STUC Response to Scottish Government's Discussion Paper on Corporation Tax

Summary

Will cutting corporation tax boost growth?

- The STUC does not accept that cutting the rate of corporation tax (CT) in Scotland will boost long-term sustainable growth in GDP and employment. The Scottish Government's case that it will is based on flawed and selective 'evidence' and a misunderstanding of the Scottish economy and current business environment. Scotland in 2011 is not Ireland in 1987. Even in Ireland, low corporation tax was but one factor contributing to rapid growth during the 1990s.

- It is not just that we can't accept the inevitability of more rapid growth; the STUC is profoundly concerned ***that cutting CT will exacerbate a long-standing and serious structural problem in the Scottish (and indeed UK) economy***: the short-termist business culture which undermines long-term patient investment.

- The UK Government has cut (and is committed to cut further) CT and yet growth is minimal, business investment extremely weak and unemployment is rising. ***Cutting CT is demonstrably not an economic magic wand***. Profits are high and the corporate sector is running a huge cash surplus; in these circumstances, boosting profits further through CT cuts is highly unlikely to generate additional investment.

- Yes, a range of factors are conflating – some self-inflicted at UK level; some global factors largely beyond the Chancellor's control – to produce an uncertain business environment. ***But this is precisely the point: the business tax regime is but one contributory factor in determining growth rates.***

- The STUC does accept that there is a link between economic growth and the level of CT paid by businesses. If for instance the CT rate was currently at 90%, we would accept that the incentive effects of a 65% cut would be significant. ***However in the current circumstances it is simply implausible to claim that even a 10% cut would unleash a wave of private investment.***

- It is also important to note ***that by cutting its headline rate to 12.5% Scotland would not be operating on a level playing field with Ireland***. Ireland is an offshore financial centre (OFC) offering a number of exceptions to normal international taxation arrangements that the UK does not. If the Scottish Government wishes to replicate these arrangements, we should be told. The STUC would regard such moves as utterly scandalous.

Are Scottish businesses over-taxed?

- ***There is <u>no credible international comparative evidence</u> demonstrating that Scottish businesses are currently over-taxed***. Remarkably, the only evidence produced to this effect in the discussion paper comes from the right-wing US 'think tank' the American Enterprise Institute. The AEI has tortured World Bank data to conclude, absurdly, that the US has the highest effective corporation tax rate in the developed world.

- The STUC presents evidence from credible international institutions that Scottish businesses are by no means over-taxed. The wider regulatory environment is also extremely conducive to business needs: the UK is the third least stringently regulated labour market in the developed world and the second least stringently regulated product market. (Of course, this is why the UK and the US - the least stringently regulated product market in the developed world - were at the epicentre of the banking crisis and why both are outliers in terms of inequality of income and wealth). Scotland as part of the UK is a very open economy.

- There is no credible evidence demonstrating a link – as the discussion paper implies but doesn't state - between low CT rates and high levels of capital investment or R&D spending.

What kind of economy is the Scottish Government trying to build?

- While the STUC is hugely sceptical about the positive incentive effects of a CT cut, we do believe the impact in terms of the distribution of the proceeds of growth would be significant. ***A CT cut would work against the model of broadly based prosperity that the Scottish Government is seeking to achieve through its economic strategy***. By reinforcing the twin trends of falling wages and rising profits, a CT cut would make Scotland more unequal and less economically resilient.

- Although not raised in this paper, many of the advocates of CT tax cuts claim that the incidence of the tax falls on workers. Suffice to say, the STUC is sceptical to say the least that a cut in tax will lead to higher wages. The very same constituencies who advocate low business taxes are thoroughly wedded to flexible labour markets and the systematic undermining of the bargaining power of workers. We have yet to hear the Scottish Government's views on trade union rights, employment protection or health and safety legislation (nor corporate governance, structure and regulation of the financial industry etc) as part of the Scotland Bill process.

Will a tax cut pay for itself?

- It is hugely irresponsible to develop policy on the basis that a CT cut will pay for itself – or even that it will partially pay for itself. ***It is simply not credible to claim that the revenues would over the medium term*** - and here it would be helpful to be specific about what constitutes the medium-term - ***rebound to the tune of £2.6bn***. The evidence presented in the paper to suggest that CT cuts will pay for themselves simply doesn't stand up.

Should CT be devolved?

- The STUC and many other civic organisations firmly believe that a stable and growing global economy requires at least a degree of upwards harmonisation of corporation tax rates. Tax competition is harmful to global social improvement and it is wrong that the Scottish Government should support such regressive policy. ***The STUC will not support any move that facilitates tax competition or indeed other low road competitive strategies***.

- The Scottish Government's ***stated intention*** is to cut the rate of corporation tax thereby transferring wealth upwards, undermining the funding of key public services and threatening economic stability. Again, the STUC cannot support devolution of this power in such circumstances.

Introduction

The STUC does not accept that corporation tax is '*one of the chief levers that any government can use to promote growth, investment and jobs over the longer-term'*[i]. The process of ***long-term*** economic growth is complex and dependent on a range of factors some of which national Governments are able to influence to a greater or lesser extent (population growth, labour supply, technological change) and some over which Governments can exert little if any influence (the global economic situation). The search for simple policy levers to dramatically increase the rate of growth is a fool's errand; if such quick fixes existed they would be immediately and widely replicated. The process by which countries attract foreign direct investment (FDI) is similarly complex and dependent on much more than the business taxation regime.

There is a pattern to the Scottish Government attributing special growth enhancing properties to business tax cuts[ii]; this is especially true in relation to the wasteful Small Business Bonus Scheme. No compelling evidence has been produced (or, as yet, even commissioned) to show that the SBBS has had the slightest impact on growth and jobs. This disregard for hard evidence is, unfortunately, once again manifest in the discussion paper.

While the STUC has always accepted that, ***in certain circumstances***, there can be a link between the level ***and structure*** of business taxation - including corporation tax - and the rate of economic growth, ***the discussion paper completely fails to make the case that a cut in corporation tax is a necessary condition for economic growth in Scotland in 2011***. The very significant short-term (at least – there is real potential that a CT cut will result in a long-term structural gap in Scotland's public finances) pressures resulting from a further cut in the block grant are hardly addressed.

The STUC opposes both the devolution of the power to set corporation tax and the Scottish Government's plans for how it would use this additional power. Not only do we believe that cutting corporation tax would not boost growth and jobs, we firmly believe that it would:

- contribute to making Scotland a more unequal society;
- render Scotland's economy more unstable by increasing the upwards redistribution of wealth; and,
- seriously exacerbate current funding pressures resulting from the UK Government's austerity programme.

We explain why below.

Part 1 Will cutting corporation tax boost economic growth in Scotland?

As the paper acknowledges, evidence for a causal link ***in all circumstances*** between reducing corporation tax and higher economic growth is extremely weak with growth dependent on a number of factors many of which are at least as important as the level of business taxation.

