Analysis of the Corporate Behaviors after the Corporate Tax Cuts with Respect to Job Creation: A Preliminary Study of Select Corporations in the United States of America

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Abstract

A preliminary study of the impact of tax cuts on job creation was done by studying a random sample of 12 largest corporations selected from the Fortune 500 companies. The Annual Reports of the 12 sample companies pre-tax cut and post-tax cut periods were downloaded, and figures tabulated for revenues, property, plant, and equipment (PPE) as well as employees reported by those companies for both the periods. We found that the revenue increased by an average of 7.78 percent which showed signs of growth in those companies, but the investment in PPE by the companies during the same period increased at an average of only 0.32 percent, which indicated that the companies did not divert the resources they saved in taxes to add capacity. Therefore, the potential for jobs growth was nonexistent or minimal. Another indicator showed the same outcome as the companies reported their workforce reduced since 2017 by an average of 0.54 percent.

Keywords: corporate tax cuts, job creation, job growth, tax cuts and jobs act of 2017

1. Background

A $1.5 Trillion tax overhaul was signed into law by President Trump on December 22, 2017, popularly known as the Tax Cuts and Jobs Act of 2017. The bill was touted as one of the sweeping legislation that would create jobs in the US. The biggest beneficiaries were the corporations in the US. The top corporate tax rate was decreased from 35 percent to a flat rate of 21 percent. This rate came into effect for corporations for the tax year starting January 1, 2018, and it is a permanent change. Many policymakers believe that corporate tax cuts are directly related to job creation in capitalist economies, that such notion is axiomatically seen as a cause-and-effect. In many instances, authorities in economic and policy studies believe that tax-cuts motivate the corporations to spend on investments in productive assets and which in turn would increase hiring to meet the demands created by a booming economy created by tax cuts. However, there has not been unquestionable data to support or refute the claims made regarding the impact of tax cuts. Therefore, this paper will use empirical data to study the data points for the year 2017 (pre-tax cut year) and 2018 (post-tax cut year) to analyze the indicators of job creation and jobs growth by corporations in support or against the assertion of the policymakers. As the title suggests, it is only a preliminary study as the impact of tax-cuts are far-reaching and longitudinal.

2. Introduction

It has been more than a year since the $1.5 Trillion tax overhaul was signed into law by President Trump. The general belief was that it would turbocharge the economy with increasing GDP, it would unleash investments by corporations in productive assets which will ultimately lead to the creation of more jobs and may accelerate the wage growth for workers. The report released by US Bureau of Economic Analysis as shown in Fig 1.1 shows that seasonally adjusted annual growth rates of GDP did not move much in the first quarter of 2018 but peaked in the second quarter of 2018 at 4.2 percent from 2.2 percent in Quarter One and started to deaccelerated to 3.4 percent in Quarter 3 and further slumped to 2.6 percent in Quarter 4.

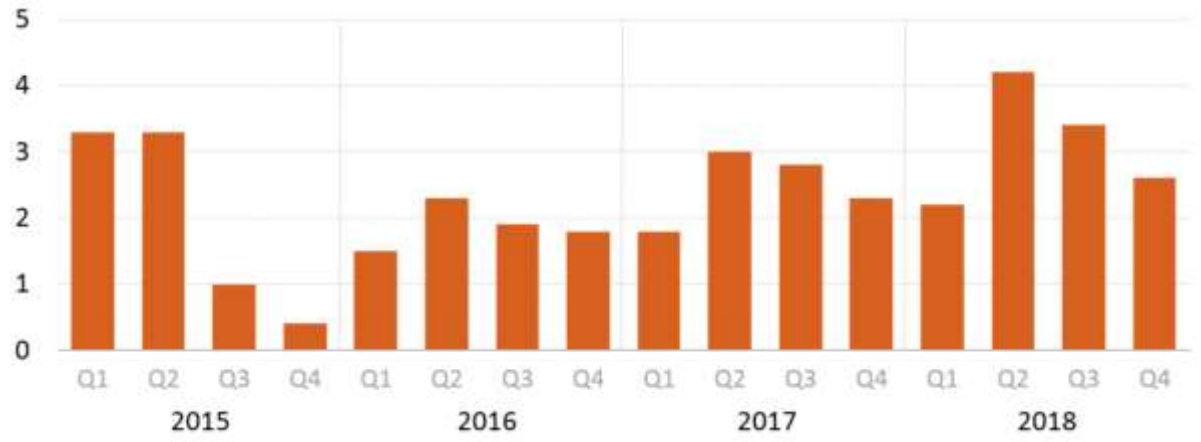

Figure 1. Real GDP: Percentage Change from Preceding Quarter

Source: US Bureau of Economic Analysis (February 2019). *U.S. Economy at a Glance Table*. Accessed from https://www.bea.gov/media/3531 on 3-21-2019.

