NATIONAL CENTER FOR POLICY ANALYSIS

Abolishing the Corporate Income Tax Could Be Good for Everyone

Brief Analysis No. 7?? by Laurence J. Kotlikoff November ??, 2013

The U.S. corporate income tax produces little revenue — only 1.8 percent of gross domestic product (GDP), or about $288 billion in 2013. Yet the compliance, collection and avoidance costs from collecting this tax are huge.

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Worse yet, America's relatively high marginal corporate income tax rate encourages both domestic and foreign corporations to operate outside the United States — that is, to take their capital and run. Our high corporate rate, in conjunction with the ability of corporations to defer paying taxes on overseas profits, also keeps firms from reinvesting their foreign profits here. Taxes that have high rates, produce low revenue, are costly to administer and drive businesses out of the country — leaving Americans with fewer jobs and lower wages — are hardly what the economics doctor, myself included, would prescribe.

Burden of the Corporate Income Tax. As with many elements of the tax system, there is disagreement over who ultimately bears the burden. The general public thinks the tax is paid by rich owners of large corporations, and that it does not affect workers. However, the tax appears to fall largely on U.S. workers. Workers rarely seek employment abroad, whereas corporate investment can readily be shifted overseas, reducing the demand for American workers.

My colleagues and I developed a dynamic economic model of the United States, Europe, Japan (with Hong Kong, Taiwan and Korea), China and India. It accounts for each country or region's changing demographics and each country's fiscal policies over many generations. The model allows us to analyze the immediate and long-term economic effects from various tax changes, including corporate tax reform. [Technical paper available at **[ncpa website address]**.]

In fact, the marginal effective U.S. tax on corporate capital appears to be quite high and, according to some independent analysts, among the highest of developed countries. One conclusion: our high tax is discouraging capital inflow. Other countries have lowered their rate to attract capital investment from abroad and grow their economies.

Our analysis shows that eliminating the U.S. corporate income tax — holding constant the corporate tax rates of other countries — would produce a rapid and dramatic increase in U.S. domestic investment, GDP, real wages and national saving. We analyzed two alternatives to make up for the revenue: an increase in taxes on wages and an increase in taxes on consumption.

Economic Effects of Replacing the Corporate Tax. Abolishing the U.S. corporate income tax produces permanent economic benefits. Among the effects:

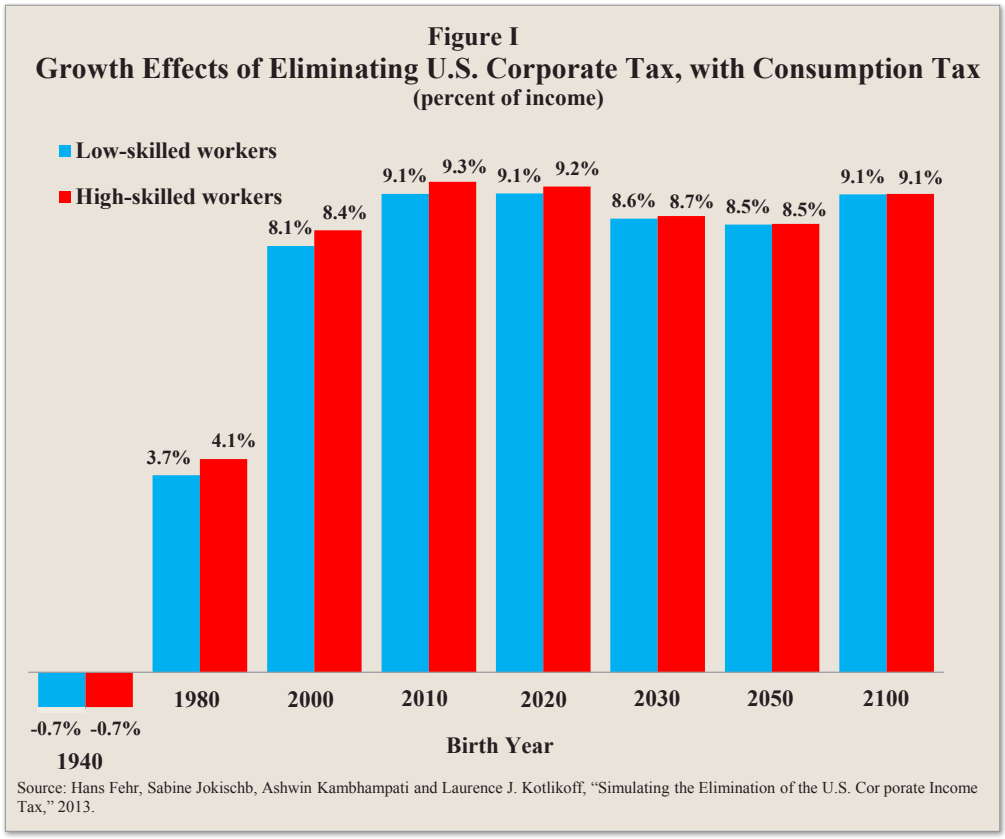
- The capital stock would increase by one-fourth to about one-third (23 percent to 37 percent)

