

How cutting corporation tax would boost revenue

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OUR PRINCIPLES

Nationhood

Each nation must be free to determine its policies to the benefit of its citizens.

Freedom

For responsible individuals, guaranteed by the rule of law administered by an independent judiciary and minimal state activity.

Democracy

The exercise of political power, with the consent of the people – through regular elections on the basis of universal suffrage and a secret ballot.

Security

The first duty of the state is to provide external and internal defence of the citizenry.

Community

Defined by geography, tradition, inheritance and sense of identity.

Capitalism

The most effective system of wealth creation. Free markets are blind to gender, race, class or religion.

Choice

For individuals must be maximised – even if the state accepts responsibility for provision of a safety net.

Enterprise

Fostered by a low tax, low inflation economy – with currency exchange rates determined by the free market.

Deregulation

Domestic and global – to maximise freedom of choice and individual responsibility in an improved society.

All views expressed in this publication are those of the authors and are not necessarily endorsed by the Council or Executive Committee of Conservative Way Forward.

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Introduction

“So I will send to Congress a proposal to cut the taxes these employers pay, from a rate of 35 to 25 percent. As it is, we have the second-highest tax on business in the industrialized world. High tax rates are driving many businesses and jobs overseas – and, of course, our foreign competitors wouldn't mind if we kept it that way. But if I am elected president, we're going to get rid of that drag on growth and job creation, and help American workers compete with any company in the world.”

**– John McCain, speech at
Carnegie Mellon University, April 2008**

There is a gap opening up in modern Western politics. There are those politicians who still work under the false impression that governments can neatly push corporate taxes up and down and revenues will rise and fall in similar proportion. Others understand that the foundation of future economic growth, prosperity and, as a result, tax revenues is a competitive, low tax economy that can attract international investment and encourage entrepreneurship. John McCain, as can be seen in the quote above, is clearly one of those who recognise the huge economic benefits of corporate tax cuts. Businesses driven overseas by high taxes represent a huge revenue and employment loss.

The evidence that high rates can cost revenue, as investment is directed towards low tax economies, is increasingly strong. Major firms are moving to lower tax economies. In 2006, Lloyd's insurer Hiscox announced that they would be relocating to Bermuda to avoid high corporate tax rates and excessive regulation¹. Shire Pharmaceuticals, a FTSE-100 company, is relocating to Ireland for tax purposes². United Business Media³ and WPP⁴, one of the world's largest advertising groups and another FTSE-100 firm, are also believed to be planning to leave for Ireland.

Globalisation is massively increasing global prosperity as nations particularly well-suited to producing particular goods specialise and trade with each other to an ever greater extent. As a result, millions of people are being lifted out of poverty in China, India and other developing countries and the developed world has seen large income and productivity gains. Globalisation

1 - Seib, C. 'Hiscox swaps London for the low-tax attractions of Bermuda', The Times, September 2006

2 - London Stock Exchange 'Shire to introduce a new UK listed holding company', Market News – Regulatory Announcement, April 2008

3 - Bland, B. 'United Business Media plans to join Ireland tax exodus', The Daily Telegraph, April 2008

4 - Winnett, R. & White, D. 'Advertiser WPP may join tax exodus', The Daily Telegraph, April 2008

also means more competition to produce better goods and services for consumers at a lower price and offer higher, more secure returns for investors as consumers and investors are increasingly able to take their money abroad. In that context national governments are less and less like monopolies that can increase their 'prices' (taxes) and extract more from their 'customers' (taxpayers) and more like companies in a competitive market who must do all they can to offer an attractive combination of quality services at an affordable price.

In this world of high capital mobility, countries with low taxes can enjoy dynamic returns in the form of higher economic growth, employment and tax revenue. Corporate tax cuts can encourage entrepreneurship, increase investment and reduce the size of the informal economy.

This study will set out how corporate tax cuts, in an increasingly competitive global economy, can produce such dramatic economic benefits that corporate tax rate cuts can actually increase revenue growth. It will describe existing evidence setting out the benefits of corporate tax rate cuts and then provide new empirical evidence; a panel data regression suggesting that low corporate tax rates are associated with high corporate tax revenue growth and a survey of high income OECD countries that have seen revenue gains after cutting rates.

There are six sections. Section 1 reviews existing evidence that corporate tax cuts often lead to revenue gains and other economic improvements. Section 2 discusses the methodology used to produce this paper's original findings, which are shown in sections 3 and 4. Section 3 shows that cutting corporate tax rates leads to higher corporate tax revenue growth. Section 4 demonstrates that many OECD countries are already benefiting from the revenue gains associated with cutting corporate tax. Section 5 concludes that the case for cuts in corporate tax rates is becoming overwhelming as more and more countries act on the evidence that a broad range of economic benefits, and higher government revenue, can be had by cutting corporate tax.

Section 1

Existing evidence that cuts in corporate tax can increase revenue

This section of the report describes the mass of evidence, from international organisations and academic researchers, that corporate tax cuts can have significant economic benefits. In particular, it will describe the existing case that it can lead, at least in the medium to long term, to an increase in revenue.

However, looking just at firms that leave outright is likely to understate seriously the effect of high corporate taxes on the revenue base. The relocation of entire firms is likely to be very rare compared to the direction of new investment by multi-national firms to areas with lower taxes and the broader effects of corporate tax on business activity.

