

THE 2017 Tax Cuts and Jobs Act and the Work Opportunity Tax Credit

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Executive Summary

- **While tax reform may have a beneficial impact on US economic growth and hiring, the reduction in business taxes alone will not be enough to result in the hiring of a large number of the stigmatized individuals eligible to be hired under WOTC. Without the WOTC incentive large numbers of individuals will remain on the margins of society dependent on public assistance.**
- **Even with a low unemployment rate and more workers entering the workforce, employers will still avoid hiring the WOTC population absent the tax incentive. This is because employers tend to hire from each other, a phenomenon known as “frictional unemployment” instead of hiring stigmatized and unemployed workers.**
- **The challenges to finding employment for those remaining on public assistance are made greater by the incentives in tax reform which encourage investment in automation. WOTC provides an incentive for employers to invest in human capital.**
- **While it is always possible that economic growth will at some point create the conditions that make WOTC unnecessary current projections suggest that is not likely to be the case anytime soon.**
- **In earlier studies Professor Cappelli demonstrated that the US saves close to \$18,000 net of the credit in public assistance costs for every individual brought into the workforce as a result of the WOTC incentive. Over the ten year budget cycle that translates into close to \$150 billion on the Federal level, and \$40 billion to state governments. Tax reform has not changed that dynamic nor eliminated the need for WOTC.**

Introduction:

The Work Opportunities Tax Credit (WOTC) program is designed to help targeted individuals get jobs and, specifically, to help them break the stigma of having little or no work history. As I have described elsewhere [CITE or attach], WOTC does not so much create new jobs as it changes who gets them: Employers disproportionately favor candidates who already have jobs, so WOTC shifts the hiring focus from those candidates to the targeted WOTC recipients, who are unemployed. While not that many employers participate in the WOTC program, it is remarkably cost-effective because there are no taxpayer costs (i.e., tax credits) unless a WOTC-eligible individual is hired. Once they are hired, they lose their eligibility and arguably their need for a wide range of government subsidies, from food stamps to medicaid to public housing. That saves taxpayers on balance far more than the modest cost of the subsidies.

Recent changes in Federal laws to cut taxes, specifically corporate taxes, are considerable and may have implications for the economy, the labor market, and in turn the WOTC program. These changes are part of the 2017 Tax Cuts and Jobs Act. Many claims are made both for and against the likely effects of this Act on the economy. For our purposes, the focus of attention is on hiring. Specifically, will employer hiring pick up so much that no incentives are needed to encourage employers to seek out and hire individuals who would otherwise be eligible to WOTC payments? If so, then the tax subsidy WOTC provides for doing so would be unnecessary and would simply be a windfall for employers.

The question I examine here is whether the changes in the 2017 Act, especially the cuts in corporate tax rates, will alter the effectiveness of the WOTC program. The Tax Cuts and Jobs Act has other provisions that might be relevant to hiring, of course. The most important of those is the change in the rules concerning capital investments, which allow businesses to write off capital investments immediately rather than over a five-year period. I consider that issue as well.

States also impose taxes on corporate profits and have their own rules about expenses associated with those profits. For the purposes of this analysis, we assume those are not changing and consider only the effects of Federal tax policy.

The Effects of Business Taxes:

To address the question of the likely effects of the 2017 Act on hiring and the effectiveness of the WOTC program requires delving into the reasonably extensive literatures on tax policy.

The place to begin might best be with the basic idea of taxes and their implications on economic activity. We often think about the effects of taxes from the perspective of an individual, so perhaps that is the place to start. A tax on an individual's income means that they "take home" or otherwise get to keep less of what they earn. As a result, we might expect that imposing a tax on individuals would make them less interested in working, or at least less interested in working more, because the benefits of doing so are reduced. This phenomenon is known as the "substitution effect" because the taxes cause individuals to substitute leisure or non-work for work time. Substitution effects also influence whether individuals enter or leave the labor force, not just whether they work more or less, and whether they shift work activities to non-taxable income, such as barter.

While that conclusion is reasonable in a general sense, it is worth noting a number of caveats to it. The first is that individuals do not just keep working more and more even if the incentives are there to do so. A tax cut, for example, which gives them more money from the same effort, at some point will cause them to shift their time to enjoying that money: perhaps they work less hard, fewer hours, or retire early if their pay check jumps because taxes are reduced. This is known as an “income effect,” the substitution of more leisure time for work time.

An important caveat to both the substitution and income arguments is that most individuals do not have a great deal of control over the amount of time they work. Employees have schedules that are often set by their employer. Forty two percent of the US workforce is paid a salary, and such workers make no more money when they work more hours.¹

We might imagine that tax cuts would have much bigger effects on those who are self-employed as they control their own hours. Not all self-employed individuals can be thought of as entrepreneurs – some simply contract their time, such as crafts people, some run small business and want to keep them small – but for entrepreneurs interested in growing their businesses, the effects may be biggest.

The analogy with individuals holds up when we think of businesses where all the proceeds go to the owners and the owners pay income tax. In that case, when individual taxes are cut, the owners receive more money from their business, and they may well want to invest more in it as a result, expanding operations and employment in turn. On a slightly more sophisticated level, more projects are now likely to be worthwhile undertaking because the return on them to the owners – after tax - is higher.

The story above appears to be the most common argument used for the advantages of cutting corporate taxes. The problem with the argument, however, is that businesses like those described above are not subject to corporate income taxes. Partnerships, sole proprietorships, S corporations, and LLC’s are known as pass-through companies where revenues go directly to the owners. They are not corporations. Business models like these where we think of owners paying for investments out of their own pocket are irrelevant for thinking about the effects of corporate income taxes and cuts in them.

Perhaps surprisingly, the majority of US business income comes from these pass-through businesses where revenue flows directly to the owners who pay individual income taxes on it.² A remarkable 90+ percent of US business operations are these pass-through companies.³ They also employ a clear majority of US employees,⁴ which is important to remember when we return to the discussion about hiring.

While these businesses do not pay corporate taxes, the tax laws for business do affect how income is calculated for the purposes of taxes: investment and capital costs are deducted before income is

¹ See <https://www.bls.gov/opub/reports/minimum-wage/2015/home.htm>.

² See Susan C. Nelson. 2016. "Paying Themselves: S Corporation Owners and Trends in S Corporation Income, 1980-2013." U.S. Department of the Treasury, Office of Tax Analysis, Working Paper 107. <https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/WP-107.pdf>

³ Prisinzano, Richard, Jason DeBacker, John Kitchen, Matthew Knittel, Susan Nelson, and James Pearce. 2016. "Methodology for Identifying Small Businesses and Their Owners." Office of Tax Analysis, Technical Paper 4 (Update), U.S. Department of the Treasury. Table 2014-2: <https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/TP4-Tables.xlsx>

⁴ Scott Greenberg. Pass through Businesses: Data and Policy. <https://taxfoundation.org/pass-through-businesses-data-and-policy/> January 17th 2017.

calculated for taxation, for example, so that the simple model of the individual noted above does not hold for understanding these pass-through businesses. We consider the special exemption granted by the 2017 Act to those business below.

Companies that do pay corporate taxes are those that have a traditional “C” corporate structure. They are different from pass-through businesses in two important ways. The first and most fundamental difference is that they have a choice as to how to use corporate revenue. They can retain it – reinvesting in the business or simply holding cash. That makes the business more valuable and increases the wealth of those who own the business. Retained income is not taxed by the corporate income tax. Companies can also pay out their income in dividends, in which case those payments are subject to corporate income tax.

