Ireland: A Study in the Effectiveness of Corporate Tax Rate Reduction

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Ireland: A Study in the Effectiveness of Corporate Tax Rate Reduction

Abstract: The Republic of Ireland, which until recently had one of the worst standards of living in Europe, experienced a period of tremendous growth throughout the 1990s and early 2000s that revolutionized their economy and society, transforming their country into the “Celtic Tiger.” Much of this growth was due to foreign multi-national corporations (MNCs) investing in the Irish economy. This study attempts to determine whether the increase in foreign direct investment (FDI) inflows was primarily due to Ireland’s reduction in corporate tax rates between 1987 and 2003. Previous studies deal with whether reduction in corporate tax rates is effective in driving FDI or debate which factors played a role in Ireland’s economic growth. This study deals specifically with whether corporate tax rate reduction was the primary driver and concludes that for every percentage decrease in the corporate tax rate, Ireland could expect an approximately four percent increase in FDI. While many consider this a prime way to boost economic growth, there are also potential negative effects, such as a race to the bottom. This should be considered when attempting to pursue such a strategy. In addition, while the primary factor was tax rate reduction, other determinants of national advantage, such as education and infrastructure, were also factors in attracting FDI.

George Bernard Shaw once joked that he would like to be in Ireland when the world ended, as the country was always 50 years behind the times (O’Connor and Ford, 2003). Indeed, Irish economic performance was abysmal for the first half of the twentieth century, to the point that one-seventh of Ireland’s population left the country in the 1950s. After this mass exodus, there were attempts at bettering the economy, but none had outstanding effects. In the 1960s, the Irish liberalized trade, and while economic growth increased, it was primarily because Ireland rode high growth rates in the rest of Europe; in fact, during this time the Irish standard of living actually declined. Furthermore, this period of moderate growth was short-lived. After oil shocks in the 1970s, the Irish government implemented Keynesian policies boosting spending, which did little more than burden the country with debt. By 1986, liabilities were 116% of gross domestic product (GDP), taxes were high, and the economy was only growing around 1.9 percent per year (Powell, 2003). It seemed as if George Bernard Shaw was right—Ireland would never be a global player.

But in the 1990s, the Irish economy finally became a global player. In 13 years, its GDP had more than tripled, exports grew by 4.5 times, the total labor force rose 50%, and unemployment dropped from 12.9% to 4.8%. The Irish exceeded the average EU growth rate by 6%. At the beginning of the 1990s, the typical Irish person made 65%
of what someone in the EU would make; in 2005, they made 135% of the typical EU salary (Harris, 2005). While some may have initially believed that this was only a temporary phenomenon, Ireland has continued to amaze in recent years. In 2015, their GDP increased by 26%, and their GNP increased by 19% (Anderson, 2016).

The transformation of Ireland, from a nation that was struggling economically to the “Celtic Tiger,” has often been attributed to Ireland cutting its tax rates in the late 1990s. Anderson (2016), for example, believes that Irish corporate tax cuts resulted in foreign companies moving their operations to Ireland, while Harris (2005), states that the corporate tax cuts were “shrewd” measures that were partly responsible for Irish economic growth. The purpose of this study is to determine to what extent corporate tax cuts had an effect on Ireland’s transformation from a nation in crisis to an economic powerhouse, specifically in the area of increasing foreign direct investment (FDI), a large factor in Ireland’s economic growth (Harris, 2005). Were Ireland’s low tax rates the reason foreign investors chose to do business there, or were the corporate tax cuts merely a side benefit for businesses that selected the country based on other factors? This study attempts to find the answers to these questions.

Previous studies regarding tax cuts have focused primarily on whether corporate tax cuts attract FDI in general, not compared to other factors. This gives us little idea whether cutting corporate taxes is the most beneficial way to attract foreign companies, or if there are other ways to attract FDI as well as, or better than, cutting tax rates. In addition, previous studies on the Republic of Ireland’s economic growth list many factors that contributed to economic growth but rarely attempt to determine primary factors or the impact of a single factor compared to all others. This study is distinct in that it attempts to determine whether the corporate tax cuts enacted in Ireland were more responsible for the massive growth of the Irish economy than all other factors of growth experienced during that time period.

