RESEARCH BRIEF • MARCH 2024

Tax Policy and Investment in a Global Economy

Based on BFI Working Paper No. 2023-141, "Tax Policy and Investment in a Global Economy," by Gabriel Chodorow-Reich, Harvard University; Matthew Smith, US Department of the Treasury; Owen M. Zidar, Princeton University; and Eric Zwick, University of Chicago

While the Tax Cuts and Jobs Act increased domestic investments of US-based multinational corporations, this extra revenue was offset by the higher cost of depreciation deductions. As a result, the 14-percentage-point tax rate cut resulted in large corporate tax revenue losses.

The Tax Cuts and Jobs Act (TCJA) of 2017 was the largest corporate tax reduction in the history of the United States. It lowered the top corporate tax rate from 35% to 21%, gave companies larger deductions for depreciating equipment and other assets, and fundamentally altered the treatment of international income. Several years after its passage, economists have not reached consensus on the effects of the TCJA. Did the sweeping changes to the tax code spur greater corporate investment and increase tax revenues, as they were intended to?

Figure 1 • Investment Growth versus Tax Change, Domestic Firms

Note: This figure shows the relationship between the magnitude of domestic tax changes that firms were subject to with the passage of the TCJA (horizontal axis), against their investment growth (vertical axis). As you can see, firms that experienced larger tax cuts tended to increase their investments more following the passage of the TCJA.

In this paper, the authors evaluate the effects of the Tax Cuts and Jobs Act on corporate investment and tax revenue. They create a model that extends traditional investment theory to include multinational corporations that face both domestic and foreign taxes, allowing them to more accurately measure how multinational corporations responded to the TCJA. The authors fit their model to data from corporate tax returns that include firm-level tax rates and investments to observe how the TCJA influenced corporate investment behavior. They find the following:

- The TCJA increased **domestic investment**. Firms that experienced the average tax change increased their investments by 20% compared to firms that experienced no change.

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Domestic investment: corporate spending on assets within the United States

- The authors predict that the TCJA will increase **domestic capital** by about 7% over the long run (after about 15 years).
- These gains in investment and capital are offset by the TCJA's increased deductions for the depreciation of certain investments. The overall impact of the TCJA on tax revenue, even after accounting for economic growth, is nearly equal to the initial loss from its 41% reduction in corporate tax collections.
- The TCJA's changes to international tax provisions also boosted domestic investment. The same new provisions that encouraged US-based multinationals to increase their **foreign capital** also stimulated domestic investment, due to complementarities between foreign and domestic capital.
- Between the 2016 election and the passage of the TCJA in late 2017, companies' stock returns incorporated their expected benefits from the TCJA. Firms with greater exposure to the reforms saw larger returns during this time.

This study is among the first to use data from corporate tax filings to evaluate the Tax Cuts and Jobs Act, and the findings presented here could help inform future corporate tax reform discussions. While the tax rate cut from 35% to 21% is permanent, the increased deductions for depreciating assets (accelerated depreciation) are already phasing out. In addition to the main findings presented here, the authors' working paper contains further details about the effects of individual provisions contained in the TCJA. For example, accelerated depreciation generates comparatively more investment per lost dollar of tax revenue relative to the TCJA's other provisions.

Domestic capital: the stock of assets owned by corporations in the United States

Foreign capital: the stock of assets that United-States-based companies own outside of the United States

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ABOUT OUR SCHOLAR

Eric Zwick
Associate Professor of Finance and Fama Faculty Fellow, Chicago Booth

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