It should come as no surprise to anyone that there '*is a significant body of academic and business research studying the link between corporation tax and economic growth*'[iii]. Like deregulation of the financial sector, business tax cuts have been a central plank of the orthodox economic thinking pushed by employer representative bodies, the financial sector and the international institutions for the last 30 years. Like financial deregulation, cutting taxes on business is a policy which benefits the wealthy and powerful; no researcher seeking to prove the benefits is likely to struggle for funding. Just as there is a huge body of research from credible institutions advocating the benefits of financial deregulation, so there is a similar body of work advocating business tax cuts. The research on financial deregulation almost completely ignored the build-up of systemic risk - the body of work on tax cuts (particularly the econometric work) is guilty of similar selectivity and omission[iv].

In this respect, it is surprising that the Scottish Government cites only three papers in support of its central thesis that corporation tax cuts will boost growth. After an extremely brief consideration of the findings of these reports, the Scottish Government concludes:

'*While such studies are difficult to interpret and apply directly to the Scottish context, they do suggest that there can be a link between corporation tax and economic growth, if used wisely'*[v].

Again, the STUC has never denied a link between CT and economic growth[vi] and we have long argued that studies are '*difficult to interpret and apply directly to the Scottish context*'. As the Scottish Government appears to concede, the academic evidence[vii] cited does not amount to a credible argument that a CT cut in Scotland in 2011/12 will change incentives to such an extent that growth will rapidly increase; and a rapid increase in company profits (combined with an effective collection process) is what would be required to fill the revenue gap created by the rate cut.

The evidence cited relates to other nations at other times and fails to address the key questions: are circumstances in Scotland in 2011 such that a reduction in CT will lead to a rise in GDP? Is the risk inherent in such a move worth the inevitable and significant drop in Government revenues at a time of minimal growth and high unemployment?

Ireland

Consider the case of Ireland. Interestingly, the Scottish Government does not in this paper propose Ireland explicitly as a model to be replicated although it has a long history of doing so. It does mention Ireland as an example of how reducing CT does not lead to a loss of revenue; a point we will return to later.

It is difficult if not impossible to measure in any credible fashion, the effect low corporation taxes have had on Irish growth. We do know that, prior to the 1990s, Ireland had a very low rate of CT through decades of economic stagnation. It is also important to highlight the other factors that contributed to the 'Celtic Tiger' growth miracle in the 1990s:

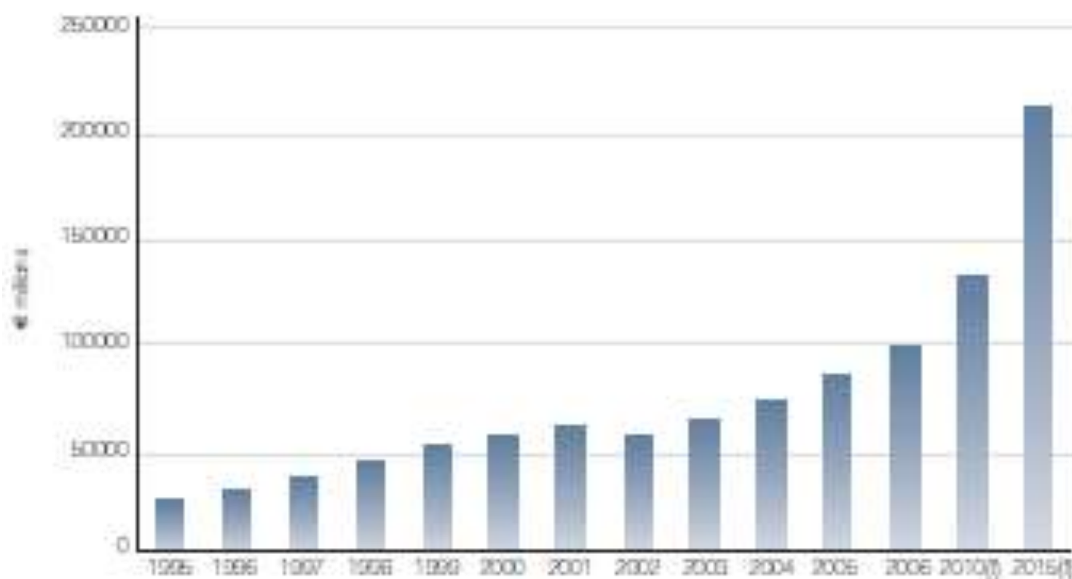
- Ireland is a ***stable democracy with secure property rights and, by the late 1980s, had lots of spare capacity due to decades of serious economic underperformance***;
- Due to decades of emigration, ***Ireland's demographics were uniquely favourable amongst western European economies***; Ireland had in effect exported its ageing population to other countries;
- ***A large pool of available, young and well educated labour***;
- ***Social partnership*** – the agreements signed between government, trade unions and employers from 1987 onwards were integral to achieving the stability and consensus on which growth was built;
- ***A strong and positive relationship with Europe***: the Irish were (here it is sensible to say 'were' instead of 'are')
    - enthusiastic Europeans, present in large numbers and influential within the institutions of the EU;
    - an English speaking, relatively low cost jurisdiction within Europe was an attractive proposition to – mainly US – inward investors;
    - the Irish were prodigiously successful in obtaining EU funds which were then spent effectively in areas that would support growth (primarily infrastructure and skills); and,
    - membership of the Euro reduced foreign exchange risk for international investors (mainly American) using Ireland as a conduit for FDI elsewhere in Europe.
- ***Effective inward investment/business support interventions*** – Enterprise Ireland used the factors listed here to achieve formidable levels of inward investment;
- ***Low cost advantage*** – while it is simplistic and misleading to claim that Ireland's success was attributable first and foremost to low CT, it would be wrong to claim that low CT contributed nothing to growth. But it should also be emphasised that other key factors were at play - during the early Celtic Tiger years; wages and property costs were significantly lower than other EU member states;
- ***Wider tax regime*** – Ireland is identified by the IMF as one of the world's top offshore financial centres (OFCs). While the UK is similarly identified, Ireland offers key exceptions to normal international taxation arrangements[viii] that the UK does not:

- Ireland does not have controlled foreign companies regulations and therefore an Irish holding company will not be taxed on the imputed income of a foreign subsidiary, even if that subsidiary is located in a tax haven;
- In most cases dividends are not taxed on receipt by a parent company based in Ireland; and,
- Ireland's 'thin capitalisation rules' are considerably weaker than the UK's.