On the other hand, a survey conducted by the National Association for Business Economics (NABE) reported that "a large majority of respondents—84 percent—indicate that one year after its passage, the 2017 Tax Cuts and Jobs Act has not caused their firms to change hiring or investment plans" (NABE Business Outlook Survey, 2019). Against this backdrop, this paper examines the corporate behavior by examining their spending on long-term PPE (like buildings, factories, equipment, and technology) and number of employees for a sample of 12 randomly selected Fortune 500 companies in the industrial sector. A comparative study of 2017 Annual Reports with the 2018 Annual Reports data is made.

3. Literature Review

There have been studies on both sides of the spectrum about the impact of tax cuts. Some studies have reported no correlation between tax levels and measures of economic performances like income growth, job creation, and firm formation. Mazeron (2013) noted that there is simply no consensus that cutting taxes boosts economic growth and create jobs. On the other hand, Phelps (2018) opined that the supporters of tax cut believe that tax cuts will cause the rate of return to jump which in turn will push the investment activity resulting in productivity to rise. Because it will stimulate the economy and increase standard output (Romer & Romer, 2010). But we have not seen research to categorically suggest that tax cuts have generated productivity growth that will ultimately result in job creation (Phelps, 2018).

Estache and Gersey (2018) studied the impact of changes in the effective corporate tax rate on unemployment rate in Europe between 1999 and 2014 and reported that a one percent decrease in the effective tax rate was associated with 0.34 percent increase in the unemployment rate on average. They argued that lower corporate income tax rates create an atmosphere whereby the labor is replaced by capital, which ultimately leads to an increase in unemployment rates. Mankiw, Weinzierl, and Yagan (2009) expressed their view of optimal tax policy based on the work of Ramsey (1927) and Murrtee (1971). They believe that flat tax with a universal lump-sum transfer could be close to optimal. The uniformity in tax policy leads to a better tax result. The authors found that tax policies should maximize social welfare function subject to a set of constraints. Good tax policy should favor equitable and low incidence. The ability to pay should also be considered. In this instance, the recent corporate tax policy violates the set of criteria for optimal tax policy. The assumption that a tax break for corporations should increase employment does not satisfy the conditions for optimal tax. The study concluded that the flat tax policy seems to be optimal compared with corporate tax cut policy as a way of increasing employment. Similarly, Donaldson (2018) points out to the fact that earlier tax reforms (Tax Reform Act of 1986 and 2016 Tax Acts) had adopted policies in a bipartisan manner. However, Republicans, this time around, came with a way to reform tax code without a bipartisan support with several changes starting from individual tax reform to more significant part of the consideration to benefit corporations with corporate tax cuts. Their anticipated solution to the economic problems such as unemployment may have been farfetched.

Leigh (2018) studied about 1000 profitable Australian firms to explore the relationship between these firms and job creation by testing the assertion that if corporate tax rates are reduced, corporations will make profits and will invest more due to an increase in revenue resulting from low tax rates. However, this study proved the reverse that all the high-profit firms with reduced tax rates created fewer jobs, which refutes the assumption of President Trump's corporate tax-cut as a means of increasing available jobs. In the same vein, Jones and Haigh (2007) recognized corporations as a legal entity existing in contemplation of laws. These corporations are always aiming at maximizing profits, usually by minimizing costs to accomplish their goals and objectives. They may reduce employment to cut down cost and improve the profits rather than creating more jobs. The authors argued that there are no indications that corporations exist to play a welfare role for the society, and if corporate tax rates are reduced, corporations will enjoy profits by first taking care of corporate executives. Richardson and Lanis (2007) emphasized that the tax rate reform is generally used by policymakers and interest groups to create incentives for their believers. In respect to this statement, it can be assumed that the recent US corporate tax cut is deep-rooted in a similar assumption. The evidence from the Australian model shows a negative association between effective tax rates and measures of firm size (a proxy for political power theory).

Page, Rosenberg, Nunns, Rohaly, and Berger (2017) argued that the Tax Cut and Jobs Act was supposed to increase GDP on a macro level by increasing output. The assertion also was that both individuals and businesses would encounter an increase in disposable income, which would boost the economy resulting in a reduction of the deficit. However, the authors showed that the act left a lot of promises of tax reforms unfulfilled. For example, the law failed to present incentives on employment. The bill leaves revenues far below expected to spend specially in the wake of spending increases enacted before the ink had dried out the Tax Cut and Jobs Act legislation. Despite arguments supporting corporate tax cuts, the disadvantages have outweighed the supposed advantages. Mertens and Ravn (2013) studied the estimate of the dynamic effects of changes in personal and corporate income taxes. They discovered that short-run effects on output of the tax shocks are significant and that it is essential to distinguish between different types of taxes when considering their impact on the labor market and expenditure components. The authors used examples from different countries around the world, which showed that none of them benefited economically in the long run because of corporate tax cut policies.

