

Study: Tax Increases Cause Major Job Losses, Harm U.S. Economy

A Summary of the Study Findings in “Dynamic Estimates of the Macroeconomic Effects of Tax Rate Increases and Other Tax Policy Changes”

There have been numerous proposals to alter the tax system enacted in 2017 under the Tax Cuts and Jobs Act. To understand the consequences of those proposed changes, Rice University economists John W. Diamond and George R. Zodrow conducted a [study](#) for the National Association of Manufacturers. They utilized the Diamond–Zodrow general equilibrium model to examine the short- and long-run impacts of possible tax changes on the macroeconomy.¹ The analysis examined what would happen if the following changes were made to the tax code in 2021:

- The corporate tax rate is increased from its current level of 21% to 25%.
- The corporate alternative minimum tax is reinstated.
- Expensing (100% bonus depreciation) of most investments in depreciable assets is eliminated immediately rather than being phased out over 2023–2027 and is replaced with the modified accelerated cost recovery system.
- The 20% deduction for certain pass-through business income is repealed immediately, rather than expiring after 2025.
- Capital gains and dividends are taxed at the same rate as ordinary income for taxpayers with incomes above \$1 million, and unrealized capital gains are taxed at death.
- The top individual tax rate is increased immediately from its current level of 37% to its pre-TCJA level of 39.6%, rather than expiring after 2025.

The study shows that the above changes, including the increased corporate tax rate, would result in less economic activity and 1 million jobs lost in the first two years.

- Total employment, measured by hours worked, would fall by 0.7% initially before moderating. The reduction in hours worked would be equivalent to an employment decline of approximately 1 million full-time jobs in 2023. Those jobs would still be gone in 2026 before stabilizing.
- The average annual reduction in employment would be equivalent to a loss of 500,000 jobs each year over 10 years.
- By 2023, GDP would be down by \$107 billion, by \$169 billion in 2026 and by \$89 billion in 2031.
- Ordinary capital, or investments in equipment and structures, would be \$70 billion less in 2023 and \$70 billion and \$51 billion less in 2026 and 2031, respectively.
- Investments in intangibles, or “firm-specific capital,” are highly mobile and more sensitive to marginal tax rate changes. Such investments would fall 1.6% by year two and would be down a total of 2.2% by year five.
- Real wages would fall by 0.5% in the long run, and total labor compensation, including wages and benefits, would decline by 0.5% initially before falling by 0.3% after 10 years. In the long run, total compensation would also decline by 0.5%.

¹ The model, developed by John W. Diamond and George R. Zodrow, is a widely cited tool for budget analysis. Versions of the model have been used in analyses of tax reforms by the U.S. Department of Treasury and the Joint Committee on Taxation and in numerous tax policy studies. Note that the model makes two key assumptions that are relevant to the analysis. First, all revenues are used to finance a proportionate increase in government transfer payments other than Social Security benefits, allowing for the model to better isolate the effects of tax changes, which is common in such studies. Second, the model assumes a full employment equilibrium in the labor market in each period, which helps to simulate labor supply and demand changes (in terms of hours worked) from tax-induced changes in prices and incomes.