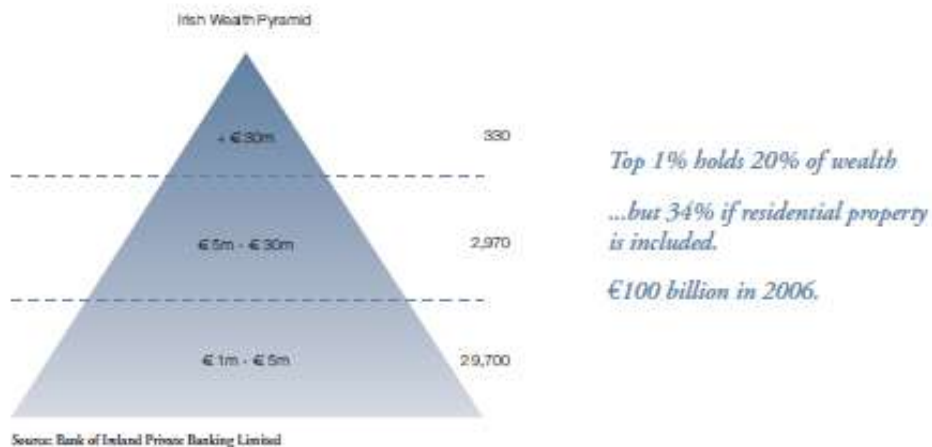
Timing was also a huge factor in the Celtic Tiger miracle; the above factors conflated as the EU single market was established in 1993 allowing Ireland to take advantage of increased FDI and grow consistently during a period of strong global growth, low inflation and low interest rates. As the prominent Irish commentator Fintan O'Toole has remarked, '*...if Ireland hadn't experienced rapid economic growth during the extraordinary global investment boom of the 1990s, the case for letting it sink beneath the Atlantic waves would have been unanswerable"*[ix].

It is also important to question both the scale and nature of the growth unleashed by Ireland's Celtic Tiger. Ireland's economic performance is routinely exaggerated by using GDP per head as the preferred measure. As the Fraser of Allander review pointed out in 2008, '…*economies that host large stocks of foreign direct and portfolio investments would, other things being equal, be expected to experience a net outflow of income thus lowering the income-adjusted estimate of GDP*'[x].

The proceeds of growth through the Celtic Tiger years were also very unevenly distributed[xi]:



Source: Bank of Ireland Private Banking Limited



In summary, Ireland benefitted from a range of factors – some luck, others the result of good policy – that conflated at an opportune time to achieve rapid economic growth ***from a very low base***. The oft-repeated account that it all resulted from cuts in CT is demonstrably untrue.

Scotland cannot replicate the growth rates of Ireland through the 1990s and 2000s and should not try: Ireland started from a much lower base (lower employment, higher unemployment and years of low GDP growth resulted in huge spare capacity) than Scotland and the latter years of the Celtic Tiger were built on an unsustainable property boom fuelled by irresponsible pro-cyclical tax policies. Ireland's performance on jobs and FDI has also been disappointing since 2000 as the two processes which supported growth in the genuine boom period between 1995-2001 – productivity growth and a surge in manufactured exports – petered out. The search for policy levers to replicate Ireland's growth rates through the 90's and 00's is futile and likely to result in poor policy choices.

What will be the nature of economic growth spurred by cutting corporation tax? Will lowering the rate of corporation tax confer a genuine, sustainable competitive advantage on Scottish based firms? Or will it simply embed the cost-reduction route to competitiveness that has inflicted so much damage over the past few years?

Over the course of this submission, the STUC's sceptical position on the potential growth impact of cutting CT should become very clear. However, it is important to consider other related consequences of cutting CT whether or not it achieves the growth rates anticipated by the Scottish Government: it is highly likely to lead to greater inequality and a more unstable economy.

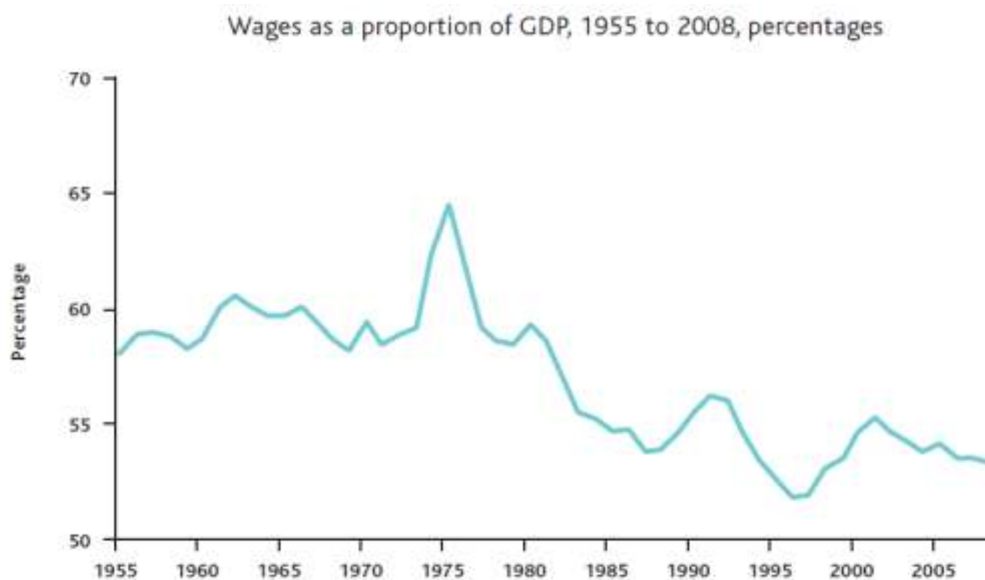
> "*...relying less on corporate income relative to personal income taxes could increase efficiency. However, lowering the corporate tax rate substantially below the top personal income tax rate can jeopardise the integrity of the tax system as high-income individuals will attempt to shelter their savings within corporations*". OECD[xii]

While, again, the STUC is happy to acknowledge that ***in some circumstances*** cutting CT can increase GDP growth, we are aware of no research demonstrating a link between tax cuts, economic growth and broadly based prosperity of the type the Scottish Government is seeking to achieve through its economic strategy. The type of mobile capital likely to be attracted by tax cuts will also demand, for instance, less rights at work and restrictions on the bargaining power of workers (flexible labour markets). There will also be expectations of weak corporate governance, deregulated finance and weak oversight of the tax regime. In these circumstances it is highly unlikely that higher GDP growth would translate into higher wages. A very substantial portion of any additional profits accrued would of course head straight out Scotland.

