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CUTTING THE CORPORATE TAX RATE MEANS CUTTING CORPORATE TAXES

By Ike Brannon

America has the highest corporate tax rate in the Organisation for Economic Cooperation and Development, or OECD. But it wasn't always so.

In 1986, the United States cut its corporate tax rate close to the current rate of 35 percent as part of broad, comprehensive tax reform at both the corporate and personal level. The reform gave the country one of the lower corporate tax rates in the developed world. In the 27 years since, we have slowly become a high corporate tax rate country through stasis: literally every single country in the OECD has reduced its corporate tax rate in the past twenty years, with many having done so multiple times. Except for the United States. There are no shortage of people on both sides of the aisle dissatisfied with this state of affairs. In the past year, members of both parties, as well as the Obama administration, have offered support for reducing corporate tax rates, but all insist that such reform be done so that the loss in tax revenue from a reduced rate is "paid for" by increasing revenues in other ways, such as eliminating certain tax deductions or tax credits made available to corporations.

Such constraints would doom corporate tax reform to have only a very slight effect on economic growth, as evidenced by not just a bevy of economic models but also by the experience of the other OECD countries. Corporate tax cuts may not pay for themselves, but the money collected via the corporate tax rate ranks among the least efficient and most costly revenue a government collects in terms of foregone economic growth. Other governments in the developed world realize this, and as a result, *the vast majority of corporate tax rate reductions that have occurred in the OECD in the last decade have not been paid for*.

The result has been more economic growth as well as more robust corporate tax revenue gains than would have otherwise been the case.

ACCELERATING CORPORATE TAX CUTS

The move toward a lower corporate tax rate has gained steam across the globe in the past decade. The average effective corporate tax rate among the other OECD nations has fallen from 37 percent to 30 percent since 2002 and shows no signs of stopping. In the last decade, **every other** OECD country lowered their corporate tax rates by at least one percentage point a combined **85 times**, while the U.S. corporate tax rate has remain unchanged.

Some of these cumulative reductions have been significant. For instance, Canada's corporate income tax rate has gone from 28 to 15 percent in the last 11 years, while Germany's has fallen from 50 percent to under 30 percent during that time span. In the first half of 2012 alone, Japan, Chile, Canada and Finland reduced their tax rates, and six countries reduced rates in 2011 as well.

What is telling is that the vast majority of the tax cuts *were not offset* by higher taxes elsewhere. Of the 85 OECD corporate tax cuts, only **16** were accompanied by an increase in either the personal income tax or value-added tax, or by the elimination of tax expenditures to offset the rate decrease.

Most of these countries recognize the high opportunity cost of the tax in terms of foregone economic growth. As the world economy becomes more tightly integrated and capital becomes more mobile, the opportunity cost of the corporate income tax has only increased.

What's more, to reduce the top tax rate while jettisoning the various investment incentives that constitute the bulk of tax expenditures would produce only modest gains in efficiency. Simultaneously increasing the cost of investment in one place and then decreasing it in another accomplishes little, studies have found.[1]

Why hasn't the United States participated in the trend towards lower corporate taxes? For starters, reducing the corporate income tax is freighted with symbolism. The left, in particular, tends to paint potential reductions in income taxes as a sop to the rich, despite a near consensus among economists that workers end up bearing the brunt of the tax, as high corporate tax rates dampen investment and productivity as well, in turn depressing wages.[2]

Opponents of corporate tax reform insist that our corporate income tax burden is in line with that of other countries once the various deductions, credits, and other expenditures are fully taken into account, although the data dispute this. For instance, analyzing more than a dozen studies that estimate an effective corporate tax rate for the United States and other OECD countries,[3] Philip Dittmer of the Tax Foundation finds that, even by this metric, the United States is anywhere from five to fifteen points above the OECD average.[4]

In 2012, the Obama administration set forth the broad principles of a revenue-neutral tax reform that would lower rates while making up lost revenue via the elimination of the bulk of the various credits and deductions.[5] House Ways and Means Committee Chairman Dave Camp also released a corporate tax reform proposal that was revenue neutral and paid for by the elimination of various tax expenditures,[6] and Senate Finance Committee Chairman Max Baucus has also suggested his intent to craft revenue-neutral corporate tax reform.[7]

While the corporate tax code does indeed have a plethora of credits, deductions, and exclusions that allow corporations to reduce their tax bill, eliminating all of these and dedicating the revenue generated to "pay for" a lower corporate tax rate does not buy that much of a tax rate reduction—perhaps less than the 25% rate promised by Chairman Camp. Corporate tax reform that is not constrained by revenue-neutrality could have significant long-term benefits to productivity, wages, and economic growth.

The United States is no longer immune from the economic forces that buffet the rest of the world. It is time we got our economic house in order and created a tax system that looks like it was designed on purpose. Reducing the corporate tax rate so as to make it competitive with the other developed nations would do much more for economic growth, employment, and wages than any amount of "stimulus" spending from the government. Making economic growth the focus for tax reform may be a novel concept for this country but we can no longer subordinate growth to more plebian political objectives and get away with it.

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Ike came to R Street from the American Action Forum, where he served as director of economic policy and director of congressional relations. Previously, he served as chief economist to the U.S. House Energy and Commerce Committee; senior policy adviser and chief economist to the Republican Policy Committee; and a senior adviser to the John McCain 2008 presidential campaign.

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1. Jane Gravelle and Thomas Hungerford, "Corporate Tax Reform: Issues for Congress" Congressional Research Service Report, December 16th, 2011.
2. For a more detailed discussion on the inefficiency of the corporate income tax see Ike Brannon, Doug Holtz-Eakin and Elizabeth Lowell, "How Reform of the Corporate Income Tax Code can create Short- and Long-Term Economic Growth." *American Action Forum Report*, July 2011.
3. Calculating an effective tax rate requires making a variety of assumptions about the size of the business, the type of business, its capital expenditures, and the like.
4. Dittmer, Philip: "U.S. Corporations Suffer High Effective Tax Rates by International Standards." *The Tax Foundation Report*, September, 2011, Table 1.
5. The President's Framework for Business Tax Reform, Whitehouse.gov, February 2012
6. Ways and Means Discussion Draft, October 26th, 2011.
7. Baucus, Max and Dave Camp, "Tax Reform is very much Alive and Doable," *The Wall Street Journal*, 7 April 2013.