Corporate Tax Laffer Curve

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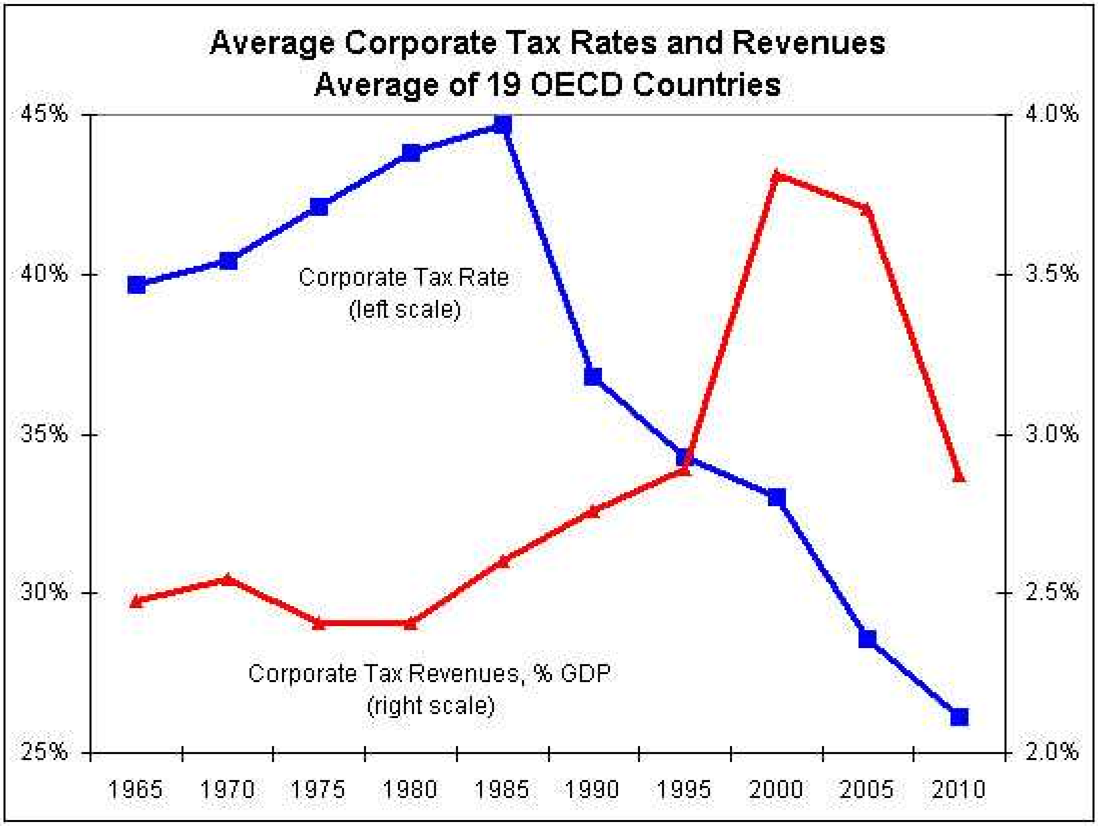
The Sunday *New York Times* described Apple's successful efforts to reduce its U.S. and California corporate tax burdens. The article hints that the situation is a moral outrage, and it includes sob stories of governments that are supposedly hurting because they don't raise enough tax revenues from businesses.

More importantly, the story provides further evidence that corporate profits, investment capital, intellectual property, and reported income are highly mobile in the global economy. Dan Mitchell and I examined these issues at length in *Global Tax Revolution*.

What should the United States do about the new global reality of footloose corporations? The obvious answer that we discuss in the book is to chop our uniquely high statutory corporate tax rate of 40 percent, which is now the highest in the world.

The *NYT* reporters did not mention that reform option, perhaps because they focused so much on the fear of governments losing revenues. But I have good news for the *NYT* reporters! We could chop our corporate tax rate substantially, and as corporate tax avoidance fell and investment rose, the government would probably not lose any money — it may even raise some. Governments, businesses, and the broader economy could all be winners from a corporate tax rate cut.

Here's some evidence. For 19 OECD countries with good data back to the 1960s, I plotted the average corporate tax rate and the average corporate tax revenues raised by those countries. The chart illustrates the Laffer Curve effect of chopping high statutory tax rates on a mobile tax base.



The chart shows that between the mid-1960s and the mid-1980s, many advanced economies had corporate tax rates of 40 percent or higher. Governments collected about 2.5 percent of GDP from corporate taxes during those years.

Then came the Thatcher-Reagan tax-cutting revolution, and corporate tax rates began falling everywhere. They kept on falling during the 1990s and 2000s. From 1985 to 2010, the average rate for the sample of 19 countries was cut from 45 percent to 26 percent.

With that huge rate cut, governments are collecting less corporate tax revenues, right? Not at all. Revenues soared during the 1990s and 2000s. More recently, revenues have dropped off due to the recession and economic stagnation in many countries.

However, it is amazing that even with the depth of the recent economic crisis, average corporate tax revenues are still higher than they were prior to the beginning of the rate-cutting revolution of the 1980s.

Data Notes:

- OECD corporate tax revenue data is here. For three countries with missing 2010 data, I proxied the values with the 2009 figures.
- OECD corporate tax rate data back to 1981 is available here. I have used the central government rates only because I have not found a good source for subnational corporate rates for years prior to this OECD data.

- For this reason, the revenues (which include subnational governments) and the rates (which don't) are not an exact match, but that's not a big problem for the purpose of showing the rate/revenue trends over time.
- The 19 countries represented in chart are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Spain, Sweden, United Kingdom, and the United States.

For further discussion and background on the data, see here.