The presence of a corporate income tax might therefore cause business to change how it operates in order to avoid the taxes. For practical purposes, that would mean reducing reported income, which is most easily done by retaining earnings, an issue we consider in more detail below. Tech firms like Microsoft and new firms like Amazon are well-known for not paying dividends, retaining the earning and driving their share prices higher as a result.

The second difference with corporations is that the executives running these companies are employees of the business who are not paid based on company revenue. While most corporate executives have some ownership stake in the business, they almost never own enough of the business to control how hard they and the business should work.

The pressure from shareholders to increase profits in these companies is intense. Executives are already pushed by shareholders to work as hard as they can to make as much money as they can for the business and the shareholders. While a higher income tax may make the leaders of pass-through companies not work as hard as they otherwise might, a higher corporate income tax does not make the employee executives work less hard. To put it bluntly, no board of directors is likely to say, “OK CEO, now that the corporate tax rate is lower, we want you to stop coasting and really make some money.”

The greatest difficulty in understanding the effects of cuts in corporate income tax comes from thinking that the corporations that pay these taxes are like individuals or like pass-through companies. They are not, and that difference means that the effect of cuts in corporate taxes are quite different from how we imagine cuts in personal income tax to work.

The Effects of Corporate Income Taxes on “C” Corporations: It seems fair to conclude that the effect of corporate income taxes on businesses that have to pay them is unlikely to be that it reduces the effort of business enterprises to make money. The effects that should concern us are much more about how such taxes change the way businesses operate in other ways.

It might also be tempting to think of taxes as another example of business costs and that raising taxes is like raising the cost of electricity, something that has to be built into the cost and price of any goods or services produced. If so, we might expect such taxes to raise prices, lower demand, and reduce the volume of business being done. Indeed that is true for taxes such as those paid on real estate. Such taxes are part of operating expenses and can be deducted from income that is taxes by corporate income taxes.

Corporate income taxes are not like that, of course, because they are paid on the residual of earnings after operating expenses are taken out, and those expenses include other taxes. Assuming that corporate income taxes are a business costs is another common mistake that complicates our understanding of the effects of the 2017 Act.

Where some suggest that the business cost argument has relevance is with respect to the cost of capital. One of the costs that businesses have to cover to remain viable is their cost of capital, the price they have to pay to get the funds necessary to operate. The argument for corporate tax cuts often assumes, at least implicitly, that investments are paid for out of after-tax profits, as they might be for an individual. Anything that improves after-tax profits would then improve investments.

The problem, though, is that view is simply not accurate. Is not true even for pass-through businesses, and it is certainly not true for corporations. Investments are deducted before corporate income taxes are paid. If a company decides to retain earnings and invest them rather than to pay them out to owners of the business, its tax bill falls. As noted below, corporate taxes actually create incentives to shift business revenues toward investments and other uses of retained earnings.

In practice, retained earnings play a relatively small role in providing the resources companies use to make investments for US companies. Virtually all the capital that businesses in the US use to operate comes from bondholders in the form of securities that pay interest. (Short-term capital is more likely to come from bank loans.) If the business cannot cover the interest payments associated with those bonds, it cannot raise money and cannot stay in business.

The interest on borrowing and therefore the cost of capital is deducted from income before profits. The surprising effect of that requirement is that higher taxes on corporate income actually **reduce** the after tax cost of debt and of capital. The empirical evidence at the company level provides ample support for this. For example, cuts in corporate taxes cause firms to raise their debt holdings.⁵ The cost of capital actually goes up when corporate taxes are cut. Arguments suggesting that corporate taxes hurt the ability to invest do not square with the facts. Companies do need to generate enough income – specifically EBITA (earnings before interest payments, taxes, and amortization) – to pay for capital, and as we will see below, cutting corporate taxes is especially good for those receiving dividend income. But it does not reduce the cost of capital.

A related argument one sometimes hears about tax cuts is that they make more business opportunities attractive because they reduce the “hurdle rate” or the return that a project has to generate to make it attractive. Tax cuts, then, would lead businesses to take on my projects and expand. This argument is simply another mistaken view about the cost of capital. The hurdle rate is derived from the cost of capital, and again, capital for investments does not come from after tax profits.

What, then, are the effects of corporate taxes on business operations? As long as there is any corporate tax, there are incentives to shift income away from taxable profits. (There is a long literature in economics on this topic of the distortions associated with taxes, including Nobel Prize-winning research.) But doing the reallocations necessary to reduce taxes has some cost, especially in terms of overall efficiency. When the tax rate falls, the motivation to pursue some of the more difficult and costly reallocations falls as well. It is a good outcome for economic efficiency to reduce those

reallocations. No doubt corporate income taxes are causing companies to retain more funds than otherwise makes sense for them. We should expect dividend payments to rise when corporate tax rates fall because the “cost” of paying out dividends in terms of the corporate taxes paid declines.

When dividend payments go up, the individuals who receive those payments pay higher personal taxes. This is sometimes described as a “double-taxation” effect, because companies pay corporate tax on that money and then the recipients pay individual taxes on it as well. This double taxation makes the calculation of the net tax effect of corporate taxes complicated. The Federal *individual* tax rate on qualified (held more than 60 days) corporate dividends has been and will continue to be 15 percent, rising to 20 percent for the top income category. That is considerably less than the pre-2018, 35 percent *corporate* tax rate and still less than the new 21 percent rate, although not by much. An extra dollar paid out in dividends therefore would yield 21 percent of corporate tax revenue and roughly 15 percent of the remaining 79 cents would be paid in personal income tax.

The next question is, what happens to the income of those who receive corporate dividends? A large proportion of dividend income goes to individuals who do not pay taxes, at least immediately. Roughly one quarter of US stocks are owned by foreign entities and individuals who do not pay US taxes; roughly half is held by retirement accounts of various kinds, where dividend payments will eventually be taxed when retirement income is withdrawn, but as little as one-quarter may be held in taxable accounts where proceeds can be spent in the US.⁶

The double taxation issue is therefore much less important than one might imagine. The idea that a corporate income tax cut will be offset by increases in personal income tax revenue is not true in any meaningful sense. An extra dollar of dividend income has a one-in-four chance of landing in a taxable account, where it would be affected by a 15 percent tax, so the net personal income tax revenue generated by an additional dollar of dividend income would be only 3.75 cents.

A related question is to what extent an extra dollar shifting from retained income to dividends will effect spending and consumption in the overall economy. The good news about the fact that so little of dividend income is actually taxed is that much of it could go to individuals and presumably to consumption that might raise business demand. The bad news from above is that most all of dividend income goes to recipients who cannot spend it, at least in the US and at least immediately with respect to retirement accounts in the US.