The implications of this study are quite important. If corporate tax cuts do result in higher FDI, and Ireland’s transition from a struggling nation to the “Celtic Tiger” was primarily as a result of low corporate tax rates, then both developing and industrialized countries would do well to follow Ireland’s example.

Recently, the United States reduced its corporate tax rates, resulting in debate as to whether such an approach was good for the country. Finding that corporate tax cuts were a large factor in Ireland’s transformation and that they resulted in increased inflow of FDI to the country would suggest that not only did the United States make the right decision, but that more countries should follow Ireland’s example and cut their corporate tax rates in order to boost their economy. On the contrary, finding that Ireland’s corporate tax cuts were not the primary factor in its economic transformation would refute the arguments of those, such as Anderson (2016), who argue for their own countries to follow the example of Ireland and cut corporate tax rates.

This study is limited by the fact that Ireland went through major economic changes in the 1990s. The extent and speed of growth experienced in Ireland has not been seen in other countries; hence, the importance of determining the primary growth factors of Ireland, but also the difficulty of comparison with another burgeoning economy in an attempt to establish continuity.

As FDI has become more important for economic growth in recent years, particularly in developing countries, the factors that increase it have been the subject of
many studies. Many researchers are now asking what a country can do to attract FDI, and why foreign multi-national corporations (MNCs) prefer certain countries to others.

**Commonly Accepted Drivers of FDI**

Mijiyawa (2015) found that, particularly in Africa, larger countries tend to attract more foreign investment, but countries with political stability and potential for a high return on investment will attract FDI regardless of their size. There are exceptions, however. In areas of Africa where there were socialist governments or political instability and few natural resources, FDI was low. However, where large amounts of natural resources existed, foreign companies appeared willing to brave these risks. Low growth, poor infrastructure, and small domestic markets are also reasons why foreign companies do not want to invest in a region (Mijiyawa, 2015).

Other researchers have made similar conclusions about regional resources having a large effect on FDI. Two researchers from the University of Lodz determined that human capital is one of the most important factors leading to higher inflows of FDI. Particularly, the education level of the workers, their health and wellness practices, the availability of a workforce, and the cost of labor were very important in determining the FDI inflows to Eastern European countries (Dorozynska & Dorozynski, 2015).

**Profit Motive as Supreme Driver of FDI**

Ascani, Crescenzi, and Iammarino (2017) argue that all actions by MNCs are for the purpose of making a profit. The reason that MNCs seek out a certain location to invest in is because they believe that that location offers the greatest potential for profit. They look for countries with large internal markets and locations where there is potential for easily exporting their finished goods to new markets. The preference for a certain state of government seems to be motivated by profit rather than morals, as there is only a weak relationship between a country’s corruption levels and FDI inflows to that country; many MNCs are willing to invest in corrupt countries as long as there is an opportunity for a high return on investment. Ascani et al. (2017) emphasize this profit-seeking motive by stating, in contradiction to Dorozynska and Dorozynski (2015), that foreign companies actually look for low education levels because it indicates the opportunity for cheap labor. Many sources offer evidence that could be used to support the theory of Ascani et al. For example, much of the information put forward by Mijiyawa (2015) seems to indicate a profit-seeking motive, such as the MNCs’ willingness to risk political instability in order to access natural resources.

The general consensus about FDI inflows seems to be that foreign investors prefer countries with more resources to those with fewer resources; but all things equal, they tend to prefer countries with political stability and favorable governments because these tend to lead to more profits (Ascani et al., 2017; Dorozynska & Dorozynski, 2015; Mijiyawa, 2015).

**The Search for Favorable Governments with Emphasis on Corporate Tax Rates**

The discussion of favorable governments and higher profits leads to the question of why businesses view certain governments as better for business than others. There seem to be multiple facets that contribute to being labeled a favorable government; there is no single factor. Because of this, many governments, especially those in developing nations, try various methods to compete for FDI. One of these methods is allowing
firms to keep more of their profits, helping companies achieve their profit-seeking motive. In order to utilize this method, many countries lower their corporate tax rates or use other forms of tax incentives (Abdioglu, Binis, & Arslan, 2016). The ideal corporate tax rate and the benefits of lowering it have been a subject of many studies.

