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Article

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The Impact of Corporate Income Tax on Wages and Employment

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Abstract *This paper is focused on impact of corporate tax on wages and the number of employees. Since the main goal of businesses is profit and because wages are part of the costs it's important to understand if businesses try to cut costs by reducing wages or through reducing the number of employees. In this paper, through the analysis is intend to understand whether there is a relation between changes in corporate tax rates, the growth rate of state revenues from corporate tax with the growth rate of wages. To achieve the purpose of this paper it will also be analyzed the relation between growth rates of corporate tax with the growth rate of employment. To reach the conclusion is analyzed the progress of wages, the progress rates of corporate tax and is presented a brief overview of the economy in general because the rate of its growth will affect businesses operating there and will affect all public because a part of them is employed in the private sector. By data analysis in this paper does not seem to pass the burden of corporate tax on employees through salary or number of employees.*

Key words Business taxes, state revenue, wage level, labor force and employment

JEL Codes: H25, H71, J21, J31

1. Introduction

Fiscal packages in Albania have undergone frequent changes in the past two decades. Taxes with changes in tariffs are corporate tax and personal income tax. These two taxes are important for their share in the revenues of the state budget and as part of payments of the businesses. At first glance it appears that these taxes do not have a direct link with each other because corporate tax levied on business profit while personal income tax is levied on the salaries of individuals. But to be more secure the links between them can be judge about their role in the cost of doing business.

Personal income tax is a tax paid by workers. It is withheld from their wages and transferred to the state budget from the business. Personal income tax is part of the gross salary, therefore is part of the expenses for salaries. The focus of this paper is corporate tax. Corporate tax is a tax applied on profits of big business at the end of the fiscal period, being as salaries payment business, cash outflows, business goal would be to lower them. The rate of corporate tax have changed over the years declining but also increasing recently, so it is important to see if businesses pass the increase to workers by reducing salaries or when rates were reduced to share this decrease in payment with employee increasing salaries and boosting their motivation.

An important element for businesses is the value added of the product or service. The value added of product or service consists of the cost of salaries, the taxes that the company pays to the state and the flows that creditors or owners receiving. Since the value added is an element that depends on the market prices of products or services, firms cannot have it under control. In the case of a change in tax treatment, by assuming an unchanged value added in time, financial management with the aim of increasing returns to shareholders would manipulate the other items. Debt obligations cannot be changed then it remains to lower wages. In expenditures for salaries is included personal income tax, while corporate tax is not.

In theory an increase in corporate tax would decrease wages, but must be seen if this is the case or tax increase affects the return of the owners by reducing only retained earnings. Reduction of wages will have an impact on personal income tax by reducing it. Reduction of wages would result immediately in the reduction of personal income tax and insurance contributions. While in this case the impact on the state budget would be complex.

Another way of reducing the cost of salaries would be for companies to pass corporate tax on employees through dismissal, notably by reducing the number of employees. This option would have social consequences due to rising of unemployment, and the economic consequences due to the decrease of work productivity. Decreasing the number of employees will consist carrying out tasks and responsibilities by a smaller number of workers, being overworked and affecting in this manner the quality of products and services. Reduction of quality of the products offered from enterprises will cause a decline in sales in the long term by reducing revenue from the sale of the products which would result in reduction of the value-added affecting the corporate profit as well as the sum of liability of corporate tax which will conclude in decrease of budget revenue.

2. Literature review

Many researchers have studied the impact of corporate tax on wages, on employment or unemployment. Their results in some cases have been clear and in some other cases have shown no clear connection. Some of these researches are presented below.

According to Alison (2009), although the effect of state corporate taxes on wages has fluctuated over time, the magnitude of the effect trended upward from 1977 to 2005. Between 1977 and 1991, a one-percentage-point increase in the state corporate tax rate reduced wages 0.27 percent, on average. In comparison, from 1992 to 2005, a one-percentage-point increase in the state corporate tax rate decreased wages 0.52 percent, on average. This jump may be due in part to increasing global competition.

The results of the paper of Hassett and Mathur (2006), suggest that corporate tax rates affect wage levels across countries. Higher corporate taxes lead to lower wages. A one percent *increase* in corporate tax rates is associated with nearly a one percent *drop* in wage rates.

Heitger (2002), long-term unemployment seems to be accompanied by higher government expenditures for the unemployed, which in turn might lead to a higher total tax rate. Thus, the relation between taxation and long-term unemployment could be mutually reinforcing. The relationship between taxation and long-term unemployment is a mutually reinforcing one: a rising total tax rate leads to higher long-term unemployment rate (and government expenditures) which in turn leads to a higher tax rate.