Auerbach (2018) studied the effects of corporate tax cut under President Trump from two perspectives: a) those who see the cut as a measure to sustain business and achieve growth in the economy. This group is the team for the current White House Economic Advisers, and b) an independent group who see no evidence theoretically and practically of any positive impact on the middle-class wages and economic growth. This group sees it as a measure to benefit the rich class at the expense of the masses. In its effect will give rise to long run decline of economic growth and negative growth in labor force. White House Council of Economic Advisers (2017) did a forecast that corporate tax rate of 20% would lead to a substantial rise in wages. In effect, the prediction was that average household income would rise by about $4,000. Using theoretical approach, the increase in household income is difficult to measure. Auerbach (2018) opined that "measuring the potential effects of the legislation requires accounting for myriad other provisions affecting investment decisions and international activity, which the law substantially altered" (p. 117). The rise in wages of households therefore becomes a farfetched argument. In an open economy like the U.S, doubts are created on the feasibility of the argument. Auerbach (2018) argued that there is no empirical evidence that supports the position of the White House Council of Economic advisers.

Literature has not taken supportive stand on the positive results of the Advisers' position on the corporate tax cuts. Several models had been tried across nations, including the United States, that have resulted is a deficit crowd out which depresses wage growth. This, of course, is the position taken by our paper. At the same time allocation burden of taxation poses long term impact on deficit, and tax cut designed for the wealthy and corporations deepens capital.

Against the backdrop of the above studies, the current research espouses to establish connections between lower tax rates, investment by companies in productive assets, and employment numbers to evaluate the impact of tax cuts on the behaviors of the corporations.

4. Research Method

We collected data from published sources to study the data points for the year 2017 (pre-tax cut year) and 2018 (post-tax cut year) and analyzed the indicators of job creation by corporations in support or against the assertion of the policymakers.

4.1 Sample

As the title suggests, it is only a preliminary study of the impact of tax cuts, a random sample of 12 largest corporations was selected from the Fortune 500 companies (See Appendix 1 for the list of companies) that have published their financial statements for a full year of operations by the time of the study.

4.2 Data Collection and Variables

The Annual Reports of the 12 sample companies were downloaded, and figures for total revenue and Property, Plant and Equipment were tabulated. The number of employees reported by these companies before the tax cut and one year after the tax cut was also tabulated. The total revenue was considered as the proxy for growth and the total PPE as a proxy to capacity to create jobs by the companies.

5. Findings and Conclusions

At an average the revenue increased by 7.78 percent which showed signs of growth in those companies, but the investment in PPE by the companies during the same period increased at an average of only 0.32 percent, which indicated that the companies did not divert the resources they saved in taxes to add capacity, therefore, the potential for jobs growth. The preliminary findings suggest that large companies continued to show signs of growth but did not add much to the capacities to create more jobs. In fact, the companies reduced their workforce since 2017 by an average of 0.54 percent.

In analyzing the impact of corporate tax cut as a policy geared towards improving the economy as well as the welfare of the masses, an economic cost benefit analysis will aid the policy maker in accepting or rejecting the policy. The analysis will also justify the impact of the policy on the economy as a whole, not on a small sector. According to Gittinger (1982), if the economic benefit exceeds economic cost, the policy should be adopted. On the other hand, if the economic cost exceeds the economic benefit, the project is unacceptable. From the result of the research and based on its impact on employment, the claim of the corporate tax cut definitely does not meet its expectations. This policy that has been adopted, will have a negative impact on the whole economy in the long run. Our study results agree with Auerbach (2018) and illustrate that the claim of the White House corporate Tax cut has no evidence of job growth and even there was any, it is difficult to test empirically. The initial little increase in wages will outweigh resulting more taxes to middle class in the long run.

6. Suggestions for Further Research

Tax cuts and job creation have been touted as positively correlated, but this study failed to support that hypothesis. However, the study is limited in the sample size and number of years that have been studied. A longitudinal study with a larger sample size may give a better idea about this important correlation. It may also be possible that the results are eschewed because of international operations these sampled companies are engaged.

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Appendix 1

AT&T
Boeing
Chevron
ExxonMobil
Ford Motors
GE
General Motors
IBM
Johnson and Johnson
McKesson
Valero
Walmart