Discussion of Abbas and Klemm

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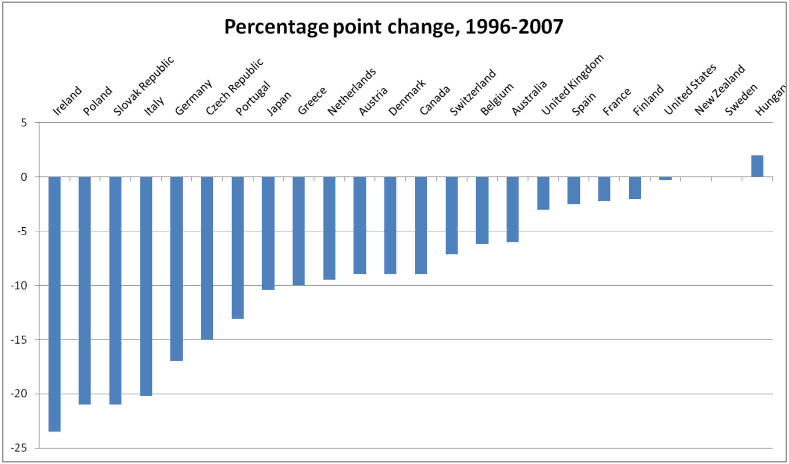
Contribution of the paper

- Assembles a new data set on corporate tax rates for developing and emerging economies.
- Depicts the trends in corporate tax rates, special regime tax incentives and macroeconomic variables over time, 1996-2007.
- Investigates empirically the relationship between corporate taxation and investment/revenue.

Findings of the paper

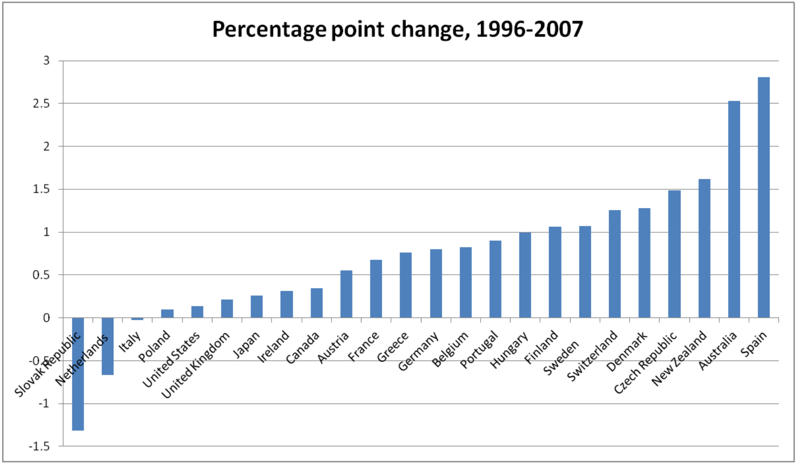
- Statutory and effective tax rates have in general declined in developing/emerging economies.
- Nonetheless, corporate income tax revenues have significantly increased across all regions.
- Lower corporate tax rates are associated with
  - higher private investment (except for special regimes), and
  - lower corporate income tax revenues (except in Africa).
- These results are by and large consistent with those known for advanced countries.

OECD countries - statutory corporate income tax rate



$\Longrightarrow$ The tax rate has fallen by 9 percentage points on average.

OECD countries - corporate income tax revenue-to-GDP



$\Longrightarrow$ The revenue has risen by 0.75 percentage points on average.

Theoretical background

What would we expect to happen from a cut in corporate taxes?

- Private investment should increase:
  - More investments are now worthwhile to be undertaken.
    $\Longrightarrow$ closed economy aspect
  - It becomes relatively more attractive to invest in this country.
    $\Longrightarrow$ open economy aspect

  Consistent with the results in the paper.

- Corporate income tax revenue may increase or decrease:
  - The tax rate declines.
    $\Longrightarrow$ tends to decrease tax revenue
  - Aggregate corporate profits increase (more in open economies).
    $\Longrightarrow$ tends to increase tax revenue

  Paper finds the first effect to dominate (except in Africa).

Results need to be seen with caution

- Endogeneity concerns are paramount and are insufficiently taken account of ("impact", "affect").
- Specification regresses investment/revenue in a given year on tax rate in the same year.
- The paper uses different empirical methodologies for the effects on investment and revenue which are not explained.
- The downward trend in tax rates is absorbed in the year fixed effects, so that the estimated effect is relative.

Policy implications: The race to the bottom may be good!

- Governments see the corporate income tax as a revenue raiser.
- More generally, however, this is a question of tax mix.
- Corporate taxes are ultimately a tax on capital.
- There are several strong reasons for a wide range of corporate investments to be taxed lightly:
  - Corporates taxes are a tax on deferred consumption.
  - They reduce the capital stock and thus potential output.
- Race to the bottom may provide incentives to reduce taxes on corporate investment and move to a more optimal tax system.

Benefits from a lower share of corporate tax revenues

OECD research has shown that corporate income taxes are particularly harmful to growth (Arnold *et al.*, 2011, EJ).

In addition, beneficial side effects from lower corporate taxation:

- Reduced distortions arising from narrow bases of corporate taxes.
- Reduced distortions from the disproportionately high taxation of corporate investment relative to housing investment.
- Reduced distortions from the dispropotionately high taxation of equity finance relative to debt finance.