The apparently inexorable decline of wages as a proportion of GDP hardly rates a mention in the public discourse about Scotland (or the UK's) economic future. This is a concern because there should be little doubt that the squeeze on wages and the concentration of earnings at the very top were key factors contributing to the financial crisis[xiii]. The author Stewart Lansley explained why in a recent TUC pamphlet:

> *"Both encouraged greater personal indebtedness. Real wages were not growing fast enough to underpin final demand without excessive borrowing by earners. By contributing to the increased concentration of wealth and income and by raising returns on some forms of financial investment, they encouraged financial speculation and excessive leveraging in financial services and contributed to unsustainable rises in asset prices"[xiv].*

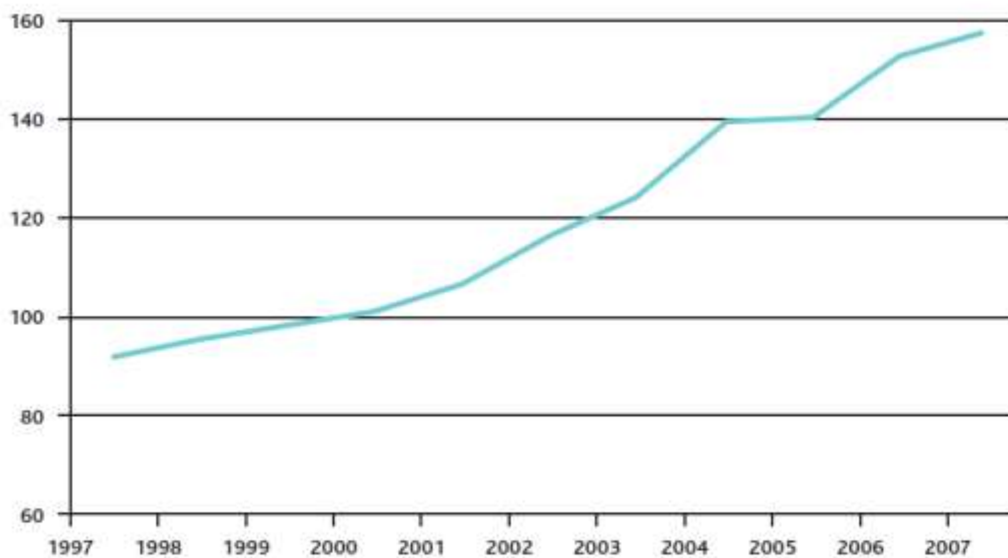
Those who believe that the recession provides an opportunity to build a fairer and more sustainable economic and social model should be profoundly concerned over the long-term trend in the pattern of earnings[xv].



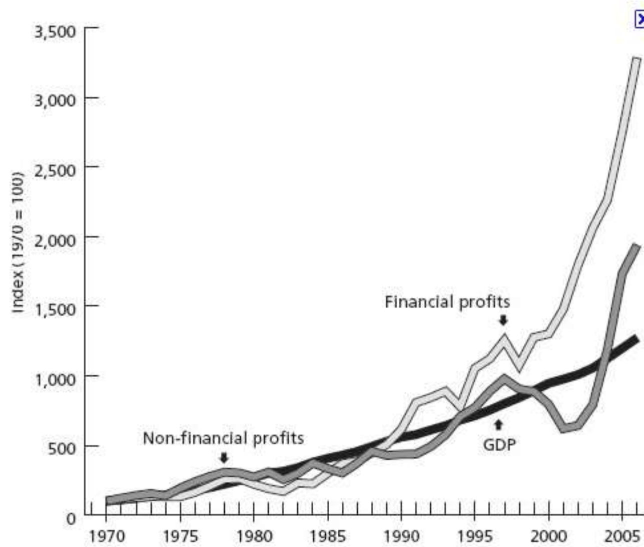
Between the end of the war and the early 1970s the wage share in the UK (we have been unable to access comparable Scottish data) was a steady 58-60% of GDP. The oil price shock set in train events which seen the wage share reach 64.5% in 1975 before a long decline started culminating in a post war low of 51.7% in 1996. From then the wage share recovered to reach 55.2% in 2001 before slipping back to 53.2% in 2008[xvi].

Real wages (wages adjusted for inflation) have risen more slowly than productivity. Since 1980, real wages have risen by 1.6% per annum while productivity has been rising at 1.9% per annum. The gap has become even more pronounced since the turn of the century with real wages rising by only 0.9% while productivity has averaged 1.6%[xvii].

Personal debt rose as wages fell:

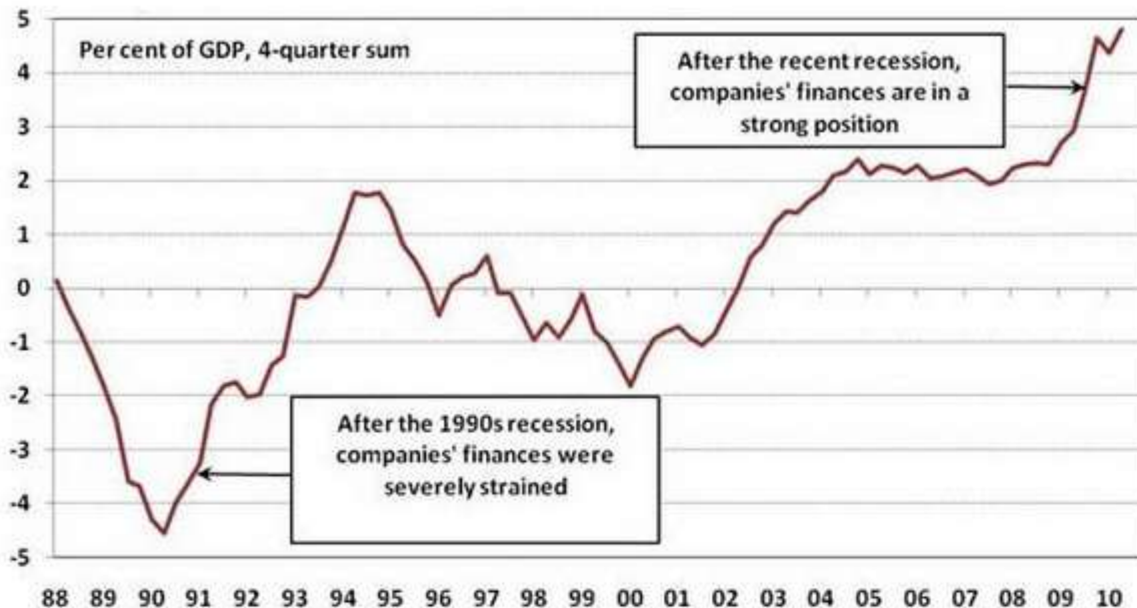


As the graph below shows, profits were high before the recession hit:



…but investment was not.

…and, of course, companies are currently cash rich[xviii]:



Boosting profits by cutting the tax due on them in no way guarantees higher investment; particularly long-term, patient investment in areas such as research and development. The fact is that the UK financial system, of which Scotland remains a part – and will remain a part at least in a cultural if not a regulatory sense – is uniquely bad at supporting long-term investment. ***Given the pressure for high returns over short timescales, there is very little chance that a greater percentage of profits will be retained for longer-term investment.*** Past attempts to change incentives through the taxation system have had very limited success.

Part 2 Are Scottish Businesses over-taxed? Is a cut in corporation tax necessary to make our firms more competitive and Scotland a more attractive FDI location?

The World Bank currently rates the UK 4th out of 183 countries in its Ease of Doing Business Rankings[xix]; an index averaging each country's percentile rankings on 9 topics, made up of a variety of indicators, giving equal weight to each topic. For instance, the UK scores as follows:

- On 'starting a business' the UK ranks 17th out of 183 countries; Denmark ranks 27th, Norway 33rd and Germany 88th; and,
- On 'paying taxes' – which considers both the level of business taxation and the administration required to comply – the UK ranks 16th; Denmark 13th, Norway 18th and Germany 88th. The United States ranks 62nd on this measure.

