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Do Taxes and Interest Rates Discipline Corporate Profits? A Post-Keynesian Nonparametric Test

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Abstract

This paper examines whether tax-rate and interest-rate changes discipline corporate profits after accounting for the laissez-faire market-price mechanism of profit growth. Future profits are modelled as a function of lagged profits, a nonparametric price-based profit-growth term, tax-rate changes, and interest-rate changes. The laissez-faire component is estimated using Nadaraya–Watson kernel regression. Using quarterly U.S. data from 2016Q3 to 2025Q4, the results do not reject the joint null hypothesis that tax-rate and interest-rate effects are zero. The evidence suggests that, over the sample period, corporate profits are weakly explained by conventional fiscal and monetary changes once market-price dynamics are taken into account.

Keywords: corporate profits; taxation; interest rates; deregulation; Post-Keynesian economics; nonparametric regression.
JEL Classification: E12; E25; E43; E62; L51.

1 Introduction

Whether public policy can discipline corporate profits is a central question in macroeconomics and political economy. Standard approaches often treat taxation and interest rates as instruments that affect firms through user costs, retained earnings, credit conditions, and intertemporal decisions (Jorgenson, 1963; Hall and Jorgenson, 1967; Woodford, 2003; Taylor, 1993). A higher tax burden should reduce after-tax returns or alter investment incentives, while higher interest rates should increase financing costs and weaken demand through credit and balance-sheet channels (Auerbach, 2002; Devereux and Griffith, 1998; Bernanke and Gertler, 1995; Bernanke et al., 1999). In this view, corporate profits are disciplined by policy, competition, and the cost of capital.

Post-Keynesian economics starts from a different premise. Profits are not simply the equilibrium reward to marginal productivity. They are monetary, institutional, and distributional outcomes shaped by effective demand, mark-up pricing, oligopoly, finance, and

power (Keynes, 1936; Kalecki, 1943, 1954, 1971; Robinson, 1956; Kaldor, 1956; Pasinetti, 1962; Minsky, 1986; Lavoie, 2014). In Kaleckian and Post-Keynesian models, firms often set prices as a mark-up over costs; profits therefore depend on demand, investment, distribution, and the degree of monopoly rather than on competitive adjustment alone (Eichner, 1976; Sylos-Labini, 1962; Steindl, 1952; Dutt, 1984; Rowthorn, 1981; Bhaduri and Marglin, 1990; Hein, 2014; Stockhammer, 2017). Deregulation may strengthen this autonomy by increasing pricing power, financial flexibility, tax planning capacity, and market concentration.

Recent empirical work on market power reinforces the relevance of this question. Rising markups, superstar firms, declining labour shares, and weak competition have been documented in advanced economies (De Loecker et al., 2020; Autor et al., 2020; Barkai, 2020; Philippon, 2019). If corporations operate with increasing strategic power, the transmission from taxes and interest rates to profits may be weaker than standard policy models imply. A policy tightening may not reduce profits if firms pass costs to consumers, preserve mark-ups, adjust labour costs, or use accounting and financial channels to defend profitability.

This paper proposes a compact empirical framework to test whether tax-rate and interest-rate changes explain corporate profits once the laissez-faire price mechanism of profit growth is accounted for. The core model is

$$\Pi_{t+1} = g^p(p_t)\Pi_t + \alpha\Delta\tau_t + \beta\Delta r_t + \varepsilon_t, \tag{1}$$

where Π_t denotes corporate profits, p_t is a market-price variable, τ_t is the effective tax rate, and r_t is the interest rate. The function $g^p(p_t)$ captures the profit-growth mechanism generated by market prices under laissez-faire conditions. It is not imposed as a linear trend; it is estimated nonparametrically using Nadaraya–Watson kernel regression (Nadaraya, 1964; Watson, 1964; Li and Racine, 2007). The estimated laissez-faire component is then removed from observed profits, and the remaining policy-profit gap is tested against tax and interest-rate changes.

The empirical strategy is deliberately close in spirit to recent model-evaluation exercises in empirical finance: first isolate a benchmark mechanism, then test whether additional variables reduce pricing or forecasting errors, and finally account for model uncertainty using information criteria and posterior inclusion probabilities (Schwarz, 1978; Kass and Raftery, 1995; Bryzgalova et al., 2023; O'Connell and Fletcher, 2026). The paper does not assume in advance that policy variables must be significant. Instead, the sign, magnitude, and significance of α and β are treated as empirical questions.

