SUBMISSION FROM PROFESSOR HUGHES HALLETT AND PROFESSOR SCOTT

Evidence 2: Corporation Tax and Extending Scotland’s Tax Powers

Summary

This evidence covers the following issues:
- Relationship between (effective) rates of corporation tax and investment;
- The non-issue of corporation tax competition;
- The “volatility” of corporation tax receipts and the need to reconcile this with stability of public spending via (a) broadening the overall tax base and (b) having access to appropriate borrowing powers;
- The possibility of devolving corporation tax power to Northern Ireland.

1. Introduction

1.1 One might ask why, if (as the Calman Commission’s report says) the Commission’s whole purpose was to make Scottish Parliament more accountable for the money it spends, did they simply not make the Parliament’s tax raising powers match its existing spending powers? That is the only logical way to make the Parliament accountable for what it spends.

1.2 We might note here that, because neither the Calman Commission nor its independent expert group even mentioned having considered that simple step, they must have had some other motive in mind. Otherwise one would be obliged to conclude, they didn’t believe in what they were doing.

1.3 In that regard, if accountability, transparency and devolution are indeed the aim, Reform Scotland’s Home Rule proposal\(^1\) to extend tax powers out to cover the 60% of public spending that takes place in Scotland through the Parliament’s budget makes a logical case which is very hard to deny. We recommend that the Committee take that evidence very seriously, and consider whether other taxes could not be usefully transferred to the Scottish Parliament. This Reform Scotland report builds on earlier paper by ourselves\(^2\), which advocated a slightly larger transfer of tax powers and went into considerable detail and made a strong economics case for which taxes and policies would best be devolved, and which would best be left under UK control. On the basis of those best able to help generate growth and jobs (“levers for growth”), we recommended all the usual taxes (including those levied on a mobile base) should be transferred to the Scottish Parliament. And those taxes and policies which set or regulate the general conditions within which the Scottish economy/markets will function (the so-called “framework policies”) might be better left to the UK government or inter-national agencies. This division was made on the basis of comparative advantage, so it had solid economic reasoning behind it. And it was possible to go through the formal analysis of decentralised decision making to explain exactly how and why these devolved tax decisions would produce better economic outcomes (and have in other jurisdictions) through greater efficiency of

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1 Reform Scotland (2011) ‘Devolution Plus’
spending; better allocation of resources; reacting to more detailed or accurate information; decisions that are more responsive to signals about the economy’s needs or preferences; or decisions that allow the economy to lay the ground work for building up new high value added, high productivity industries. We urge the Committee to keep these kinds of economic considerations in mind when reviewing what taxes they would like to see transferred.

1.4 It is also important to keep in mind that the transfer of tax powers can only be carried out successfully if the right kind of supporting institutions are in place. In this context, that would mean the domestic collection of taxes (something that is missing from the Scotland Bill’s income tax proposal, causing major problems in forecasting the likely revenues and then reconciling them with the actual outturns); a procedure for coordinating Scottish policies with the rest of the UK so that they form a consistent UK macroeconomic framework; a disciplined debt management process; a system for regulating what revenues are due to the UK and which for Scotland, and so on. It is important that the Committee keep in mind that the right framework will need to be devolved with the taxes in many cases.

1.5 An important feature of our own scheme was that the revenues derived from the devolved taxes would all be collected in Scotland, and that an agreed proportion (agreed through the coordination procedure highlighted above) remitted to the UK government as payment for shared services. Some might regard this as an unusual step, but there are strong reasons to do with simplicity and economic incentives for recommending it:

a) It is simpler. There is only one tax collection system. Removing duplication saves on collection and compliance costs; and it saves costs for the individuals and firms who have to supply only one set of information, fill in only one tax return, keep only one set of records. The costs would then be no different to the system we have now, except to the extent that devolved tax collection may be more efficient.

b) It allows us to define clearly, exactly and unambiguously what are Scotland’s competences and responsibilities; and exactly what are the UK’s responsibilities and competences.

c) It makes it clear that the UK government is accountable to Scotland as well as Scotland to the UK, (in addition to each government being accountable to its own Parliament). This is something missing entirely from the current Scotland Bill, yet every flow of funds needs an accountability mechanism to ensure it is most efficiently used.

d) This flow of funds to the UK provides a necessary linkage to the UK budget, and hence preserves the Union and risk sharing. All of this would fit devolved tax powers into a consistent UK macro-economic framework, but which is an aspect totally missing from the Scotland Bill.