The '*paying taxes'* ranking assesses performance on a number of indicators including the *'total tax rate'* which is designed to provide a comprehensive measure of the cost of all the taxes a business bears. It differs from the statutory tax rate, which merely provides the factor to be applied to the tax base. In computing the total tax rate, the actual tax payable is divided by commercial profit.

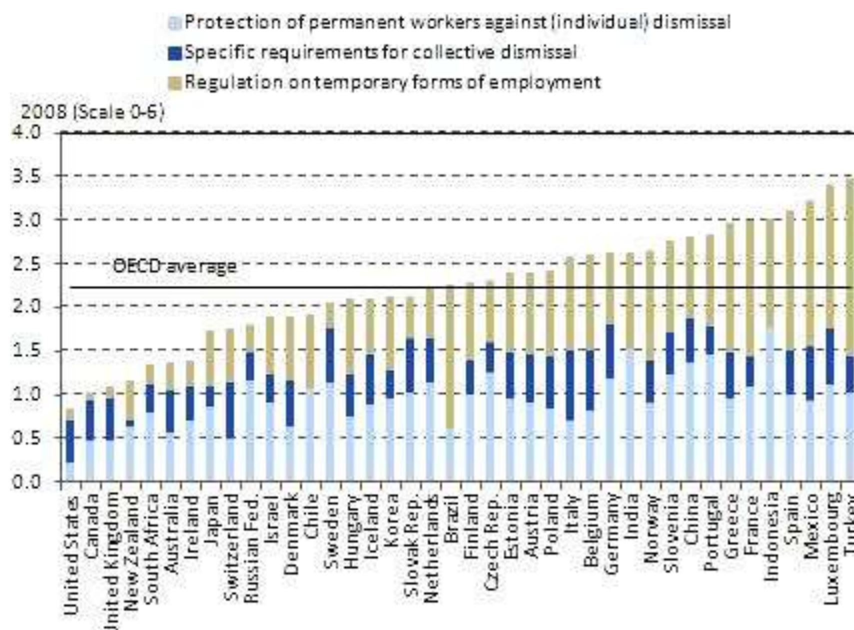
On this measure, the UK's rate of 37.3% is less than the OECD average of 43%. Only New Zealand, Canada, Switzerland, Iceland and Ireland have lower rates. The great exporting nations of Germany (48.2%), Japan (48.6%) and Sweden (54.6%) all have substantially higher rates.

On headline rates of combined central and sub-central government CT rates, the UK rate of 26% is slightly higher than the OECD[xx] average of 24.2%. However, the average is reduced by the very low rates in Ireland, Iceland and the EU accession states. The UK's combined corporate income tax rate of 26% is lower than that of the US (39.2%), Canada (27.6%), Spain (30%), France (34.4%), Germany (30.2%), Italy (27.5%), Luxembourg (28.8%), Australia (30%), Japan (39.5%), Belgium (34%), Sweden (26.3%), Norway (28%) and New Zealand (28%). The coalition Government's commitment to reducing the headline rate to 24% over the course of this Parliament will take the UK rate below that of Austria (25%), Denmark (25%) and Finland (26%). The full table is attached at Annex A for ease of reference.

The OECD indicators of employment protection measure the procedures and costs involved in dismissing individuals or groups of workers and the procedures involved in hiring workers on fixed-term or temporary work agency contracts.

Employment Protection in 2008 in OECD and selected non-OECD countries[xxi]

Scale from 0 (least stringent) to 6 (most restrictive)



The OECD also publishes Indicators of Product Market Regulation; a comprehensive and internationally-comparable set of indicators that measure the degree to which policies promote or inhibit competition in areas of the product market where competition is viable. The indicators cover formal regulations in the following areas: state control of business enterprises; legal and administrative barriers to entrepreneurship; barriers to international trade and investment.

The OECD's analysis[xxii] of product market regulation 2008 found that, out of the 37 countries studied, only the United States regulated its product markets less stringently than the UK.

The STUC is aware of no credible international comparative work that contradicts the evidence cited above. The UK is, on any measure, a lightly regulated economy and it is not over-taxed. ***The credible international comparative data does not support the proposition that UK companies are rendered 'uncompetitive' due to high levels of taxation***. More than that, it is manifestly the case that the nations where manufacturing continues to account for a higher proportion of GDP supporting a balance of trade surplus, pay higher rates of taxation than the UK.

The source of the only evidence provided in support of the Scottish Government's case that the UK has one of the highest effective rates of corporation tax in the OECD is given as the 'World Bank'[xxiii]. It is only on clicking on the link in the footnotes that it becomes clear that the evidence is provided by the American Enterprise Institute who have tortured World Bank data in an effort to show, absurdly, that the US has the highest effective rate of corporation tax in the developed world. It is remarkable that 1) this is the only evidence provided to this effect, 2) that it directly contradicts World Bank published commentary; and 3) that the Scottish Government is prepared to align itself with an extreme right-wing American 'think-tank' whose purpose is to lobby for the abolition of all taxes on capital.

Corporation tax and the UK Government

Somewhat surprisingly given their differences on macroeconomic policy, the Scottish Government invokes the views of the UK Government in support of their case on corporation tax. The UK Government has committed to reducing corporation tax. In his 2011 Budget speech, the Chancellor, George Osborne argued that:

> "*Our country has to compete if we are going to create growth and jobs. Britain has fallen behind many others in the world in the last decade. We've dropped from 4th to 12th in the global competitiveness league*".
>
> "*The most competitive tax system in the G20 is the first of our economic ambitions. The second is that Britain becomes the best place in Europe to start, finance and grow a business.* ***Again, let's face facts: we are not that today****. In the last decade, countries like Germany, Denmark, Finland and the Netherlands have all overtaken us in the international rankings of competitiveness. That is not surprising when the total cost of regulation imposed on business since 1998 is almost £90bn a year*"[xxiv].

The only source cited in support of the Chancellor's analysis is the World Economic Forum's **Global Competitiveness Report (GCR)**[xxv]. It is on this league table that the UK has slipped from 4th to 12th[xxvi]; it is on this '*international ranking of competitiveness'* that the UK has been overtaken by Germany, Finland, Denmark and the Netherlands.

