

# Competitive Corporate Tax Policy Is Essential for European Economic Growth

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## Key Findings

- In a more geopolitically hostile world, economic growth matters not only for individual opportunity but also as the foundation of governments' ability to defend their values and interests in international conflict.
- Too often, tax reform discussions focus on headline rates without considering the tax base and how specific taxes interact with the broader fiscal framework.
- Tax Foundation's *International Tax Competitiveness Index (ITCI)* provides a useful tool for evaluating the efficiency of tax systems and their support of long-term capital formation and growth.
- Countries with more competitive overall tax systems (as measured by the *ITCI*) tend to perform better economically.
- An improvement by one standard deviation in the corporate category score (14.3 points) translates into roughly 1 percentage point higher annual GDP per capita growth and a cumulative 2.29 percentage points over three years.
- EU tax policy harmonization can support economic growth only if the harmonized policies reduce frictions between Member States and improve their systems compared to the national status quo.

## Introduction

Debates over tax fairness and anti-avoidance rules have dominated European tax policy circles for over a decade. However, as geoeconomic pressures increase around the world, policymakers are looking for ways to boost European competitiveness and economic growth.<sup>1</sup>

The current global economic context underlines the urgency of this challenge. The European Commission has forecasted gross domestic product (GDP) growth of 1.4 percent in 2026 and 1.5 percent in 2027, while deficits are expected to rise to 3.4 percent of EU GDP.<sup>2</sup> At the same time, International Monetary Fund (IMF) forecasts indicate that economic growth in North America (2 percent), South America (2.2 percent), Asia and Pacific economies (4.1 percent), and Africa (4.3 percent) will significantly outpace growth in the EU in 2026.<sup>3</sup> These trends highlight the need for policymakers at both the EU and national levels to prioritize policies that strengthen economic growth and competitiveness.

European countries face difficult economic headwinds, such as declining populations, increasing welfare costs, and energy security risks, but that makes the renewed focus on economic growth more, not less, critical to compete with other global powers. Driving investment in important sectors, reducing foreign dependencies, and increasing the cost of losing EU market access all rely on a predictably growing economy in the future, not only in absolute terms but also relative to potential adversaries.

The question for policymakers is therefore how to design sound tax policies to support stable economic growth over time. This is particularly important when fiscal pressures, such as the demands of defense spending and support for aging populations, reduce a government's flexibility. In short, policymakers need to know how to raise revenue as efficiently as possible because the room for error is shrinking.

This paper examines how the design of a country's tax system affects economic growth, and what role European-level harmonization should play.

## Tax Competitiveness and Economic Growth Go Beyond the Statutory Rate

Rather than focusing only on individual tax rates, we consider whether the broader structure of taxation—the overall tax mix, the treatment of investment, the neutrality of tax bases, and the complexity of tax rules—is associated with stronger economic performance. This distinction matters because countries can raise similar amounts of revenue through very different tax systems, with different consequences for growth. Our focus is on Europe, where tax burdens are often relatively high, but where tax structures vary substantially across countries.

The relationship between taxation and growth has long occupied a central place in economic research. Early cross-country studies suggested that tax structure may matter for long-run growth, but the

1 European Parliament, "The policy priorities of the von der Leyen II Commission," 2025, [https://www.europarl.europa.eu/RegData/etudes/IDAN/2025/775898/EPRS\\_IDA\(2025\)775898\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/IDAN/2025/775898/EPRS_IDA(2025)775898_EN.pdf).

2 European Commission, "Autumn 2025 Economic Forecast shows continued growth despite challenging environment," Nov. 17, 2025, [https://economy-finance.ec.europa.eu/economic-forecast-and-surveys/economic-forecasts/autumn-2025-economic-forecast-shows-continued-growth-despite-challenging-environment\\_en](https://economy-finance.ec.europa.eu/economic-forecast-and-surveys/economic-forecasts/autumn-2025-economic-forecast-shows-continued-growth-despite-challenging-environment_en).

3 International Monetary Fund, "Global Economy in Flux, Prospects Remain Dim," October 2025.

results were sensitive to specification choices and control variables.<sup>4</sup> Another key study showed that estimated tax effects often changed significantly depending on the empirical framework.<sup>5</sup> Later contributions argued that some taxes may be more growth-friendly than others, particularly indirect taxes relative to direct taxes.<sup>6</sup> Subsequent work, however, questioned the robustness of these rankings. While theory strongly suggests that taxes influence incentives to invest, work, and innovate, empirical evidence has often remained mixed.