As noted above, the more important and complicated effect of corporate taxes is that they alter the business decisions that companies make, shifting resources internally to other uses to avoid profit taxes. How big the shift in resources away from taxable profits has been can be compared by comparing the charts below. The corporate tax rate reached its peak level in 1968 at 53 percent, and declined since then, falling sharply during the Reagan administration from 43 percent to the 35 percent level. In the first chart, we can see how tax revenue from the corporate income tax as a share of GNP declined from the 1950s

⁶ The Dwindling Taxable Share Of U.S. Corporate Stock By Steven M. Rosenthal and Lydia S. Austin. May 16 2016. <http://www.taxpolicycenter.org/sites/default/files/alfresco/publication-pdfs/2000790-The-Dwindling-Taxable-Share-of-U.S.-Corporate-Stock.pdf>

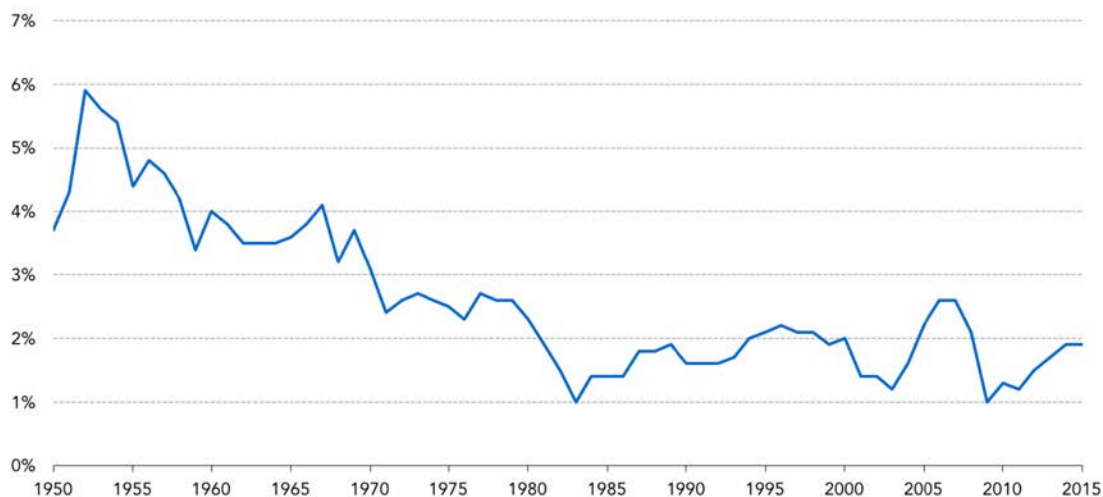
through 1968, even as the tax rate increased, and declined quite sharply after that, including in those periods when the tax rate remained the same. [DO THESE INCLUDE STATE TAXES?]

FIGURE 1

Corporate Income Tax Revenue as a Share of GDP FY 1950–2015



Share of GDP



Source: Office of Management and Budget, Historical Table 2.3.

Data Sources

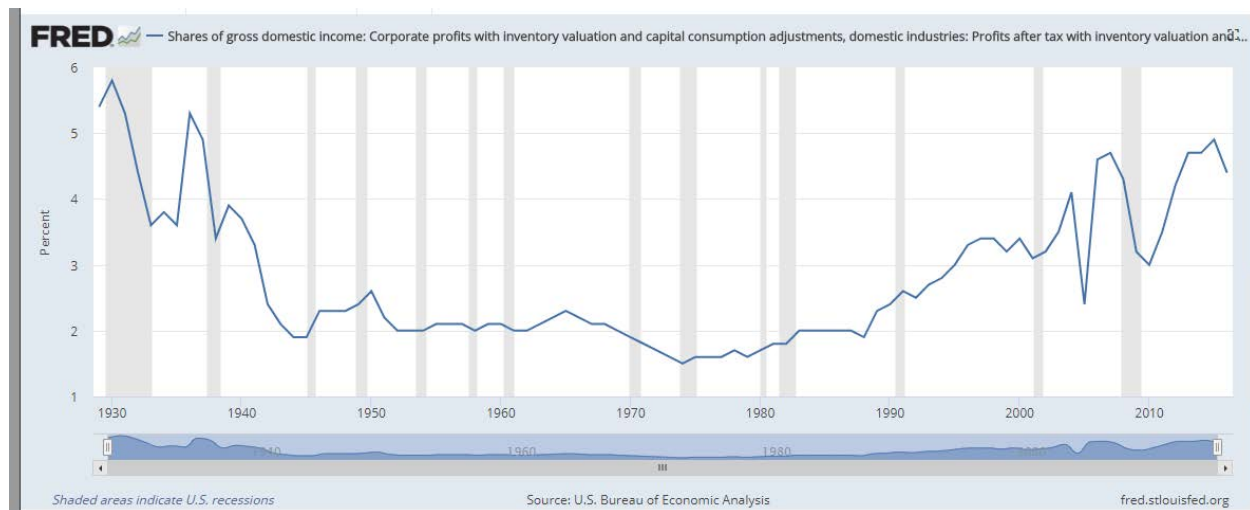
Office of Management and Budget. Historical table 2.3. *Historical Tables*. "[Receipts by Source as Percentage of GDP: 1934–2020](#)."

Tax Policy Center, Urban Institute and Brookings Institution.

Over the same period, however, corporate profits as a percentage of the economy have risen quite sharply.⁷ The difference between the two charts reflects the rise of undistributed profits, that is, retained by companies in various ways. Whether retaining earnings is a good or bad thing for the companies and for the economy is a difficult question to answer as it depends in part on what is done with those retained earnings, as we discuss below. The general view in economics, though, is that

⁷ The two sets of data are not strictly identical as the tax revenue chart is as a percentage of Gross National Product while the profit chart is as a percentage of Gross Domestic Income. As the US Department of Commerce's Bureau of Economic Analysis notes, the two measures are "conceptually equal," essentially two sides of a balance sheet, but may differ in terms of statistical discrepancy because of the timing of data collection, and so forth. An in-depth discussion as to how that shift of resources within the profit category from taxable to non-taxable items takes place is provided in: The 35 % Tax Myth. Institute on Taxation and Economic Policy. <https://itep.org/the-35-percent-corporate-tax-myth/>.

distorting the decisions that companies would otherwise make in response to markets and business needs, as taxes do, always hurts economic efficiency.



14	Taxes on corporate income	521.9	516.7	485.6	505.6	455.9	471.5	487.2	469.5	466.3	479.6	475.5	445.6
15	Profits after tax with IVA and CCAAdj	1,653.7	1,658.5	1,650.3	1,477.7	1,584.8	1,525.1	1,614.1	1,685.7	1,642.7	1,643.8	1,738.2	1,767.0
16	Net dividends	1,062.0	1,036.3	1,048.1	1,013.3	1,000.7	971.3	976.3	979.1	988.1	994.2	998.6	979.9
17	Undistributed profits with IVA and CCAAdj	591.7	622.2	602.2	464.4	584.1	553.9	637.7	706.6	654.6	649.6	739.6	787.1

The shift of resources away from taxable profits means that the “effective tax rate,” that actually paid on corporate profits, has been considerably less than the 35 percent rate, just as the effective tax rate for individuals minus deductions and so forth is less than the stated tax rate. Estimates of the effective corporate tax rate require accounting calculations and many have been generated. But they center around 23 percent, which is also the figure generated by the Penn-Wharton model. The variation across industries and more so across companies is huge.⁸

The effective tax rate concept is a reminder that the stated tax rate is not the only factor driving tax revenues. One might be tempted to say that if the percentage of income actually paid on average is 23 percent and the new tax rate is cut to 21 percent, then the cut will not have much effect. But what can be deducted from taxes matters a great deal as well. A cut in tax rates will not necessarily produce the expected effect in terms of actual taxes paid unless deductions and the implementation of the tax schedule are considered as well, something we return to below. The Penn-Wharton model estimates that the effective tax rate minus deductions after the 2017 Act will be roughly 15 percent, an eight percentage point reduction. That is substantial, although less than the 14 percentage point difference in the tax rates. A summary conclusion is that we should be wary of estimates of the impact of tax cuts that assume corporations are all paying the maximum rate.