Using quarterly U.S. data from 2016Q3 to 2025Q4, the paper finds that the joint null hypothesis $H_0 : \alpha = 0, \beta = 0$ is not rejected. The tax-rate coefficient is positive but statistically insignificant, and the interest-rate coefficient is negative but statistically

insignificant. The full tax-and-interest model has the highest adjusted R^2, but it is not preferred by BIC. Posterior inclusion probabilities are below 0.5 for both policy variables. Robustness tests using sign-preserving logged shocks and a preliminary regime-interaction test lead to the same conclusion.

The contribution is threefold. First, the paper introduces a Post-Keynesian decomposition of profits into a laissez-faire price-dynamic component and a policy component. Second, it uses a transparent nonparametric estimator rather than imposing a parametric law of profit growth. Third, it provides a disciplined interpretation of a non-rejection result: the evidence suggests weak policy discipline over corporate profits in the sample rather than strong tax or interest-rate control.

The remainder of the paper is organised as follows. Section 2 discusses the theoretical background. Section 3 presents the empirical specification. Section 4 describes the data and estimation strategy. Section 5 reports the results. Section 6 discusses interpretation and limitations. Section 7 concludes.

2 Theoretical background

2.1 Profits, mark-ups and distribution

The Post-Keynesian theory of profits begins with the idea that capitalist economies are monetary production economies in which firms make production and pricing decisions under uncertainty (Keynes, 1936; Minsky, 1986; Lavoie, 2014). Kalecki's profit equation links profits to investment, capitalist consumption, government deficits, and the external balance (Kalecki, 1954, 1971). This framework implies that profits cannot be reduced to a competitive marginal product. They reflect macroeconomic expenditure flows and institutional power.

Mark-up pricing is central to this view. In oligopolistic settings, firms set prices with reference to costs, desired margins, and the degree of monopoly (Kalecki, 1954; Eichner, 1976; Sylos-Labini, 1962). A rise in taxes or financing costs need not reduce profits one-for-one if firms have the power to shift costs into prices. Conversely, policy may affect profits indirectly through demand, investment, debt service, and distribution. This ambiguity motivates an empirical test rather than an imposed theoretical sign.

Distributional models also imply that the relationship between policy and profits is historically contingent. Wage-led and profit-led growth regimes depend on consumption, investment, capacity utilisation, and external-sector responses (Rowthorn, 1981; Dutt, 1984; Bhaduri and Marglin, 1990; Hein, 2014; Stockhammer, 2017). In such models, the same policy variable may have different effects across regimes. A higher interest rate may reduce demand and profits, but it may also redistribute income to financial institutions. A higher tax rate may reduce after-tax profits, but it may also coincide with periods of

high profitability or public spending that supports demand.

This interpretation is also consistent with Post-Keynesian monetary approaches that emphasise uncertainty, credit, and stock-flow consistency (Davidson, 1972; Godley and Lavoie, 2007). The construction and interpretation of effective tax measures also relate to the broader empirical tax literature reviewed by Hanlon and Heitzman (2010).

2.2 Deregulation and weak discipline

Deregulation matters because it can alter the pass-through from policy to profits. If deregulation strengthens corporate market power, policy changes may be absorbed, shifted, or neutralised. The empirical literature on rising market power suggests that large firms may have become more capable of sustaining high markups and profitability (De Loecker et al., 2020; Autor et al., 2020; Barkai, 2020; Philippon, 2019). This supports the Post-Keynesian concern that laissez-faire reforms may not produce competitive discipline, but rather institutional conditions under which firms preserve profits more effectively.

The paper therefore interprets the laissez-faire price mechanism $g^p(p_t)$ as the market-price process through which corporate profits evolve before explicit fiscal and monetary shocks are added. The empirical question is not whether policy can affect profits in theory, but whether tax-rate and interest-rate changes explain the component of profits not already captured by this price-driven mechanism.

