Additionally, some workers may receive marketplace subsidies for their insurance purchases.[6]

Companies with 50 or more full-time equivalent workers not offering affordable health care coverage to full-time employees—those working 30 or more hours per week—are assessed a penalty for each full-time employee purchasing insurance through the ACA marketplace and receiving a subsidy. The penalty may induce the firms to reduce their full-time workforce and, instead, rely more intensively on part-time jobs or outsource operations to staffing firms.[7]

Thus, the ACA could potentially contribute to higher involuntary part-time employment. But any such impact will be limited because a vast majority of firms with 50 or more full-time equivalent employees already provides affordable health insurance to full-time workers. Others can avoid the fine by extending affordable health care coverage to their full-time workforce in exchange for increased employee plan

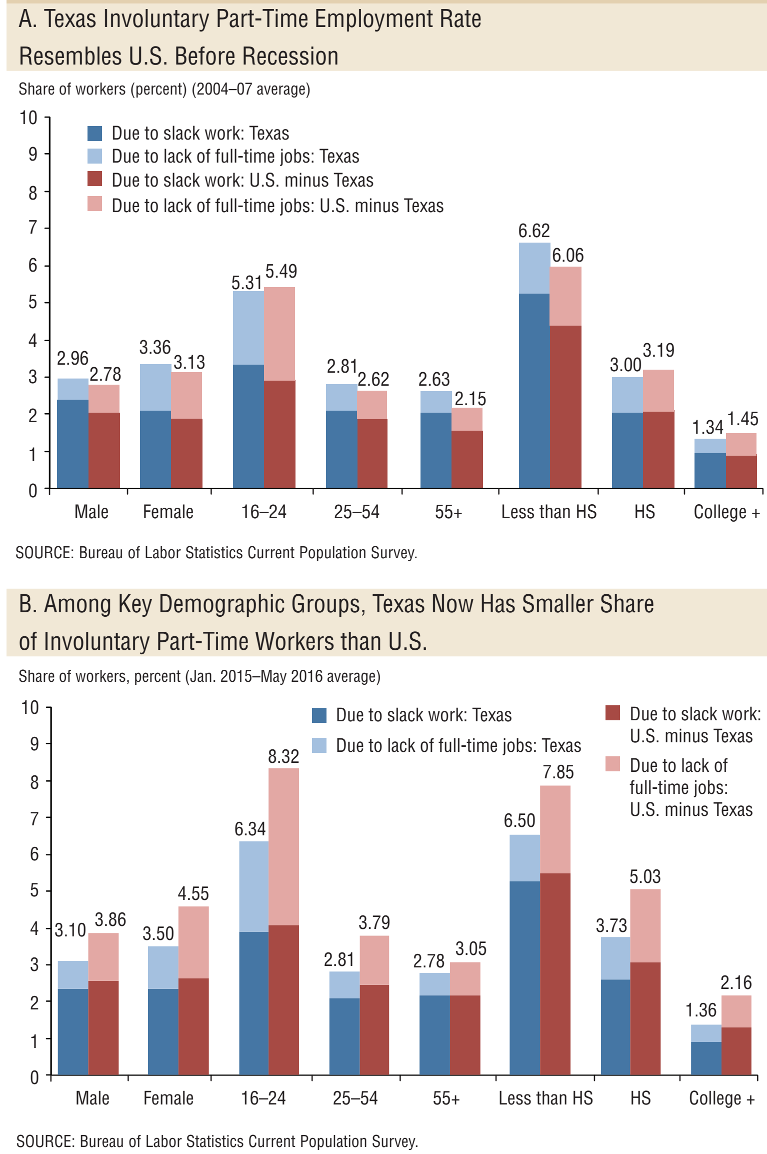


Chart 6 Texas Part-Timers Less Like Nation Since Great Recession

contributions or lower wages, although minimum wage requirements and downwardly rigid wages can present significant challenges.[8]

Only about 5 percent of full-time wage and salary workers nationally encounter the employer mandate, according to recent research.[9] The corresponding share in Texas is likely greater given the lower incidence of health care coverage in the state. Moreover, because the state opted out of Medicaid expansion under the ACA, a higher share of Texans than workers in Medicaid-expanding states would potentially qualify for marketplace subsidies.[10]

Despite a larger expected ACA impact in Texas, involuntary part-time employment has declined more in Texas than in the nation since 2015, when the ACA provisions took effect, pointing to the law's still muted impact on involuntary part-time work. A relatively low minimum wage, more flexible labor markets and lighter regulatory burden than the nation likely help mitigate the ACA's potential impact on involuntary part-time employment in Texas.

