

WSJ Print Edition

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Tax Capital, Not Labor, to Fix AI Job Loss

CAPITAL ACCOUNT

By Greg Ip

Economists don't typically worry about machines replacing people. Job displacement is, after all, a natural byproduct of labor-saving technology.

Artificial intelligence is starting to change that. More than 1,000 economists, including 17 Nobel laureates, were worried enough to sign an online petition circulated recently by Stanford University's Erik Brynjolfsson warning of "large scale job displacement" from AI and pleading for action.

But what action? As it happens, there is one policy response drawing growing support, at least among economists if not legislators: Stop taxing capital more favorably than labor. *Note*

This runs counter to decades of tax policy in the U.S. and indeed most advanced nations. To attract investment and boost growth they have lowered taxes on profits, business investment, capital gains and dividends. *Note*

Lower taxes on capital that made sense in normal times might not in the face of a technology that could wipe out jobs to an unprecedented degree. "There's a reasonable case that with the rise in AI, it's more important to protect labor demand than to encourage more capital investment, and therefore capital taxes could be higher," said Harvard economist Doug Elmendorf, a former Congressional Budget Office director.

AI's threat to safety, national security and computer networks is frightening, but we have experience regulating the negative side effects of otherwise helpful products. Nuclear power, for example.

The jobs threat is infinitely more complicated. All labor-saving technology replaces humans. It makes us more productive and wealthy over time. Some jobs are lost in the short run, but even more are created in the long run. *Note*

Historically, anyway. With AI, economists have real doubts. A major survey published in March found that in the unlikely yet plausible scenario in which "AI systems surpass humans in most cognitive and physical tasks," economists see roughly 3% of the working-age population gone from the labor force by 2050, and the permanent loss of 10 million jobs.

Brynjolfsson, a leading technology economist, says it's in business leaders' "enlightened self interest" to complement rather than replace workers with AI. "We are right now steering them in the wrong direction."

But how to steer them? If complementing rather than replacing workers is more profitable, successful firms will choose that path without government intervention. If replacement is the more efficient path, a firm that refuses to cut jobs will lose to one that does.

Retraining those displaced by AI is probably the most popular policy response. But it's unclear what workers should be retrained to do. Five years ago, everyone was told, "learn to code," said Pascual Restrepo, a Yale economist. "That career advice has gone out the window. ... We don't know in which order AI is going to advance and make leaps."

Then there are ideas for compensating job losers such as wage insurance or "universal basic income." But they don't preserve employment.

To actually discourage AI-driven job replacement, some call for a "compute" or "robot" tax, perhaps levied on tokens (the unit of AI usage). This, though, could be a nightmare to design and administer, and discourage the use of AI to benefit all humanity, such as new drug discovery.

That brings us to the tax system. The case for low taxes on capital is that this boosts investment, which raises productivity and, ultimately, wages. Note

The bipartisan drive for lower capital taxes goes back decades, to accelerated depreciation (that is, expensing buildings and equipment faster than they wear out) in 1954 and the investment tax credit in 1962. From the 1980s through the 2000s, depreciation became even more generous, while taxes were trimmed on capital gains and dividends.

The most sweeping reductions came in the 2017 tax bill that slashed the corporate rate to 21% from 35% and temporarily allowed immediate 100% expensing of many capital expenditures.

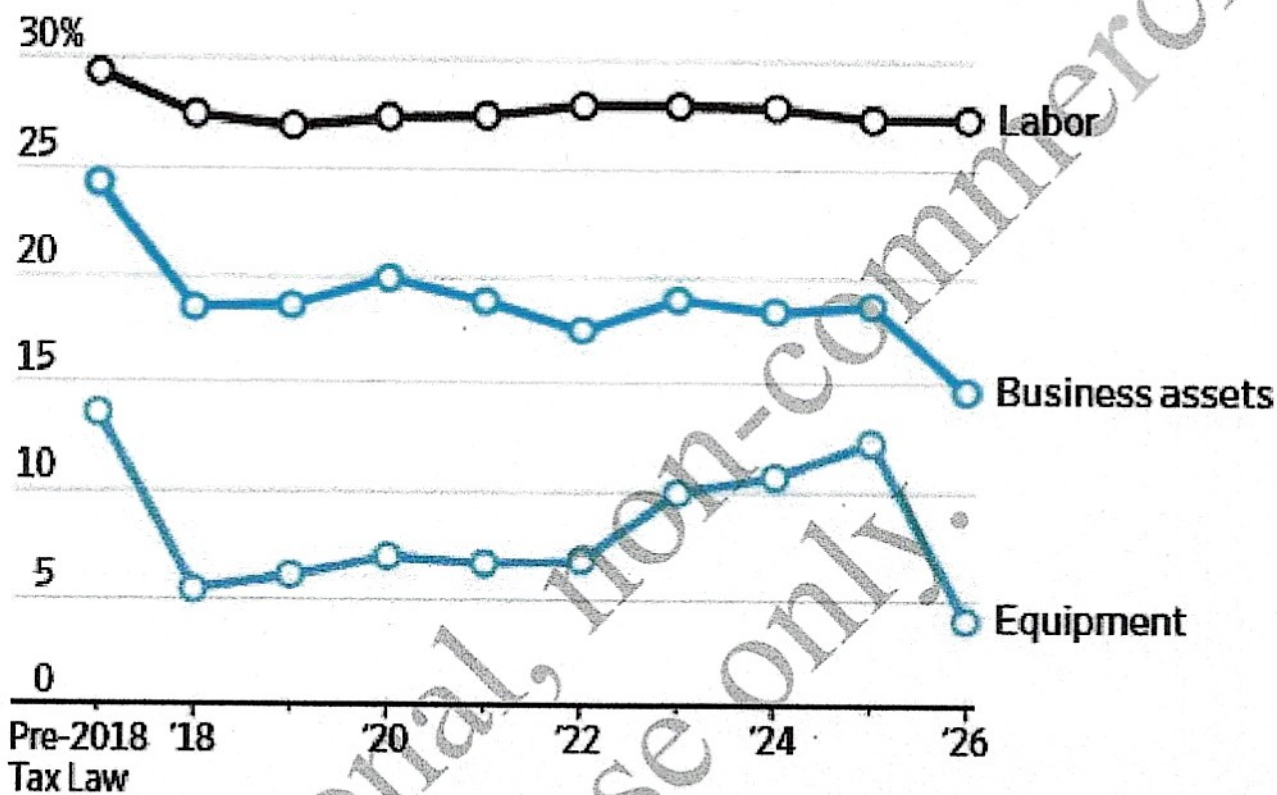
That 100% expensing provision was restored and made permanent last year. The upshot is that since 2017, the marginal tax rate on new equipment dropped to 4% from 14% while the marginal rate on labor edged down to 27% from 29%, the CBO said.

In theory, taxing capital would slow AI's deployment. It would also deter non-AI investment, a potential drawback. In practice, how much tax rates alter investment decisions isn't clear. One study found the 2017 tax cuts did boost investment, while raising economic output over the long run by less than 1%.

Still, even if capital taxes have little effect on AI deployment, there is another consideration. The share of national output going to capital instead of labor is at an all time high, and AI promises to push it even higher. As long as capital tax rates remain low, that limits how much new revenue flows into the Treasury. Narrowing the imbalance in taxes on capital and labor is one way of dealing with the largest peacetime deficits on record.

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Effective marginal tax rate



Note: Labor includes income and payroll taxes. For business assets and equipment, new investment only. Definitions and methodology might change between years.
Source: Congressional Budget Office

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