Many researchers appear decidedly in favor of corporate tax cuts. A research team from Turkey, Abdioglu et al. (2016), found that a lower corporate tax rate has a significant influence on FDI inflows into a country. While the study states that corporate tax rates are not the only factor but that other advantages also come into play, the researchers agree that corporate tax rates have a big impact on FDI (Abdioglu et al., 2016). In addition, Marilena (2017) found that as Romania lowered its corporate tax rates and created various tax exemptions for business, FDI increased. He credits corporate tax cuts with influencing both return on investment and economic growth.

On the other hand, other researchers tend to be skeptical that lowering corporate tax rates is a prime method of attracting FDI. Jim Stanford (2011), a Canadian economist, states that Canada's $745 billion in tax cuts have actually decreased investment by one percent. He found that $6 billion in additional money allocated to tax cuts would only generate about $600 million in private investment (Stanford, 2011). Similarly, Göndör and Nistor (2012) found that most FDI inflows go to more developed economies with higher corporate tax rates. Competition between governments for FDI was not over corporate tax rates, but over which country had a better fiscal policy. In fact, these researchers claim that a government that uses a high corporate tax rate to fund public goods that improve the business environment is more likely to attract FDI (Göndör & Nistor, 2012). One limitation of many of these studies is that they primarily focus on countries quite distinct from Ireland, with a more established history of business that may have attracted more FDI because they were generally accepted as strong economies in the first place.

Many sources list favorable governments as a main driver of FDI, but they fail to describe what makes a government favorable or how much influence favorable governments have in terms of attracting FDI. One key gap in the research is that there were few studies about what attracts FDI to industrialized countries. Many of the countries studied were in areas of strife with little manufacturing capacity; the sole reason for doing business in these countries was to extract valuable natural resources. This allows for little comparison with Ireland, a country with comparatively less strife but with few natural resources. A larger issue with existing research is that while studies argue about whether low corporate tax rates lead to higher FDI, no studies cover the growth due to the increase in FDI in Ireland, which occurred about the same time as the corporate tax cuts. This study attempts to fill this gap in the research and ascertain whether this growth was due to the tax cuts, or merely happened to come about at the same time the tax rates were lowered.

**Link Between Ireland’s Tax Rates and FDI**

Davies, Siedschalag, and Studnicka (2016) suggest that Ireland’s economy is largely boosted by its low corporate tax rate. They found that an increase in the Irish corporate tax rate by one percent would reduce the probability of FDI investment from fellow EU members by 0.4% and from non-EU countries by a staggering 4.6% (Davies, Siedschalag, & Studnicka, 2016). This sensitivity to corporate tax rate changes is
the highest in the European Union. Additionally, Anderson (2016) credits Ireland’s economic growth to its tax policy, suggesting that the United States could “end its economic malaise” by cutting taxes and stating that Ireland’s policies toward corporate taxation are the reason it is “the one Western country that is actually growing.”

Hynes and O’Connor (2014), writing a literature review for An Roinn Airgedais, the Irish Department of Finance, found similar statistics, although their attempt to vigorously defend their country’s corporate tax decisions may have resulted in a bit of bias. They discovered a negative relationship of between 0.6% and 1.8% on economic growth for each one percent increase in corporate tax, as well as a 3.72% decrease in FDI for every one percent increase in the corporate tax rate (Hynes & O’Connor, 2014). Moreover, they cite a 2008 study by Arnold et al. that considers corporate tax as the form of taxation most damaging to growth (as cited in Hynes & O’Connor, 2014).

Although these studies seem to suggest that Ireland’s greatest strength is its tax policy, it also might be the country’s greatest weakness. Were the United Kingdom (pre-Brexit) to have decreased its corporate tax rate by just one percent, Ireland’s advantage would have decreased by 0.3%. Moreover, researchers have found that corporate cuts are much more effective for attracting investment from MNCs in the service industry, while manufacturing countries tend to be less sensitive to tax rates. Similarly, countries from outside the EU tend to be much more influenced by tax cuts, while EU-based companies tend to choose to invest in countries with a larger market size and other local advantages (Davies et al., 2016). These studies tend to suggest that while cutting corporate taxes can boost the economy, there are dangers with relying on tax cuts to become a favorable government for FDI.