⁸ Penn-Wharton Budget Model. <http://budgetmodel.wharton.upenn.edu/issues/2017/12/15/effective-tax-rates-by-industry> For industry variation, see NYU Professor Aswan Amodaran’s estimates: http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/taxrate.htm

An important issue is what happens to earnings that have been retained in a conscious decision to avoid paying higher corporate income taxes. The decisions vary considerably across industries and companies, but among the Fortune 500 where investigations have been calculated, a little more than one-third (37 percent) of total corporate earnings were paid out in dividends, which means that the remainder were retained. The majority of earnings – 54 percent – and therefore the vast majority of retained earnings went to stock buyback programs where the company uses the funds to buy and hold existing shares of its company.⁹

A story suggesting that corporate tax cuts will increase investment by giving companies money that they can use to invest has to address the fact that companies already have huge cash resources that they are not using for investment, roughly \$2.4 trillion.¹⁰ There is no explanation as to why savings for tax cuts will be used differently than current cash is now.

To summarize, tax savings associated with corporate income tax cuts could be retained by the companies, and if so, it is likely to increase share prices, but it will have little effect on a company's business operations. Tax cuts that are paid out through dividends and go to investors have a different effect by stimulating the economy, assuming they are spent. Assuming business continues to distribute earnings the way they are doing at present, then an additional dollar of savings from a cut in the corporate income tax will lead to 37 cents of additional payout to shareholders in the form of dividends. Roughly one quarter of those dividends will go to shareholders who can spend them now. That leads to a roughly nine cent increase in consumption. We return to that issue below.

The Change in Depreciation: Other than the cut in the corporate tax rates, the most important effect of the 2017 Act is arguably the change in the treatment of capital investments, which can now be deducted immediately as opposed to being amortized over time. There may be reasons why companies prefer to amortize investment expenses, for example, if the traditional amortization schedule helps them offset greater earnings in future years. But on balance the change is certainly beneficial to companies by allowing them to reduce taxable income sooner. The fact that this tax treatment ends in five years may well cause companies to accelerate investment decisions, front-loading more in them in the next five years, depending on their view as to how tax laws and regulations will change in the future.

We should expect that this new tax treatment will make capital investment relatively cheaper, causing companies to make more of it at least in the next five years. Under the current tax plan, though, we should expect investment to decline right after that five-year period as companies will accelerate planned investment to make the five-year deadline, reducing planned investment after that. The long run pattern of investments should not be much altered as opposed to a situation where the cuts were permanent. That may well be good for the companies, especially for their productivity, and may ultimately be good for the economy as a whole. Capital investment is typically seen as the substitute for labor, however, so increases in capital investment do not necessarily create jobs.

⁹ William Lazonick. Profits Without Prosperity. Harvard Business Review September 2014.
<https://hbr.org/2014/09/profits-without-prosperity>.

¹⁰ <https://www.wsj.com/podcasts/companies-sit-on-more-than-2-trillion-in-cash/0065FEAF-E046-4814-B0F3-43C16EB3D310.html> April 18 2018.

The analyses above give us a much better sense of how to think about what the effect of this recent corporate tax cut will be. They include the following:

- The corporate tax cut in the 2017 Tax Reform and Jobs Acts applies to less than half the business earnings in the US.
- The effective tax rate that companies are paying on corporate profits now is on average close to the new tax rate. The assumption that companies are now paying 35 percent of their corporate income in taxes and will soon pay only 21 percent is not true.
- Analogies between individuals and pass-through businesses to corporations do not hold up. Specifically, the corporate income tax is not an operating expense as it is only paid on company profits. The cost of capital, which determines which investments are worthwhile to make, is not based on after tax profits. Because virtually all company investments are funded by bonds/debt whose costs are operating expenses deducted before profits, cuts in corporate income taxes actually raise the cost of capital.
- At the moment, most corporate income that would be subject to taxes is retained. If companies allocate income saved by the tax cut in the same way as they allocate income now, most will be used to buy back shares, increasing shareholder wealth but doing little for real economic activity. Funds allocated to dividends should have a stimulative effect on the economy, but that effect is limited by the fact that so few of the recipients of dividend income can spend it in the US.
- The effects of the new rules on depreciation may very well encourage employers to invest more in capital equipment and other depreciating assets for the next five years. One of the most important purposes of capital investments is to substitute for labor: productivity improvements, which are essential for economic growth, are measured in terms of output per worker. Greater capital investments should reduce future demand for labor, other things equal.

The 2017 Act also makes a wide range of changes as to how foreign income is treated. The most important of these is a general shift in defining taxable income from based on where the company is headquartered to where the company earns that income is earned. Multinational companies headquartered in the US would therefore pay significantly less US tax on income it earns outside the US. That change may encourage companies to shift more of their operations abroad by eliminating the tax it pays on such income.¹¹

On the other hand, the new law allows favorable treatment of at least some income earned outside the US., exempting some income from US taxes but retaining taxes on other types of income. While the perception is that taxes are cut on foreign income, the reality appears to be far more complicated. As

¹¹ A detailed overview of the tax treatment of various kinds of foreign income is provided in: 2017 Tax Reform: Checkpoint Special Study on foreign income, foreign persons tax changes in the “Tax Cuts and Jobs Act.” Thompson Reuters. <https://tax.thomsonreuters.com/media-resources/news-media-resources/checkpoint-news/daily-newsstand/2017-tax-reform-checkpoint-special-study-on-foreign-income-foreign-persons-tax-changes-in-the-tax-cuts-and-jobs-act/>.

one international accounting firm concluded, “...the sum total of these changes [the 2017 Act] represents a considerable expansion of the base of cross-border income to which US taxation applies.”¹²

The most immediate concern about the treatment of foreign income is to what extent tax changes will encourage US companies to bring back to the US considerable cash reserves they are currently holding in foreign subsidiaries. The application of a new tax on repatriated income as well as mandatory repatriation of at least some classes of income are hard to anticipate. I have seen no credible estimates as to what these changes will mean for cross-border income flows, let alone how corporate decisions will be affected. It seems reasonable that considerable sums will be brought back into the US, but what corporations will do with the additional cash is the open question. A reasonable assumption is that they will treat the post-tax income from repatriation the same way they treat the savings from the corporate tax cuts.

We turn next to the empirical evidence on changes in corporate tax rates.

Who Pays the Tax – Employees or Shareholders?

The first set of studies relevant to assessing the effects of the 2017 Act are those addressing directly the effects on labor. These studies begin with a classic question in economics as to who actually pays for a tax. The answer is never straight forward. Consider the classic example of a payroll tax paid by employees directly out of their pay check to the government. It may seem obvious that the tax is paid by the employees, and it clearly is in the literal sense of who is passing the tax revenue to the government. The question is, what else happens next.

Say that employees are paid the market wage and that a new, 10 percent payroll tax paid by the employees cuts their take-home pay by 10 percent. Now their take home pay has fallen 10 percent below the market wage. If they can find a job elsewhere at a higher rate of pay, perhaps in a sector where the payroll tax does not apply, they will quit their current job. If the employer wants to keep them, the employer has to raise their wage. Exactly how much they raise the wage is determined by the ability of the employees to move and how much the employer needs them to stay, or in more technical terms, the elasticity of the supply of labor. The more the wage goes up, the more the employer essentially “pays” for the tax increase even though the money for it literally comes out of the employees’ paycheck.