This idea that tax increases may not increase revenue has been expressed, at its simplest, in the Laffer Curve (see Figure 1.1). This builds from the simple intuition, that if tax is set at 100 per cent there is no incentive for anyone to generate and report wealth in the first place, to show that higher tax rates will not always translate into higher revenues.

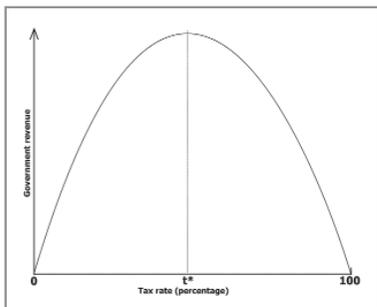


Figure 1.1: The Laffer Curve

There are two factors that complicate things when attempts are made to take advantage of the logic of the Laffer Curve:

1. Lags – higher levels of tax may not lead to lower revenue immediately but over a number of years due to lower rates of economic growth.
2. Different types of tax – increases in different taxes may have very different effects on revenue

There is already significant evidence that corporate tax rate cuts can lead to higher revenue. A recent study for the American Enterprise Institute⁵ found that there is a rate of corporate tax that maximises revenue. This revenue-maximising rate has been significantly lower than the actual rate of corporate tax in many countries, since the 1980s at least, and has fallen from 34 per cent in the late 1980s to 26 per cent in 2005. This implies that the United Kingdom's rate is, even taking into account the recent cut to 28 per cent, set at above the revenue maximising rate and that the revenue maximising rate is on a long term downward trend.

5 - Brill, A. M. & Hassett, K. A. 'Revenue-Maximizing Corporate Income Taxes: The Laffer Curve in OECD Countries', The American Enterprise Institute: Working Paper, July 2007

This phenomenon has also been studied for the TaxPayers' Alliance by the Centre for Economics and Business Research (CEBR). They modelled the impact of a TaxPayers' Alliance plan for pre-announced, phased corporation tax cuts of 2 per cent each year until the Irish level of 12.5 per cent was reached⁶.

The CEBR estimated that if such cuts were made, by 2021, relative to the baseline forecast:

- GDP would be 8.7 per cent higher;
- Total fixed investment would be 60.9 per cent higher;
- Total employment would be 8.7 per cent higher while manufacturing employment would be 10.1 per cent higher;
- Disposable income would be 9 per cent higher largely due to a 13.5 per cent boost to wages and salaries;
- Consumer spending would be boosted by 2.3 per cent;
- The savings ratio would be 13.1 per cent higher.

Although this plan would cost £3.8 billion initially, by 2021 revenue would be £28.7 billion higher in that year than in the base case, largely due to higher income tax and VAT receipts. Within eight years revenue would be higher than without corporation tax cuts.

There are three key reasons why cutting corporate tax rates can increase revenues, despite the static loss associated with reduced rates:

1. Attracting international investment

With increasing capital mobility there are big revenue gains to be had by attracting investment from abroad:

- A study for the World Bank as part of its "Doing Business" programme⁷ found that a 10 percentage point increase in the effective corporate tax rate reduces the ratio of investment to GDP by 2 percentage points.
- In 1982 large countries subjected corporations to significantly higher rates of corporate tax than smaller countries. By 1999 there was no longer a statistically significant difference⁸. Large countries have traditionally set higher rates of corporate tax as smaller countries have a more elastic corporate tax base. The erosion of the difference between large and small countries suggests that corporate tax competition has significantly intensified. No country can afford to ignore corporate tax competition in the way that large countries might have been able to in earlier years.

6 - Centre for Economics and Business Research 'The dynamic impact of the 2007 Budget and a comparison with the impact of gradually introducing an Irish level of corporation tax', TaxPayers' Alliance, April 2007.

7 - Djankov, S., Ganser, T., McLiesh, C., Ramalho R. & Shleifer, A. 'The effect of corporate taxes on investment and entrepreneurship', World Bank: Doing Business, May 2008

8 - Hines, J. R. 'Corporate Taxation and International Competition' in Auerbach, A. J., Hines, J. R. & Slemrod, J. 'Taxing Corporate Income in the 21st Century', Cambridge University Press, 2007

- A KPMG survey found that countries have recently been cutting corporate taxes and shifting the burden towards indirect taxation. According to the report, this constituted “competition to attract and keep inward investment”⁹.

2. Encouraging entrepreneurship

As a tax on profits, corporate tax decreases the returns to entrepreneurial activity. This reduces the number of start-ups, cutting employment and output growth and limiting competition:

- The World Bank “Doing Business” study¹⁰ found that a “10 percentage point increase in the 1st year effective corporate tax rate reduces business density by 1.9 firms per 100 people (average is 5), and the average entry rate by 1.4 percentage points (average is 8)”.

Reductions in corporate tax revenue due to high rates discouraging entrepreneurship are likely to take longer to become apparent than the effects on international investment or non-compliance but they may be vital to a country’s long term prospects.