**Causes of Ireland’s Growth**

These studies analyzing the links between Ireland’s corporate tax rates and FDI suggest that Ireland’s economy is highly sensitive to corporate tax rates, but has it always been this way? Did the tax cuts of the 1990s and 2000s open Ireland up to a new group of competitors that were highly sensitive to low corporate tax rates, creating the “Celtic Tiger” and allowing the economy to reach its current position? It is crucial to analyze what happened around the time Ireland lowered its corporate tax rates and determine if there were other major changes that could have led to the rise of the Celtic Tiger.

With regards to Ireland’s history and growth, it is incontrovertible that Ireland was formerly a very poor country and far behind the times, only to experience a surge of growth in the 1990s (Harris, 2005; Rios-Morales and Brennan, 2007; O’Connor and Forde, 2003; Powell, 2003). Yet, beyond this, there is some disagreement about the reason behind the change. Harris (2005), a scientist publishing in Issues in Science and Technology, credits much of Ireland’s growth to education, membership in the European Union, and an emphasis on attracting investment, mentioning the corporate tax cuts last and as only one part of the solution, and suggesting that Ireland would not have become the Celtic Tiger if it had only cut corporate tax rates without utilizing the other three drivers of growth.

Benjamin Powell (2003), similarly, does not give the tax cuts a lot of credit. Instead, he views them as “the final missing piece.” Yet, writing for a journal with an admitted libertarian bias, his conclusions must be questioned more closely. Powell credits Ireland’s economic growth almost entirely to a decrease in government spending. While he seems quite confident, his argument for this theory is actually
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quite weak. Furthermore, his admission that the tax cuts came around the time of the massive “tiger growth,” years after government spending had been cut, is one more piece of evidence that suggests the corporate tax cuts did make an impact. Without other evidence, though, such an assumption is very weak.

Rios-Morales and Brennan (2007) use a very similar argument to Harris (2005), crediting Ireland’s growth largely to its improvement with regards to the Porter’s diamond of global competitive advantages, specifically the development of an educated labor force and an increase in the availability of infrastructure. Rios-Morales and Brennan (2007) barely even mention tax cuts as a factor in Ireland’s growth and competitive advantage in FDI, and when they do, they mention that low taxes existed in some form since 1954. While this seems to weaken the argument that the increase in FDI resulted solely from the lowering of taxes, a review of the history of corporate taxation in Ireland is necessary.

History of Corporate Tax Rates in Ireland

An Roinn Airgedais commissioned a report on the history of their tax structure since the early 1800s. This report makes the discussion of Ireland’s tax rates far clearer, and helps identify why the low taxes that existed since the 1950s did not do much to benefit Ireland, as well as what caused the tax cuts in the 1990s and 2000s to revitalize the economy.

In 1956, Ireland haltingly took their first step toward tax reform by implementing a complicated tax cut on exports (one with an explanation that would be long and unnecessary). By 1960, this tax cut was simplified (Walsh & Sanger, 2014). However, this early tax break only applied to manufacturing exports, which, as it has already been established, are not very sensitive to corporate tax cuts (Davies et al., 2016).

Little in terms of actual tax rates changed until 1981, when Ireland offered a 10% effective tax rate for, again, manufacturing profits (although the definition of manufacturing was later expanded to include certain services). However, the laws were unclear and the 1980s and early 1990s were a time of chaos, as the regular corporate tax rate was 50% and lawsuits abounded as companies endeavored to stretch the definition of manufacturing to include things like the ripening of bananas in order to apply the coveted 10% tax rate (Walsh & Sanger, 2014).

