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Tax cuts: Economists see modest impact on workers, economy as corporate taxes fall

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Will the corporate tax cut trickle down to workers and the broader economy? Or will it simply fatten the cash reserves of the largest U.S. companies and their shareholders?

Republican lawmakers argue the reduction in the corporate rate from 35% to 21% will spark a boom in business investment that ultimately lifts the paychecks of average Americans.

If true, that could be the saving grace of tax reform legislation whose cuts for middle-class households are criticized by Democrats as temporary and limited compared with the windfall for the wealthy.

Some leading economists say the $1.5 trillion in cuts will juice business capital spending and wages — but just modestly, and those effects will likely be largely offset by higher interest rates triggered by a jump in the deficit.

One source of their skepticism is this: Non-financial companies in the Standard & Poor’s 500 stock index are already flush, sitting on an estimated $1.63 trillion in cash, according to data from S&P Dow Jones Indices. Yet that hasn’t led to an investment boom.

“To build a new assembly line with a windfall is a complicated decision,” says Tom Block, a Washington policy strategist at FundStrat Global Advisors. He notes that reasons to invest in a business are based mostly on demand for products and services, not simply having extra money

The argument of tax-cut supporters: The plan will prod companies to buy computers and factory machines because the after-tax profits generated by that equipment will be larger. The new technology will make each worker more productive, allowing employers to raise their wages, according to President Trump’s Council of Economic Advisors. Besides the reduced tax rate, the plan will spur more investment by letting companies write off capital purchases instantly and setting a lower tax rate for firms that bring overseas profits back to the U.S.

Also, companies will use their bigger profits to lift pay to and attract higher skilled workers, the CEA report says. Other economists say it's the laws of supply and demand that determine worker pay, not any extra cash in the pockets of employers. Still, in five to 10 years, the CEA report says, all the benefits of lower corporate taxes should boost the nation's gross domestic product by 3% to 5% and the average worker's annual salary by $4,000.

Yet in recent months, some top U.S. companies have said they plan to use their tax windfall not on investment, but to increase dividends and buy back stock in an effort to increase share prices. On an earnings call in October, Amgen CEO Robert Bradway, speaking of the tax package, said, "we've been actively returning capital in the form of growing dividend and buyback, and I'd expect us to continue that."

A Bank of America-Merrill Lynch survey of more than 300 CEOs last summer found this: The most common ways they planned to spend any profits returned from abroad were paying down debt and stock buybacks. Capital investment was a less popular response.

Jason Trennert, co-founder at New York-based Strategas Research Partners, says, "If the economy is growing between 3% and 4% over the next few years, you will see a pickup in capital spending."

Meanwhile, in the 12-month period ending in September, companies in the S&P 500 spent $517.7 billion on stock buybacks, S&P Dow Jones Indices data show. Similarly, they've shelled out an estimated $1.48 trillion so far this year on U.S.-focused mergers and acquisitions, according to Dealogic. And they've paid out $414.1 billion in cash dividends to shareholders in the 12 months ending Sept. 30, up 5.4% from the prior 12-month period.

These uses of cash have been described by many Wall Street pros as a form of "financial engineering," designed to keep investors happy by boosting stock prices, as opposed to using cash to invest for the future.

All of this doesn't mean companies won't spend a chunk of their tax savings on new equipment and structures that benefit workers and the economy, says Mark Zandi, chief economist of Moody's Analytics.

AT&T, for example, confirmed Wednesday that it will spend an additional $1 billion in the U.S. next year once the tax overhaul is signed into law.

The telecom giant also announced that it will pay a "special" $1,000 bonus to more than 200,000 of its U.S. workers, saying the bonus could go out over the holidays if Trump signs the bill before Christmas. The AT&T news was among the initial signs that the tax cut windfall for companies is making its way to Main Street workers. Wells Fargo, Boeing, Comcast and Fifth Third Bancorp also weighed in Wednesday with various pledges of bonuses, raises, investments and philanthropy.

Zandi expects the tax legislation to increase business investment growth from about 4% to 6% over the next couple of years. But he says the tax cuts will swell the deficit by $1.1 trillion — even after accounting for added revenue from their effect on economic growth. That could lead to higher interest rates, discouraging business borrowing and investment. Instead of the 3% to 5% increase in economic growth the White House expects over 10 years, Zandi expects just a 0.5% gain.

And Eric Toder, co-director of the non-partisan Tax Policy Center, says the annual lift to workers’ pay will likely be about $100 — not the $4,000 the White House claims.

Ryan Bourne, an economist at the libertarian Cato Institute, predicts the tax reform will modestly lift business investment but doesn’t think a rising deficit will push up interest rates. That, he says, will leave a bigger net gain for the economy and workers. He estimates the tax changes will eventually raise the salary of the average worker by $1,500 to $2,000.