According to Bania *et al.*, (2007), the extent to which increases or cuts in state corporate taxes coincide with state-level policy changes that could independently affect economic outcomes, confounding the estimated effects of corporate tax changes. Economic and political conditions play an important role in states' tax policies. Compared to states that cut taxes, those that raise taxes tend to run budget deficits (averaging 1.8%, compared to surpluses averaging 5.1% among tax-cutting states), are more likely to have suffered a credit-rating downgrade, and have a more unionized private-sector workforce (18.5% versus 15.4%). Growth in gross state product (GSP) and unemployment rates, on the other hand, are statistically similar in tax-cutting and tax-raising states.

Mazerov (2010) highlighted that state balanced-budget requirements prevent corporate tax cuts from providing any meaningful short-term stimulus to total in-state spending. Even in the long run, numerous studies conclude that corporate tax cuts alone can have only a small impact on private-sector job creation and are likely to come at the cost of substantial cuts in state and local services. Such cuts are likely to create personal hardships for the families and individuals who receive the services and, if they occur in areas that businesses demand, will have a negative impact on the state's attractiveness for future business investments.

Randolph (2006) stressed that in an open economy, the tax causes income to be redistributed internationally between foreign and domestic owners of capital, and intranationally between the labor and capital owners resident within each country. Marlow (2001) it may be convenient to think that corporations pay taxes, but only individuals can bear the burden of taxation. Corporations are only legal structures that provide the nexus for individuals acting in different capacities to accomplish their goals. It may also appear that only owners of corporations (i.e. shareholders) bear the burden of the corporate income tax, but this is not correct either.

3. Methodology of research

The methodology used in the function of the goals set at the beginning of the paper. For the accomplishment of this paper, are used a number of publications and works of local and foreign authors. To conduct the study are used a number of sources of information from official websites of important national institutions such as the Ministry of Finance and Albanian Institute of Statistics.

4. Corporate tax and economic performance

Corporate tax is an important tax to the state budget as well as for businesses that are subject to it. Corporate tax is a tax applied on so called big enterprises which are businesses that has a turnover of over 8 million ALL. It is a direct tax that is applied on the profits of a company after it has discounted all costs necessary for the performance of the business including payroll costs. Tax liabilities have had a few changes in the last decade as a result of reforms implemented by the Albanian government. Corporate tax is levied on big enterprises which are very important not only to the level of corporate tax paid to the state budget but also for the employment of people in them.

Big enterprises with 50 and more employed represent 1.1 % of total enterprises. Their contribution on employment is on average 46.2 percent (INSTAT 2016). This figure has varied over the years, by 38.8 percent in 2012, is 26.7 percent of employees in 2013 and 50 percent of employees in 2014. As a consequence it is important to study the impact of corporate tax rate on employees.

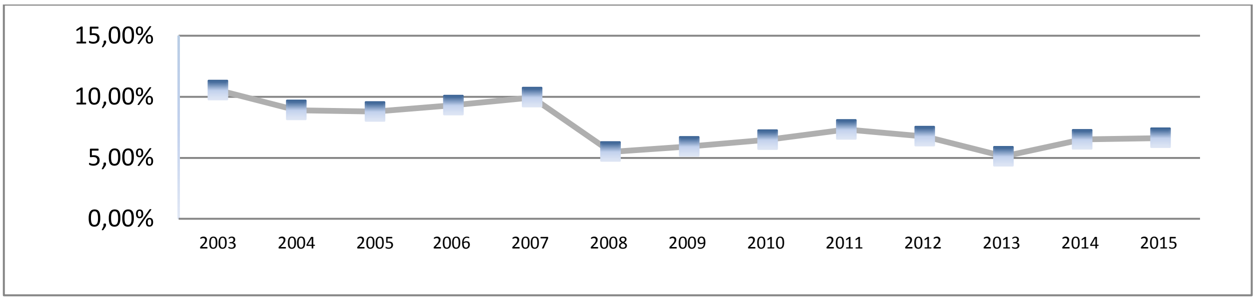
Albanian economy has experienced low rates of its growth especially after 2009 with the lowest growth in 2013. After 2013 it seems that the growth rates are improving. This is presented in the table 1.