3. Reducing non-compliance

High rates of corporate tax increase the incentives for firms to avoid tax. Usually, this involves legal measures to minimise their tax liability or, in extremis, moving to another country. However, it can mean using loopholes to entirely avoid tax. This is often made easier by the loopholes that often accompany high corporate tax rates:

- A study of corporate tax non-compliance in the United States suggests that non-compliance, as measured by deficiencies discovered by the Internal Revenue Service, amounts to approximately 13 per cent of the “true” tax liability¹¹. If anything, this finding is thought to be an underestimate as it is based on data from before a boom in the use of tax shelters in the mid-1990s¹². This suggests that there is room for substantial increases in revenue if corporate tax rate cuts reduce the amount of non-compliance.
- The World Bank study cited above¹³ found that a “10 percentage point increase in the 1st year effective tax rate raises the informal economy as a share of economic activity by 2 percentage points.”

9 - KPMG, *KPMG’s Corporate and Indirect Tax Rate Survey 2007*, June 2007

10 - Djankov, S., Ganser, T., McLiesh, C., Ramalho R. & Shleifer, A. *The effect of corporate taxes on investment and entrepreneurship*, World Bank: Doing Business, May 2008

11 - Hanlon, M., Mills, L. & Slemrod, J. *An Empirical Examination of Corporate Tax Noncompliance* in Auerbach, A. J., Hines, J. R. & Slemrod, J. *Taxing Corporate Income in the 21st Century*, Cambridge University Press, 2007

12 - Erard, B. *An Empirical Examination of Corporate Tax Noncompliance: Comments* in Auerbach, A. J., Hines, J. R. & Slemrod, J. *Taxing Corporate Income in the 21st Century*, Cambridge University Press, 2007

13 - Djankov, S., Ganser, T., McLiesh, C., Ramalho R. & Shleifer, A. *The effect of corporate taxes on investment and entrepreneurship*, World Bank: Doing Business, May 2008

Section 2

Method

Many of the beneficial effects of low corporate tax rates have been established already elsewhere in the literature. However, the general effect of a cut in corporate tax on future revenue growth is still to be conclusively established. This paper presents a panel data regression analysis that suggests corporate tax cuts have a significant, positive, impact on revenue growth. This section will set out the method and the data used to carry out that regression.

Method

To estimate the effect of corporate tax rates on revenue growth, a simple model was tested:

$$\text{Corporate Tax Revenue Growth}_{it} = \alpha + \beta(\text{Five-Year Average Corporate Tax Rate}_{it}) + e_{it}$$

A linear regression was performed to establish the coefficients for such a model and test their significance. A linear relationship was used as this seemed the most appropriate looking at the scatter diagram:

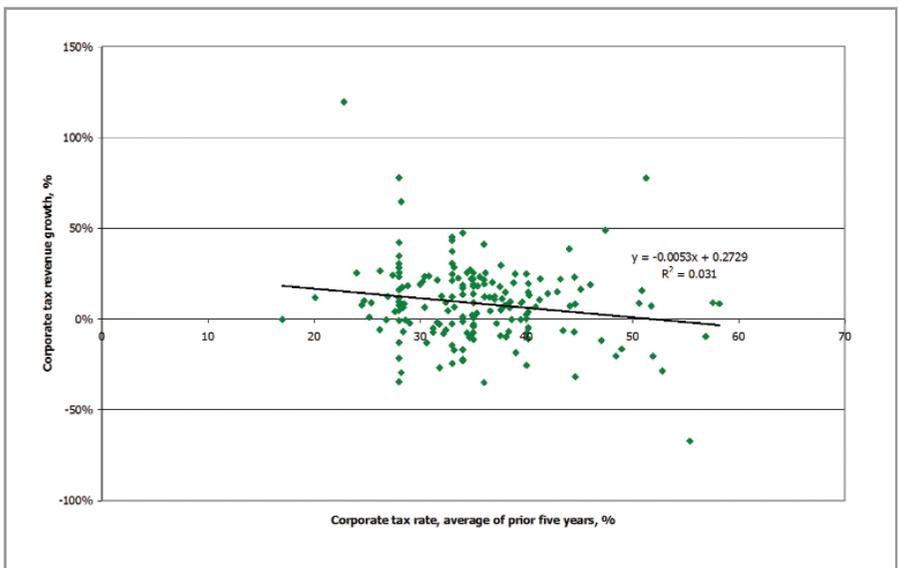


Figure 2.1: Corporate tax rate versus corporate tax revenue growth

Data

Those OECD countries classified by the World Bank as 'high-income' were studied as they constitute the developed economies that Britain is in most direct competition with¹⁴. The KPMG Corporate and Indirect Tax Rate Survey 2007 provided data on corporate tax rates from 1993 to 2006. This was compared to corporate income tax revenues, in US dollars and as a proportion of GDP, from the OECD Revenue Statistics Database. Growth in corporate tax revenues was put in real terms using GDP Deflators taken from the OECD Economic Outlook 81.

There was insufficient data for Portugal, the Czech Republic and Korea so they have been left out entirely.

Years studied

Our study looks at the years 1998 to 2005. The KPMG Corporate and Indirect Tax Rate Survey 2007 provides comparable corporate tax rates going back to 1993. Our study starts from 1998 so that revenue data can be compared with rates five years earlier.

Lag

It is widely thought that individuals and businesses will take some time to adjust to changes in the tax system. This makes it likely that revenue gains from tax cuts, and revenue losses from tax rises, will take a number of years to appear. Existing research confirms this expectation¹⁵. As a result the five-year average of corporate tax rates before the year in which revenue growth is studied was used.

