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The global economics of corporate tax cuts [1]

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Jim Flaherty, Canada?s minister of finance, may well be exasperated. Speaking of the federal government?s plan for a national corporate tax of 25 per cent [3], the Minister affirmed that ?we believe lower taxes create investment and jobs. I continue to encourage our provincial partners to follow our lead.? Unfortunately, his counterparts remain to be convinced, with British Columbia and Ontario signalling their intentions to halt the downward trend.

How times have changed! ?On New Year?s Day,?reported Neil Reynolds [4], ?Canada?s corporate tax rate ? federal and provincial rates combined ? fell to 25 per cent, giving Canada the lowest rate in the Group of Seven countries, and a more competitive economy on a global basis.? (According to the *2012 Index of Economic Freedom*[5], Canada?s federal rate of 15 per cent compares favourably with the United Kingdom?s 26 per cent.)

Flaherty could remind officials in the provincial treasuries of the global consequences of their actions, citing an economic truism published in *The Wealth of Nations* two-centuries-and-a-half ago:

> *The proprietor of stock is properly a citizen of the world, and is not necessarily attached to any particular country. He would be apt to abandon the country in which he was exposed to a vexatious inquisition, in order to be assessed to a burdensome tax, and would remove his stock to some other country where he could, either carry on his business, or enjoy his fortune more at his ease. By removing his stock he would put an end to all the industry which it had maintained in the country which he left (V.ii.f.6 [6]).*

Proponents of raising corporate taxes make two fundamental mistakes. First, since the fundamental reason for taxes is to fund public expenditures which benefit the common good, a logical corollary follows: You can?t tax what you don?t have. ?Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible,? Adam Smith cautioned, ?over and above what it brings into the publick treasury of the state.? But a rise in corporate taxes will punish native industry, as Henry Hazlitt noted in Economics in One Lesson [7]:

> *It does not expand its operations, or it expands only those attended with a minimum of risk. People who recognize this situation are deterred from starting new enterprises. Thus old employers do not give more employment, or not as much more as they might have; and others decide not to become employers at all. Improved machinery and better-equipped factories come into existence much more slowly than they otherwise would. The result in the long run is that consumers are prevented from getting better and cheaper products, and that real wages are held down.*

Moreover, in to-day?s globalised economy, high corporate tax rates serve as incentives for businesses to move to countries with more favourable tax structures. Thus it was even in Smith?s day: ?A tax which tended to drive away stock from any particular country, would so far tend to dry up every source of revenue, both to the sovereign and to the society. Not only the profits of stock, but the rent of land and the wages of labour, would necessarily be more or less diminished by its removal (f.6).?

Second, a rise in corporate taxes will not necessarily raise more revenue. Businesses will simply transfer the burden of the tax to the ordinary consumer, whether through price increases (thereby shifting over-all demand) or through lost employment. Smith alluded to this ?expence? when he wrote that ?much unnecessary trouble, vexation, and oppression (b.6)? is visited upon the tax-payer by the tax-gatherer. Ultimately all will suffer in the drag on capitalist accumulation, which in turn effects innovation ? and a contributing factor why businesses are ?hoarding? profits and not investing in either human or capital resources.

Worse, a rise in corporate tax rates may raise less revenue. As John Ivison noted in his report on Flaherty, ?Corporate tax reductions increase after-tax profits. When after-tax profits rise, there is more money available for wages, machinery to improve competitiveness and dividends ? which can, in turn, be taxed.? The data contradict the critics:

> *In fact, the federal government?s corporate income tax revenues have been on a steady incline since the recession, averaging around 1.9% of GDP. At the same time, the Bank of Canada?s latest business outlook survey suggests 40% of businesses plan to increase investment this year, with only 19% saying they plan less investment. More than half said they see increased employment.*

These rosy projections are shared by Reynolds. ?Remarkably?, he wrote, ?the gradual lowering of the corporate tax rate appears to have resulted in little loss in corporate tax revenue?, noting that revenues were higher with a lower tax than a higher tax ? the Laffer curve hypothesis [8] at work.

All this would be old hat to Smith, who had observed in 1776 that excessive taxation ?may obstruct the industry of the people, and discourage them from applying to certain branches of business which might give maintenance and employment to great multitudes. While it obliges the people to pay, it may thus diminish, or perhaps destroy some of the funds, which might enable them more easily to do so (b.6).?

All open-market countries can either accept global economic realities and tailor their tax systems to encourage industry; or bow to calls for ever-higher rates, subjecting corporations to uncompetitive taxation, and in the process ?dry up every source of revenue, both to the sovereign and to the society.? Adam Smith knew the right answer ? does Canada?

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