Table 1. Annual real growth of gross domestic product

Years	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Real growth of GDP	6.95	8.29	4.54	5.53	5.51	5.53	5.90	5.98	7.50	3.35	3.71	2.55	1.42	1.00	1.83	2.59

Source: Annual real growth of gross domestic product by economic activities, INSTAT 2016

For a satisfactory economic performance of a country, collected taxes are very important to deal with the budget expenditure and to promote specific sectors of the economy therefore the share of corporate tax in budget is very important. More specifically, the share of corporate tax on tax revenues in the budget has fluctuated with great decrease in 2008 when the tax rate was reduced by 20% to 10% (figure 1). Halving corporate tax rate by the Albanian government aimed at relieving by tax burden big enterprises. High level of tax evasion thought to be decreased with the reduction of the tax rate. The figure below shows the evolution of the share of this tax in tax revenues to the state budget. Its significance has declined by around 10% in 2003 to 5.1% in 2013.



Source: Author

Figure 1. The corporate tax to total tax revenue

In 2014 the corporate tax rate rose from 10% to 15%, increasing the share of this tax to the state budget from 5.1% in 2013 to 6.6% in 2015.

5. Relation between wages and corporate tax

As outlined above, this paper emphasizes the impact that corporate tax has on the average wage level. The level of average wages is very important in an economy because the employee is also the client in the market so if the public has less income then there will be less cash to spend. If the growth rate of economy does not increase than the public will be conservative spending becoming more careful in order to have some income aside for possible cases of dismissal from job. All this leads to a vicious circle because since less people are employed then would fall sales of goods and services to the public and subsequent will fall profits of companies and at the same time the corporate tax payments.

Corporate tax and personal income tax has been subject of tax reforms. The most striking changes have been two recent changes. In 2008 the corporate tax rate was reduced from 20 percent to 10 percent and in 2013 where the corporate tax rate rose from 10 percent to 15 percent.

The first one was part of the fiscal package, aimed at the transition from the progressive tax, at the flat tax, with a single rate of 10 percent on personal income that was followed by the tax on corporate profit of 10 percent. This tax which was called flat tax would lead to simplification of the management system and increasing the taxable base. Over 50% of the Balkan countries have applied the flat tax (Altax, 2011).

Table 2. Rates of corporate tax over the years

Years	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Income tax	13,001	15,200	16,013	18,308	22,900	14,420	17,559	19,375	21,127	21,980	15,016	21,904	23,547
corporate tax rate	25%	25%	23%	20%	20%	10%	10%	10%	10%	10%	10%	15%	15%

Source: Ministry of Finance

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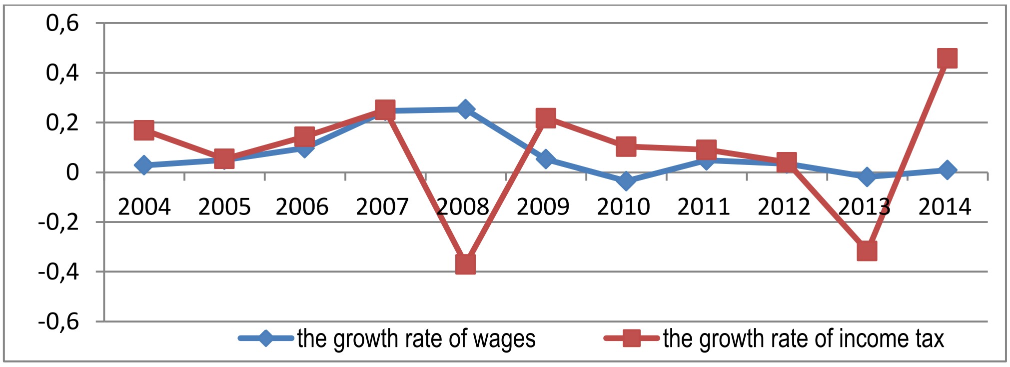
As seen from table 2, from year 2004 till 2008 corporate rate has decline. The decline in the rate of corporate tax in 2006 led to an increase in state revenues from corporate tax and increasing the average wage in the economy, that trend has continued 2007 and 2008 (figure 2). The revenues collected from this tax after 2008 have come increasing with the exception of 2013. As is mention above, in 2013 the corporate tax rate rose from 10 percent to 15 percent. This change brought increase in budget revenues, as a result of increased tax rate also as a consequence of action undertaken by government against informality in the last two years.

In terms of wage levels it can be seen that it is increasing. In Figure 2 is the evolution of revenues in the state budget of the corporate tax rate and wage change from 2000 to 2014. The study restrictions in these years come from the availability of data. The chart below will show the progress change of corporate tax revenues in state budget and rate change of wages.