With respect to corporate taxes, similar questions apply. The corporate tax is obviously paid by the firm. As in the example above, though, the question is, what happens next? If the firm can turn around and raise its prices to cover the cost of the tax increase, for example, then customers are actually bearing the burden of the tax.

Economic models on this question are frankly more concerned about addressing the classic tension between labor and capital than they are in assessing the overall effects of taxes accurately. To illustrate, they assume implicitly that business cannot push tax increases onto customers, which would seem to be the most obvious secondary effect, nor can they squeeze lower costs from their suppliers to cover the extra costs of the tax. In these simple models, the firm’s resources go either to shareholders or to employees. In that context, the question about corporate taxes is whether the firm can squeeze

¹² Tax Reform: KPMG Report on the New Tax Law. KPMG. February 8th 2018.
<https://home.kpmg.com/content/dam/kpmg/us/pdf/2018/02/tnf-new-law-book-feb6-2018.pdf>

payments to labor when taxes go up, effectively getting employees to bear the burden of the tax increase. If that is the case, then when taxes are cut, the pressure is off employees to pay for the increases, and they would benefit, or so the argument goes. The reason this reasonably abstract modeling matters is because claims have been made that the current tax cut will benefit labor.

Practically-minded readers may see this academic discussion as silly: If employers could squeeze their workers for lower wages, why aren't they doing it already? The responses is that individual employers cannot do that as employees would respond to the lower wages by jumping to another employer. But if all employers have to pay the tax, they may all be in a position to squeeze their employees by effectively saying, "with these increased tax costs, we can only afford to keep you on if wages are reduced."

The initial research on this question concluded that because labor was mobile (could quit and go to another employer) and most capital was locked up within individual businesses, capital bore all of the burden of corporate taxes and therefore received all the benefits from tax cuts.¹³ More recent studies have asserted that capital is now more mobile, especially in its ability to move out of the country, and so labor should be bearing more of the burden. The practical implications of this conceptual debate is that government estimates of the effects of tax increases and tax cuts have used it as the basis to allocate some of the expected costs and benefits of tax changes to labor¹⁴ although interestingly none to consumers. Thoughtful observers have concluded that the evidence is not clear enough to know with any certainty which group is bearing the real costs.¹⁵

The studies above typically rely on quite rigid models of the economy (viz: the forced choice between capital and labor), and their results depend crucially on the assumptions they must make about various aspects of the economy. Again, the reason these studies matter is because they are sometimes used to suggest how the 2017 Act's tax cuts will play out for labor.

Studies of Cuts in Corporate Taxes:

¹³ See the seminal study articulating this position, Arnold C. Harberger, "The Incidence of the Corporate Income Tax," *Journal of Political Economy*, 70:3, June 1962, pp. 215-240. Among the classic studies using this labor/capital view are Alan J. Auerbach, "Who Bears the Corporate Tax?" in James Poterba, ed., *Tax Policy and the Economy* Vol. 20, ed., Cambridge, MA: MIT Press, 2006, pp. 1-40, and Arnold C. Harberger, "Corporate Tax Incidence: Reflections on what is Known, Unknown, and Unknowable" in John W. Diamond and George R. Zodrow, eds., *Fundamental Tax Reform: Issues, Choices, and Implications*, Cambridge, MA: MIT Press, 2008. Harry Grubert and John Mutti, "The Taxation of Capital Income in an Open Economy: The Importance of Resident-Nonresident Tax Treatment," *Journal of Public Economics* 27, August 1985, pp. 291-309.

¹⁴ For a review of this literature, see *MODELING THE DISTRIBUTION OF TAXES ON BUSINESS INCOME*. Prepared by the Staff of the JOINT COMMITTEE ON TAXATION. October 16, 2013 JCX-14-13.

¹⁵ A.C. Harberger. 2008. The incidence of the corporation income tax revisited. *National Tax Journal*, LXI(2):303-12.

There is another approach to examining the effects of corporate taxes that takes a distinctly less theoretical and more empirical approach. These studies typically look at changes in actual corporate tax rates to examine the effects of the taxes and, more important here, the effects of actual tax cuts.

The most obvious attribute to study would be changes in US Federal taxes and their effects on the economy. The most prominent tax cuts in modern times occurred during the Reagan Administration where both personal and corporate taxes were reduced. Those cuts were not associated with increased growth in the economy. The corporate tax cuts did increase investment, however.¹⁶

Arguably the most influential study on US Federal taxes, at least for advocates of tax cuts, was Christina Romer and David Romer's examination of the effects of increases in US tax rates on overall GNP. They find that on average, there is no effect. But when they examine changes that were not done in the context of other, broader policy changes, the effects were dramatic: a one percent increase in taxes led to a long-run decline in GNP of three percent.¹⁷ A critic would say that this result depends entirely on the choice of which increase to consider, but at a minimum, it does suggest that the effects of specific changes can be dramatic. Unfortunately, the study did not examine the effect of tax reductions on GNP, and while it might be reasonable to assume that the effect would be significant, it is also reasonable to assume that the effects of increases and of cuts would not be symmetrical. The other caveat for the purposes here is that the study examined personal income taxes rather than corporate income taxes.

The other studies fall into two general approaches. One examines tax rates across countries, typically within the European Union. A survey of research on tax cuts in Europe actually found a negative relationship with jobs. The reason appears to be because the cuts led to investment in labor-saving technology and, in turn, lower job growth.¹⁸ An Australian study found no simple relationship between effective tax rate and job growth and in fact some evidence that firms paying more had faster job growth.¹⁹ A Canadian study found no systematic relationship between corporate tax regimes (rates, changes, and so forth) and business outcomes there.²⁰

The other set of studies examines changes in corporate taxes at the state level within the US. Although state tax rates tend to be much smaller than Federal rates, the effect of tax differences across states might be substantial because of the greater ability to avoid higher state corporate taxes by moving businesses from one state to another.

¹⁶ Feldstein, Martin, and Douglas W. Elmendorf. 1989. "Budget Deficits, Tax Incentives, and Inflation: A Surprising Lesson from the 1983-1984 Recovery." *Tax Policy and the Economy* 3: 1– 24.

¹⁷ Romer, Christina D., and David H. Romer. 2010. The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks. *American Economic Review* 100, no. 3: 763–801.

¹⁸ Do Corporate Income Tax Rates Cuts Create Jobs? The European Experience. Antonio Estache and Brigitta Gersey January 2018. ECARES working paper 2018-01. Brussels, Belgium.

¹⁹ Economic Analysis and Policy. [Volume 59](#), September 2018, Pages 25-28 Do firms that pay less company tax create more jobs? [Andrew Leigh](#).

²⁰ Do Corporate Income Tax Rate Reductions Accelerate Growth? Jordan Brennan. Canadian Centre for Policy Alternatives. November 2015.