The STUC has published an analysis[xxvii] of the GCR which shows that it **does not** provide evidence in support of cutting business taxes and further deregulating product and labour markets. We would encourage the Scottish Government to read the full paper but, for ease of reference, here are parts of the section on 'goods market efficiency' which includes taxation:

Under '*Pillar 6 Goods Market Efficiency',* a number of factors are considered. These include:

Extent and effect of local taxation (local meaning national in this context)
What impact does the level of taxes have on incentives to work or invest? [1=significantly limits incentives, 7=has no impact on incentives. Mean 3.6]

Overall GCI Rank	*Country*	*Local taxation Rank*	*Score*
9	Denmark	130	2.6
7	Finland	114	3
12	United Kingdom	95	3.2
5	Germany	90	3.3
8	Netherlands	59	3.7

Here's some selected others:

Overall GCI Rank	*Country*	*Local taxation Rank*	*Score*
2	Sweden	110	3
8	Japan	102	3.1
4	United States	71	3.5
14	Norway	64	3.6

Total Tax rate
This variable is a combination of profit tax (% of profits), labour tax and contribution (% of profits) and other taxes (% of profits) Source World Bank Ease of Doing Business 2010

Overall GCI Rank	Country	Rank	Score
9	Denmark	27	29.2
12	UK	54	35.9
8	Netherlands	65	39.3
5	Germany	84	44.9
7	Finland	93	47.7

Here's some selected others…

Overall Rank	Country	TTR Rank	Score
31	Iceland	19	25
29	Ireland	22	26.5
14	Norway	72	41.6
4	United States	89	46.3
2	Sweden	108	54.6
8	Japan	111	55.7

Of course, many of the world's poorest nations outperform the UK on both rankings. There is little in this survey to find that business taxation is a key factor explaining a supposed lack of competitiveness in the UK. Indeed, countries which are ranked higher than the UK in terms of overall competitiveness have higher TTR's. However, they outperform the UK on a range of factors including infrastructure, skills, innovation and corporate governance.

The GCR also finds that the UK is a more open economy than the countries identified by the Chancellor as overtaking the UK in competitiveness (Germany, Finland, Netherlands and Denmark) as the following rankings confirm:

- *Prevalence of trade barriers* – the UK (21) ranks above Netherlands (22), Denmark (31) and Germany (36) but below Finland (8). The UK is a much more open economy than the US (67);
- *Prevalence of Foreign Ownership* – the UK (7) ranks above all the CECs: Finland (23), Netherlands (27), Germany (36) and Denmark (44). The US is ranked 47th;
- *Business Impact of Rules on FDI* - the UK (14) ranks far higher than the CECs: Netherlands (38), Finland (41), Germany (63) and Denmark (78). Switzerland – the most competitive country in the world is 26th. The United States is 77th.

Interestingly, the UK (44) ranks well below these nations on the *Degree of Customer Orientation* (i.e. how well do companies treat customers) indicator: Denmark (7), Germany (11), Finland (25) and Netherlands (28). The UK ranks above all the CEC's on the *Buyer Sophistication* indicator.

In summary, contrary to the Chancellor's beliefs, there is nothing in the Global Competitiveness Report to suggest that high business taxation is an explanatory factor in the UK's supposedly falling competitiveness.

Part 4 Options for reform - Should control of corporation tax be devolved?

The STUC does not support devolution of this power:

- The STUC believes that tax competition is harmful both to sustainable long-term growth and the fair distribution of the proceeds of that growth. As argued above, the 30 year decline in wages as a proportion of GDP and concomitant rise in profits was a factor underlying the financial crisis. Tax competition contributes to a model of economic development which is neither fair nor effective and one that runs contrary to our ambitions – and we would argue – the Scottish Government's – for Scotland. The STUC believes that harmonisation of tax rates at EU level and global action to ensure that mobile global capital pays its fair share of taxation should be the primary goals of tax policy. We cannot support anything that will exacerbate tax competition at this time. The STUC firmly believes that economic development in Scotland cannot be founded on beggar-thy-neighbour policies;
- The Scottish Government's explicit intention is to use new powers to reduce corporation tax. The STUC is willing to engage in a constructive debate about ways in which the tax system can be used to support sustainable growth but the options for reform outlined in the paper fall very far short of stimulating such a debate. The thrust of the paper is clearly that the headline rate of corporation tax will be reduced and in these circumstances the STUC will not support the devolution of the power.

Economic under-performance

The first part of this section of the paper lists a number of problems identified with Scottish economic 'under-performance': relatively small corporate sector, small overall business base, low level of business start-ups, weak record in producing medium to large sized companies from small companies and relatively weak business investment.

It is then claimed that '*a lower headline rate of corporation tax could – in theory – help address all of these issues'*. The STUC accepts that this could happen 'in theory'; reality is a different matter altogether. There is no mention of other structural factors which influence the performance of Scotland's economy. To expect a cut in corporation tax to solve all these ills is not serious policy making.

It is then argued that 'a lower headline rate of corporation tax could encourage foreign business to invest in Scotland'. No evidence is presented that Scotland's rate of FDI is low by international standards (in fact, evidence is presented to the contrary) or that low business taxes are the most important factor considered by potential international investors. The advantages that Scotland already possesses in this respect (see for instance GCI indicators listed above on openness) are ignored. Of course, when a global firm purchases a Scottish owned firm this is counted towards FDI totals – the STUC does not regard this as a good thing.

Tax and the distribution of competitive advantage

The paper then argues that a unified rate of corporation tax is neither desirable nor economically efficient.

"The current system means that a company based in Stornoway pays the same headline corporation tax rate as one based in London. Given the competitive advantages of London relative to other parts of the UK (such as London's position as one of the largest financial centres in the world, and its transport links with major cities worldwide etc) there is clear evidence that London (and indeed the South East of England) already has an in-built competitive advantage over not only Scotland but also other parts of the UK. Scotland needs the lever of corporation tax to consider a wider array of options than is currently the case to help address this imbalance"[xxviii].

The STUC has long criticised the failures of macroeconomic, regional and industrial policy which have resulted in an unfair distribution of jobs, growth and wealth across the UK. However, it is important to stress the following:

- The logic of the above argument would necessarily lead to differential rates of corporation tax across Scotland should the power be devolved: Edinburgh also enjoys 'competitive advantages' that Stornoway does not;
- The paper fails to explain how implementing different rates of corporation tax is economically efficient, or even consider the various inefficiencies that would arise with different rates;
- There are numerous policies which can help mitigate the historic, cultural and geographical factors which produce uneven growth. The fact that policy has often failed in this respect does not make it any less true. Cutting corporation tax (when many companies in peripheral economies will not even be liable for the tax) is likely to be very ineffective; and,
- Most importantly, ***Scotland already enjoys a significant cost advantage over London and the South East***. Wages and rents are lower and this has been a factor in recent FDI successes. But it is only one factor (others include skills, quality of life, infrastructure improvements, availability of business premises etc) and it is far from clear that further tax cuts are the best use of public money in this respect.

SME's

There is little to respond to in this section which simply assumes that SMEs will respond to tax cuts by investing more; much the same thinking that encouraged the Scottish Government to implement the SBBS.

The STUC has yet to see evidence of any job related investment stemming from the SBBS and we believe the impact of cutting the small profits corporation tax rate would be similarly negligible. It is notable that the same OECD report the Scottish Government cites in support of its plans concludes that, '*evidence in this study suggests that favourable tax treatment of investment in small firms may be ineffective in raising overall investment*'[xxix].