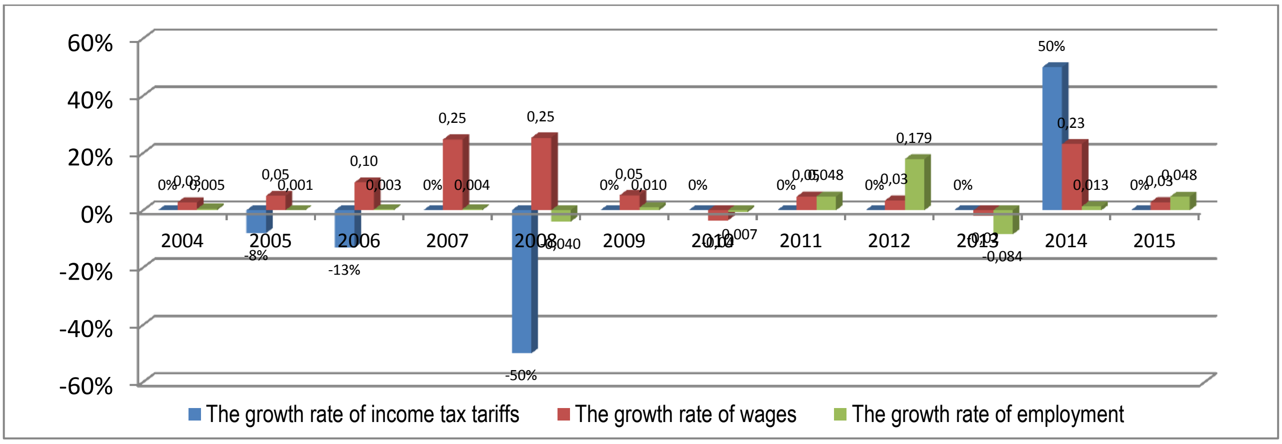


Source: Author

Figure 2. The progress change of corporate tax revenues in state budget and change of wages

From the figure 2 it can be say that growth rates of corporate tax revenues and the rate of wage growth does not always coincide with each other. And there are strong movements in opposite in the 2008, the year in which the tax rate dropped from 20 to 10 percent. It seems that the reduction of the tax rate is reflected in the increase in wages.

After 2008 it seems that the growth rate of revenue from corporate tax increase rapidly while the rate of wage growth begins to decrease apparently passed in negative showing movement in reverse in 2010, while reducing their differences in 2013, the year in which their growth rate is negative. In 2014 revenues from corporate tax are result of increased tax rate. However, in this year has been reform in personal income tax bringing back progressive structure that may have increased the declared salaries.



Source: Author

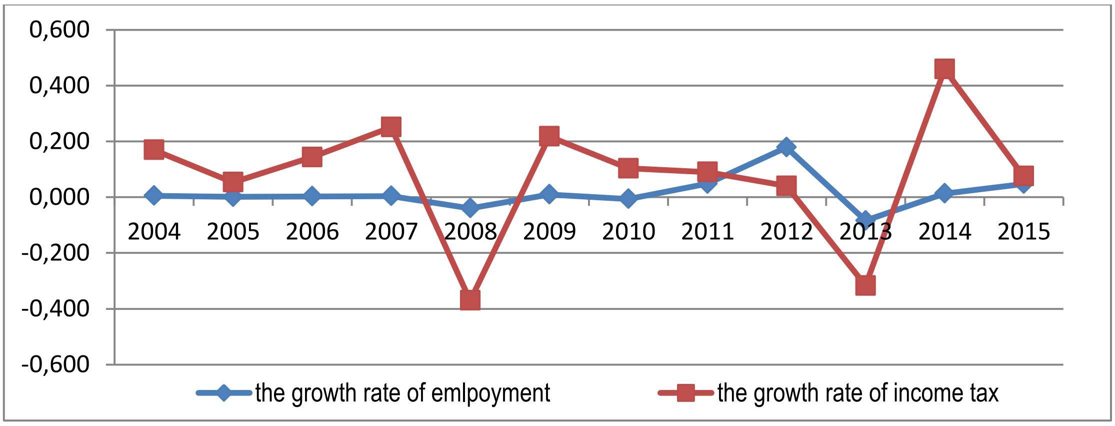
Figure 3. The change rate of corporate tax tariffs, wages and employment

For being surer in conclusion i have studied and the relation between rates of corporate tax not only revenues in state budget, with wage changes and employment change as is seen in figure 3. Every year is presented in a specific way for displaying as much information as possible. In 2005 the corporate tax rate decreased by 8 percent, while the average wage has increased by 5 percent. In 2006 the corporate tax rate decreased 13 percent while the level of wages has increased by