3 Empirical specification

The baseline model is

$$\Pi_{t+1} = g^p(p_t)\Pi_t + \alpha\Delta\tau_t + \beta\Delta r_t + \varepsilon_t. \tag{2}$$

The realized profit-growth ratio is

$$y_t^{\Pi} = \frac{\Pi_{t+1}}{\Pi_t}. \tag{3}$$

The laissez-faire price function is estimated from

$$y_t^{\Pi} = g^p(p_t) + u_t. \tag{4}$$

The fitted value $\widehat{g^p}(p_t)$ gives the laissez-faire predicted profit level:

$$\widehat{\Pi}_{t+1}^{LF} = \widehat{g^p}(p_t)\Pi_t. \tag{5}$$

The policy-profit gap is

$$Gap_{t+1} = \Pi_{t+1} - \widehat{g^p}(p_t)\Pi_t. \tag{6}$$

The second-stage policy regression is

$$Gap_{t+1} = c + \alpha\Delta\tau_t + \beta\Delta r_t + \varepsilon_t. \tag{7}$$

The null hypothesis is

$$H_0 : \alpha = 0, \quad \beta = 0. \tag{8}$$

Rejecting the null would indicate that tax-rate and interest-rate changes explain the part of profits not captured by laissez-faire price dynamics. Failure to reject the null indicates that these policy variables do not significantly explain the policy-profit gap in the estimated specification.

4 Data and methodology

4.1 Data

The empirical analysis uses quarterly U.S. data downloaded from FRED through Python. Corporate profits before tax are used as Π_t. Corporate profits after tax are used only to construct the effective tax rate:

$$\tau_t = 1 - \frac{\text{corporate profits after tax}_t}{\text{corporate profits before tax}_t}. \tag{9}$$

The market-price variable p_t is proxied by the S&P 500 index. The interest-rate variable r_t is the effective federal funds rate expressed in decimal form. Policy changes are defined as

$$\Delta\tau_t = \tau_t - \tau_{t-1}, \qquad \Delta r_t = r_t - r_{t-1}. \tag{10}$$

The matched sample starts in 2016Q3 and ends in 2025Q4. After constructing leads and first differences, the usable sample contains 38 quarterly observations.

All series are obtained programmatically from the Federal Reserve Economic Data (FRED) database using Python. The replication script downloads the raw series directly from FRED, converts them to quarterly frequency, constructs the effective tax rate, computes first differences, estimates the nonparametric laissez-faire profit function, and produces all tables reported in the paper. The implementation uses standard open-source Python libraries, including `pandas`, `numpy`, `scipy`, and `statsmodels`. No `sklearn` routines are used. The nonparametric component is implemented directly through a Nadaraya–Watson kernel estimator with a Gaussian kernel and a rule-of-thumb bandwidth.

The empirical workflow is therefore fully reproducible from the Python script: no manually prepared spreadsheet is required. The script creates the final estimation sample, stores the constructed data set, and exports the regression, model-comparison, posterior-inclusion, robustness, and regime-test tables as separate output files. This design reduces the risk of transcription errors and ensures that the empirical tables are generated from the same data transformations used in the estimation.

4.2 Nonparametric estimation

The laissez-faire price function is estimated by the Nadaraya–Watson kernel estimator:

$$\widehat{g^p}(p_t) = \frac{\sum_{s \neq t} K\left((p_t - p_s)/h\right) y_s^{\Pi}}{\sum_{s \neq t} K\left((p_t - p_s)/h\right)}. \tag{11}$$

A Gaussian kernel is used, and leave-one-out fitted values are computed to reduce mechanical overfitting. The bandwidth is selected using a standard rule-of-thumb. This procedure is transparent, reproducible, and appropriate for the small sample, although the results should be interpreted cautiously because nonparametric methods are sensitive to sample size (Hastie et al., 2009; Li and Racine, 2007).

4.3 Inference and model comparison

Equation (7) is estimated by OLS with Newey–West heteroskedasticity and autocorrelation consistent standard errors (Newey and West, 1987). The main test is a joint Wald test of $\alpha = \beta = 0$.

The paper also compares four models:

$$M_0 : Gap_{t+1} = c + \varepsilon_t, \tag{12}$$

$$M_1 : Gap_{t+1} = c + \alpha \Delta\tau_t + \beta \Delta r_t + \varepsilon_t, \tag{13}$$

$$M_2 : Gap_{t+1} = c + \alpha \Delta\tau_t + \varepsilon_t, \tag{14}$$

$$M_3 : Gap_{t+1} = c + \beta \Delta r_t + \varepsilon_t. \tag{15}$$

Models are compared using AIC, BIC, adjusted R^2, and posterior model probabilities approximated from BIC (Schwarz, 1978; Kass and Raftery, 1995). Posterior inclusion probabilities are obtained by summing the posterior probabilities of all models containing each policy variable. This is a parsimonious model-uncertainty exercise inspired by the broader Bayesian model-selection literature (Bryzgalova et al., 2023; O'Connell and Fletcher, 2026).