2. Corporation Tax

1.1 One of the obvious candidates for devolution to the Scottish Parliament is Corporation Tax. Nearly every economy in the world that has any decentralisation of taxes, has some part or all of corporation taxes devolved to the regional administrations – most obviously in the US, Canada, Australia, Germany, and smaller jurisdictions like Switzerland or Sweden – and for good reason. Control over
corporation tax is seen as one of the most powerful growth levers in the fiscal armoury. Scot-land would therefore be the exception and an outsider if there were any devolution of tax powers, but corporation tax was not devolved in some form. Moreover, given its association with investment and growth, not to include corporation tax would raise serious questions about the policymakers’ commitment to creating economic growth and new jobs really is.

2.1 Evidence: Both economic theory empirical evidence confirm there is a basic inverse relationship between rates of corporation tax and levels of investment (not economic growth itself – although in all growth models it is the rate of investment which plays a decisive role in determining the rate of economic growth over the short to medium term). Permanent increases in the rate of growth require in addition, permanent increases in the working population and in the rate of growth of productivity at the same time).

2.2 Moreover empirical research demonstrates that, much as all these factors are helpful, the link between corporation tax and growth becomes even stronger if we consider effective (as opposed to ‘headline’) rates of corporation tax. To put that remark into perspective, the corporation tax rate in Ireland in 2008 was 12.5%, but yielded revenues amounting to 2.9% of GDP. German rates of corporation tax vary between 30% and 33% depending on which state, region or city you are in; but the yields amounted to only 1.1% of GDP. These figures demonstrate that lowering the tax rate, but broadening the base on which it is levied, will typically raise the revenues generated. This happens both because lower tax rates attract higher rates of activity in the regions, or the firms of the regions where the tax rate is lower; and because, with lower tax rates, compliance is higher (firms readily pay a higher proportion of what they owe, and there are many fewer loopholes and exemptions that allow them to avoid the taxes they would otherwise have to pay). The last point is the salient one for the comparison with Germany; the lower tax rate has attracted new activity in Ireland (more so than new firms), but also allowed Ireland to raise greater revenues from a broader tax base. This is why corporation tax is viewed as such a strong growth lever.

2.3 Higher revenues mean governments can put greater resources into their growth and employment generation strategies. That may itself raise investment; but, with lower tax rates and higher activity levels, firms will need and want to invest more. So investment rises with lower corporation tax rates. In addition, recent research has demonstrated that the effective rate of corporation tax is also inversely related to new firm foundation and entrepreneurship. The hard evidence to support all these statements is in the papers cited later in this paper.