14 - World Bank 'Data – Country Groups', April 2007

15 - Brill, A. M. & Hassett, K. A. 'Revenue-Maximizing Corporate Income Taxes: The Laffer Curve in OECD Countries', The American Enterprise Institute: Working Paper, July 2007, pg. 11

Section 3

The effect of corporate tax rates on corporate tax revenue growth

This section presents the results of the regression discussed in section 2. The results suggest that there is a significant inverse relationship between corporate tax rates and growth in corporate tax revenue. In particular, it appears that a cut of ten percentage points in the corporate tax rate will lead to an over 5 per cent increase in annual corporate tax revenue growth.

Results

Regression Statistics						
Multiple R	0.176062					
R Square	0.030998					
Adjusted R Square	0.025429					
Standard Error	0.211149					
Observations	176					
	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%
Intercept	0.272919	0.08079	3.378121	0.000901	0.113464	0.432374
5-year average corporate tax rate	-0.00526	0.002229	-2.35928	0.01942	-0.00966	-0.00086

As noted above this result suggests that a ten percentage point reduction in the 5-year average corporate tax rate will lead to an over 5 per cent increase in corporate tax revenue growth. The coefficient can be considered significant with a 95 per cent level of confidence.

Other factors

This is clearly too simple a model and other factors besides five-year average corporate tax rates will affect corporate tax revenue growth. This can be seen in the very low Adjusted R Square reported in the table above, which indicates that a lot of variation in the sample cannot be explained by five-year average corporate tax rates alone. Such a simple, univariate, analysis can only provide an initial suggestion that high corporate tax rates may be adversely affecting revenue growth.

However, we can see a highly significant correlation between corporate tax rates and corporate tax revenues and a relationship that would not be expected by a conventional, static analysis of tax policy but, instead, fits with supply-side economic theory. That is important and suggests that

this is an area well worth further investigation.

This paper will only attempt an initial exploration of the many other factors that might influence corporate tax rates. However, it will show that including several other variables does not weaken the finding of an inverse relationship between corporate tax rates and revenue growth.

Oil revenues

Some nations, particularly Norway, will have benefited from high earnings from oil. Changes in the price of oil, as well as dwindling reserves in countries like the UK, may affect corporate tax revenues.

Oil revenues are measured by multiplying oil production, in barrels, by the oil price, dividing by GDP and then looking at growth rates. This is a somewhat convoluted procedure but provides the best proxy for how changing oil revenues affect a national economy.

Statistics on oil production are taken from the US Government Energy Information Administration's Total Oil Supply estimates. The oil price is taken from the OECD Economic Outlook 81. This will not give an exact account of oil revenues but is close enough to form a more than adequate proxy. This is divided by GDP taken from OECD.Stat. Growth rates are then calculated for each year.

Export market growth

International economic conditions could be particularly favourable at certain times, to certain economies. If international demand for a good in which a nation has a particular comparative advantage increases substantially then this will improve their terms of trade and increase their prosperity.

Export market growth data is taken from the OECD Economic Outlook 81.

Other

Other factors were studied. The total tax burden might affect corporate tax revenues as it has a significant effect on GDP but no statistically significant relationship was found. Similarly, it was thought that import penetration might be relevant as a proxy for openness of the economy but this was, again, not found to be significant.

There are several factors that seem likely to be highly significant but where sufficient data could not be found. In particular, regulation imposes a substantial burden on businesses. Unfortunately, there is no international comparison with yearly data. The World Bank 'Doing Business' survey has excellent data on the burden that regulation imposes on business but, unfortunately, estimates are only available since 2006. The OECD did compare regulations internationally but only in the years 1998 and 2003.

Some countries have relatively low average rates of corporate tax but are increasing them and others have high rates that they are cutting. Finland, in particular, has low average rates but

put up corporate tax throughout the period studied (see Section 4). That change in rates has particular effects on revenue as companies adjust their plans to reflect the new rate. The change in rates can be measured, simply, by the rate in the year that revenue growth is measured minus the rate five years earlier. However, rate cuts are correlated with average rates which leads to a problem with multicollinearity. For that reason a measure of rate change has been left out.

Trade union membership and employment regulation could clearly affect corporate profits and, therefore, corporate tax revenues. Unfortunately, there are gaps in the OECD data on both. Finally, information on skills and educational standards is, for many of the countries studied, not sufficiently up to date or complete to be added to the regression.

Expanded regression

These are the results of the regression, expanded to include other variables that significantly effect corporate tax revenue growth.

Regression Statistics						
Multiple R	0.421273					
R Square	0.177471					
Adjusted R Square	0.163124					
Standard Error	0.195665					
Observations	176					
	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%
Intercept	0.175496	0.078497	2.235712	0.026657	0.020555	0.330437
5-year average corporate tax rate	-0.00525	0.002067	-2.54011	0.011967	-0.00933	-0.00117
Export market growth	0.014803	0.004077	3.631246	0.000372	0.006757	0.02285
Oil revenue growth	2.157593	0.655336	3.292347	0.001206	0.864057	3.451129

The 5-year average corporate tax rate is still statistically significant, at a 95 per cent level of confidence, and the coefficient is similar to before. These results suggest that a ten percentage point cut in 5-year average corporate tax rates will lead, all else equal, over time to an over 5 per cent increase in corporate tax revenue growth.

The other variables are also significant at a 95 per cent level of confidence.