5 Empirical results

5.1 Laissez-faire price function

Table 1 reports the nonparametric estimation setup.

Table 1: Nonparametric estimation of the laissez-faire profit function

Quantity	Value
Estimator	Nadaraya–Watson kernel regression
Kernel bandwidth	548.616
Frequency	Quarterly
Sample period	2016Q3–2025Q4
Usable observations	38

The estimated function $\widehat{g^p}(p_t)$ is used to construct the laissez-faire profit prediction $\widehat{g^p}(p_t)\Pi_t$. The empirical tests below evaluate whether tax and interest-rate changes explain the remaining policy-profit gap.

5.2 Policy regression

Table 2 reports the policy regression. The dependent variable is Gap_{t+1}.

Table 2: Policy effects after controlling for laissez-faire price dynamics

Variable	Coefficient	HAC Std. Error	HAC t-statistic	p-value
Constant	2.135	27.263	0.078	0.938
$\Delta\tau_t$	2277.856	1452.422	1.568	0.126
Δr_t	-9562.998	8851.857	-1.080	0.287
Observations		38		
Adjusted R^2		0.090		

The coefficient on $\Delta\tau_t$ is positive but statistically insignificant. The coefficient on Δr_t is negative but also statistically insignificant. The sign on Δr_t is consistent with the idea that monetary tightening may reduce profits through demand and financing-cost channels, but the estimate is too imprecise to support a strong conclusion.

5.3 Joint test

Table 3 reports the central Wald test.

Table 3: Joint test of tax-rate and interest-rate effects

Null hypothesis	Wald statistic	p-value	Decision
$H_0 : \alpha = 0,\ \beta = 0$	2.321	0.113	Do not reject H_0

The null hypothesis is not rejected at conventional significance levels. The evidence therefore does not support the claim that tax-rate and interest-rate changes significantly explain the policy-profit gap once the laissez-faire price mechanism is removed.

5.4 Model comparison

Table 4 compares the four candidate models.

Table 4: Model comparison

Model	Variables	AIC	BIC	Adjusted R^2	Posterior prob.
M_2	$\Delta\tau_t$	510.896	514.171	0.066	0.313
M_0	Constant only	512.548	514.185	0.000	0.311
M_3	Δr_t	511.480	514.755	0.052	0.234
M_1	$\Delta\tau_t, \Delta r_t$	510.838	515.751	0.090	0.142

The lowest BIC belongs to the tax-only model, but its advantage over the constant-only model is negligible: the BIC difference is 0.014. The full tax-and-interest model has the highest adjusted R^2, but it is penalised by BIC for additional complexity. Overall, model comparison does not provide strong support for adding both policy variables.

5.5 Posterior inclusion probabilities

Table 5 reports BIC-approximated posterior inclusion probabilities.

Table 5: Posterior inclusion probabilities

Variable	Posterior inclusion probability
$\Delta\tau_t$	0.455
Δr_t	0.376

Both posterior inclusion probabilities are below 0.5. The tax-rate change carries more model weight than the interest-rate change, but neither variable appears as a robust determinant of the policy-profit gap.

5.6 Robustness and regime tests

A robustness test uses sign-preserving logarithmic transformations of the policy shocks:

$$x_t^{log} = \text{sign}(x_t) \log(1 + |x_t|). \tag{16}$$

The joint test is then repeated. Table 6 reports the result.

Table 6: Robustness test using logged policy shocks

Null hypothesis	Wald statistic	p-value	Decision
$H_0 : \alpha^{log} = 0,\ \beta^{log} = 0$	2.324	0.113	Do not reject H_0

The conclusion is unchanged. The result is not driven by extreme movements in tax-rate or interest-rate changes.

A preliminary regime test splits the sample at the median date, 15 May 2021. The split is mechanical and should not be interpreted as a theoretically definitive deregulation date. Table 7 reports the interaction test.