2.4 Tax on corporate profits is only one element that determines the overall business environment for investment – whether domestic or inward. The corporate tax environment that a company faces involves many more variables than simply the headline rate at which the tax on profits is applied. The committee should keep that in mind when deciding what case to advance for devolving corporation tax. Here are some examples
a) Corporation tax interacts with other taxes within a jurisdiction, and that interaction has to be recognised in determining the optimal corporate tax regime;
b) Tax competition can be engaged in different ways. If tax competition is solely about profit-shifting (i.e. where companies arrange their affairs to realise their profits in the lowest tax jurisdiction) then it is generally classified (including by the OECD) as ‘harmful’ tax competition and, understandably, frowned upon. If however, tax competition is designed to influence the location of economic activity then it is widely regarded – including by the UK Government – as ‘fair’, and indeed efficiency-enhancing tax competition;³
c) The ‘race-to-the-bottom’ evidence on the effects of tax competition is weak. Over the period since 1985 the average rate of corporation tax in the EU has declined from approximately 45% to under 30% but the share of corporation tax receipts in GDP has remained remarkably stable – if anything it has risen;⁴
d) There seems to be an inverse correlation between the rate at which corporation tax is levied and the corporation tax collected. Based on a study of EU countries, Mooij & Nicodeme report that “…A simple regression suggests that an increase in the corporate tax rate by 1%-point is accompanied by a fall in corporate tax-to-GDP ratio by 0.0319…”⁵ This provides a justification for lowering corporation tax that does not rely on increased investment – either or both inward or domestic – or activity levels, but simply on increased rates of tax collection;
e) There is therefore strong indicative evidence implicit in c) and d) above that lowering the rate of corporation tax will broaden the tax base – i.e. an increase in the numbers of corporations paying tax, and a decrease in the number relying on loopholes and exemptions to avoid it.

2.5 The “Race to the Bottom” red herring: Much has been made of intra-country tax competition. The Independent Expert Group to the Calman Commission stated “A serious factor in Swiss federal finance is tax competition between cantons...[which] is...more marked for corporate taxes (which are exclusively cantonal)”.⁶ No academic source is referenced in support of this assertion, and it is one disputed by authorities on the Swiss system themselves. For instance, Bessard (2008) states:

“The sometimes purported fear of a “race to the bottom” proves to be unfounded. The central government and the cantons provide high-quality infrastructure, and voters can approve and reject public projects, including the tax revenues necessary to finance them. Tax competition therefore ensures greater diversity, choice, and efficiency. This has been theoretically and empirically substantiated (Feld,

³ See Financial Secretary to the Treasury speech to Brussels Tax Forum, 31st March 2009. This idea also appears in the OECD’s official analysis of tax competition: see Blochinger and Pinero-Campos (2011), p28.
⁵ ibid
⁶ Point 4.6.1 of the IEG Report, 2008
Kirchgässner and Schättegger, 2003; Alesina, 2002). As individuals and businesses choose their location freely, politicians and administrations are forced to offer an attractive combination of public services for the lowest possible tax burden.

It is an assertion that would also be disputed by the UK government’s distinction between “harmful” and “fair” (efficiency inducing) competition. The key, of course, is the last sentence of the quote; precisely because the tax base is mobile, the authorities must offer an attractive level of services together with an acceptably low tax burden. Those services cannot be offered without sufficient revenues. Hence any race to the bottom, if it ever got started, would rapidly come to an end. More likely it will never get started (there is no actual empirical evidence of a race to the bottom, in an extensive academic literature) since each policy authority will see that being unable to provide the necessary services will be more important to firms and individuals than variations in the amount of taxes they have to pay. In other words, lower corporate taxes are a negotiating tool to get a required level of basic services most cheaply; not a way of avoiding costs to get no services.

2.6 Why has there been no race to the bottom? There have been some extensive studies of this question, and the conclusion is “for good reason”. A study of the US states by Chirinko and Wilson (2008)\(^7\), where you might expect competition to produce a race to the bottom before anywhere else, shows very clearly that there is no perceptible connection in corporate tax rates in one state and the rates in another state. There is however a significant negative connection between one state’s tax rate, and the rate in neighbouring states by lagged a year. The explanation is exactly that in paragraph 2.5 above. If you neighbour puts up its tax rate, so that extra business and the revenues flow your way, you tend to keep your existing tax rate in place and then reduce it later by a limited degree in order to be able to spend the windfall gains on improved services to attract that new business. You do not increase your tax rates in competition, in a race to the top for services. Similarly, if your neighbour lowers his rate of tax, you keep your tax rate in place for a while and then raise it to a limited degree to provide extra revenues to replace those lost to the neighbour in order to keep the level of services you can offer in place. You do not lower your tax rate in response, in a race to the bottom for competitiveness and low taxes. Far from a race to the bottom, it is a see-saw – demonstrated in this case by a theoretical model and extensive empirical results.