Incentives for particular activities

While the paper acknowledges that '*such activities [capital investment and R&D] are clearly driven by a wide range of factors and taxation is often only a small element in company decisions*'[xxx] it is very selective in describing what these other factors might be. The paper lists 'skills, education and quality of a country's workforce'. To this we would add:

- the sectoral mix i.e. the presence and scale of industrial sectors where R&D is a feature of normal industrial activity;
- access to the patient, committed finance necessary to fund long-term, risky investments where the pay-off can be difficult to quantify;
- level of retained profits which are historically low in UK firms given the pressure to return large profits over short timescales; and,
- quality of corporate governance and extent to which firm is run with a longer-term outlook.

The problem here is not that cutting corporation tax would not address these structural problems but ***that it could make them worse***. The table at Annex B looks as BERD expenditure as a proportion of GDP for OECD countries. It is very difficult to identify any correlation between corporation tax and R&D expenditure from this table.

Support for other activities

The STUC does accept that an industrial policy case can be made for lowering rates of corporation tax for nascent industries in some circumstances but we were unconvinced that the employment or spillover effects justified such a move for the computer games industry.

What is remarkable in this paper is that there is no consideration at all of how tax might be used to support the much discussed 'rebalancing' towards manufacturing. Measures such as a targeted reduction in manufacturers' corporate tax for increasing output, an enhanced depreciation allowance or targeted national insurance relief should at least have been part of this discussion.

Financial implications

The paper argues that, '*at first glance, a more competitive corporation tax policy could be seen to lead to an immediate reduction in revenues collected in Scotland. If such a position was adopted, then decisions regarding budgetary priorities would be needed. However, experience has shown that, particularly over the medium to long-term, a more competitive corporation tax strategy may not necessarily imply lower revenues*'[xxxi].

The STUC believes it is essential to use clear and precise language when discussing an issue of such import to the public finances of Scotland: a reduction in the rate of corporation tax will result in an immediate and significant drop in the funds available to invest in public services. The medium to long-term effects on the public finances of cutting corporation tax are entirely unclear. The STUC is highly sceptical whether the incentive effects of the tax cut will be sufficient to increase revenue at all, never mind to the level of £2.6bn.

Some of the arguments presented in this section border on the misleading and are out of place in a Scottish Government discussion paper.

i. In arguing that the 'a reduction in the headline rate of corporation tax would not necessarily reduce tax receipts from corporation tax', the paper cites the example of Ireland and the UK where in 2006 the revenue from corporation tax was almost 4%, despite the corporation tax in Ireland being 12.5%, less than half the UK rate. The paper states that, '*In short, while the amount of tax collected for each unit of profit in Ireland was lower than in the UK, the actual level of profit being generated was significantly higher*'. Of course this profit was being generated at the height of a completely unsustainable property boom fed by deeply irresponsible pro-cyclical tax policies. There is no argument here for the incentive effects of tax cuts.
ii. The paper then goes on to argue that, '*a reduction in the headline rate of corporation tax would not necessarily reduce tax receipts from corporation tax*', citing OBR forecasts predicting that despite the planned reduction in corporation tax, total on-shore receipts in 2013-14 will be higher than the pre-recession peak. Leaving aside the OBR's poor forecasting record, it is hardly news that corporation taxes will grow during the (anticipated) recovery or that 6 years after the recession started, and after an extended period of above target inflation, receipts will be higher than before the recession! Again, no evidence here for the incentive effects of tax cuts. At the time of writing, it is being reported that business investment in the UK is heading towards a record low – perhaps record low investment is also a consequence of the corporation tax cut? The logic is the same. Also worth noting that the OBR's growth estimates and revenue forecasts which flow from them are predicated on business investment in 2011 of 6.7%. As things stand, investment declined by 3.2% in the first quarter and is forecast to be stagnant in the second. All this despite companies sitting on a mountain of cash.

Administering a separate system

Before responding to the points made in this section it is probably sensible to mention the problems that HMRC currently has in collecting tax due:

- The Treasury currently estimates that of the £42bn tax gap at least £15bn is lost to corporate evasion and avoidance. Other credible sources put the figure significantly higher at around £95bn (£70bn evasion and £25bn avoidance) [xxxii]

- In its last survey[xxxiii] of large company taxation, the National Audit Office found that one third of the UK's top 700 companies paid no corporation tax in the last financial year.

- Del Monte, Chiquita and Dole sold over £400 million worth of bananas in Britain in2007. Yet these three corporations between them paid only £128,000 tax in the UK[xxxiv].

- Saga/AA – on the announcement of their merger in July 2007 it was found that the Private Equity owned businesses Saga and the AA, incurred no liability for corporation tax in the previous year. Indeed, in the 2 ½ years of ownership by private equity they paid almost zero corporation tax. In the same period, the private equity owners of these businesses – Permira, CVC and Charterhouse – generated profits of £2.5bn[xxxv].

This discussion paper skirts around the issues of collecting corporate taxation due. What is manifestly clear to the STUC and others is that the political will, technical expertise, capacity and resources are simply not there at UK level. The paper does not explain, or even attempt to explain, how the Scottish Government would put in place a tax collection regime that would remedy this situation should the power be devolved.

It is perplexing and worrying that the Scottish Government appears to prioritise minimising 'business burdens' over an effective collection regime. And here again, the use of evidence is highly selective: the UK actually performs well on the average time for completing tax returns: 24th out of 183 countries on the World bank index – many rich, developed nations come much further down the rankings. Of course, the ease with which UK businesses complete their returns might not be unconnected to their prodigious success in avoiding liabilities.

Scotland Bill

It is important that the STUC's opposition to the Scottish Government's proposals on corporation tax are not read as support for Scotland Bill in its current form. We support the Scottish Government's calls for immediate and substantial borrowing powers, authority over the Crown estate and greater EU involvement. The STUC supports greater Scottish involvement in the regulation of broadcasting and is discussing specific proposals in this respect with its affiliated unions. The STUC has yet to take a position on the devolution of responsibility for excise duties.

For clarity, the STUC does not support the devolution of corporation tax to Northern Ireland. The benefits as outlined in this paper are very dubious and the costs potentially enormous. We note that there is no cost/benefit analysis included here and that if there was it would show that the costs per job created would be huge.

