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Tax increases are the wrong medicine for our struggling economy

by Erik Paulsen | March 05, 2021

America's economy was in high gear prior to the pandemic. Our country's gross domestic product grew 4.1% in 2019 after increasing 5.4% in 2018. Unemployment reached a 50-year low of 3.5%, and 6 million new jobs created historically low unemployment levels across all demographic groups. Business optimism was at record highs, and workers saw their wages increase by their highest levels in 10 years.

These impressive numbers were no accident. The 2017 Tax Cuts and Jobs Act created prosperity and opportunity and made our economy boom again.

One of the most significant provisions of this pro-growth policy was lowering the U.S. corporate tax rate from 35% to 21% to make America more internationally competitive. Previously, America's unfair and uncompetitive tax code made foreign countries more attractive for investment.

With increasing frequency, U.S. companies were moving their headquarters to other countries, and good-paying jobs and manufacturing were shipped overseas. These transactions, where an American company acquires a foreign company for the purpose of relocating its headquarters to another country with a lower tax rate, are called inversions.

Losing a U.S. headquarters to another country isn't just a news headline. It means losing investment, innovation, and jobs. Lowering the corporate rate to 21%, closer to the average rate of our trading partners, was a central component of our national commitment to bring back jobs and manufacturing to the United States. It allows American businesses to make smart decisions based on factors other than tax avoidance and discourages them from shifting profits to lower tax jurisdictions.

News reports of inversions have largely disappeared from the financial pages, but that could easily change. President Biden and some in Congress are proposing to raise the corporate rate to 28%.

This would be a major mistake and discourage investment in domestic manufacturing, technology, and production. It would widen our competitive disadvantage with our major trading partners. Competition is fierce, and the rest of the world isn't standing still. Just last year, nine countries lowered their corporate tax rate, and others are sure to follow.

Treasury Secretary Janet Yellen was asked during her Senate confirmation hearings if the proposed 28% would hurt the competitiveness of American corporations. She dodged the question but said that "the administration could reach an agreement with our trading partners to stop a destructive global race to the bottom on corporate taxation." This is, at best, wishful thinking.

Analysts at Bank of America Securities have estimated that Biden's tax plan could cut the S&P 500 earnings by 7%, and companies in the technology, healthcare, and communications industries would be the hardest hit.

Yellen pledged in her testimony that Biden would not move to raise the top corporate tax rate until the pandemic is over. If it is true that it makes no sense to diminish the attractiveness of the U.S. to locate a business, invest in new equipment, and hire new workers during the pandemic, then it is equally true that it would be just as controversial in good economic times.

Instead of tax hikes, I hope that a bipartisan consensus develops in Washington on ways to keep America economically competitive and strong. Otherwise, senior corporate executives may start asking their tax advisers to dust off their inversion plans and begin to move their companies and jobs to countries where the tax and regulatory environment is more friendly.

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