2.7 Another study, by Tillmann and Wigger (2010)\(^8\), provides another reason why a race to the bottom would not appear. A standard result from earlier studies is that policymakers who share a tax base tend to overtax their constituents in a competition to attract the revenues to themselves (a “race to the top” in other words). This is a long standing result taken from the work of Lockwood and others. Comparing the outcomes from the competition between a unitary state and a federal

\(^7\) Chirinko, B. & Wilson, D. ‘Tac Competition among US Sates: Racing to the Bottom or Riding a Seesaw?’; CESifo Paper


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state, to the outcomes from the competition between two federations, Tillmann and Wigger are able to show that there will never be a race to the bottom between the two states because the interstate tax revenues are needed to balance the losses in revenues caused by the tax competition between the upper and lower level governments within a federation. The rationale of course is that a certain level of services has to be provided somehow.

2.8 **A summary on tax competition:** The arguments above are supported by other research in a wide ranging survey conducted by the OECD which has a specialised department examining just such questions. They too conclude that corporate tax competition between sub-state governments is not a feature in those countries in which it could be practiced. Indeed there are fairly obvious reasons why we would not expect SSGs to engage in such competition. We do not know what literature was drawn upon by the Independent Expert Group to the Calman Commission as justification for their statement, but it has no support in the academic or policy analysis literature. On the contrary, the OECD study shows the potential competition creates greater equality between regions and sectors of society because it provides the smaller economies and regions with the only weapon available for offsetting the cost advantages, or economies of scale, inherent in the large economies or regions. So the problem is not so much that corporation tax may unleash harmful competition, but that it is needed to redress the unfair competition already built in to the cost advantages of being in a large agglomeration or regional economy.

2.9 **Implementation issues:** It is important to recognise that the overall ‘tax’ (index of net location costs) for businesses locating in Scotland are likely to be higher than the UK average. This is because companies located within the larger conurbations in England benefit from a range of external economies of scale – including access to a larger pool of skilled workers and business services, and better economic proximity to the EU internal market – than do comparable firms in Scotland. This impacts on the net-of-taxes profitability of corporations and will doubtlessly influence their location decisions. This has been recognised in previous years through policies such as selective regional economic assistance. However under EU state aid rules many of the most effective of these instruments have been discontinued. Arguably only the “enterprise zone” model remains – although this too will need to comply with these EU rules.

2.10 Parallel to that, there is the argument that corporation tax can only be granted to Northern Ireland since that is the only UK region with a land border to another jurisdiction. On that argument we should hand UK corporation tax to Brussels. In reality, Scotland has only a short sea crossing to Ireland. If the transport costs for goods sold to Ireland was say 1.5%, and Ireland’s tax rate is 12.5%, then a corporate tax rate in Scotland of 14% would produce a level playing field with our nearest non-UK competitor; land border or none. To argue for the status quo ante on these grounds looks specious to us.

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10 For a comprehensive discussion about the role of corporation tax and other factors in the locational decisions of corporations see Auerbach, A., Devereux, M. & Simpson, H. (2011) ‘Taxing Corporate Income’, *Mirlees Review; Reforming the tax system for the 21st century* (IFS), Chapter 9
2.11 A final argument is that a Scottish corporation tax would be costly and difficult for Scottish businesses (and those operating in Scotland) to comply with. This also appears to be specious. First, if we adopt the remit to London model of paragraph 1.5, there would be no extra costs or complications at all. Second, the study by Djankov et al (2010) cited below examined that precise question for 22 OECD countries, and found no evidence at all that having more complicated rules or multiple jurisdictions (and paperwork) imposed any additional costs on the firms in question, or was perceived to do so.