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Annex A

Country	Central government corporate income tax rate [2]	Adjusted central government corporate income tax rate [3]	Sub-central government corporate income tax rate [4]	Combined corporate income tax rate [5]	Targeted corporate tax rates [6]
Australia*	30.0	30.0		30.0	Y
Austria	25.0	25.0		25.0	N
Belgium*	33.99 (33.0)	34.0		34.0	Y
Canada	16.5	16.5	11.1	27.6	Y
Chile*	20.0	20.0		20.0	Y
Czech Republic	19.0	19.0		19.0	Y
Denmark	25.0	25.0		25.0	N
Estonia*	21.0	21.0		21.0	
Finland	26.0	26.0		26.0	N
France*	34.4	34.4		34.4	Y
Germany*	15,825 (15,0)	15,825	14.4	30.2	N
Greece	20.0	20.0		20.0	Y
Hungary*	19.0	19.0		19.0	Y
Iceland	20.0	20.0		20.0	N
Ireland	12.5	12.5		12.5	Y
Israel*	24.0	24.0	0.0	24.0	Y
Italy*	27.5	27.5		27.5	N
Japan	30.0	28.0	11.6	39.5	Y
Korea	22.0	22.0	2.2	24.2	Y
Luxembourg*	22.05 (21.0)	22.1	6.8	28.8	Y
Mexico	30.0	30.0		30.0	Y
Netherlands*	25.0	25.0		25.0	Y
New Zealand*	28.0	28.0		28.0	N
Norway	28.0	28.0		28.0	Y
Poland*	19.0	19.0		19.0	N
Portugal*	25.0	25.0	1.5	26.5	Y
Slovak Republic	19.0	19.0		19.0	N
Slovenia	20.0	20.0		20.0	
Spain	30.0	30.0		30.0	Y
Sweden	26.3	26.3		26.3	N
Switzerland*	8.5	6.7	14.5	21.2	N
Turkey	20.0	20.0		20.0	N
United Kingdom*	26.0	26.0		26.0	Y
United States*	35.0	32.7	6.4	39.2	Y

Annex B

	1999	2000	2001	2002	2003	2004	2005	2006
Scotland	**0.52**	**0.51**	**0.64**	**0.59**	**0.49**	**0.45**	**0.51**	**0.43**
UK	**1.20**	**1.16**	**1.19**	**1.14**	**1.08**	**1.04**	**1.08**	**1.05**
Germany	1.67	1.73	1.72	1.72	1.76	1.74	1.72	1.77
France	1.36	1.34	1.39	1.41	1.36	1.36	1.30	1.32
Italy	0.50	0.52	0.53	0.54	0.52	0.52	0.55	0.55
Japan	2.14	2.16	2.30	2.36	2.40	2.38	2.54	2.63
Canada	1.06	1.15	1.29	1.17	1.16	1.18	1.15	1.10
USA	1.96	2.02	1.97	1.83	1.81	1.76	1.80	1.86
Demark	1.41	..	1.64	1.73	1.78	1.69	1.68	1.66
Iceland	1.07	1.50	1.74	1.69	1.46	..	1.43	1.59
Ireland	0.87	0.80	0.77	0.76	0.79	0.81	0.82	0.83
Norway	0.92	..	0.95	0.95	0.98	0.87	0.82	0.82
Finland	2.16	2.37	2.36	2.35	2.43	2.42	2.46	2.48
Sweden	2.66	..	3.20	..	2.83	2.63	2.59	2.75
EU 27	1.09	1.11	1.12	1.11	1.10	1.09	1.08	1.11
OECD	1.49	1.53	1.55	1.50	1.49	1.48	1.51	1.55

[i] Pg 3, Corporation Tax: Discussion paper, The Scottish Government, August 2011
[ii] In doing so, the Scottish Government aligns itself with the 'Supply Side economics' movement which has its origins in 1970s America. See 2008 STUC paper, 'Supply Side Scotland' http://www.stuc.org.uk/files/Forum%20papers/Supply%20Side%20Scotland.pdf
[iii] Pg 14, discussion paper
[iv] For an accessible summary of the failures of this research see Chapter 4, 'Trickle down economics', in John Quiggin's 'Zombie Economics', Princeton 2010.
[v] Pg 15, discussion paper
[vi] the TUC paper Corporation Tax and Competitiveness, May 2011 – argues that the relationship between growth and falling corporate taxes is weak and does not prove causality. http://www.tuc.org.uk/economy/tuc-19619-f0.pdf
[vii] There are a couple of points about the evidence which should be noted: first, the Djankov et al study fundamentally contradicts the risible AEI conclusions cited later in the paper – it is simply not credible to argue that the US has the highest effective CT rate in the developed world. Secondly, the OECD paper covers the full range of taxation and has much to say about the equity, efficiency and growth enhancing properties of property taxation.
[viii] See 'Pot of Gold or Fool's Gold', Murphy, 2011 for an examination of Ireland's extremely lax business taxation regime http://www.taxresearch.org.uk/Documents/CorpoTaxlores.pdf
[ix] Ship of Fools, O'Toole, 2010 (Public affairs)
[x] Pg 5, Fraser of Allander Quarterly Economic Commentary, Vol 31, No 4
[xi] Graphs taken from The Wealth of the Nation, Bank of Ireland Private Banking Ltd 2007 http://www.finfacts.ie/biz10/WealthNationReportJuly07.pdf
[xii] Pg 8, Tax and Economic Growth, Economic Dept Working Paper No. 620, 2008
[xiii] The STUC is researching these trends at Scottish level but, not for the first time, we are being frustrated by a lack of quality data at Scottish level.
[xiv] *Unfair to Middling*, TUC Touchstone pamphlet 2009 http://www.tuc.org.uk/extras/unfairtomiddling.pdf
[xv] ibid

[xvi] ibid
[xvii] ibid
[xviii] UK Government, 'The Path to strong, sustainable and balanced growth', 2010 – joint Treasury/BIS paper
[xix] http://www.doingbusiness.org/rankings
[xx] http://www.oecd.org/dataoecd/26/56/33717459.xls
[xxi] http://www.oecd.org/document/11/0,3746,en_2649_37457_42695243_1_1_1_37457,00.html
[xxii] http://stats.oecd.org/Index.aspx?DataSetCode=PMR
[xxiii] Pg 24, discussion paper
[xxiv] Budget Statement 2011
[xxv] http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2010-11.pdf
[xxvi] The Chancellor refers to the UK slipping from 4th to 12th in the Budget statement. The 'Path to strong, sustainable and balanced growth' paper notes that the UK slipped from 7th to 13th between 1997 and 2009-10.
[xxvii] The Wrong Plan for Growth – Budget 201, the GCR and the dangers of formulating policy on a false premise
http://www.stuc.org.uk/files/Congress%202011/Wrong%20Plan%20for%20Growth%20Final.pdf
[xxviii] Pg 34 discussion paper
[xxix] Pg 9, Tax and Economic Growth, Economics Dept Working Group Paper No. 620, OECD
[xxx] Pg 36 discussion paper
[xxxi] Pg 42 discussion paper
[xxxii] http://www.ft.com/cms/s/0/63255cbc-c1c5-11df-9d90-00144feab49a,s01=1.html#axzz1X4ervMvE
[xxxiii] http://www.nao.org.uk/publications/0607/management_of_large_business_c.aspx
[xxxiv] http://www.guardian.co.uk/business/2007/nov/06/19
[xxxv] http://news.bbc.co.uk/1/hi/business/6263866.stm