

***Comments on
Tax and Economic Growth***

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*Selected policy recommendations
from "Tax and Economic Growth"*

- 1. Shift tax burden from income taxes to consumption and property taxes**
- 2. Lower marginal tax rates on income**
- 3. Cut corporate tax rates**
- 4. (By implication from revenue neutrality)
Increase consumption and property taxes**

What is the evidence underlying these policy recommendations?

1. OECD Research on Fiscal Policy/Taxation:

- **“Do Tax Structures Affect Aggregate Economic Growth?” (Arnold, 2008)**
- **“How do taxes affect investment and productivity?” (Vartia, 2008)**
- **“Do corporate taxes reduce productivity and investment at the firm level?” (Schwellnus and Arnold, 2008)**

2. Other Research

Which results have consensus support in the economics literature?

FOREIGN DIRECT INVESTMENT IS NEGATIVELY AFFECTED BY TAXES

1. U.S. Investment Abroad

- Altshuler, Grubert and Newlong (NBER, 1998)
- Devereux and Griffith (Journal of Public Economics, 1998)
- Grubert and Mutti (National Tax Journal, 2000)

2. Foreign Investment in U.S.

- Hines (American Economic Review, 1996)

3. Cross-country evidence

- Devereaux and Freeman (International Tax and Public Finance, 1995)
- Stowhase (Mimeo, 2002)

Which results have consensus support in the economics literature?

ENTREPRENEURIAL ACTIVITY IS NEGATIVELY AFFECTED BY TAXES (though is it tax level or progressivity?)

1. The decision to become an entrepreneur (US data)

- Gentry and Hubbard (American Economic Review, 2000)

2. The decision by entrepreneurs to invest in capital (US data)

- Carroll et al. (NBER, 1998)

3. The decision by entrepreneurs to employ labor (US data)

- Carroll et al. (Journal of Labor Economics, 2000)

Good overall survey: Rosen (in "Venture Capital, Entrepreneurship, and Public Policy," MIT Press, 2004)

Which results have consensus support in the economics literature?

R&D ACTIVITY IS RESPONSIVE TO TAX INCENTIVES

1. US data

- Hall and Van Reenen (Research Policy [Review], 2000)

2. Cross-country and non-US data

- Hall and Van Reenen (Research Policy [Review], 2000)
- Bloom, Griffith, and Van Reenen (Journal of Public Economics, 2002)
- Australian Bureau of Industry Economics (1993)

Which results have consensus support in the economics literature?

INVESTMENT MAY BE SENSITIVE TO TAXES (depends on whether one uses micro- or macrodata)

From Backus, Henriksen, and Storesletten (Journal of Monetary Economics, 2008):

"In the investment literature, studies generally find little impact of taxes with aggregate data, but substantial impact when they use firm or industry data. See, for example, Hasset and Hubbard's (2002) survey. Gordon and Hines (2002) and Hines (1999) describe a similar difference between macro and microevidence in the international tax literature."

Which results have consensus support in the economics literature?

SHIFTING TAXES AWAY FROM INCOME TAXES TOWARDS CONSUMPTION/PROPERTY TAXES MAY INCREASE ECONOMIC GROWTH

- 1. Theoretical literature strongly suggests that shifting taxation from income to consumption will increase growth**
 - Judd (Journal of Public Economics, 1985)**
 - Stokey and Rebelo (Journal of Political Economy, 1995)**
- 2. Empirical literature is thin, but supportive**
 - Kneller, Bleaney, and Gemmell (Journal of Public Economics, 1999)**
 - Bleaney, Gemmell, and Kneller (Canadian Journal of Economics, 2001)**

Which results have consensus support in the economics literature?

NOT SO CLEAR :

EFFECT OF TAXES on LABOR SUPPLY (participation, yes; hours worked, no?)

EFFECT OF TAXES on SAVINGS

EFFECT OF TAX PROGRESSIVITY on ECONOMIC GROWTH (difficulty in measuring Marginal Tax Rates)

How do the OECD studies relate to the existing literature?

THE FOLLOWING POLICY RECOMMENDATIONS HAVE SOME SUPPORT IN THE EXISTING LITERATURE

- Shift from income taxes to consumption/property taxes
- Reduce tax progressivity (related to entrepreneurship?)
- Reduce the corporate tax rate below the top income tax rate

*An overall tax structure prescription
for NZ policy makers*

- 1. Lower corporate income tax rates to be in line with competitor countries (Australia)**
- 2. Adjust personal income tax rates so that the top personal income tax rate does not deviate substantially from the corporate income tax rate**
- 3. Increase consumption and property taxes to maintain revenue neutrality (little need to worry about cross-border effects)**
- 4. Change the mix of public spending to better benefit lower income citizens as compensation for regressive effects of tax structure changes**

How confident can policy makers be that these policy recommendations will increase growth?

MAJOR CONCERNS:

- 1. It is bothersome that that macro-level studies have difficulty finding significant tax effects**
- 2. The OECD studies provide a valuable empirical complement to existing studies. However, they are strangely silent on the estimated size of the tax effects. This matters when weighing the benefits of tax reform against adjustment costs**
- 3. Two ways that this research could be more useful to policy makers:**
 - provide country-specific estimates of tax effects (robustness)**
 - make data available to other researchers**