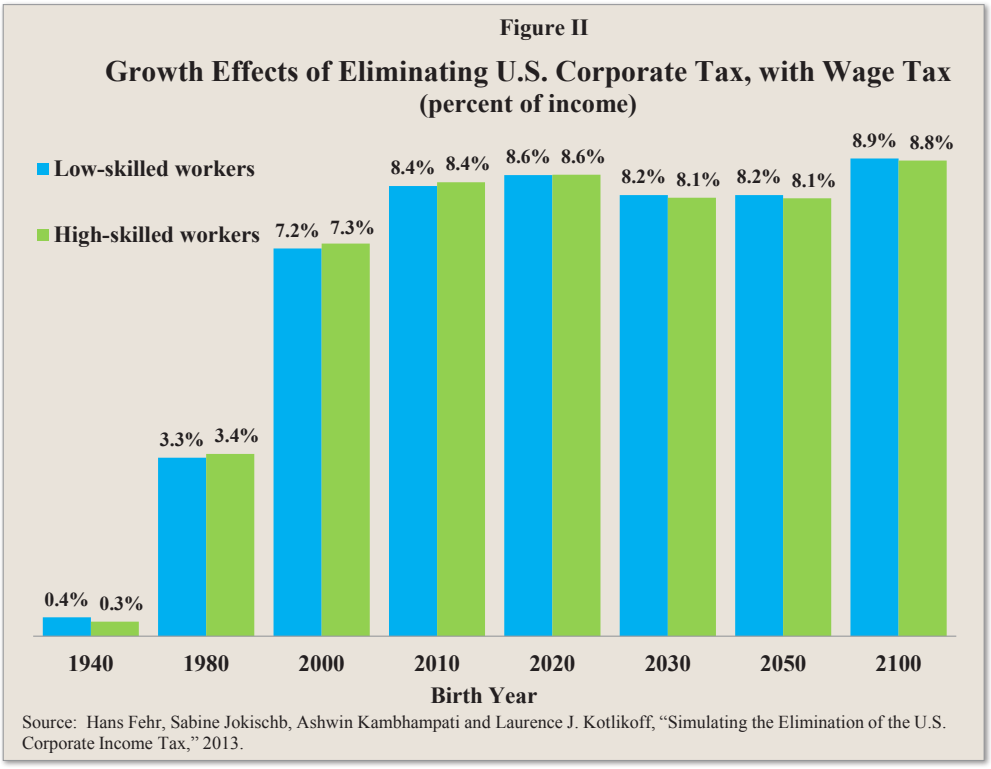
— with most of the added investment reflecting capital flowing into the United States.

- Real wages would rise 12 percent to 13 percent.
- Gross domestic product would rise 8 percent to 10 percent.

Further, the tax base would expand over time, producing additional revenues that would make up for about one-third of the revenue loss from repealing the corporate tax. Over time, due to economic growth, the tax rate required to replace corporate tax revenues would fall.

The beneficial economic effects of a consumption tax are somewhat greater than a wage tax, as are the long-run welfare gains for individuals. [See Figures I & II.] But, a consumption tax comes at some modest losses to current older generations. Using our progressive wage taxes to make up the loss in tax revenues produces a quite remarkable finding: All generations, including those yet to be born, are better off. And the gains to our children are remarkably large.





Conclusion. Economists call policies that hurt no one and help at least someone *Pareto Improvements*, after the famous Italian economist, Wilfredo Pareto. Pareto Improvements are generally viewed as a theoretical possibly, but hard to find and small in size. When it comes to corporate tax reform, the situation, as our research shows, is quite the opposite. Other things equal, eliminating the U.S. corporate income tax has great potential to make all Americans better off because the corporate tax drives investment out of our country with surprisingly small benefit in terms of revenue generation.

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