ECONOMIC ANALYSIS

A Grown-Up Conversation About Corporate Tax

By Martin A. Sullivan — martysullivan@comcast.net

Nothing is more fun for liberals than to catch a big multinational abusing U.S. tax laws. Google, Cisco, General Electric, and Apple — to name a few — now have public relations problems because the press has put a spotlight on their use of offshore tax havens. The tax dodging is disgraceful. The worst part of it is that it's all perfectly legal. We need to close the loopholes that make this all possible.

Liberals would like to end the conversation right there. But that is not an option in today's globalized economy. There was a time when liberals could follow their inclinations to keep corporate taxes high with few qualms. Corporate taxes increased the progressivity of the tax system because the burden of the tax fell on rich shareholders. And the damage to the economy was minimal because there was not much foreign competition.

But that era is gone, and it's not coming back. Sure, shareholders will not rejoice at any corporate tax increases. But it is now true that competition from around the globe creates a new dynamic. Higher corporate taxes do not reduce corporate capital formation. They shift it abroad. The result is domestic job losses and lower domestic wages.

On April 1 Japan will lower its corporate tax rate to 38 percent. In the competition for the world's highest corporate tax rate, the United States will then be on top, with a combined federal and state rate of 39.2 percent. There is a broad consensus that rates should be reduced. President Obama says 28 percent. Republicans have coalesced around a 25 percent figure. Liberals cannot afford to be nostalgic. They should embrace rate reduction not because business tells them so but because it is in their own interests.

Now, how do we make up for the lost revenue? Even conservatives agree that spending cuts won't be enough. Vague exhortations to close ''loopholes'' top the list of revenue-raising options. But that is a pipe dream. Yes, there are more than a few tax breaks that should be jettisoned, particularly those that make parking profits in offshore havens possible. But when you get down to specifics, most of these tax benefits are not as horrible as they seem in the abstract. For example, tax credits for domestic research and extra tax deductions for manufacturing are not big, bad loopholes the public or Congress are inclined to see eliminated. The bottom line is that Congress will be hard-pressed to pay for a 5 percentage point reduction in the corporate rate by trimming corporate tax breaks.

A 5 percentage point cut would be progress. But it would be only a Band-Aid. The need to cut the corporate tax is not just business propaganda. As any economist will tell you, the corporate tax is our worst tax. The more we smash it down, the more opportunity there is for expanding the economy, and — in the modern world — the more opportunity there is for wage growth.

We need a major new source of revenue to make up for an obsolescent corporate tax. That new revenue source is obvious to most policy experts. As shown in the table, the economies around the globe that we are presumably trying to emulate with lower corporate taxes have VATs, and, for the most part, they are raising consumption taxes while they cut their corporate taxes.

The knee-jerk response from liberals will be to howl about the disproportionate burden a VAT will place on the poor. That is a legitimate concern, but it is routinely overstated. First, there are quirks in the presentation of government statistics on the distribution of the tax burden that make the tax look more regressive than it really is. Second, VAT revenues are likely to be used to fund programs that disproportionately benefit lower-income families. But more importantly, the tax it would be replacing is also a burden on working families.

Corporate and Value Added Tax Rates, 2011

Country	Corporate	VAT
Canada	27.6%	5%
France	34.4%	19.6%
Germany	30.2%	19%
Ireland	12.5%	21%
Italy	27.5%	20%
Japan	39.5%	5%
Korea	24.2%	10%
Spain	30%	18%
United Kingdom	26%	20%
United States	39.2%	none

Source: OECD

It's time for the United States to adopt a 21st-century tax system. More than anything else, that will mean minimizing the role of the corporate tax. It does not mean that liberals have to abandon their core objectives, just the traditional tactics for achieving them. ■