The corporation tax is under attack. It must be defended

Feb 29 2012

Nicholas Shaxson *argues that a corporation tax cut may increase revenue for big business but this does not in any way translate to increased revenue for the country in which they reside. Corporations the world over sit on vast sums of wealth and without a tax on revenue, economic growth and vital public services will remain all the more elusive.*

British corporations are awash with cash. According to Deloitte, non-financial companies held £731.4 billion in the third quarter of 2011 – the highest ever. Britain also faces soaring fiscal deficits – and the two issues are related, as Martin Wolf explains in the Financial Times: "If the fiscal deficit is to disappear, offsetting adjustments must occur, above all, in the foreign and corporate sectors."

Corporations have all this cash because they are not investing: the opportunities are not there. They are hunkering down, spending less than they are earning, while the government is spending more than it is earning (and thus running deficits). How to shift this ugly picture? There are various ways – but cutting corporate tax rates – further pumping up those bloated and dormant corporate cash piles – clearly isn't one of them.

If stimulus is your recipe for growth, then, cutting corporate taxes is the least effective option. As the U.S. Congressional Budget Office noted in a 2008 report: "The most effective types of fiscal stimulus (delivered either through tax cuts or increased spending on transfer payments) are those that direct money to people who are most likely to quickly spend the bulk of any additional funds provided to them. . . . a cut in corporation taxes is not a particularly cost-effective method of stimulating business spending."

Corporate taxes transfer money away from a sector (corporations) that lets it sit idle, into the hands of a sector (government) that puts it straight to work – educating children, building roads and so on. Corporation taxes and appropriate spending are exactly what Britain needs right now.

In light of all of this, it is puzzling that Tim Knox, Director of the Centre for Policy Studies, argued in a recent LSE blog for a cut in the corporation tax rate. Not just a cut, but a massacre: from 26 percent to as low as 10 percent. In making this astonishing pitch, he wheels out some hoary old myths. For one, he advocates the ideas of cranky U.S. economist Arthur Laffer that have been amply dealt with by John Christensen in this earlier post.

The next Knox myth concerns this woolly weasel word 'competitiveness.' It is important to get one thing straight: The process of competition between firms in a market bears *absolutely no economic resemblance whatsoever* to 'competition' between jurisdictions on tax. The former is generally beneficial, while the latter is always harmful.

Think about it like this: When a *company* cannot compete it goes bust and another, better one, takes its place. For all the pain involved, this 'creative destruction' weeds out bad firms and is a source of capitalism's dynamism. But what do you get if a *country* cannot "compete?" A failed state? As Wolf, again, puts it, "the notion of the competitiveness of countries, on the model of the competitiveness of companies, is nonsense."

Countries do ‘compete’ in meaningful ways, however. The World Economic Forum (WEF)’s Global Competitiveness Report ranks countries on 12 ‘pillars’ of competitiveness such as infrastructure, healthcare, education, technological readiness and more – factors that depend heavily on tax revenues. Of the WEF’s four most ‘competitive’ countries in 2011, two – Sweden and Finland – are among the world’s highest tax countries; and in general, the less competitive (developing) countries tend to have the lowest taxes as a share of national income.

There is no clear empirical link between corporate tax rates and true economic competitiveness either. This stands to reason: investors’ prime concerns in a country are usually things like political and economic stability, access to sizeable markets, infrastructure, or a healthy and educated and workforce. Surveys regularly show that tax comes some way down the list of factors.

Moreover, if corporate tax rates (big and small) are cut far below the top rate of income tax, then wealthy individuals will shift income into forms that will attract the lower corporate tax rate. So this increases pressure on governments to cut top income tax rates, further compressing the tax system away from the wishes of the electorate and from Adam Smith’s principle of basing tax rates on ability to pay. In these times of soaring inequality, which is harmful in its own right, corporate tax cuts are therefore particularly worrisome.

One more thing: Tax cuts and tax loopholes typically don’t create jobs. Chancellor George Osborne recently told Radio 4’s Today programme that Britain would keep cutting corporation tax. Following a particularly dangerous move last year to provide a juicy five percent tax rates for corporations that shift certain types of income into tax havens, Osborne stated that “there is evidence that businesses are coming to Britain more than they were,… creating factories and jobs.”

Really? Private Eye heard the programme and asked the Treasury to provide this evidence. The Treasury came up with . . . . precisely nothing. So far, two big companies appear to have been persuaded to relocate back to the UK as a result of the tax moves: Aon and WPP. Aon is expected to create 20 new jobs. WPP is likely to provide none. Accountancy Age estimated the short-run costs of the stealthy offshore tax-cut plan at £6.7 billion, and concluded that Osborne was “paying a lot of money for very good PR.”

Additionally, IMF research has found that while tax cuts and tax holidays may boost *investment* in some countries, it does not seem to boost growth (which is the end goal of policy, after all.) And, given that corporate tax cuts boost inequality, crude aggregate GDP growth figures understate the problems for the middle and poorer classes.

There is yet more. Knox also provides a graph showing corporate tax rates falling sharply for the past 30 years. What he fails to mention is that the quarter century before that, when corporation tax rates in the UK were higher (around 40 percent in the UK for much of the time) is now known as the Golden Age of capitalism, when taxes were high and growth was high around the world. The period of tax-cutting ushered in an era of lower economic growth, soaring inequality and stagnating wages. Correlation isn’t causation, but this episode proves that higher corporation tax rates can be compatible with growth.

Knox’s article ends with a rather sad plea for an end to ‘banker-bashing.’ The City of London Corporation provides a lot of misleading information about its tax ‘contribution’ to the economy. But if you factor in all the costs associated with the bailouts, the hit to growth from the financial crisis, the implicit taxpayer subsidies to the big banks, and the fact that much if not most of the tax revenue comes from the ‘utility’ part of the financial sector (about which nobody is arguing) then clearly the ‘casino’ side of banking has been a large and net *consumer* of tax revenue, not a contributor.

A different argument is therefore in order: stop mollycoddling those ‘casino’ bankers, and take the gloves off. But that is a topic for another day.

Please read our comments policy before posting.

About the author

Nicholas Shaxson is author of *Treasure Islands: Tax Havens and the Men who Stole the World*. He is an Associate Fellow of Chatham House and writes for the Tax Justice Network. His blog is available here, and he provides further arguments about the corporation tax here.

You may also be interested in the following posts (automatically generated):

1. Arguments linking a lower corporation tax to increased productivity and growth have no basis in reality
2. A cut in the corporation tax may not be popular but it would be beneficial to everyone
3. Budget 2011: A footnote to the existing agenda, but the public is waking up to the attack on the welfare state
4. The Bank of England has failed to achieve the 2% inflation rate and its forecasting has been ill-judged. However, its stance on interest rates is entirely justified given the parlous state of the UK's domestic economy

This entry was posted in Austerity and Economic policy and tagged corporation tax , economic growth , economics , tax justice , uk government , uk politics . Bookmark the permalink . Edit