The Adjusted R Square is substantially higher than before, at nearly 0.2, but still quite low. Evidently a large number of factors affect corporate tax revenues and we have only started to explain why it varies between years and countries. However, the negative relationship between the 5-year average tax rate and revenue fits far better with supply side economic theory which emphasises the benefits of tax cuts and the possibility of increasing revenue with a corporate tax cut.

Cyclical factors

It is possible that corporate tax revenues may grow faster in some years than others, regardless of corporate tax rates. This is somewhat controlled for in our model above by the inclusion of the export market growth variable, but not entirely. It is possible that due to cyclical variations or other factors there are simply good years.

To test for this possibility we studied a cross-section of OECD, high-income countries as in the study above but averaged corporate tax rates and real terms revenue growth over the years 1998 to 2005, and found a similar relationship.

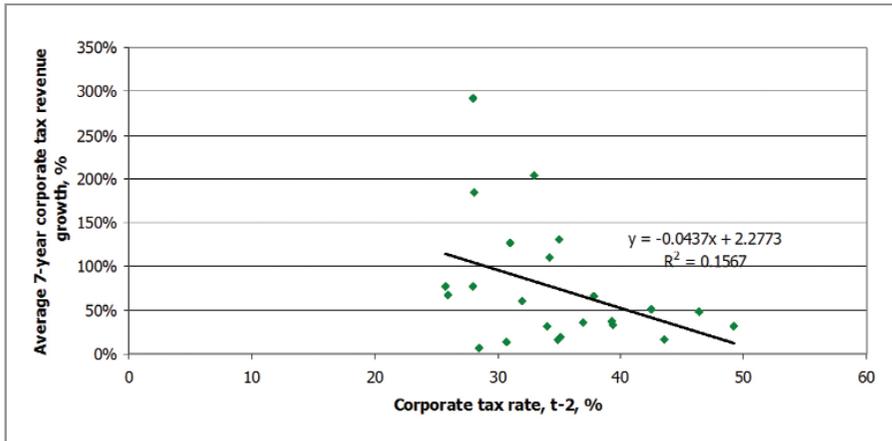


Figure 3.1: 1998 to 2005 average corporate tax rate (t-2) versus corporate tax revenue growth

Section 4 Other countries benefiting from corporate tax cuts

Section 3 showed that increases in corporate tax rates can be expected to reduce corporate tax revenue growth. This next section does not contain similar statistical analysis but, instead, shows a number of countries that have cut their corporate tax rates and seen corporate tax revenue increase, or vice-versa. The exact year when revenue gains from corporate tax cuts manifest themselves will vary so the most convenient lag (two-year or five-year) has been used; as this section is not seeking to establish the relationship itself the problems with that kind of methodological flexibility should not be too severe.

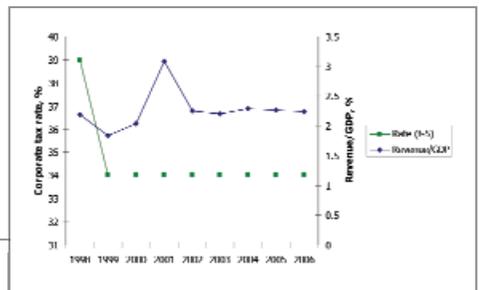
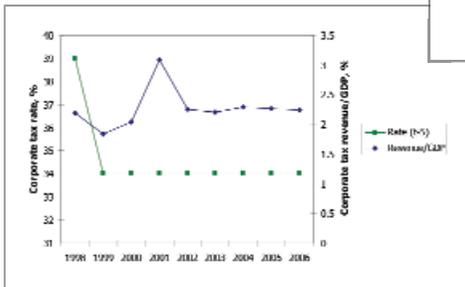
These graphs show that a number of countries have cut corporate tax rates and then seen revenues increase, even as a share of GDP:

- 13 countries have increased corporate tax revenue as a share of GDP after cutting rates while 4 countries have reduced corporate tax revenue as a share of GDP by raising rates, including France and the Czech Republic which did both.
- 3 countries did not change their corporate tax rates during the period studied.
- 3 countries present exceptional results; two of these can easily be explained by other factors.

Countries that increased corporate tax revenue by cutting rates or vice-versa

Austria:

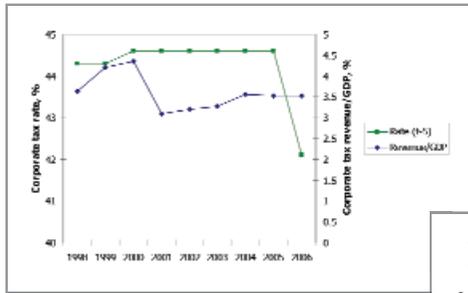
Cuts to Austria's corporate tax rates in 1994 were followed by rises in corporate tax revenue from 1999 to 2001. Though revenue fell off somewhat after that it did not fall overall. →



Belgium:

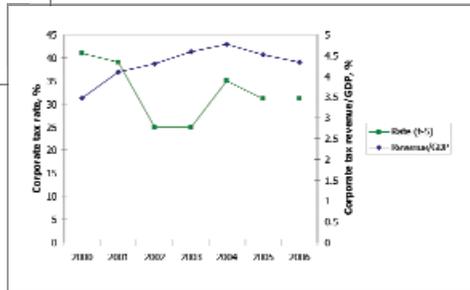
← Belgium's corporate tax rate cut in 1994 had led, by 1999, to a reversal of an earlier trend of falling corporate tax revenues. This reform may have led to a

relatively rapid revenue return as it was a large cut, 6 percentage points, which would have led to a certain amount of certainty that even if the measure were partially reversed companies would be paying a lower rate than before. This certainty would make companies less cautious about adjusting their operation in response to the tax cut – they would be less likely to ‘wait and see’.



