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A Cross-national Comparison of R&D Expenditure Decisions: Tax Incentives and Financial Constraints*

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Abstract

We provide evidence on the impact of tax incentives and financial constraints on corporate R&D expenditure decisions. We contribute to extant research by comparing R&D expenditures in the United States and Canada, thereby exploiting the differences in the two countries' R&D tax credit mechanisms and generally accepted accounting principles. The two tax incentive mechanism designs are consistent with differing views of the degree of financial constraints faced by firms in these economies. Our sample also allows us to explore the effects of capitalizing R&D on Canadian firms. Employing a matched design, we document relations between tax credit incentives and R&D spending consistent with both Canadian and U.S. public companies responding as though they are not financially constrained. We estimate that the Canadian credit system induces, on average, $1.30 of additional R&D spending per dollar of taxes forgone while the U.S. system induces, on

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