Opinion: Corporate tax cut may boost pay by more than the $4,000 the White House claims

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The most appealing facet of the Republican tax reform plan for most economists is the reduction in the corporate income-tax rate from 35% — nearly the highest in the world — to just 20%. Economic theory suggests that a lower tax on corporate income — or capital income in general — should result in more domestic investment, which in turn should increase productivity, wages, and economic activity.

Of course, we would like to know precisely how much wages and economic growth will increase for our corporate tax cut, but the data don't give us a cut-and-dried answer. A few people have taken stabs at it, and some of those attempts have been attacked as unduly partisan or wildly optimistic. For instance, Kevin Hassett, chair of the President's Council of Economic Advisers, came under fire for saying that reducing the corporate income tax to 20% would increase annual income by $4,000.

Before it became open season on anyone attempting to answer such a complicated question, Marquette University economics professor Andrew Hanson and I tried to shed some light on the question simply by looking at a host of academic studies that had estimated the relationship between corporate taxes and income.

We faced a basic problem in the exercise: The U.S. has scarcely changed its corporate income tax since 1986 (the sole change was a one percentage point increase in 1993), which means that we could not use national data to answer the question. If there is no variation in tax rates then there is no way to discern any relationship between rates and income.

Instead, we looked for studies that examined corporate tax rate changes across the 50 U.S. states or else across other countries that belong to the Organization of Economic Cooperation and Development. Over the last three decades, there have been numerous corporate-tax-rate changes across the states, and we tallied over 100 corporate tax rate changes in OECD countries since 2000 — nearly every one of which has been a tax-rate reduction.

We found a half-dozen studies we thought were sufficiently rigorous. Each attempted to estimate the relationship between corporate-tax-rate changes and wage changes and to control for other factors that may have influenced pay.

There was some variation in the results across the studies, but each one found that a lower corporate tax rate boosts income.

We aggregated across these studies to create a rough interval estimate. For the corporate-rate cut Congress is contemplating, our data predicts a wage increase between 16% and 28% spread out over several years. A 20% wage increase, which is in the lower end of our interval, translates to an additional long-run wage increase of $16,000, well above Hassett's $4,000 estimate.

The number is, no doubt, higher than we can reasonably expect from a U.S. corporate rate cut: the United States isn't a state or a small country operating in a market where goods and workers are fully mobile across the market. The response that Belgium or Massachusetts gets from a corporate tax rate cut is more pronounced than what might occur in the United States.

It's also a rough estimate and subject to large swings in either direction. And of course wage gains probably wouldn't be distributed equally across all jobs.

Also, the extent to which our economy responds to a corporate rate reduction depends upon how we finance that cut. Its economic impact will be greater if it is financed via the elimination of unproductive tax expenditures or reduced profligate government spending instead of just incurring higher deficits. State corporate-rate tax reductions typically has to be balanced by spending cuts or tax increases elsewhere, but most corporate-rate reductions in the last 15 years in OECD countries have not been fully offset.

Economists aren't great at predicting the future and the data we have available to us are often of limited use in doing so. However, there is value in noting that numerous studies suggest that lower corporate tax rates have boosted wages elsewhere. While we do not expect anywhere near the wage response we encountered in these studies, the data demonstrate that American workers will benefit from higher wages and employment if there is a sensible reduction in the corporate tax rate.

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