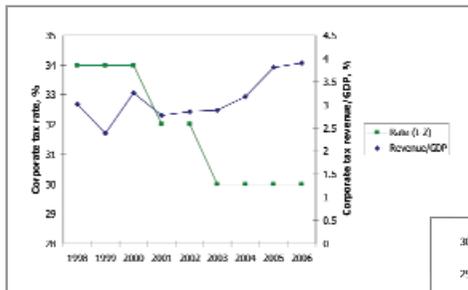
← **Canada:**

After corporate tax rate cuts began in 2000 corporate tax revenues began to rise in 2002, continuing to rise until levelling off along with the rate around 2006.



Czech Republic: →

Cuts in rates from 1995 translated into increased revenue between 2000 and 2004. An increase in rates in 1999 meant that from 2004 onwards some of the revenue gains from cuts in rates were lost and growth in revenue as a share of GDP stalled. Early years have been left out due to lack of corporate tax rate data.

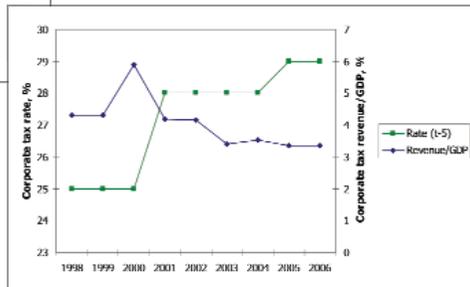


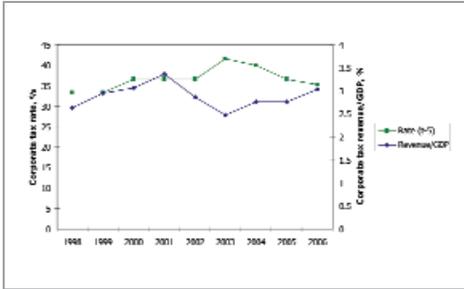
← **Denmark:**

After cuts in corporate tax rates in 1998 revenue began to increase in 2001. Increases in revenue have continued since.

Finland: →

Finland, unlike many of the more fortunate countries in this survey, suffers the effects of increasing corporate tax and reducing competitiveness. Rates

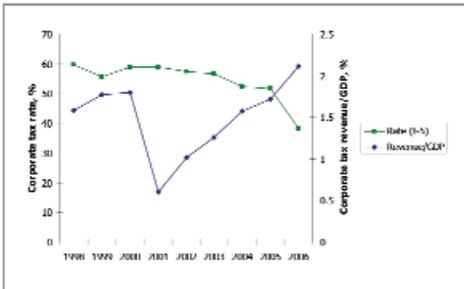




increased in 1995. After that, between 2000 and 2003, corporate tax revenue as a share of GDP nearly halved.

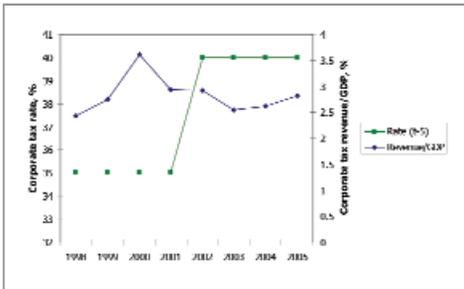
← **France:**

France's rates changed very little until 1997 when they increased significantly. That led to a fall, between 2001 and 2003, in corporate tax revenue of around one percent of GDP. After that corporate tax rates were cut and the revenues increased again.



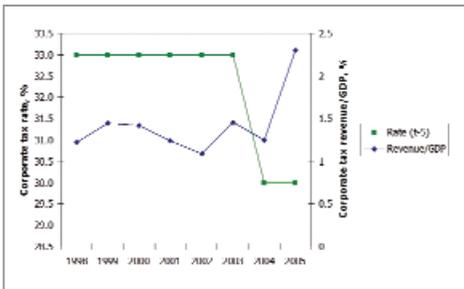
← **Germany:**

The pattern in Germany is obscured by a heavy fall in corporate tax revenue in 2001. This is thought to be due to a corporate tax reform that led to a one time loss as firms were allowed to use unused depreciation allowances from periods prior to the reform¹⁶. After that corporate tax revenue recovered in line with corporate tax rate cuts and is now higher than before the 2001 reform.



← **Greece:**

Greece, like Finland, increased rates of corporate tax. In 1997 it increased the rate by five percentage points. This led to a fall in revenues from 2001.