One reason for these mixed findings is measurement. Many studies rely on tax revenue data, yet revenues rise and fall automatically with the business cycle. When growth is stronger, revenues increase even without policy reform; when growth weakens, revenues decline. This makes it difficult to isolate genuine policy effects. More recent studies have therefore turned to statutory tax rates. A recent paper assembled a cross-country dataset of top corporate income tax, personal income tax, and value-added tax (VAT) rates, supplemented by selected base measures.<sup>7</sup> The conclusion was striking: the paper found no statistically robust medium-term growth effects of changes in these headline rates.

This paper builds on the view that headline rates may be too narrow a proxy for the true economic burden of taxation. Two countries can have identical corporate tax rates while offering very different depreciation rules, loss carryforwards, selective incentives, or cross-border tax treatment. These broader features affect investment incentives, firm location decisions, innovation, and productivity. To capture these dimensions, we use Tax Foundation's *International Tax Competitiveness Index (ITCI)*, which measures tax systems across five pillars: corporate taxes, individual income taxes, consumption taxes, property taxes, and cross-border tax rules. The *ITCI* combines tax rates with indicators of tax-base design, focusing on indicators of economic neutrality and simplicity.

Using data for 23 European and comparable Organisation for Economic Co-operation and Development (OECD) economies from 2014 to 2024, the underlying paper estimates panel regressions linking changes in tax competitiveness to changes in real GDP per capita growth.<sup>8</sup> The empirical strategy compares countries to themselves over time while controlling for country-specific characteristics and common year shocks. Additional controls include income levels, education, inequality, redistribution, foreign direct investment, institutional quality, and investment shares. This approach allows us to focus on whether improvements in tax design are associated with stronger growth performance.<sup>9</sup>

## The Importance of the Overall Tax Mix

A central finding is that the overall competitiveness of the tax system matters for growth. Improvements in the aggregate *ITCI* score are positively associated with stronger GDP per capita growth, particularly once standard controls are introduced. Across specifications, the coefficient remains positive and stable, indicating that countries with more competitive overall tax systems tend to perform better economically.

4 Robert J. Barro, "Economic growth in a cross section of countries," *The Quarterly Journal of Economics* 106:2 (1991): 407-443; Young Lee and Roger H. Gordon, "Tax structure and economic growth," *Journal of Public Economics* 89:5-6 (2005): 1027-1043.

5 William Easterly and Sergio Rebelo, "Fiscal policy and economic growth," *Journal of Monetary Economics* 32:3 (1993): 417-458.

6 Hüseyin Sen and Ayşe Kaya, "Do revenue-neutral tax swaps boost growth?" *Journal of Economic Policy Reform* 26:4 (2023): 401-420; Jens Matthias Arnold, Bert Brys, Christopher Heady, Asa Johansson, Cyrille Schwellnus, and Laura Vartia, "Tax policy for economic recovery and growth," *The Economic Journal* 121:550 (2011): F59-F80.

7 Laura Kawano, John S. Olson, Joel Slemrod, and Meng Hsuan Hsieh, "How taxes affect growth: evidence from cross-country panel data: L. Kawano et al.," *International Tax and Public Finance* (2025): 1-70.

8 Michael Christl and Monika Köppl-Turyna, "Competitiveness of the tax system and economic growth," GLO Discussion Paper, 2026.

9 Readers interested in the econometric framework, model specification, and robustness tests are referred to the accompanying technical working paper on which this publication is based: Michael Christl and Monika Köppl-Turyna. "Competitiveness of the tax system and economic growth."

This result shifts attention away from isolated tax instruments and toward the tax system as a whole. Too often, tax reform discussions focus on one visible rate—for example, the corporate tax rate or the VAT rate—without considering how that tax interacts with the broader fiscal framework. In practice, households and firms respond to the combined effect of multiple taxes and rules.

A country with moderate rates but a broad, neutral, and predictable tax base may perform better than a country with lower headline rates but a narrow, distortionary, and complex tax code. Similarly, a country that relies heavily on taxes that discourage labor supply or investment may experience weaker growth even if total tax revenues are similar to those of its peers. The findings therefore suggest that policymakers should think first in terms of the overall tax mix. Growth-friendly tax policy is less about one “good” or “bad” tax and more about whether the system raises revenue efficiently while limiting unnecessary distortions.

This broader perspective is consistent with earlier literature emphasizing tax composition rather than tax levels alone. It is the mix between direct and indirect taxes that matters for growth.<sup>10</sup> Our findings extend that insight by suggesting that not only the composition, but also the structural quality of the overall system is relevant.

## When Broad Reform Is Difficult, Corporate Tax Reform Matters Most

Although comprehensive reform is economically desirable in principle, it is often politically difficult in practice. Political constraints, coalition bargaining, fiscal pressures, and administrative limits frequently prevent governments from redesigning the full tax system at once. In such circumstances, policymakers need to know where targeted reforms are most likely to improve growth.

