How Lower Corporate Tax Rates Lead to Higher Worker Wages

Key Points

• The person or entity directly paying a particular tax is not always the one who bears the economic incidence of the tax—this is particularly true of the corporate income tax.

• The burden of the corporate tax is unevenly split among three parties: businesses that lose profits, customers who pay higher prices, and workers who lose wages and income.

• The consensus among economists is that workers’ lost wages represent a disproportionate share of the corporate income tax burden, with most studies finding that share to be 70 percent or higher. The long-term burden of the corporate tax falls on the least mobile segment of the economy. Both capital and customers are extremely mobile; workers, in contrast, are less able to move from country to country in response to high corporate tax rates.

• **Bottom Line:** Lowering corporate tax rates lowers the cost of capital, which reduces pressure on companies to move their business elsewhere and encourages investments in expansion and productivity, all of which results in higher wages for workers.
Introduction

Over the past three decades, in the face of international competition, many countries have opted to lower their corporate tax rates to increase economic productivity and attract investment. As much of the industrialized world considers following suit, an international debate has ensued. The outcome of this debate will largely hinge on the question of how the corporate income tax affects average workers.

The bad news is that most people tend to think that they will not personally benefit from a change in business tax policy. The good news is that the economic evidence on this matter largely favors lowering corporate rates as a means of improving wage growth.

Who Pays the Corporate Tax?

It has long been recognized by economists that while businesses bear a legal responsibility to pay taxes directly and remit other taxes on behalf of others, the ultimate economic burden of those taxes tends to fall on workers through lower wages, shareholders and owners through lower returns on capital investments, or consumers through higher prices.

Thus, the notion that businesses or corporations should pay their “fair share” of taxes is a rhetorical device, not an actual one. Any attempt to increase the tax burden on corporations will inevitably harm workers, shareholders, and/or customers. The amount of the harm will simply depend upon the type of tax and the economic circumstances in which the tax is levied.

While the economic burden of these taxes may fall on workers or consumers, businesses do typically bear the compliance costs of collecting and remitting these taxes themselves. These costs can be significant and should be considered when assessing the overall economic impact of business taxes.

Bottom Line: While businesses do have a legal liability for paying taxes, this is different from where the real economic burden of those tax payments falls. Ultimately, people bear the economic burden of corporate income taxes—customers through higher prices paid on the goods they buy; workers through lower wages; and/or, the owners or shareholders of the business through lower dividends or profits.

Hypothetical: A Tale of Two Countries

Economists tell us that, over the long term, the burden of a tax will ultimately be borne by the least mobile factors in the economy. Customers’ purchases are very mobile because few people are willing to pay higher prices when cheaper alternatives are available. And, because capital and investments are also very mobile, the clearest way for a company to avoid overly high taxes is to move its business activity to a jurisdiction with lower taxes. Of the three kinds of bearers of the corporate tax burden, workers are the least mobile—not many people are able to move from country to country in response to changes in corporate tax rates.
For the sake of illustration, let us consider two hypothetical countries—Country A and Country B—and one hypothetical company doing business in both places. Suppose that, in response to various fiscal and economic pressures, the government in Country A imposes a 10 percent hike on corporate taxes. How will that impact the company, its customers, and its employees?

Assuming the company has competitors, it cannot pass much of the burden of the tax hike on to its customers without harming their position in the marketplace. This is particularly true in a global market where lower-priced options from other countries tend to be readily available. In the near term, a company could opt to absorb the tax hike, reducing its profits and avoiding price hikes to remain competitive. But, because capital investments are extremely mobile, it would not be difficult for the company begin shifting its investments and business activity to other locales. As facilities become obsolete in Country A, they may be replaced by facilities in Country B. As that occurs, the burden of the tax hike will ultimately shift to workers in Country A in the form of lower wages and lost income.

Now, suppose that the very same business resides in Country B where, in response to the same pressures, the government chooses to lower corporate tax rates by 10 percent. The company may opt to simply pocket the savings from the tax cut, but, as with the tax hike, it is unlikely to simply absorb new tax benefits for long.

