DOES LOWER CORPORATE INCOME TAX PROMOTE PRIVATE INVESTMENT?

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dx.doi.org/10.18374/JIFE-23-1.3

ABSTRACT

The general argument offered by the supporters of trickledown economics is that any cut in corporate income tax will raise per-unit profit to investors encouraging them to increase investment leading to the increase in real output. The increase in real output then will subsequently raise the demand for labor resulting in the rise in wage rate and the standard of living for workers.

This study tests the validity of the theory on US data from 1990 to 2020. We apply the vector autoregressive model on our model variables INV (gross private domestic investment) and HCIT (highest rate of corporate income tax). In the equation with INV as the dependent variable and the lagged values of INV and HCIT as independent variables, the coefficients associated with the independent variables, $HCIT_{t-1}$ *and* $HCIT_{t-2}$ *were found to be statistically insignificant which implied that any change in highest corporate income tax would have no effect on gross private domestic investment thereby invalidating the so-called trickledown economics.*

Keywords: *Trickledown economics, corporate income tax, investment, VAR, etc.*

1. INTRODUCTION

The so-called trickledown economics claims that lowering corporate income tax leads to higher level of investment, output, employment, and standard of living for the people. The economic logic behind this theory is that when corporate income tax is lowered, it raises the profitability encouraging producers to increase investment leading to the increase in real output, which subsequently raises the demand for labor resulting in the rise in wage rate and the standard of living for workers. It means lowering corporate income tax will raise the real output (GDP) and standard of living for the workers and general people. It is this argument that prompted President Donald Trump to lower the US corporate income tax from the highest level of 39% to 21% in 2018.

To get a first-hand impression of the impact of the change in highest rate of corporate income tax on the level of gross private domestic investment we ran a graph with the two variables, HCIT (highest corporate income tax rate) and INV (gross private domestic investment) and got the output as below.