2.12 In fact the problem is not the cost of administering the tax collection system, but assessing how much of a multinational (multiregional) firm’s profits actually arise in Scotland. To get around this difficulty, the revenues could be collected in proportion to each firm’s employment, production, or investment in Scotland and in RUK. Take employment levels. Assessing corporation tax on this basis simplifies both the collection and the assessment of taxes due. Firms are not required to collect or report any more information that they already do now. All they need to report (or allow HMRC to assess for them from their national insurance records which include home addresses) is the average number of employees registered for national insurance purposes in the Scottish plants/offices; and also the average number employed at their RUK plants/offices. This is information they already have, or which HMRC holds for them. Then if Scotland declares a corporation tax rate of $x$, and the UK declares a UK rate of $y$, then any firm with any operations in Scotland will be charged tax at the rate:

$$z = \frac{x \cdot n_s + y \cdot n_u}{n_s + n_u}$$

where $n_s$ is the number of employees registered by HMRC as employed by that firm in Scotland, and $n_u$ is the number working in that firm’s RUK plants. [Note, if $x<y$, then $z<y$].

2.13 Note this is the tax rate to be applied to all firms in the UK, just as the UK-wide rate is now. If a firm is not present in the Scottish economy $n_s=0$, so $z=y$ and that firm is unaffected by and does not benefit from the Scottish tax rate. But if it is present only in Scotland, $n_u=0$ and $z=x$ and that firm gets the full benefit of the Scottish rate. In all other cases, the firm will pay a rate somewhere between the Scottish and UK rates. Notice the major advantage of this: it does not require any further information than firms have to collect and report now. The adjusted tax rate is applied to the aggregate profits of each firm, just as they do now. It avoids having to make any assessment of exactly how much profit should be attributed to each plant in Scotland, separately from how much arises in each plant in RUK.

Third, it is equally easy to calculate the corporation tax revenues due to Scotland as a whole. Of the total tax revenues taken in, the proportion due to Scotland is the total number of registered employees in Scotland divided by the total number of registered employees in the UK. So unlike the Scotland Bill’s income tax proposal, there are no additional collection, compliance or assessment costs to be paid out of the Scottish budget.
2.14 There is another advantage from this simplified scheme. There is absolutely no incentive for firms to try to shift profits to the lower tax zone, create market distortions by manipulating transfer prices, or set up a shadow head office in the lower tax zone. Instead, there is an incentive to shift real economic activity to the lower tax zone; and to shift it either to increase employment or to increase high value added/high productivity investment there. This follows directly from the formula for $z$, and from the fact that the more firms shift their high productivity operations to the lower cost zone the higher will be their (retained) profit margins. That is why corporation tax, at least in this form, is a genuine lever for creating growth, jobs, higher value investment and higher total factor productivity, in a way that a devolved income tax is not.

3. Numerical Evidence: Corporation Tax and Growth or Investment

3.1 One of the key questions is the relationship between corporation tax and investment and economic growth. This was the subject of a recent paper in the American Economic Journal looking at the effects of corporation tax in 21 OECD economies by Djankov et al. That paper concludes: “The results show no statistically significant effect of the statutory tax rate on investment but a large effect of that rate on FDI. The effects of effective rates (of corporation tax) on both investment and FDI are statistically significant and large. The estimates indicate that raising the first-year effective tax rate by 10 percentage points reduces the investment rate by 2.2 percentage points (average investment rate is 21.5 percent) and FDI rate by 2.3 percentage points (average FDI rate is 3.36 percent”).

3.2 This leads to two conclusions. First the empirical record shows that reducing the ‘headline’ rate of corporation tax can be expected to trigger an increase in inward investment – wholly consistent with economic theory. Second that the ‘headline’ rate of corporation tax interacts with other fiscal levers to determine the effective rate of corporation tax, and that reducing the effective tax rate can be expected to trigger not only increased inward investment but, additionally, an increase in domestic investment and entrepreneurship. The effective rate of corporation tax is the statutory ‘headline’ rate adjusted for all deductions as well as depreciation provisions, R&D credits and the like going forward. The effective rate of tax therefore includes changes in the rules governing corporation tax liability (the tax base) beyond simple adjustments in the statutory rate. Devolving control over corporation tax would empower the Scottish Government to influence the effective rate of corporation tax, and not simply the ‘headline’ or statutory rate.

