IS TAX REFORM STILL DELIVERING GROWTH?

While the short-term effects of the Tax Cuts and Jobs Act seem positive, the long-term effects are still in question.

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The Tax Cut and Jobs Act (TCJA) of 2017 is intended to be a game changer. Along with slashing tax rates for individual taxpayers, the tax reform cut the highest tax rate for C corporations from 35 percent to 21 percent. Among other things, this put the corporate tax rates in the United States more in line with the balance of the developed world. According to the Tax Foundation, today, "the United States' statutory corporate tax rate is closer to the middle of the distribution and closer to the worldwide average."[1] Owners of flow-through tax entities also likely benefit from the reform, with owners of LLCs, S corporations, and other forms of business enterprise permitted to deduct up to 20 percent of earned income.[2]

Among other things, the TCJA is intended to trigger a virtuous cycle of accelerated business investment, job creation, income generation, consumer spending, and additional business investment. Those pushing for the tax cut vigorously argued that growth would be sufficiently stimulated to offset any short-term federal budget deficits.

The question is, "Has the TCJA generated an ongoing virtuous cycle, or did the TCJA merely create a sugar rush for the economy for two or three quarters and then effectively melt like a quickly burning candle?" There is no question that the short-term impacts were massive. During 2017's final quarter, which represented the prior tax code's last hurrah, U.S. net domestic private business investment totaled $525.7 billion on a seasonally adjusted annualized basis.[3] The following quarter, it rose to $597.3 billion, representing an increase of 13.6 percent in just three months.[4]

One should not overlook such a statistic. The American republic has been in place for nearly a quarter millennium, so a nearly 14 percent increase is meaningful and historic. That is not where the trend ended. Although business investment failed to rise in a straight line during the remainder of 2018, business investment had surged to $712.2 billion on an annualized basis by that year's final quarter, representing more than 35 percent growth over the same

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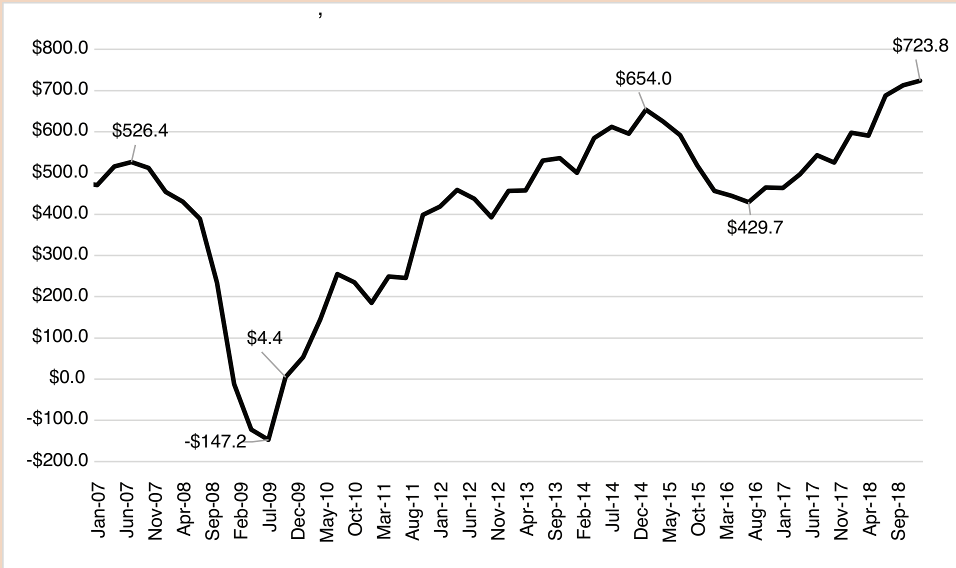
EXHIBIT 1

Net Domestic Investment, Private: Domestic Business, Billions of Dollars, January 2007–Present



Source: U.S. Bureau of Economic Analysis (2019).

quarter one year prior. To put this in even plainer terms, investment is up 66 percent since the third quarter of 2016.[5]

As of this writing, the country is 16 months removed from the signing of the TCJA. Recently released data from the first quarter of 2019 indicate that business investment continued to rise. Some economists concluded as early as last year that the tax reform would generate impacts largely during the short term. To the extent that the TCJA would trigger longer-term effects, they argued that these impacts would be primarily related to larger federal budget deficits and an engorged national debt.

