Lessons from the biggest business tax cut in US history

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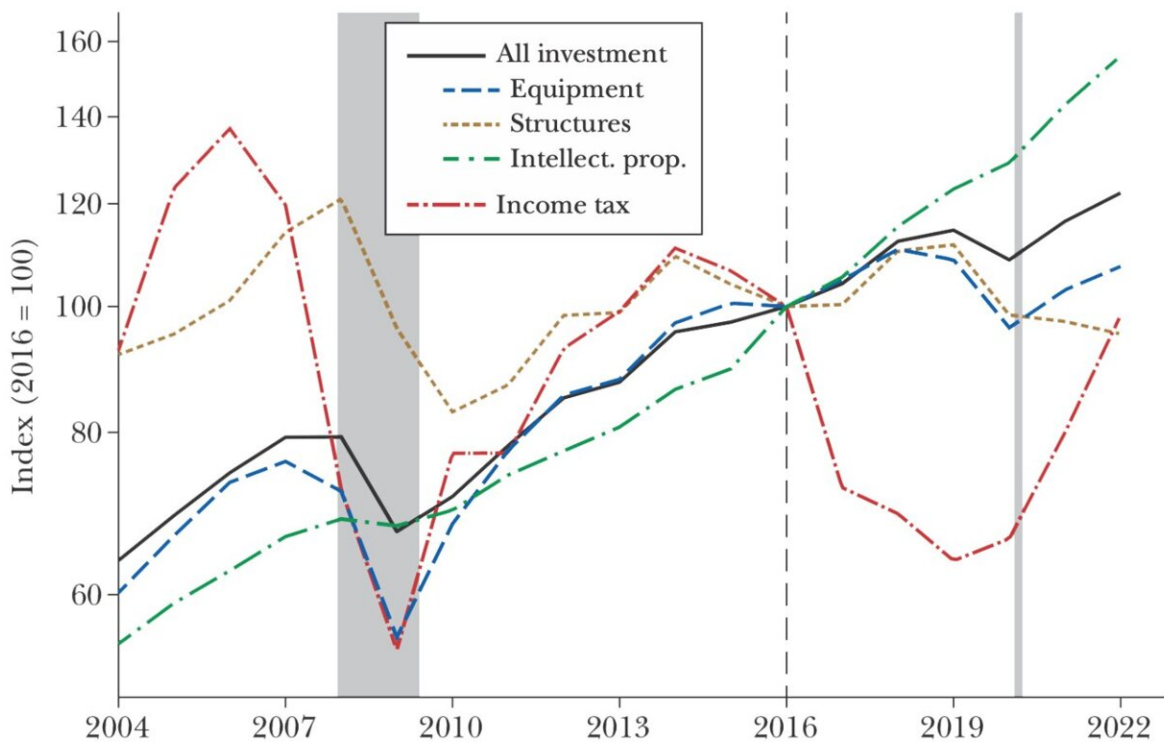

Corporate income tax revenue and investment around the Tax Cuts and Jobs Act of 2017. Credit: *Journal of Economic Perspectives* (2024). DOI: 10.1257/jep.38.3.61

Congress is spoiling for a tax battle in 2025. Key parts of the 2017 Tax

Cuts and Jobs Act are set to expire. Most urgent to many voters are sunsetting provisions aimed at households, including the more generous Child Tax Credit. But renewing the law's deep cuts to corporate taxes are also up for debate.

Republicans and Democrats have seized on the issues in campaign speeches, with Kamala Harris endorsing a higher top corporate rate to pay for other initiatives and Donald Trump arguing that lowering rates further will foster growth.

In a new analysis of the TCJA, published last month in the *Journal of Economic Perspectives*, Harvard macroeconomist Gabriel Chodorow-Reich charts the real-world impacts of the 2017 law's various corporate tax cuts.

His paper, co-written with Princeton's Owen M. Zidar and the University of Chicago's Eric Zwick, M.A. '12, Ph.D. '14, describes modest increases in wages and business investments, with some expired and expiring provisions proving most cost-effective. But these gains were hardly large enough to offset the big hit to tax revenue.

Chodorow-Reich hopes the findings challenge partisan narratives and inspire smarter solutions. "People may look at what happened with corporate income and say, 'Hey, look! Tax cuts pay for themselves through higher investment!'" Chodorow-Reich said. "But that's just not what we see in the data. Others may want to raise corporate taxes, because they think taxes have no effect on corporate policy. But that's not what we see in the data, either."