3.3 The Djankov et al (2010) paper provides more direct evidence on business conditions: for the OECD countries, a 10% reduction in corporation tax (or factors that reduce that tax liability, such as R&D credits) improves growth by 1%-2%12, the number of entrepreneurs from 3 to 5 per 100 population; and company registrations by 20%. These are significant figures because the numbers of entrepreneurs, and especially company births, in Scotland are well below UK averages.

4. The Volatility of Different Tax Revenues by Source

4.1 The principal reason the Calman Commission gave for ruling out devolving North Sea revenues was on the grounds of their volatility. It is easy to calculate the standard deviations of Scottish grant revenues (from GERS data, 2003-09); Scottish north sea revenues (GERS, 1995-2009), Scottish income tax revenues (GERS, 1999-2009), and Scottish corporation tax revenues (GERS, 1998-2010). These are rough and ready hand calculations, but the standard deviation is the standard measure of variability or volatility in any statistical textbook. The results in this case were:

Grant income 4761; North Sea revenues 2941;
Income tax revenues 1673; Corporation tax revenues 377.

So, following Calman’s own logic, the Commission should have recommended devolving corporation tax before income tax, and North Sea revenues before the Grant.

4.2 Three points are important to this discussion:
   a) The reason these standard deviation are not ranked as you might expect is because they depend on scale; a given degree of volatility will cause bigger holes in the budget, the bigger is the revenue stream we are looking at;
   b) The uncertainty in oil prices is all on the up side; since 1995 North sea revenues have risen 8 times (by an average of 43%), but fallen 4 times and then by an average of only 8%. So what Calman has done is denied Scotland all the gains, not saved her from the losses;
   c) The OBR is forecasting oil revenues at around £12bn to 2015. People facing savage public spending cuts might legitimately ask why the Scotland Bill is denying them the services they could have had, just to subsidise spendthrifts in London (bear in mind the Scottish budget with North Sea revenues would on these numbers be approximately in balance, hence the subsidy).

5. The gains from tax devolution more generally

5.1 Starting from first principles, work by Brueckner (2006) has shown that greater fiscal devolution will be unambiguously associated with higher output levels and higher steady state growth rates if taxes move to support the chosen levels of public spending; that is, if tax devolution is included along with spending devolution. This result continues to hold, and robustly so, if tax competition is allowed between regions. But it does not follow if the tax regime involves a shared tax base, as proposed in the Scotland Bill. These arguments therefore imply that greater fiscal devolution should be expected to deliver better economic performance in terms of GDP per head. There is no guarantee, however, if policymakers are incompetent or the economic institutions weak, or if shared tax bases are involved. That is true in any system. And it is especially true in the new Scotland Bill since that, unlike fiscal autonomy, explicitly depends on a shared tax base.

5.2 Moreover Professor Feld, in evidence to the Scottish Parliament’s first Scotland Bill Committee, stated that:
“Revenue decentralisation has the expected positive effect on productivity, and is consistently highly significant. Expenditure decentralization, however, has a robust and highly significant negative effect on productivity…” (paragraph 21).

Thus, devolving revenue powers elsewhere has delivered a positive and highly significant effect on economic performance, GDP/head, whereas expenditure devolution has had a significant negative effect on performance. That again suggests that the present Scotland Bill, where devolution is to remain 85% expenditure based, will be unhelpful – if not likely to hold the Scottish economy back.

5.3 **Direct empirical evidence:** There are many studies that report devolving tax powers leads to higher incomes per head. For example, there are several studies of OECD countries (e.g. Germany, Switzerland) that show that improvements in GDP per head come with tax and spending devolution – for example two by Thiessen; and another six studies cited by Hallwood and MacDonald.