New Overtime Rules

Changes to the federal Fair Labor Standards Act on Dec. 1 will double the salary threshold under which workers can earn overtime for work beyond 40 hours a week. The limit increase, from $23,660 to $47,476 annually, is expected to be most keenly felt in the retail and food service industries, where labor demand may be more variable on a seasonal or day-to-day basis.

The use of exempt "managers," particularly in sectors such as retail and food services, has traditionally been one way the industries have recruited and developed talent while at the same time meeting customer service demands that can vary by time of day or season.

The Labor Department estimates that 4.2 million workers nationally will be affected by the upcoming changes. As a result, they will receive overtime pay or a salary increase that puts them above the new threshold; alternatively, employers will cut worker hours.

As overtime hours by existing full-time salaried employees become more costly, the revised salary threshold could increase the amount of available part-time work. Firms may hire more, lesser-paid part-timers for fixed schedules that may include periods of slack demand. The trade-off for employers involves calculating the comparative compensation costs of having full-time versus part-time workers perform those overtime hours.

On the other hand, the current mix of full-time versus part-time work may remain unchanged in response to the new overtime rules if management and workers can agree on a lower base salary so the workers could be on the job as many hours as before—including hours at the overtime rate—at the same overall compensation.

Persistent Part-Timers

Despite recent improvement in the headline unemployment rate, involuntary part-time unemployment remains above its prerecession levels and has emerged as an important concern for monetary policy because it suggests the continued presence of labor market slack despite a low headline jobless rate.

Involuntary part-time employment increased less sharply in Texas during the recession and improved more rapidly through the recovery among all

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major demographic groups. A less severe recession and stronger recovery in Texas, particularly in the construction and service sectors, mostly contributed to Texas' relatively good performance.

Among the involuntarily part-time employed, a relatively smaller share in Texas than the U.S. is due to diminished availability of full-time jobs—a gap between the state and nation that has widened in recent years despite the energy bust.

Why is there more full-time work available in Texas than in the rest of the nation? Part of the difference is cyclical, but structural differences such as higher wage flexibility and lesser regulatory burden in Texas may also have played a role, particularly in the aftermath of the ACA's employer mandate.

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Notes

[1] "Compensation in Part-Time Jobs Versus Full-Time Jobs: What If the Job is the Same?" by Michael K. Lettau, *Economics Letters*, vol. 56, no. 1, 1997, pp. 101–06.

[2] "Why Is Involuntary Part-Time Work Elevated?" by Tomaz Cajner, Dennis Mawhirter, Christopher Nekarda and David Ratner, Board of Governors of the Federal Reserve System, FEDS Notes, April 14, 2014, www.federalreserve.gov/econresdata/notes/feds-notes/2014/why-is-involuntary-part-time-work-elevated-20140414.html.

[3] Percent of voluntary part-time workers employed plotted in Chart 3 excludes usually full-time workers who voluntarily worked fewer than 35 hours during the reference week.

[4] Public assistance programs such as the Temporary Assistance for Needy Families create strong incentives for lower earnings and hours because they phase out if income exceeds a specified threshold.

[5] Other reasons include seasonal work and job started or ended during the week.

[6] There are two subsidy types: (1) tax credit on health insurance plan premiums (premium subsidy) and (2) subsidy on out-of-pocket costs (cost-sharing subsidy).

[7] A company can avoid the penalty by offering a full-time worker who is getting the premium subsidy health care coverage that costs the employee no more than 9.5 percent of household income. Alternatively, a company can avoid the penalty by limiting the number of full-time equivalent employees to fewer than 50.

[8] Recouping the cost of extending health care coverage may be effective for high-wage, full-time employees. For low-wage, full-time workers, minimum wage requirements make it more difficult to lower pay to recoup health care coverage costs.

[9] "The Potential Effects of Federal Health Insurance Reforms on Employment Arrangements and Compensation," by Marcus Dillender, Carolyn J. Heinrich and Susan N. Houseman, Upjohn Institute, Working Paper no. 15-228, 2015.

[10] Texans without affordable employer-provided insurance and with incomes ranging from 100 percent to 400 percent of the federal poverty level (FPL) would qualify for marketplace subsidies compared with those with incomes between 138 and 400 percent of FPL in Medicaid-expanding states.

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