Reform was desperately needed by the time Congress passed the TCJA in December 2017. Back then, the U.S. government's last landmark tax legislation was more than 30 years old.

The world experienced radical changes over that period, but the corporate tax code saw only tweaks in the '90s and early '00s. "If you were an economist who worked on corporate taxation around the Tax Reform Act of 1986 and you did a Rip Van Winkle—falling asleep for 30 years—the tax code would look pretty familiar to you in 2016," Chodorow-Reich said.

Less familiar would be the state of the U.S. economy, which was far more global than in the 1980s. International competition had moved governments large and small to rethink their tax codes. "In 1986, the U.S. corporate tax rate fell right in the middle for rich countries," explained Chodorow-Reich, who worked for the Council of Economic Advisers before earning his Ph.D. at the University of California at Berkeley. "By 2016, the U.S. was at the top with France. All the other countries had cut."

There was bipartisan recognition that something needed to change, Chodorow-Reich recalled. The TCJA, passed by a Republican Congress and signed into law by Trump, permanently slashed the corporate statutory rate—or percentage of profits, before write-offs, legally due in taxes—to 21 from 35%. It was projected to reduce federal corporate tax revenue by a whopping $100 billion to $150 billion per year for the next 10 years.

To avoid a huge budget shortfall, other measures were set to phase out. That included cuts geared to low- and middle-income households, all expiring at the end of 2025. But also included were popular changes aimed at encouraging business innovation, which started winding down in 2022.

Some of the key provisions of the TCJA allowed firms to immediately write off the full cost of new capital investments and research. A bill to restore some of these breaks as well as the expanded Child Tax Credit

recently failed in the Senate, as Republicans held out hope for controlling the chamber (and any legislative updates) in the new year.

The Journal of Economic Perspectives devoted much of its summer issue to assessing the TCJA, with Chodorow et al. focusing on its corporate provisions. Reviewing a range of evidence—from studies of individual corporate tax returns to an original macroeconomic analysis outlined in a companion paper—led them to conclude that capital investments had, in fact, increased under the law by about 11% .

"That means we learned something," offered Chodorow-Reich, citing a recent poll that found economists split on whether the law actually drove business investments. "Firms definitely do respond to corporate tax policy."

The biggest gains came from expired and expiring provisions concerning expensing. According to Chodorow-Reich, reviews of corporate tax returns show that these measures performed better at driving investment than old-fashioned rate cuts. After all, cuts to statutory rates reward new and old capital alike, while expensing provisions are more targeted at growth. Should lawmakers go looking for new revenue next year, he noted, "a good tradeoff" would entail raising statutory rates while restoring expensing provisions.

In theory, all that new investment can benefit taxpayers directly by driving up wages. "Firms would need more workers in order to use the additional capital they just put into place," Chodorow-Reich said. "And if every firm wants to hire more, they wind up bidding up the price of labor."

How much the law increases wages is, however, a matter of dispute. Ahead of the plan's passage, the Council of Economic Advisers had predicted the reforms would drive an annual wage increase of $4,000 to

$9,000 per full-time employee. Citing other research and their own analyses, Chodorow-Reich and his co-authors landed closer to $750 per year in 2017 dollars.

"You can have a glass half-full or half-empty view on whether that's a little or a lot," Chodorow-Reich said. "But it is certainly well less than what some of the TCJA's proponents suggested."

What happened to the federal government's corporate tax revenue under the law? It took an immediate dive of 40% when the TCJA was implemented. But then this revenue source rallied starting in 2020. In fact, corporate tax revenue climbed much higher than imagined, as business profits soared beyond all predictions.

In an interview, Chodorow-Reich said more research is needed to understand why corporate profits took off amid the pandemic. Possibilities range from supply chain maneuvers and so-called "greedflation" to the fact that the former tax haven of Ireland abandoned its ultra-low corporate rates in 2020. That compelled U.S. multinationals, including Google's parent company Alphabet, to start booking more profits in the U.S. amid the TCJA's lower tax rates.

More information: Gabriel Chodorow-Reich et al, Lessons from the Biggest Business Tax Cut in US History, *Journal of Economic Perspectives* (2024). DOI: 10.1257/jep.38.3.61

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