Instead, because the reduced corporate tax rates will reduce the cost of capital in Country B, the company will have more incentive to invest and expand operations there instead of somewhere else, including additional hiring. The company could opt to directly raise workers' wages or invest in improvements to increase productivity. In either case, the workers are primary beneficiaries, as history has demonstrated that a more productive workforce is paid more and enjoys a higher standard of living.

**Bottom Line:** Businesses are generally free to move capital in search of better tax conditions, and customers are largely shielded from tax-related price increases by market competition. Workers are essentially stuck with whatever conditions are imposed by their country’s tax system. As a result, workers’ wages are among both the primary casualties of high corporate tax rates and the principal beneficiaries of corporate rate cuts.

**Literature Review**

Economists have studied the economic incidence of the corporate income tax since the 1960s. While many of the earliest studies tended to conclude that owners of capital bore the lion’s share of the cost of the corporate income tax, most recent studies are finding that more of the burden is falling on labor, although the precise share depends on various factors and methods of measurement.¹ But, across these different approaches, studies show that workers bear between 50 percent and 100 percent of the burden of the corporate income tax, with 70 percent or higher being the most likely outcome.²

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² Entin, 9.
When examining the incidence of any tax, it is important to remember that the relevant burden amounts to more than just the raw government revenue figures; it includes additional losses in the economy, particularly lost income and reduced output. In most industrialized economies, the overall size of the wage base is many times the amount of the corporate taxes collected, so a small dollar increase in the corporate tax can have a relatively outsized effect on wages. If a segment of taxpayers suffers wage and income losses that exceed the government’s revenue gains from a specific tax, the workers’ share of the burden is more than 100 percent. Once again, in studies of the workers’ share of the corporate tax burden, a finding like this has not been uncommon.

For example, the Congressional Budget Office reports that corporate income taxes in the U.S. totaled $297 billion in 2017. By contrast, wages and salaries in the U.S. totaled $8.3 trillion—27 times larger than corporate tax collections. Noting that disparity, a 2007 working paper by a U.S. Federal Reserve economist found that for every $1 of corporate income taxes collected by a high tax rate, the overall amount of aggregate worker wages fell by $4, or 400 percent of the tax increase.³

Other studies have involved similar comparisons among different state or provincial tax jurisdictions within a single country, where there is greater uniformity among the regions in nontax factors like regulations and political climate than is found in international comparisons. One such study from 2016 compared data from Canadian provinces and suggested that labor bears 75 percent of the economic burden of the corporate income tax.⁴ Other studies comparing tax-policy variances across the United States have found that workers bore between 30 percent and 360 percent of the corporate income tax prior to the reforms enacted in December 2017.⁵

Another area of research focuses on the extent to which labor has sufficient bargaining power to capture some of the returns accruing to capital. This is most common when returns to capital are higher than normal due to some form of pricing power, and when unions are strong. Insofar as the tax lowers returns available to be shared with labor, labor bears some cost of the tax. One such study of corporate tax changes in 11,500 German municipalities found that, when corporate tax rates were reduced, workers enjoyed 40 percent of the benefits through higher wages. A similar study in the U.S. found that workers captured 54 percent of the benefits when corporate tax rates were lowered.⁶

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⁵ Cited by Entin, 9.

⁶ Both studies are cited in Entin, 10.
Conclusion

There is substantial agreement among economists that increases in corporate taxes impose significant burdens on workers in the form of reduced wages and lost income. Among those researchers using empirical, real-world data, this conclusion is almost unanimous.

The main reason for this negative correlation between corporate taxes and wage growth is relatively simple: The corporate income tax is a tax on economic productivity and investment. And, as with virtually any other activity or commodity, raising taxes on productivity and investment usually results in less of both. When that happens, most workers, unlike their employers who pay the corporate tax or the consumers who purchase their goods, do not have the option of simply changing location or behavior to escape lower wages or income losses. So, in the end, they are the ones who bear the brunt of the corporate tax.

Fortunately, both history and the relevant economic data have shown us that lowering corporate tax rates can have the opposite effect. By reducing the cost of capital, cuts in the corporate tax rate encourage productivity and investment. Ultimately, when that happens, workers receive the largest share of the benefit in the form of higher wages and improved living conditions.