An overall study of the level of state corporate tax rates finds no relationship with jobs and economic growth.²¹ A similar study looked at the effects of cuts in business taxes across states and found no impact on jobs or wages.²² A different study that looked at the effects of state tax cuts at the county level – comparing counties next to each other where one was located in a state where taxes were cut and the other in a different state where taxes were not cut. It would be relatively easy to move a business from one of those counties to the other, yet tax cuts in one state were not associated with increases in jobs.²³ Dramatic tax cuts in Kansas that eliminated the corporate income tax altogether were associated with no increase in jobs in the state.²⁴

A study that included personal income tax and corporate tax rates together to measure overall taxes that affect businesses at the state level, however, found that cuts in those combined taxes were associated with considerable growth in the number of establishments operating and in wages. Dividing the benefits across capital, property owners, and labor (again excluding consumers), they find that labor secures roughly one-third of the gains from corporate tax cuts through higher wages.²⁵

A related study examined the difference between tax cuts manifested by reductions in withholding requirements vs. tax rebates and found that reduced holding had little effect on spending and the associated economic stimulus: rebates, on the other hand, were more useful.²⁶

It is difficult from these studies to conclude that we should expect much change in economic outcomes from cuts in corporate taxes. The case for arguing that the Tax Cuts and Jobs Act might have a different outcomes lies perhaps with the scale of the cuts: Federal corporate income tax rates are far higher than state corporate tax rates, and the cuts in the Act are substantially bigger than most of the state tax cuts that have been considered.

²¹ Kenneth J. Meier and Soledad Artiz Prillaman. 2014. Taxes, Incentives, and Economic Growth: Assessing the Impact of Pro-Business Taxes on U.S. State Economies. The Journal of Politics 76(2).

²² Taxes, Incentives, and Economic Growth: Assessing the Impact of Pro-Business Taxes on U.S. State Economies. The Journal of Politics 76(2) · April 2014. Kenneth J. Meier Soledad Artiz Prillaman

²³ The J Ljungqvist, Alexander, and Michael Smolyansky (2016). "To Cut or Not to Cut? On the Impact of Corporate Taxes on Employment and Income," Finance and Economics Discussion Series 2016-006. Washington: Board of Governors of the Federal Reserve System.

²⁴ The Short-term Effects of the Kansas Income Tax Cuts on Employment Growth
Tracy M. Turner, Brandon Blagg. Public Finance Review. First Published March 29, 2017

²⁵ *Suárez Serrato, Juan Carlos, and Owen Zidar. 2016. "Who Benefits from State Corporate Tax Cuts? A Local Labor Markets Approach with Heterogeneous Firms." American Economic Review, 106 (9): 2582-2624.*

²⁶ Am Econ J Econ Policy. 2012 Aug; 4(3): 216–50. Check in the Mail or More in the Paycheck: Does the Effectiveness of Fiscal Stimulus Depend on How It Is Delivered? Claudia R. Sahm, Matthew D. Shapiro, and Joel Slemrod.

The Pass-Through Exemption:

Potentially more important than the corporate tax cut itself is the exemption that the 2017 Act included for some income of pass-through businesses. This exemption could be important because, as noted above, so many employers operate with a pass-through model. Section 199A of The Act states that up to 20 percent of the income generated by these businesses could be exempt from the personal income tax that the owner might otherwise pay. The complication in considering the effects of this provision is that there are a great many restrictions on it. A very general overview is that for what we might think of as high-income pass-through businesses, including finance, medicine, and law, the tax break goes phases out quickly for all but the lowest income businesses. For other businesses, the income eligible for the exemption first has to pass a number of hurdles and offsets associated with W-2 income the business has paid, reasonable wage compensation for the owner, and so forth.²⁷

The value of the deduction is difficult to estimate because of these many restrictions, but it would appear that for very small businesses, it could represent noticeable savings: Brookings (above citation) calculates that a couple with roughly \$575k in taxable income \$75,000 of “qualified” income that would be passed through to personal income would end up with a \$10,000 deduction, which would and save roughly \$3000 in their tax bill. As with any tax on income, this exemption does not create an incentive for additional investment because investments are already deductible, nor does it reduce the cost of capital. What it may do is make certain investments that are already above the cost of capital more attractive for an owner to undertake, and some of those may create more jobs. The effects of this gain for any individual business are obviously trivial, but the effects across a million small businesses could be noticeable. An important limitation of the pass-through provision, though, is that it set to end in eight years.²⁸

The deduction depends on the amount of net income and on the nature of the business. For services that we might think of as high-end, such as investment, healthcare, or consulting businesses, the deduction phases out as income rises, after \$157,000 for an individual tax filer. For other sources of “qualified income,” the deduction phases out at a higher income level. An additional criterion allows that 20 percent deduction up to a limit of 50 percent of the wage compensation of the business as measured by W-2 payments.

For taxpayers who can take the full 20 percent deduction, the tax they will pay on that qualified income is effectively capped at 29.6 percent (assuming their total income puts them in the top personal income tax bracket). That is a reduction from the top personal income tax rate of 37 percent, although not as

27 An overview of the provision is in: William G. Gale and Aaron Krupin. Navigating the new pass-through provisions: A technical explanation. Brookings. February 12 2018. <https://www.brookings.edu/research/navigating-the-new-pass-through-provisions-a-technical-explanation/>

28 The rules governing this deduction are considerably more complicated than the description here. Among the many guides to Section 199A are Tax Reform and Section 199A Deduction of Qualified Business Income of Pass-Through Entities. January 2018. <https://www.bdo.com/insights/tax/federal-tax/tax-reform-and-section-199a-deduction>.

much of a reduction as seen on the corporate tax rate. Securing the entire 20 percent deduction is not always easy as the restrictions are reasonably complex.

Should we expect the effective tax rate caused by the new deduction to change the behavior of owners of these pass-through companies? This takes us back to the earlier discussion of incentives and income and substitution effects. For businesses where the efforts of the owners are essential to business outcomes, we might expect some increase in effort by the owners because substitution effects associated with the greater return now that the effective tax rate of their business has been cut are probably greater than the wealth effects associated with the additional income they retain after the cuts. The question is, how much.

The effects might be most notable where there are many owners in a business, such as in partnerships. Most partnerships are in professional services, though, and are excluded from Section 199A coverage. One might wonder whether employee ownership in the form of Employee Stock Ownership Plans or broad-based stock options could extend these effects to all employees in a business. Stock-based plans are limited to corporations, however, and the evidence that either employee ownership or stock options per se drive better firm performance is decidedly mixed.²⁹

The most important effects of Section 199A deductions are likely to be the increase in consumption of the kind associated with a cut in personal taxes and the effect on the overall economy. We consider those below and turn next to the empirical evidence on changes in corporate tax rates.

Forecasting Models of the Tax Cuts and Jobs Act:

Yet a final approach to anticipating what the effects of the Act will be on the economy and on jobs comes from forecasting models. These receive the most attention first because they can be generated in real time, unlike the analyses above that examine historical tax cuts, and second because they are often rolled out with some media fanfare.

Forecasting models begin their life as attempts to explain some outcome in earlier periods, such as the level of unemployment in the economy, based on data from those periods. Then it takes the equation that forms the model, changes the levels of some of the factors in it, and sees what the outcome is then. A key factor in an equation predicting unemployment levels might be tax rates, for example, so predicting how changes in tax rates would affect unemployment would involve putting a new tax rate into the equation to see how the unemployment outcome variable changes.

There are many challenges in producing an effective forecasting model. The first is that the equation used to do it has to begin by explaining historical outcomes accurately. Explaining any economy-wide outcome is a real challenge because so many factors likely contribute to those outcomes, and capturing

²⁹ Among the studies showing that there is no net effect from broad-based stock options are Paul Oyer and Scott Schaefer (2005): "Why Do Some Firms Give Stock Options to All Employees? An Empirical Examination of Alternative Theories," *Journal of Financial Economics*, 76, 99–133. Among the studies showing that they do have an effect are Peter Cappelli and Martin Conyon, forthcoming. *A Social Exchange Model of Stock Option Plans*. ILR Review.

all of them is extremely difficult. Factors such as consumer sentiment are important for economic growth, but measuring it accurately is a challenge.