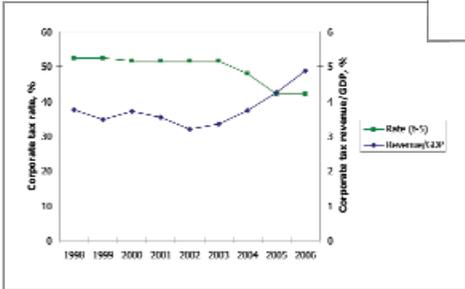
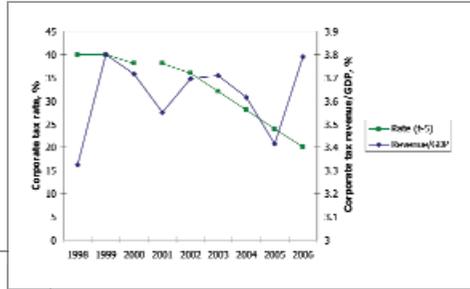
← **Iceland:**

Iceland's corporate tax revenues remained broadly constant until a rate cut in 2000 led to a significant rise in revenue in 2005.

16 - Siebert, H. *The German Economy: Beyond the Social Market*, Princeton University Press, 2005

Ireland: →

Ireland's corporate tax rates were cut steadily throughout the period studied and revenue, despite significant fluctuation, rose substantially.

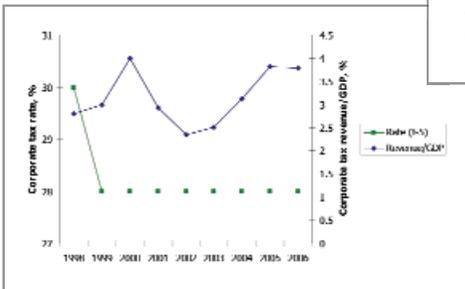
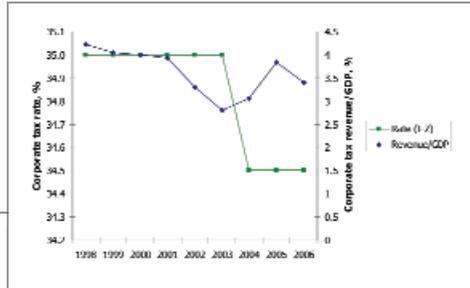


← **Japan:**

Japan's corporate tax rate and revenue as a share of GDP did not change significantly until 1999 when the rate began to fall. This was followed, from 2004, by steady increases in revenue as a share of GDP.

Netherlands:

In 2002 the Netherlands cut its corporate tax rate and, in 2004, this reversed the earlier pattern of falling corporate tax revenue as a proportion of GDP. →

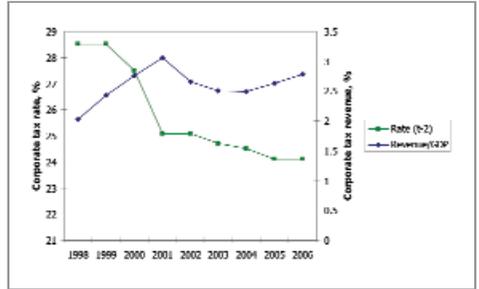


← **Sweden:**

Sweden initially cut its corporate tax in 1993 and this led to a rise in corporate tax revenue in 1999 and 2000 but it then held the rate constant and revenue fluctuated.

Switzerland: →

Between 1996 and 1999 Switzerland cut corporate tax rates and between 1998 and 2001 revenues increased. The rate cutting then halted and revenue as a proportion of GDP began to decline before rates were cut again and revenues once again increased.



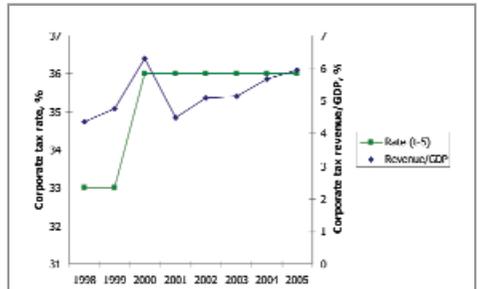
Countries that did not vary their corporate tax rate

New Zealand, Norway, Spain.

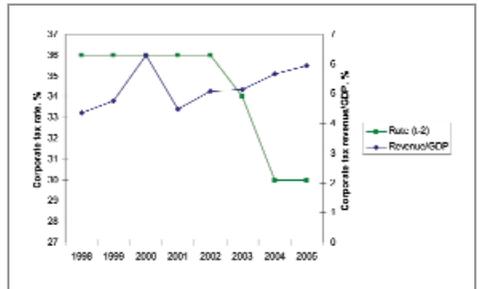
Others

Australia:

Australia is exceptional in that it appears to show corporation tax rises delivering increased revenue. →



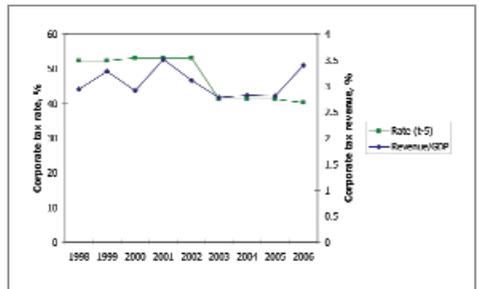
However, this may be the result of the corporation tax rise not having lasted long enough to have a negative effect on income. If we look at the results again with a two year lag it appears that later corporation tax cuts have led to a recovery in revenues. →



Combining both graphs it seems likely that the tax rise initially increased revenue but this trend was beginning to reverse and the decline in revenue was only arrested by a cut in corporate tax rates.

