Funding the Future

Economic shibboleths: why Corporation tax cuts are insa...

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Just as the cuckoos herald spring's arrival in Britain, so the shrill calls for corporate tax cuts signal the imminence of an upcoming Budget. The lobbyists are in full voice. And their argument are, as usual, quite insane: divorced from all economic logic. (That doesn't stop the likes of the BBC routinely parroting this nonsense - voodoo economics - without balancing comment, or apparent thought.)

Last week we had a blog on the London School of Economics (LSE) site from Tim Knox of the Centre for Policy Studies (a Thatcherite think-tank) calling for the corporate tax rate in Britain to be cut from its current 26 per cent to 20 per cent, and then lower and lower. Yesterday we had several hundred business leaders signing up toa letter in The Telegraph calling for a cut in the top income tax rates to boost business and entrepreneurialism. And lurking in the background we have the Oxford Centre for Business (Non) Taxation with their cloud cuckoo notion that businesses shouldn't pay tax in the first place since they simply pass the cost on to consumers or workers (but never to shareholders, oh no!).

But is there any merit to these arguments?

In a riposte to Tim Knox posted on the LSE site, Nicholas Shaxsonnotes that corporations in Britain (and elsewhere) are sitting on record piles of unspent cash. The current shortfall of investment has nothing to do with high tax rates and everything to do with insufficient demand to meet potential supply. Cutting corporate taxes will simply make the situation worse as more wealth gushes upwards into the hands of the 1 per cent, and it goes to corporations that are letting it sit idle. As Shaxson points out, corporate tax cuts at this stage will be as effective as pushing on a piece of string:

"*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."

Also responding to Tim Knox on the LSE blog, John Christensen referred back to the seductive ideas of Arthur Laffer, an American economist who theorised that a curve might exist which could demonstrate a relationship between government revenues raised and the nominal tax rate. Lowering tax rates would stimulate investment and therefore boost long-term revenue yields; wonderfully seductive stuff, but totally adrift from reality. As Christensen notes:

"*I would hope that any university lecturer promoting the Laffer Curve to first year undergraduates would be quickly called to task. Embarrassingly for it proponents, empirical evidence for its existence remains elusive. Most accept that it is shifty, which limits its policy application. You might like to consult the FT's Martin Wolf who has said: "the theory that cuts would pay for themselves has proved altogether wrong." Or Greg Mankiw, chairman of the Council of Economic Advisers under George W. Bush no less, who described supporters of the idea to be 'charlatans and cranks.*'"

Christensen also takes on the hardy perennial argument that high tax rates deter entrepreneurs from investing time, money and effort. The evidence for this deterrent effect was always scarce, and is getting scarcer. Tax rates have fallen significantly across Europe and North America, but there's little evidence of fresh innovation and job creation in productive industries. Too much of what has passed for entrepreneurialsim in the past 30 years has been rent-seeking activity, mergers and acquisitions and privatisation of natural monopolies. But, as John notes, tax cuts for the wealthy have merely served to feather their nests, rather than spurring them to greater effort:

"*Way, way back, it might have been arguable that high marginal tax rates reduced rich people's willingness to work. But the evidence was scarce even back in the 1970s, and* more recent research suggests that lower tax rates for top earners do not stimulate output, kicking that particular argument into the long grass."

Just as pin-up minister Michael Heseltine was expert in finding the Conservative Party's heart in the 1980s, corporate lobbyists these days know that nothing gets the blood pumping faster within the Tory members in parliament than the idea of a good, meaty tax cut.

The economic shibboleths live on.

NB: From the TJN blog, with permission