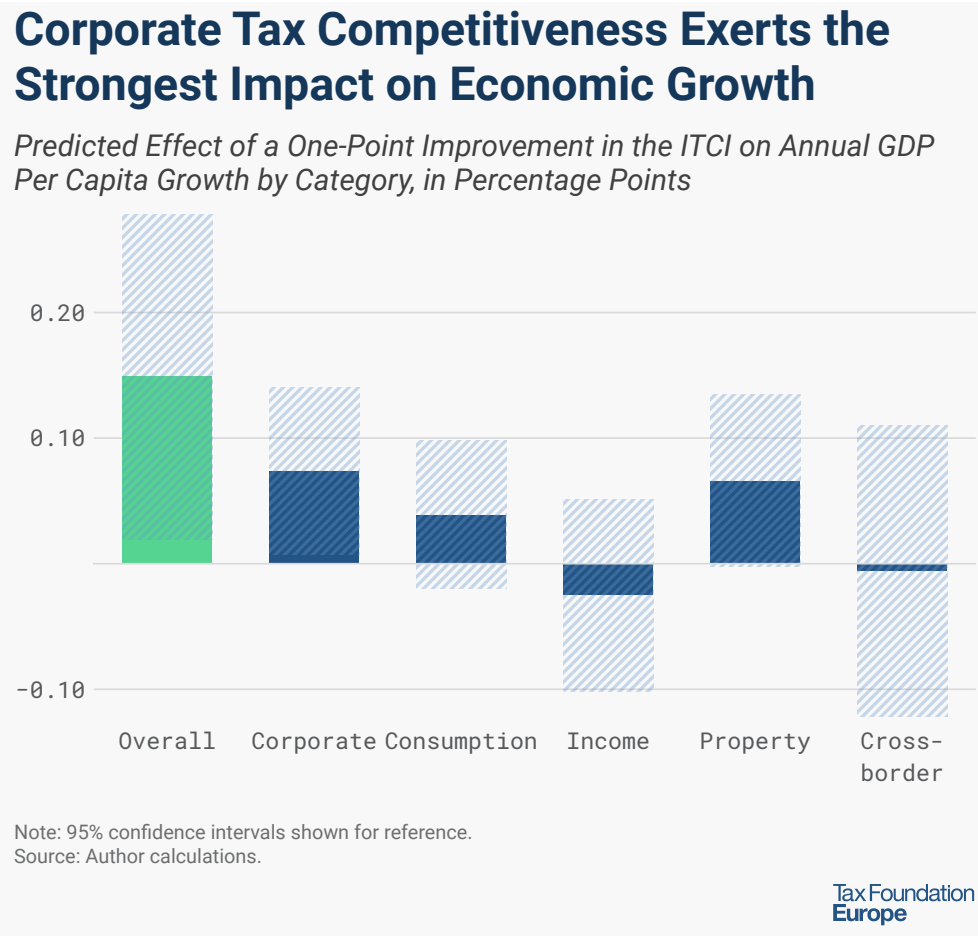
Our evidence points clearly to one area: the corporate tax system. When we decompose the overall tax competitiveness index into its five pillars (Figure 1), the corporate component is the only category that shows a robust and consistent positive association with growth across the main specifications.<sup>11</sup> In the static estimates, a one-point improvement in the corporate tax competitiveness score is associated with roughly 0.07 percentage points higher annual GDP per capita growth. In the dynamic estimates, the cumulative effect rises to around 0.16 percentage points over a three-year horizon.

A one standard deviation improvement in the corporate category score equals 14.3 points over the observed period. This translates into roughly 1 percentage point higher annual GDP per capita growth and 2.29 percentage points over three years for a one standard deviation improvement. For the year 2025, the corporate score ranges between the lowest result of 28.54 points for France and the standardized maximum score of 100 points for Latvia.

10 Jens Matthias Arnold, Bert Brys, Christopher Heady, Asa Johansson, Cyrille Schwellnus, and Laura Vartia, “Tax policy for economic recovery and growth,” *The Economic Journal* 121:550 (2011): F59-F80.

11 The *ITCI*'s corporate component is comprised of 14 variables, including, but not limited to, the statutory corporate rate. For more information, see Alex Mengden, *2025 International Tax Competitiveness Index*, Tax Foundation, [https://taxfoundation.org/wp-content/uploads/2025/10/International\\_Tax\\_Competitiveness\\_Index\\_2025\\_10-21.pdf#page=63](https://taxfoundation.org/wp-content/uploads/2025/10/International_Tax_Competitiveness_Index_2025_10-21.pdf#page=63).