Ireland’s GDP growth, which picked up in the early 1990s and steepened in the mid-90s, largely coincides with the first non-discriminatory corporate tax cuts (the overall tax rate was cut by 10% between 1987 and 1991) and a steady corporate tax rate reduction between 1995 until 1998, when Ireland announced a 12.5% tax rate that was to gradually take effect by January 1, 2003 (Harris, 2005; Powell, 2003; Trading Economics, 2018; Walsh & Sanger, 2014). While the tax rates were not yet particularly low in the early 1990s, the economic growth was likely spurred along by an increase in globalization combined with the expansion of the definition of manufacturing to include more services. In addition, as the tax rates kept lowering and rumors continued to spread regarding Ireland’s intent to keep reducing tax rates, MNCs may have been willing to take a gamble on further reductions. Finally, as the 10% tax rate began to apply to more service-oriented firms, it would have attracted foreign MNCs most sensitive to lower tax rates (Davies et al., 2016; Trading Economics, 2018).
Alternatives to the Corporate Tax Theory

While some argue that the main reasons for Ireland’s growth were better education, membership in the European Union, and better infrastructure, there is little evidence to support that these were the reasons behind Ireland’s transformation into the “Celtic Tiger.” Education reforms began 40 years before 1990, and it seems highly unlikely that these reforms that had taken place decades before would suddenly kick the economy into high gear in just a few years (Harris, 2005). Ireland joined the European Economic Community (EEC) in 1973, which did little to help its struggling economy (Powell, 2003); the European Union seems to have made little more impact. Aid from the European Union also did little to create “tiger growth” in other countries besides Ireland.

Crediting the infrastructure improvements for the “tiger growth” is outright ridiculous. A news article published on an Irish website in 2017 states that “Ireland’s infrastructure is completely mediocre” (Hosford, 2017). The article goes on to discuss a report that gave much of Ireland’s infrastructure a C grade, and how the infrastructure problems lay in “a legacy of lousy planning,” alluding to a history of poor infrastructure (Hosford, 2017). If Ireland’s infrastructure is that bad now, how was it attracting waves of foreign investors twenty years ago? While one might say that infrastructure was drastically worse before the early 1990s, and the European Union’s improvements to roads, ports, and communications created more opportunities for MNCs, it still begs the question: If companies were seeking a host country based on the quality of infrastructure, why did they choose Ireland?

The improvements in education, infrastructure, and joining the European Union were not the primary causes of Ireland’s transformation, though they were likely secondary factors. The real cause of Ireland’s economic growth was that through lowering corporate taxes, Ireland allowed profit-sensitive MNCs to see that there was an opportunity for gain in their country. A country with no advantages aside from a low corporate tax rate, however, may still find it hard to attract FDI, as foreign MNCs look to invest in the country that enables them to make the highest profits (Ascani et al., 2017; Davies et al., 2016; Göndör & Nistor, 2012). While a country with tax advantages may increase business profits, additional advantages will clearly draw even more investors. Therefore, while better education, membership in the European Union, and infrastructure improvements did not cause the “tiger growth,” they may have aided in it once the corporate tax breaks led to MNCs recognizing Ireland as a potentially advantageous place to invest.

Other Corporate Tax Cuts as a Driver of FDI

Two additional questions lie behind the link between corporate tax cuts and increased FDI inflows to Ireland: Is it replicable, and what other requirements are needed to attract FDI besides lowering taxes? If lowering corporate tax rates in other countries is shown to increase FDI at a similar rate, it strengthens this study’s argument that the corporate tax cuts in Ireland were the cause of Ireland’s increase in FDI and resulting economic growth. Ireland’s drastic change in the corporate tax rate from 50% to 12.5% must be taken into account (Walsh & Sanger, 2014; Trading Economics, 2018). Such a large tax decrease resulted in a huge increase in growth, a change that will likely be less pronounced in other countries due to the fact that most countries will not or cannot cut their tax rate by such a large amount. However, if Ireland’s example can be imitated, a change in a country’s corporate tax rates should result in an increase
in FDI. Several locations have made changes to their corporate tax rates in recent years, resulting in an opportunity to analyze what effects these adjustments have had.