Table 7: Preliminary regime-interaction test

Null hypothesis	Wald statistic	p-value	Decision
$H_0 : \theta_\tau = 0,\ \theta_r = 0$	2.133	0.135	Do not reject H_0

There is no statistically significant evidence that the tax-rate and interest-rate effects differ across the mechanical split. A stronger version of this exercise would require a historically justified deregulation date or a continuous deregulation index.

6 Discussion

The empirical results are consistent across the baseline regression, the joint test, model comparison, posterior inclusion probabilities, logged-shock robustness, and the preliminary regime test. The data do not reject the null hypothesis that tax-rate and interest-rate effects are zero after controlling for the laissez-faire price mechanism.

This result should not be interpreted as evidence that taxation, interest rates, or institutions never matter for profits. The sample is short, the proxy variables are imperfect, and the test is deliberately parsimonious. The result is narrower: in this sample and specification, conventional fiscal and monetary changes do not significantly explain the profit component left over after the price-based profit-growth function is estimated.

For a Post-Keynesian interpretation, the non-rejection is meaningful. It suggests that corporate profits may be weakly disciplined by the observed policy variables. The positive

but insignificant tax coefficient is consistent with the possibility that effective tax-rate increases do not mechanically reduce the unexplained profit component. The negative but insignificant interest-rate coefficient is directionally consistent with monetary restraint but too imprecise to imply effective discipline. The dominant empirical object is the laissez-faire price mechanism $\widehat{g^p}(p_t)$.

The paper therefore shifts the interpretation from "policy controls profits" to "policy discipline appears weak once price dynamics are accounted for." This conclusion is compatible with theories emphasising mark-up pricing, corporate power, financial autonomy, and the institutional weakness of laissez-faire discipline (Kalecki, 1943; Eichner, 1976; Minsky, 1986; Lavoie, 2014; De Loecker et al., 2020; Barkai, 2020).

7 Limitations

Several limitations should be addressed in future work. First, the usable sample contains only 38 quarterly observations, which limits statistical power. Second, the S&P 500 is an imperfect proxy for the economy-wide market-price mechanism. Third, the effective tax rate is constructed from aggregate before-tax and after-tax profits, and may reflect accounting and cyclical effects as well as policy changes. Fourth, the deregulation test uses a mechanical split, not a theoretically grounded deregulation measure. Fifth, the nonparametric estimator is transparent but sensitive to bandwidth and sample size.

Future research should use longer samples where available, sectoral or firm-level profit data, alternative price variables, statutory and effective tax measures, corporate borrowing rates, and explicit deregulation indices. Sectoral data would be especially useful because market power and interest-rate sensitivity are likely to differ between financial firms, technology firms, energy firms, and competitive manufacturing firms.

8 Conclusion

This paper developed a Post-Keynesian empirical framework for testing whether taxation and interest rates discipline corporate profits after accounting for the laissez-faire market-price mechanism of profit growth. The function $g^p(p_t)$ was estimated nonparametrically using Nadaraya–Watson kernel regression, and the remaining policy-profit gap was tested against tax-rate and interest-rate changes.

The empirical evidence does not reject the joint null hypothesis that the tax-rate and interest-rate effects are zero. Model comparison, posterior inclusion probabilities, robustness checks, and a preliminary regime test support the same conclusion. In the observed sample, corporate profits are not strongly explained by conventional fiscal and monetary changes once market-price dynamics are taken into account.

The paper's central finding is therefore one of weak policy discipline. Rather than showing that tax and interest-rate changes control profits, the evidence suggests that corporate profitability is largely governed by the laissez-faire price mechanism captured by $\widehat{g^p}(p_t)$. This finding is consistent with a Post-Keynesian view in which profits reflect market power, mark-up behaviour, and institutional conditions rather than competitive policy discipline alone.

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Author contributions

Houssam Boughabi conceived the study, developed the theoretical framework, wrote the empirical code, conducted the econometric analysis, interpreted the results, and prepared the manuscript.

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Data availability

The data used in this study are publicly available from the Federal Reserve Economic Data database. The Python replication script downloads the required series directly from FRED and constructs all variables used in the empirical analysis.

Code availability

The Python code used to produce the empirical results is available from the author upon reasonable request. The code uses publicly available Python libraries and does not rely on proprietary software.

Declarations

Conflict of interest The author declares no conflict of interest.

Ethics approval Not applicable.
Consent to participate Not applicable.
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