The Daily Dish

Tax Reform and the Household Budget

DOUGLAS HOLTZ-EAKIN | AUGUST 10, 2017

Eakinomics: Tax Reform and the Household Budget

The Congressional Budget Office (CBO) projects that the corporation income tax will produce $3.9 trillion in federal revenues over the next 10 years. Typically, this is reported as "corporations paid $3.9 trillion," but that's not really right. Those $3.9 trillion must come from somewhere—or rather, someone. If corporations raise prices to make up for the $3.9 billion hit, then household customers of corporate products will ultimately pay the tax. If corporations cut back on hiring and raises to make up the $3.9 trillion, it is workers who will pick up the tab in the form of lost wages. Finally, if corporations cut back on their dividend payments to make up for the $3.9 trillion, investors will effectively pay the corporation income tax. Indeed, it could be some combination of all three channels.

The key insight is the people pay the tax, not corporations. And the fact that prices are higher, wages lower, or dividends reduced is evidence of who bears the economic burden of the tax (as opposed to who sends in the check). That is an interesting economics question. *The Wall Street Journal* yesterday pointed out that which people are paying the tax might also be a key part of the politics of tax reform.

Suppose that workers end up paying the corporation income tax. There are about 145 million employed workers in the United States, so that $3.9 trillion means that the average worker loses nearly $27,000 in wages over the next ten years because of the tax. A significant reduction in the 35-percent corporate tax rate would mean a big raise for America's workers. If that was well understood, it might translate into political tailwinds for tax reform. On the other hand, if the effective burden is borne by investors, a corporate tax cut might be portrayed as simply helping fat cats. The economics matter.

Who pays the tax? In the end, it is the party least able to avoid the tax — the least mobile factor. If customers can easily switch to non-corporate products or substitute imports, it will be difficult to pass along the cost of the tax in higher prices. If capital can quickly and easily move out of the corporate sector, and out of the country, to avoid low returns, then it will be hard to pay lower dividends and still attract investors. The same logic would apply to workers.

For a long time, the presumption was that investors effectively paid the corporation income tax. But increasingly, the research community is finding that it is workers who pay the tax, in whole or in part. In a global economy, workers are the relatively immobile player and most likely to be unable to avoid the tax. That is one of the reasons that tax reform is so important — it will be good for American workers. (It is also the reason that the "trickle down" metaphor is dead wrong.)

There are lots of superficial aspects to tax reform. It is worthing thinking through the implications to the bottom line.