In 2002, Russia gave many of their individual provinces freedom to lower their corporate tax rates but forbade them to liberalize in other ways. Given this option, the provinces made one of three choices: not to change the tax rate, to cut taxes across the board for all investment profit, or to offer tax breaks for only government-sanctioned investment projects. This created a prime opportunity, complete with a control group, to analyze the effects of corporate tax cuts on FDI (Baccini, Li, & Mirkina, 2014).

This study, conducted by Baccini et al. (2014), is especially reliable, because the researchers controlled the study to remove, as far as possible, differences in risk and investment climate that may have made tax cuts appear more or less effective than they actually were. They concluded that regions that cut taxes across the board received a disproportionate amount of FDI compared to those who either did not change tax rates or gave preferential treatment to government-approved projects (Baccini et al., 2014). While this research suggests that preferential tax breaks are ineffective, it could be argued that projects approved by a statist government differ widely from tax breaks for particular industries. However, this research does strongly imply that across-the-board tax cuts do increase FDI.

Bellak and Leibrecht (2009) came to similar conclusions as they analyzed the flows of FDI in Central and Eastern Europe. They found that for every one percent increase in corporate tax rates, FDI decreases by 4.3% (Bellak & Leibrecht, 2009). However, they discovered that corporate tax rates are not the sole driver of investment; factors such as market size, distance, and labor costs also have an effect on FDI (Bellak & Leibrecht, 2009).

Finally, the United States’ recent corporate tax cut appears likely to benefit the country by attracting more FDI. While the movement of capital takes time, and little empirical data has been accumulated up to this point to evaluate whether the United States’ decision has led to increased FDI, analyses done by foreign countries reveal that researchers expect the United States to benefit. A news article published soon after the tax reform was announced quotes a United Nations analysis that states the lower tax rate will increase the attractiveness of the United States to foreign firms (Hannon, 2018). It then gives an example of Novo Nordisk A/S, a Danish company that chose to acquire assets in the United States following the tax break (Hannon, 2018).

The Zentrum für Europäische Wirtschaftsforschung (Centre for European Economic Research) published a report in anticipation of U.S. tax cuts, discussing what the potential effects would be. The researchers worried that U.S. businesses may start to lose interest in investing in European countries, such as Germany, because the tax rates in those countries would be higher than the U.S. tax rate after tax reform (Heinemann et al., 2017). They expect a huge increase in FDI to the United States; for example, they determined through simulations that German FDI into the United States could increase by up to 25% after tax cuts (Heinemann et al., 2017). At the same time, they expect U.S. FDI into the EU to go up by a much smaller amount (Heinemann et al., 2017). As written in the report, the United States will become “significantly more attractive” to FDI (Heinemann et al., 2017). The authors worried about the potential disadvantage countries like Germany with higher tax rates may be placed at as local businesses move more of their operations to countries like the United States (Heinemann et al., 2017).

The uniformity throughout all these studies suggests a clear pattern. If corporate
tax cuts were only loosely correlated with FDI, one could expect researchers from different countries studying vastly different economies to discover different sensitivities of FDI to every one percent change in the corporate tax rate. However, FDI flows (except inter-EU FDI) change by between 3.7-4.6% for every one percent change in the corporate tax rate, regardless of the country being studied. This is even true for the United States. Initially, it may appear that the United States decreased its tax rate much more than it did, as it dropped from a 39% tax rate on the top bracket of corporations to a 21% flat tax rate. In reality, however, the United States had an average effective tax rate of 27.1%. Therefore, President Trump’s tax cuts resulted in a 6.1% decrease in the effective rate. If the 25% increase in FDI from the German study’s simulations are assumed correct, this results in an approximately 4.1% increase in FDI for every one percent decrease in the corporate tax rate (Gravelle, 2014).

It appears, then, that corporate tax cuts are not only an important factor in increasing FDI to Ireland, but that many countries can take advantage of the benefits of lowering corporate tax rates, especially those that possess other factors valuable to MNCs looking for a place to invest. Everything else equal, a country that has lower tax rates will receive more FDI than a country with higher tax rates. The implication of this finding is that countries should, and will, lower their corporate tax rates if government representatives wish to increase economic growth. This could lead to a wave of corporate tax cuts throughout the world.