10 percent. In 2007 the corporate tax tariff is not increased while wages continued to grow by 25 percent. In 2008 happened the highest decrease of the corporate tax rate by 50 percent, in that year wages have increased by 25 percent just as much as in the previous year when there was no movement in the rate of corporate tax.
From 2009 to 2012 the corporate tax rate is not changed while wages have increased very little from 0 to 5 percent. In 2013 when the corporate tax rate did not change the average salary again fell 2 percent. If we see table 1, in this year (2013) entire economy performed poorly. However the level of wages has many influential factors. The level of informality in the economy has been high in recent years and this affects the volatility of figures without economic reasons. The informal economy of Albania, assessed by international organizations, is at 35-40% of the GDP (Albania's economic reform programme 2016-2018).
In 2012 it was removed by law the reference salary for professions and the decline of wages in 2013 may have also this reason, because of informality businesses may have cut salaries declared to employees in order to reduce income personal tax and insurance contributions. In the following two years the average wage is increased, especially in 2014 even though the rate of corporate tax increased by 50% in 2014.

6. Relation between employment and corporate tax

As mentioned above, a possible impact of corporate tax on employees is through employment. In the figure 4 are presented the growth rate in level of employment and the growth rate of corporate tax in state budget.



Source: Author

Figure 4. The progress change of corporate tax revenues in state budget and change of employment

According to the figure above, we see that the growth rate was negative in 2008 as the level of corporate tax as well as level of employment. As i mention above, in 2008 the corporate tax rate was reduced from 20% to 10%, which justifies the reduction of the amount collected from this tax in the state budget. With a simple explanation would say that the reduction of corporate tax rate has no reason to affect the reduction in the number of employees, while business owners are left with more money in their hands after payment of the profit tax. In that year the economy has performed better than other years, whether the number of employees decreased by 4 percent (figure 3).
In 2009 it appears that rates rise but in terms of employment growth rate is very low about 0.01 while the corporate tax collected in the state budget has increased slightly by 0.2, however, the basis of calculation of 2008 is very low. In 2010 again the growth rate of employment is negative, while revenues from corporate tax increased by 10 percent. In 2013, both increases are negative. Year 2013 was an election year, however, there were no tax rate change but there was information about possible changes to the fiscal package in the next year. Change of the fiscal package in 2014 has brought increasing corporate tax rate, which has increased the inflow of this tax to the state budget.
In 2015 the growth rate of revenue from corporate tax has continued to be positive but lower because it is calculated on the data of 2014 that has been a high base, while the rate of employment growth is positive. However it must be said that the economy has performed better in the last two years considered in the study. The number of employees in big enterprises has been growing in the last two years 2014 and 2015, respectively 50% and 46.2%, indicating that businesses have not reduced the number of employees in order to reduce the costs of employment. According to Business register 2014 and Business register 2015, the number of enterprises has been increasing and this trend has been following also the number of employees. So the increase in the corporate tax rate does not seem to have affected the number of employees.

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From above, there's no corporate tax impact on the number of employment, perhaps even it is the opposite. In the case of a higher employment companies seem to perform better.

In 2015, government launched a large-scale reform effort against tax evasion, noncompliance, and informality. It focuses on companies that are unlicensed, with employ undeclared, with wages declared lower and decreasing their payrolls, or do not issue receipts. This reform effort has already yielded a large increase in the number of registered small businesses and employees. And this may be the reason of increasing the level of salaries and number of employees. However it cannot be concluded in a negative relation between the growth rate of corporate tax to the level of wages.

7. Conclusions

The growth rate of corporate tax and growth rates of wage do not always coincide with each other. From 2005 to 2007 it seems that the movement of the growth rate of wage follows the reverse movement of the corporate tax rate, although in variable percentages. The same thing happened with the number of employees. In 2008 it continues the movement in reverse but more significant between tax rate and the rate of wage growth, while there was a positive movement between tax rates and rates on either employees. In subsequent years, even though tax rates have no change it can see the same movements increase or decrease of the level of average wages and number of employees. While in the last two years when corporate tax rate is increased and the two indicators of the minimum wage and the number of employees are increased. From the above results is not a clear link between corporate tax and the average wage level. The study shows negative link when corporate tax rates are reduced but is not followed this negative link when corporate tax rates rise. The same can be said for the employee’s level. It also seems that the level of wages and the level of employees pursuing better economic performance of the country.

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