Those predictions may ultimately prove to be the case. But the business investment data indicate that it is too soon to conclude that the TCJA will end up producing only a short-term sugar high. The United States has gone from having one of the highest corporate tax rates in the advanced world to one that is rather competitive. It seems reasonable to believe that the TCJA could have long-term impacts, and thus far, the data are neatly in accordance with that belief.

The rise in business investment is especially impressive given four other considerations. First, human capital is scarce. Often, labor and physical capital are complementary. Accordingly, if firms have difficulty finding sufficiently skilled workers, they may not move forward with related capital purchases. The most recent data indicate widespread skills shortages in the United States as the presence of more than 7 million unfilled job openings crashes up against a 3.8 percent national rate of unemployment.[6] Despite these shortfalls, many firms have moved ahead with equipment and other capital purchases.

A second consideration is that all of this is occurring in the midst of a mature economic expansion cycle. One might expect surging business investment during the early stages of an economic expansion. During periods of economic downturn, businesses slow their investment, but once a downturn ends, businesses race to replace aging equipment and to purchase technologies that allow for fuller participation in the expansion to come.

Tax reform came to the United States after more than eight years of economic recovery. This renders the growing investment all the more impressive.

Yet another factor has been ongoing trade disputes, including between the United States and China. With the future global trade flows remaining in a state of flux, many businesses may have seen fit to delay major capital purchases. Presumably, once there is more clarity regarding the future of the global trading regime, business investment will expand further.

As a final point, the global economy has been slowing as of late.[7] This would also tend to suppress business investment, but the domestic investment cycle has progressed to date nonetheless.

That said, it is conceivable that there have been other forces at work. There has been a push toward deregulation in recent years, and this may also be supporting business investment. The advent of new technologies may also be encouraging businesses to invest, whether in artificial intelligence, 3-D printing, or the cloud. In the context of shifting technologies and the perpetual need for businesses to keep up with competitors and shifting consumer preferences, it is possible to accord too much credit to the tax cuts for the observed surge in business investment.

The biggest issue is that we still have only five quarters of evidence regarding the impact of tax reform on business investment. Many economists forecast a downturn in 2020–2021. Presumably, business investment would soften in the context of the next recession and, at that point, it would be more difficult to make the case that the tax cuts were meaningfully more than a short-term phenomenon. In other words, it remains too soon to tell. But the early returns have been good — much better and more durable than many economists had predicted. ■

NOTES

1 Bunn, D., "Corporate tax rates around the world, 2018," Tax Foundation (Nov 27, 2018). Available at: https://taxfoundation.org/corporate-tax-rates-around-world-2018/.

2 Nitti, T., "The 20% pass-through deduction: Where do we stand now?" Forbes (June 20, 2018). Available at: https://www.forbes.com/sites/anthonynitti/2018/06/20/the-20-pass-through-deduction-where-do-we-stand-now/.

3 "Net domestic investment: Private: Domestic business," Federal Reserve Bank of St. Louis. Available at: https://fred.stlouisfed.org/graph/?g=nNFq.

4 Net private domestic investment indicates the total amount of investment in capital by the business sector that is actually used to expand the capital stock.

5 *Ibid.*

6 "Job openings and labor turnover survey," U.S. Bureau of Labor Statistics. Available at: https://data.bls.gov/timeseries/JTS00000000JOL; "Labor force statistics from the current population survey," U.S. Bureau of Labor Statistics. Available at: https://data.bls.gov/timeseries/LNS13000000.

7 The world economy is slowing down, *The Economist*. (April 9, 2019). Available at: https://www.economist.com/graphic-detail/2019/04/09/the-world-economy-is-slowing-down.