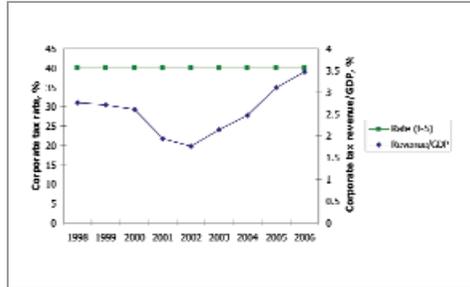
Italy: →

Italy's data shows little correlation between lagged corporate tax rate and revenue.



The United States: →

The United States shows a rise in corporate tax revenue as a share of GDP from 2003 while rates have remained constant. There were significant changes in dividend taxation in 2003¹⁷ which could be significant in explaining this change.



17 - Michel, N. J. & Rector, R. A. 'Dividend Policy and the 2003 Tax Cut: Preliminary Evidence', Heritage Foundation: WebMemo #594, October 2004

Section 5

Conclusions

Politicians of all parties assume that the Treasury can act like a monopolist facing a totally inelastic demand curve. Their analysis, planning and policies are all still constructed in a mindset that cuttings rates leads to less revenue and vice-versa. Whether it is the Government increasing taxes and being surprised, year after year, that revenue isn't as high as they expect¹⁸, or the Conservatives proposing to impose a new levy on the most mobile population in the world and not expecting any to leave, the parties are too attached to a static understanding of the economy.

They haven't yet woken up to the fact that, in an increasingly open world economy, the elasticity of tax receipts with respect to the rate of tax is both high and rising. They will need to compete with other countries to offer as much to their taxpayers for each pound of those taxpayers' money as possible. This is the challenge every serious politician, the world over, should be facing up to. The British parties' attachment to Britain's current high burden of tax represents a dismal failure to do so.

This is, perhaps, clearest in the case of corporate taxes where there is a mountain of evidence that rate cuts can yield dramatic economic benefits. The regression presented in this study suggests that a ten percentage point corporate tax cut, like the one proposed by John McCain, could lead to an over 5 per cent rise in corporate tax revenue growth over time. The experience of other countries that have cut corporate tax rates supports this finding.

Our plan, for the United Kingdom to follow in Ireland's footsteps, could deliver dramatic increases in prosperity, employment, investment and living standards while actually increasing revenue in the medium term. It is the plan that any politician who really hopes to provide for Britain's economic future should support.

18 - Sinclair, M. 'Budget 2008 Report', The TaxPayers' Alliance, March 2008

About the authors

Matthew Elliott is Chief Executive of the TaxPayers' Alliance. Brought up in Leeds, Matthew moved to London in 1997 to study at the London School of Economics, where he graduated with a First in Government and was President of the LSE Hayek Society. Matthew then worked for a number of MPs and MEPs before founding the TaxPayers' Alliance in 2004. Under his leadership, the TPA has grown from operating as a group of volunteers meeting in Starbucks, to employing eight members of staff working from two offices in London and Birmingham. In 2006, the TPA won the ConservativeHome "One to Watch" award and in 2007 the Bumper Book of Government Waste, which he co-authored, was awarded the Sir Antony Fisher International Memorial Award. In November 2007, Matthew was presented with the Conservative Way Forward 'One of Us' award by The Rt Hon William Hague MP and in December the TPA won the Stockholm Network's Golden Umbrella Award for Innovation. Matthew organizes the London "Wednesday Meetings" and a Daily Telegraph survey in May 2008 named him as one of the 50 most influential figures on the new Right in Britain. In June 2007 he was elected a Fellow of the Royal Society of Arts. He is on the Advisory Council of the European Foundation and the Young Briton's Foundation and on the Advisory Committee of the New Culture Forum. His next book, on the European Union, is being published by Random House in 2009.

Matthew Sinclair began his work as a Policy Analyst at the TPA in May 2007, specializing in public service delivery and environmental policy. He was born in Reading, Berkshire and studied Economics and Economic History at undergraduate and Master's level at the London School of Economics. As a student, he was involved in intervarsity debating and is a former World Master's Debating Champion. He is the principal author of, among others, 'Wasting Lives: A statistical analysis of NHS performance in a European context since 1981' (TPA, January 2008), 'Funding Hate Education' (TPA, January 2008) and 'The Case Against Further Green Taxes' (TPA, September 2007).

Corin Taylor is Research Director at the TaxPayers' Alliance. His research projects have included the commissioning of a dynamic model of the UK economy, which showed the economic benefits of reducing the tax burden. He has also written a number of opinion pieces on tax for the Financial Times. In 2006, he was Political Secretary to the Tax Reform Commission and wrote several sections of the Commission's report. Prior to that he worked for the think tank Reform for two years as Economics Research Officer, where he authored a number of papers on tax and economic reform, including drawing up Reform's "growth rule" for sustainable public spending and co-authoring a pensions reform plan with Tony Blair's former economic adviser, Derek Scott. Corin is also a Senior Policy Adviser at the Institute of Directors, working on fiscal policy and public sector reform issues, and sits on the Economic Dependency Committee of the Centre for Social Justice.

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Conservative Way Forward was founded in 1991 to defend and build upon the achievements of the Conservative Party under Margaret Thatcher's leadership, and to adapt the principles of her era in government to modern concerns and challenges.

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The core aim of Conservative Way Forward is to provide a forum for all those who share our philosophy, from Parliament to the constituencies. Speaker meetings (like our widely acclaimed Forthright debate series), seminars and receptions are regular features of our activities, supported and attended by Government Ministers past and future.

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