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A Real Stimulus

To create jobs, repeal the corporate-income tax.

By Jeffrey A. Miron

As the unemployment rate remains in double-digit territory, policymakers continue their search for an appropriate response. The administration's preferences, as discussed this past weekend by Christina Romer, chairman of the president's Council of Economic Advisers, are tax credits for job creation and increased support for the unemployed. These policies focus on the labor market itself and aim to address unemployment in the short term.

This focus is exactly backwards. Rather than attempt to target jobs in the short run, the administration should advance policies that make sense independent of the recession and that enhance economic efficiency over the long haul. One such policy is to repeal the corporate-income tax, which will stimulate employment far better than a jobs tax credit.

If corporations face zero taxation on their profits, they will expand investment and employment for two reasons. First, the increased cash flow will allow corporations to invest without borrowing from banks. These new investments will generate employment both to build new plants and equipment and to staff the new factories. This is the standard Keynesian argument for business-tax cuts, and it can operate almost instantly. Second, repeal of the corporate-income tax means a higher return to investment, which encourages capital accumulation in the long run.

The beauty of this approach is that taxation of corporate income never made sense in the first place; it double-taxes corporate income, given that the personal-income tax covers both dividends and capital gains. And corporate-income taxation has other negatives.

The corporate-income tax requires rules and regulations over and above the personal-income-tax system. This creates large compliance costs and favors specific industries or kinds of capital, thus distorting private investment decisions and creating the incentive to game the system rather than just investing in industries that seem profitable. Corporate-income taxation reduces the transparency of corporate accounting, making it harder for investors to monitor corporate behavior.

The corporate-income tax also gives the government a way to reward behavior it likes: by designating certain activities as "non-profit." The justification is that some activities — especially those of schools, churches, and charities — are socially beneficial. This may be true, but the power to define "non-profit" allows the government to decide what constitutes education, religion, or charity, and to exclude some groups that fill these roles. The decisions inevitably favor the status quo and suppress competition.

The corporate-tax system, by its very name, distorts the way voters see the tax system — many are led to believe that inanimate objects pay taxes. In the end, however, only people pay taxes — every decision to tax affects real people and impacts far more than the direct target of the tax.

The usual justification for corporate-income taxation is that it makes high-income taxpayers — the corporation owners — pay their fair share. Yet while some of the tax's impact falls on owners — it reduces after-tax profits and therefore the dividends and capital gains received by shareholders — much of the impact falls on employees, who take a hit in the form of lower wages, and on customers, who face the higher prices a corporation charges when its costs increase. High taxation pushes corporations to locate overseas, reducing employment and further harming employees.

Repeal of the corporate-income tax will of course impact the federal budget, but this is true of any fiscal stimulus. And since repeal stimulates productive activity, it generates increased revenue from employment taxes, personal-income taxes, and sales taxes. The net increase in the deficit will therefore be substantially smaller than the revenues currently collected under the corporate-income tax would suggest.

There is, of course, a major problem with this policy: It does not appeal to the administration's liberal supporters, who oppose any policy not explicitly designed to transfer income to their favored interest groups. Nonetheless, there are political benefits; it would disarm Obama's critics and appeal to independents who value the president's social moderation but not his preoccupation with redistributionist economics. Factor in that it makes infinite sense on the merits, and repeal is a no-brainer for the Obama administration.

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