To illustrate this challenge, consider the basic question of estimating how much money companies will save from the 2017 Act's tax cuts. A simple approach, which some of the estimates use, is to assume (incorrectly of course) that companies are currently paying 35 percent of their income in taxes and that this figure will be reduced to 21 percent of their income. To do it correctly requires looking at overall corporate finances and match them line-by-line to the provision of the 2017 Act's new requirements.

The second challenge is the assumption that the equation itself remains essentially unchanged in the future period being forecast: the manner in which tax rates affects jobs in 2020 will be the same as the way in which it affected them from 2000 to 2017. Knowing whether the structure of the economy will change in the future is impossible to know, indeed would require its own forecast. Better forecasting models include in their analyses estimates as to how the structure behind the model itself might change. For example, rather than assuming that companies will allocate the same share of savings from tax cuts to dividends as they have done with previous income, the model might estimate how that share has and will change over time based on different levels of overall income.

There are only two projects that actually generate real forecasts of the effects of the 2017 Act. They are the Joint Committee on Taxation (some US Treasury reports use the same model) and the Penn-Wharton forecasting model. The others are closer to accounting projections, which use partial figures generated from other studies to yield approximate answers – for example, assume that companies will invest the same percentage of new income saved from the cuts as they invest from current income, or assume that they will invest the same percentage of as they did from the corporate tax cut in 1983, and so forth. It should be obvious that the choice of the assumption alters the conclusion. So many assumptions are required and so many different arguments are possible as to the appropriate criteria for choosing assumptions that it is possible to produce almost any estimate one wants with the choice of assumptions.

To add to the complexity, we are interested in many different outcomes that might be associated with the economy, and each outcome requires at least a slightly different forecasting model. Generating a true forecasting model is a tremendous amount of effort, and so far the estimates from the two true forecasting models – the Joint Committee and the Penn-Wharton model – look at only overall outcomes rather than specific corporate decisions, such as what kind of investments will be made. The models themselves are data driven – that is, based on past relationships between the variables – as opposed to driven by theory or assumptions. An advantage of them for the purposes here is that they include changes in the pass-through exemption as well as in the corporate tax rates.

The estimates assume that the cuts in tax revenue will not be offset by tax revenue elsewhere or by spending cuts, that they constitute deficit spending. The estimates try to factor in the effect of growing deficits associated with these cuts on the economy.

Looking first to the cuts in the corporate tax rate, the effects are front-loaded: the effective corporate tax rate is expected to be 43 percent of the 2017 rate but 80 percent of the 2017 rate in ten years. Briefly, the Penn-Wharton model asserts that overall gross domestic product in the US will be from 0.6 to 1.1 percent higher in ten years (2017) than it would have been in the absence of the 2017 Act's tax cuts. That works out to 0.06 greater per year (to be clear, that is six one hundredths of one percent). It

also asserts that labor income (which could come from more jobs or higher wages for existing jobs) will be from 0.6 to 1.1 higher than it otherwise would have been in 2017.

The Joint Committee's model see GNP being 0.8 percent greater in 2027 than it otherwise would be. This is in the mid-point of the range of the Penn-Wharton model. The Joint Committee also estimates that employment will be 0.6 percent greater than otherwise. It is interesting to note, however, that the mechanism they see for greater employment is on the job seeker side, that lower individual tax rates will cause more individuals to join the labor market. It is true, however, that if GNP is higher, there will likely be more jobs to support that demand.

How meaningful are these estimates? One percentage point of US GNP is a huge number, of course, but when spread across the entire US economy and workforce and over a ten-year period, the effect is quite small per individual worker and employer – roughly an 0.08 percent increase in GNP each year for the Joint Committee model, e.g.

The empirical relationship between GNP growth and jobs has for decades been described as “Okun's Law,” after the economist Arthur Okun, who found a quite stable relationship between them: A one percent increase in GNP led to a 0.30 percent decrease in unemployment. Recent estimates find a similar result with contemporary data– 0.28.³⁰ While the conceptual basis for the relationship is not well established, its stability over time is remarkable.

The conclusion that matters for the WOTC program is the effect that the 2017 Tax Cut and Jobs Act will have on the labor market. In ten years, applying the Joint Committee's GNP estimate to Okun's Law, the unemployment rate will be 0.22 percent lower than otherwise as a result of the 2017 Act or roughly 0.02 percent lower per year. This assumes that everything else remains the same in the future period, which is highly unlikely, but whether new developments on average will make unemployment higher or lower is impossible to say.

How significant is that reduction? The variance in the annual unemployment rate for the US economy is 3.5 over the past 10 years (using January data). In that context, an estimated ten-year reduction of 0.22 percent reduction is trivial and is likely to be swamped by year-to-year variation. On the other hand, a 0.22 percent reduction in unemployment in 2018 is still 134,200 people, although per year that is only 13,400, while recent job increases have averaged a little over 200,000 per month. Unemployment is historically low at this point, of course, so in periods of higher unemployment, the increase in jobs associated with stronger GNP might have much bigger effects.

In terms of real-time estimates, financial analysts have already begun trying to identify what corporations are doing with the savings from their tax cuts. This is a difficult exercise to do because of the challenge of inferring causation: While it is straightforward to see how much more money a company has because of the tax cut and also seeing how money is distributed, knowing whether it is distributed that way because of the tax cut as opposed to other factors (e.g., if more is spent on wages, is that because of a tighter labor market or is it because companies are sharing the tax cut savings). With that caveat, the analysts conclude that the majority of the tax savings has gone to stock buy

³⁰ Michael T. Owyang, E. Katarina Vermann, and Tatevik Sekhposyan October 2013. Output and Unemployment: How Do They Relate Today? Federal Reserve Bank of St. Louis. <https://www.stlouisfed.org/publications/regional-economist/october-2013/output-and-unemployment-how-do-they-relate-today>.

backs.³¹ Evidence through the 1st quarter of 2019, the first information about how companies are reacting to the 2017 corporate tax cut, suggests similar conclusions. Two-thirds of companies surveyed by a business group report that their investment and hiring plans have not been affected by the tax cut.³² A separate survey of businesses by the Atlanta Federal Reserve Bank reached exactly the same conclusion: two-thirds of respondents saying that the tax cut had not affected their business plans.³³ Estimates suggest that the vast majority of the tax cut is being spent on stock buybacks.³⁴

The State of the Labor Market

The current unemployment rate of 3.8 percent is a considerable achievement and the sign of a robust economy. Even at this level, however, there is a large number of individuals willing to work who cannot secure jobs. Some of this no doubt is the result of the continuing hangover from the Great Recession and the large number of individuals who withdrew from the labor force.

May 2018 Bureau of Labor Statistics data suggests that despite a 3.8 percent unemployment rate, there are still 6.1 million unemployed, which means they are actively seeking jobs, and another 1.5 million individuals “marginally attached” to the labor force, which includes those “discouraged” workers whose lack of success in job hunting caused them to stop looking, and those who say they would like a job but for various reasons are not looking. Then we also have 4.9 million workers in part-time jobs who want full-time work and cannot find it.

The Bureau of Labor Statistics’ U-6 measure includes all the above groups together and calculates that the equivalent of 7.3 percent of the labor force is available for full-time jobs.³⁵ None of this suggests that the current unemployment rate is anything other than a very positive development, and the tight labor market is pulling individuals into jobs and out of taxpayer-funded support programs for the unemployed. It simply makes the point that even at this level of unemployment, there is still lots of opportunity to move individuals into jobs.