An issue with countries receiving the benefits of tax reform has to do with pushback from political parties and voters who believe that corporate tax cuts are not helpful. Such was the case in the United States in 2017. Many voters who were less informed opposed the corporate tax cuts. Democracies around the world risk being left behind when other nations choose to cut taxes but voters elect government officials who refuse to move toward tax reform, resulting in a potential economic slowdown as they lose FDI to countries with lower tax rates.

Conclusion

While secondary factors did come into play, corporate tax cuts were the primary driver in the allocation of FDI to Ireland. Lowering corporate tax rates turned Ireland from a struggling economy into the “Celtic Tiger.” Because of Ireland’s excessively high tax rates to begin with, the growth was particularly notable.

The examination of the history of tax rates in Ireland indicated why certain tax breaks did little to help the economy while others had major effects. Some studies brought up certain factors that are believed to be primary factors in the increase of FDI to Ireland, but this study showed why there appears to be little correlation between these factors and Ireland’s economic growth. Finally, the similar correlation of 3.7-4.6% change in FDI per every one percent change in the tax rate, regardless of the country studied or other economic policies enacted, is further proof that Ireland’s tax cuts resulted in the country’s metamorphosis from one of the worst economies in Europe 30 years ago to its current status as economic powerhouse. George Bernard Shaw, were he alive today in Ireland, might find the world ending there 50 years sooner than anywhere else.
Race to the Bottom

This paper would not be complete without a word of caution in regards to countries following the example of Ireland and cutting corporate tax rates. This study suggests that lowering corporate tax rates, ceteris paribus, leads to economic growth. But, as indicated by Davies et al. (2016), nearby countries lowering their tax rates decreases the economic advantage of the country in question. If every country in the world were to seek to grow their economies in this manner, it would, theoretically, lead to all nations eventually having a 0% corporate tax rate, as each country would undercut the other in a bidding war for the lowest rates and the most FDI (often called a “race to the bottom”). With a 0% corporate tax rate, tax would no longer be a factor in FDI inflows and countries would begin looking for other ways to attract FDI. A 0% corporate tax rate would be undesirable for national interests, yet countries would fear to raise their corporate tax rates because they would risk losing FDI. While this is unlikely to happen in the short run due to the reticence of many governments to reduce taxes, seeking to undercut competing countries by lowering corporate tax rates may become harmful as more governments seek to do so.

Recommendations

While evidence does seem to show that lowering corporate tax rates will increase FDI inflows, many countries would do well to think in the long-term. The potential for a “race to the bottom” should give countries pause as they think about attempting to undercut each other in a bidding war for the lowest corporate tax rate. Instead, countries should attempt to modernize their tax rate to the level of other regional players, and then work on things such as education, infrastructure, and other potential drivers of FDI that can benefit both citizens and foreign MNCs.

Smaller countries and those less likely to become powerful economic players through large receipts of FDI should think of other potential solutions to economic growth than slashing tax rates. While lowering their corporate tax rates to a reasonable rate is perfectly acceptable, competing solely on the basis of taxes will not benefit their citizens or the world in the long run. Instead, it would be better for these countries to focus on other ways to attain economic prosperity.

Cutting taxes is more of a short-term solution than a long-term one; and as such, this strategy should be used sparingly and in order to level the playing field with other countries offering lower tax rates. It might be wise for international governing bodies to pass a recommendation for an acceptable minimum corporate tax rate. While there is a risk of a few countries attempting to “free-ride,” to a large extent this may help prevent a race to the bottom. A low corporate tax rate may boost economic growth in the short run, but are the potential negative effects in the long-term worth it? This is an important question that should be carefully considered.

Opportunities for Further Research

Further investigation could be conducted into the United States’ corporate tax cuts, particularly after they have been given time to make an impact, to confirm that corporate tax rates have the same inverse relationship with FDI across the board. In addition, more in-depth investigation could be conducted into other variables regarding the FDI increase in Ireland in order to determine how much of an impact they had compared to the
corporate tax cuts. Also, a more in-depth study into Ireland’s financial and tax situations for each year of the 1980s and 1990s might be able to pinpoint the optimum corporate tax rate, as well as whether Ireland did too much or too little with regards to tax cuts.
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