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High Corporate Taxes Undermine U.S. Global Competitiveness

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High corporate tax rates are undermining U.S. international competitiveness. The global economy demands that companies be flexible and swift in order to remain competitive. High tax rates deprive companies of both the means and the incentive to take advantage of new market opportunities or technological changes that can improve productivity.

Most advanced countries in the world have responded to new global economic realities by slashing corporate tax rates. The U.S. stands almost alone in having resisted such cuts, and its corporate tax rates are now among the highest in the world. Future U.S. prosperity depends on the willingness of our political leaders to resist populist anti-corporate dogma and make the necessary adjustments to keep the U.S. economy competitive.

Tax Cutting Spree. The global tax cutting trend is dynamic and powerful. Consider, for example, Europe, which has half of the world's 10 largest economies as well as half of the world's 20 freest economies as measured by the *2008 Index of Economic Freedom*, an annual publication by The Heritage Foundation and *The Wall Street Journal*.[1]

Over the last decade, almost every member of the European Union has cut its corporate tax rates. Just in the last five years, over 15 EU members have legislated reductions. Germany has reduced its corporate tax rate from nearly 40 percent to around 30 percent, effective January 2008. The U.K. has also cut its corporate rate to 28 percent from 30 percent effective this spring.

Even Europe's old welfare states have joined the aggressive tax cut parade: Sweden has cut its corporate tax rate to 28 percent from 60 percent; Norway's rate has dropped over 50 percent to 28 percent; and Denmark's corporate tax rate is now 25 percent.

In the meantime, the U.S.'s top federal corporate tax rate has not been cut in over a decade. In fact, the last time the U.S. adjusted its top federal corporate tax rate, in 1993, it actually increased the rate from 34 percent to 35 percent. Our economy now has, on average, a statutory corporate tax rate of 39 percent (including state corporate tax rates, which range from 0 percent in Washington to 12 percent in Iowa). This average rate is higher than the rates of all 27 members of the EU.

With such high rates, the U.S. can no longer afford to remain inactive. In a business environment where capital flows are extremely mobile, lower tax rates do matter in attracting more business investment. With the nation's economy slowing, the need to attract and inspire more business investment has never been stronger. It is such private investment, not government handouts or fiscal stimulus packages, that will get the economy moving again. As

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President Reagan reminded us, "government must provide opportunity, not smother it; foster productivity, not stifle it."[2]

America Needs Lower and More Competitive Corporate Tax Rates. A corporate tax cut is a key step toward attracting more investment capital. A recent Treasury Department study estimated that a country with a 1 percentage point lower tax rate than its competitors attracts 3 percent more capital.[3] A reduction of the federal corporate tax rate would increase firms' productivity and investment incentives, and ultimately stimulate our nation's long-term competitiveness by enhancing economic freedom.

America's strength and economic success are based on economic freedom, which fosters the virtuous cycle of entrepreneurship, innovation, and growth. This nation's economic freedom has sustained economic opportunity and prosperity, as well as the creativity that leads to new products and new jobs.

In the *2008 Index of Economic Freedom*, the U.S. economy scored 80.6 out of a possible 100. The U.S. ranked as only the fifth-freest economy—behind Hong Kong, Singapore, Ireland, and Australia—among 157 countries graded along a line from "repressed" to "free." It is tempting to ask, "What's so bad about fifth place?" For an economy that aspires to lead the world—and does so in so many areas—fifth place in anything is a warning. America's economic freedom rating remains bright, but it is not as bright as it should be. In fact, America's corporate tax rate is the highest among the top 10 freest economies in the world and remains, along with high levels of government spending on entitlements, the biggest drag on U.S. economic freedom.

Making the situation worse, America's competitors within the top 10 freest economies continue to lower corporate tax rates while our nation does nothing.

For instance, Hong Kong, the freest economy, just cut its corporate rate to 16.5 percent from 17.5 percent, and Singapore, the second freest economy, now enjoys an 18 percent corporate tax rate effective this year. New Zealand, which stands right behind the U.S. in the *2008 Index*, has a lowered corporate tax rate of 30 percent as of April this year. America's next-door competitor, Canada, which ranks seventh in the *2008 Index,* has also joined the tax cut race. Effective January 2008, its federal corporate income tax rate fell to 19.5 percent from 22.1 percent. Canada will further reduce its tax rate to 15 percent by 2012.[4]

Towards Fiscal Freedom. Clearly, U.S. inaction and complacency in improving fiscal freedom through tax cuts risks the nation's global competitiveness; America stands still while its competitors are moving forward.

Such inaction is particularly damaging in a time of economic slowdown. A long-term policy plan that strengthens economic fundamentals would calm fears among entrepreneurs and restore confidence in the U.S. economy. There are noticeable differences between the two presidential candidates on corporate tax policy. Barack Obama would keep the current 35 percent rate, though he does promise unspecified breaks for "companies that create jobs in America." John McCain, by contrast, has promised to cut the corporate tax rate to 25 percent.

Whichever way the American people vote at the polls, it is a fact of the market that domestic and international investors will have the final say on economic growth. A cut in the corporate tax rate will lead to more investment and a growing economy. Failure to act will lead investors to look elsewhere, and the American people will suffer as a result.

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1. Kim Holmes, Edwin Feulner, and Mary Anastasia O'Grady, *2008 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2008), at *www.heritage.org/research/features/index*.
2. Address by President Ronald Reagan before a Joint Session of Congress on the State of the Union, January 25, 1988, at *www.presidency.ucsb.edu/ws/index.php?pid=36035* (September 12, 2008).
3. Treasury Conference on Business Taxation and Global Competitiveness, background paper, U.S. Department of Treasury, July 23, 2007, at *http://www.treasury.gov/press/releases/reports/07230%20r.pdf* (September 12, 2008).
4. Fact Sheets, "Investing for Tomorrow—Budget 2008," Invest in Canada, April 15, 2008, at *http://www.investincanada.gc.ca/download/701.pdf* (September 12, 2008).

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