5.4 Second, a look at the performance of the regions with devolved taxes in Spain, relative to the non-autonomous regions of Spain, shows the same thing. In Navarra, GDP/head grew from 25.9% above the non-autonomous average, to 29.3% above between 1995 and 2009. In the Basque lands, GDP per head rose from 19.3% to 34.2% above that average. This is an effective “controlled” experiment because no other institutional changes were made in that period, apart from the introduction of fiscal autonomy in 1995. The point is not that these two regions were richer than the rest of Spain. They were richer, but the point is they increased the degree to which they were richer after tax devolution was brought in. These gains represent increases in GDP per head of between 0.25% and 1.06% per year over the period indicated.

5.5 The unemployment rates are instructive too. Unemployment has risen in all of Spain, but the rates in the Basque country (10.9%) and Navarra (11.6%) has remained at about half the non-autonomous Spanish rate (20.3%) throughout the current recession to 2011. However, non-autonomous Catalonia suffered, with unemployment rising 18% in 2010. It appears that fiscal autonomy, sensibly managed, can help us weather a recession better than a centralized system. As a result the Basque credit rating remained AAA when that of Spain fell to AA.

5.6 A simple way to check on the generality of this evidence is to compare GDP/head to the share of revenues devolved across different countries. We use data from the IMF’s “World Economic Outlook” October 2010, and “Government Financial Statistics” for 2008, for a group of countries comparable to Scotland: UK, Switzerland, Sweden, Canada, Netherlands, France, Germany, Spain, and the US. Note several are richer than the UK; but some are poorer or about the same. We are interested in the relationship: \( y=\alpha+\beta.x + u \), where \( y=\text{GDP/head} \), \( x=\% \text{ of revenues devolved} \), \( u=\text{regression error} \) and want to test if \( \beta \) is positive. We get:

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\alpha=33.165; \quad \beta=0.329; \quad R^2=0.392; \quad t\text{-ratio for } \beta, 2.283.
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13 Spanish National Institute of Statistics (January 2011)
The critical value for a one-tail t-test (ie to test for a positive relationship) with 7 degrees of freedom and at a 5% significance level is 1.895. So at all conventional levels of significance, this is a robustly significant positive relationship. It is not even marginal.

6. Evaluation

6.1 The first Scotland Bill Committee made two significant comments about devolving corporation tax to Scotland. First it acknowledged that this was a potentially important lever of economic policy. Second it suggested that if a scheme became available to permit other devolved administrations to set the rate of corporation tax in their jurisdictions then this should also be available to Scotland. We agree wholeheartedly with the first proposition – indeed it explains precisely why we support devolving corporation tax authority to Scotland. The second point, however, serves only to reveal the muddled thinking in that Committee. None of the alleged “downsides” it listed about devolving corporation tax to Scotland are altered should – say – Northern Ireland acquire authority over corporation tax. Either the tax is helpful, or is not. Indeed the implication is that Scotland must acquire offsetting corporation tax power to allow it to initiate the very tax competition so feared (yet not supported by any evidence we can find) by that Committee. It takes two to compete!

6.2 The opposition to devolving corporation tax to the Scottish Parliament and Government is, in our view, at best ill informed. Critics seem prepared to ignore both the predictions from economic theory and the wide range of evidence from empirical investigation. As we have demonstrated in this paper, there is considerable economic evidence supporting the proposition that changes in the effective rate of corporation tax is a key economic policy lever with which to influence the levels of investment and entrepreneurship in an economy. There is, on the other hand, no body of evidence to support the proposition that devolving competence for corporation tax will trigger a “race to the bottom”. On this latter aspect the evidence is virtually unanimous.

6.3 As we have noted elsewhere, the proposals to devolve partial competence for income tax in Scotland to the Scottish Parliament will not increase the economic policy levers at the command of the Scottish Government. Indeed it is likely to make more difficult the task of stabilising the Scottish economy with the tools that are available to it. As the evidence shows, devolving corporation tax will provide this, and future, Scottish Governments and Parliaments with one of the key economic levers it requires if it is to be able to improve the underlying performance of the Scottish economy.

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