Among the most encouraging outcomes of the tighter labor market has been a decline in the number of individuals claiming and receiving social security disability status as more of them find jobs. In large measure this development appears to be the result of employers facing a tougher labor market and now

³¹ A review of these investor reports can be found at: Emily Stewart. “Corporate Stock Buyback Plans Are Booming, Thanks to Republican Tax Cuts. Tax Cuts.” **Vox**. March 22nd 2018. <https://www.vox.com/policy-and-politics/2018/3/22/17144870/stock-buybacks-republican-tax-cuts>

³²https://nabe.com/NABE/Surveys/Business_Conditions_Surveys/April_2018_Business_Conditions_Survey_Summary.aspx

³³ <http://macroblog.typepad.com/macroblog/2018/03/what-are-businesses-saying-about-tax-reform-now.html>

³⁴ <https://www.vox.com/policy-and-politics/2018/3/22/17144870/stock-buybacks-republican-tax-cuts>

³⁵ These statistics are all contained in Bureau of Labor Statistics. The Employment Situation – May 2018 News Release. <https://www.bls.gov/news.release/pdf/empst.pdf>

digging deeper into the pool of candidates that they had passed over previously, in this case those with disabilities.³⁶

The significance of this disability development for WOTC is two-fold. First, it is a reminder of the substantial savings to taxpayer programs when individuals move out of - or avoid entering - social welfare programs because they find a job. The second point is that there are still large numbers of individuals not currently counted as unemployed who could be drawn into jobs.

A final point to note about the labor market concerns the fact that not all individuals move as easily from the ranks of jobless into employment as do others: When the unemployment rate was 10 percent and very qualified, recently unemployed individuals were looking for work, there was little risk to employers in bringing them on. When the unemployment rate is very low, the number of highly qualified candidates in that pool is much smaller.

Twenty percent of the unemployed now have been without work for at least half a year. Employers may well wonder why those individuals have not been able to find a job yet. The unemployment rate for those with less than a high school degree is 5.5 percent against the overall rate of 3.8 percent in part because the demand for them is low. Even given the development above, the unemployment rate for those with disabilities is 20 percent (see the above citations). There is a considerable body of research I reviewed in an earlier report showing that employers are reluctant to hire such individuals. It is also the case that the long-term unemployed are both disproportionately recipients of government support and eligible for participation in WOTC.³⁷

It may seem that employers will have no choice but to hire those individuals if the economy gets tighter, and at some point, no doubt that may be true. Before then, however, employers have a much better and easier option, and that is simply to hire from each other. It is already the case that the vast majority of hiring in the US is of individuals who are already employed. To see this obvious point, 66 million people were hired into jobs in the US from April 2017 to April 2018 while total unemployment was 6.1 million.³⁸

While it is clearly not possible for the economy as a whole to meet greater demand just by moving existing employees from one employer to another, it is important to remember that individual employers, who after all are making the hiring decisions, are not trying to solve a problem for the overall economy. They are trying to meet their own business needs. Hiring from the ranks of those employed elsewhere is an alternative to taking on workers with attributes one does not like, such as a record of long-term unemployment. It may take a very tight labor market to entice employers to hire those individuals. In that context, programs like WOTC are still useful to encourage employers to hire workers to whom they otherwise might not give a chance.

³⁶ Evidence on the decline in disability claims is reported in Nelson D. Schwartz. New York Times. Disability Claims Plunge as Economy Strengthens. June 19th 2018.
<https://www.nytimes.com/2018/06/19/business/economy/social-security-applications.html>

³⁷ See, e.g., Josh Mitchell. 2013. Who are the Long-Term unemployed? Urban Institute.
<https://www.urban.org/sites/default/files/publication/23911/412885-Who-Are-the-Long-Term-Unemployed-.PDF>

³⁸ Bureau of Labor Statistics. Job Openings and Labor Market Summary, June 5th 2018..
<https://www.bls.gov/news.release/jolts.nr0.htm>

It is difficult to know at any point in time how many of those who are unemployed or marginally attached are eligible for WOTC-supported jobs - perhaps a substantial proportion of the 1.2 million long-term unemployed and a larger proportion of 1.5 million marginally attached. In contrast, the 13,400 net new jobs created by the 2018 Act per year are a drop in that bucket. When employers do hire from the ranks of the unemployed, evidence surveyed elsewhere suggests that candidates of the kind supported by WOTC, such as the long-term unemployed, minorities, the disabled, and so forth, are at the back of the queue of desirability.

Summary and Conclusions

Forecasting anything about the economy is difficult because of its complexity. Even if the forecasting model was perfectly accurate, many factors outside the model – foreign policy and trade issues, consumer confidence, and so forth – make accurate predictions are extremely. That difficulty increases considerably the longer into the future the forecasts go.

The review above considers three different ways to anticipate what the effect of the 2017 Tax Cuts and Job Act will be on the economy and, in turn, on our concern here, which is hiring.

The first begins with a basic understanding of how corporate income taxes work, including the fact that most businesses are not subject to them. Most important is the fact that they are not equivalent to the way personal income taxes work for individuals or even for pass-through businesses. Notions that we sometimes hear in popular discussions such as that corporate tax cuts are needed to fund investment or that they encourage companies to expand come from a confusion between the way personal income taxes affect individuals with the way in which corporate income taxes work.

The credible argument for a relationship between corporate income tax cuts and economic expansion is through the effects they may have on stimulating the economy. Those effects are blunted in practice by the fact that companies retain most of their income and use it to buy back company stock. Dividend payments have a more direct effect on possible consumption, but as noted above, only about one-third of corporate income is paid out to dividends, and only about one-in-four shares are held in a context where they can be spent.

The conclusions for the pass-through tax exemption are slightly better for growth in that its effect on owners, who are the decision makers in business, are much more direct than for the corporate tax cut. The exemption per se is less significant than the corporate tax cut, however, because of the many restrictions that narrow the applicable income to which it can be applied.

The second method for examining the potential effects of the 2017 Tax Cuts and Jobs Act is look at studies that have examined prior cuts in corporate taxes. Those studies show very little relationship between such tax cuts and economic activity, particularly hiring. I know of no studies relevant to estimating the effects of the pass-through exemption.

Finally, we examine the conclusions of formal forecasting models that attempt to see how the 2017 Act per se will affect the economy. The two credible forecasts include the pass-through exemption along with the corporate tax cut and suggest that the effect on the economy even 10 years out will be quite modest.

These models as of yet do not consider the effects of the deficits, which at present the tax cuts are creating. It is not reasonable to guess as to what those effects will be, but we do know that efforts to draw down deficits either through spending cuts or tax increases, other things equal, have a dampening effect on economic growth.

Bringing the discussion back to where it started with the Work Opportunities Tax Credit program, the question asked was whether the 2017 Act would change the economy in such a way that there would be no need for tax credits to encourage employers to hire the disadvantaged candidates who are the subject of the WOTC program. What that question means in practice is whether economic growth and hiring will be strong enough as a result of the Act that even disadvantaged job candidates will get hired. It is true that if economic growth is strong and the interest in hiring is great, then the need for additional incentives to hire most job seekers sharply diminishes but may not go away given the difficulty many job seekers have in securing employment. There is nothing about the 2017 Act per se to suggest that it will create that situation.