Figure 1.



These are meaningful magnitudes, particularly in Europe's low-growth environment, where even modest improvements in annual growth rates accumulate substantially over time.

This does not mean that only corporate taxes matter. Consumption taxes, personal income taxes, property taxes, and international tax rules remain relevant for economic growth and the efficient allocation of resources, as well as distributive and revenue goals. Rather, it means that within the sample and time horizon examined here, reforms to the corporate tax framework appear to generate the clearest measurable growth payoff, consistent with economic theory.

## Why the Corporate Tax System Stands Out

The corporate tax result is economically plausible. Business taxation directly affects investment incentives, the cost of capital, financing choices, entrepreneurship, and the location of productive activity. These channels are closely linked to productivity growth and medium-term economic expansion.

Importantly, the relevant lesson is not simply that lower corporate tax rates increase growth. Our findings relate to the competitiveness of the main features of the corporate tax base in addition to the statutory rate.

This includes how much of their investment costs firms can deduct from taxable income in real terms through depreciation, amortization, or expensing; how well losses can be carried forward or backward; the relative treatment of debt versus equity financing; the taxation of retained versus distributed earnings; the presence of various surtaxes, minimum taxes, or overlapping levies; and the intensity of complex incentives, measured by the presence of differential treatment for patent income and the intensity of tax subsidies for qualified research and development expenditures.

This interpretation is consistent with the wider literature. The literature shows that multinational firms respond to effective average tax rates rather than statutory rates alone.<sup>12</sup> A meta-analysis found that lower effective corporate tax rates significantly increase inward foreign direct investment.<sup>13</sup> Additionally, a stronger investment allowance raised business investment,<sup>14</sup> while accelerated depreciation increased eligible investment spending.<sup>15</sup> These studies confirm the theoretical result that firms respond more strongly to the broader effective marginal tax rate on business investment, not simply the headline rate.

The treatment of risk-taking and innovation also matters. Several studies suggest that patent boxes lead firms to overstate their revenues from patents without necessarily exerting a strong effect on innovative activity.<sup>16</sup> Others show that R&D tax incentives increase firm spending directed into research activities,<sup>17</sup> although privileged tax treatment can also lead to the relabeling of expenses.<sup>18</sup> Improvements to the recovery of losses are related to higher-risk investments, outlining a more incentive-compatible way to support private sector innovation.<sup>19</sup> This supports the view that tax systems encouraging investment and innovation can strengthen medium-term growth, but their effectiveness depends on the incentive compatibility of the instrument used.

Complexity itself can also reduce the effectiveness of reform. Many firms fail to claim tax benefits for which they are eligible, especially when compliance is difficult.<sup>20</sup> Even well-designed incentives may therefore produce weaker results when tax systems are overly complicated.

## What the Evidence Shows for Europe

The empirical results provide a clear message: tax structure matters for growth, and it matters in a measurable way across European economies. The advantage of the empirical approach used here is that it focuses on reforms and changes over time within countries, rather than simply comparing permanently high-growth and low-growth economies.

12 Michael P. Devereux and Rachel Griffith, "Evaluating tax policy for location decisions," *International Tax and Public Finance* 10:2 (2003): 107-126.

13 Ruud A. De Mooij and Sjeef Ederveen, "Taxation and foreign direct investment: a synthesis of empirical research," *International Tax and Public Finance* 10:6 (2003): 673-693.

14 Giorgia Maffini, Jing Xing, and Michael P. Devereux, "The impact of investment incentives: evidence from UK corporation tax returns," *American Economic Journal: Economic Policy* 11:3 (2019): 361-389.

15 Eric Zwick and James Mahon, "Tax policy and heterogeneous investment behavior," *American Economic Review* 107:1 (2017): 217-248.

16 Fabian Gaessler, Bronwyn H. Hall, and Dietmar Harhoff, "Should there be lower taxes on patent income?," *Research Policy* 50:1 (2021): 104-129; Rachel Griffith, Helen Miller, and Martin O'Connell, "Ownership of intellectual property and corporate taxation," *Journal of Public Economics* 112 (2014): 12-23.

17 Nick Bloom, Rachel Griffith, and John Van Reenen, "Do R&D tax credits work? Evidence from a panel of countries 1979-1997," *Journal of Public Economics* 85:1 (2002): 1-31; Irem Guceri and Li Liu, "Effectiveness of fiscal incentives for R&D: Quasi-experimental evidence," *American Economic Journal: Economic Policy* 11:1 (2019): 266-291; Bronwyn Hall and John Van Reenen, "How effective are fiscal incentives for R&D? A review of the evidence," *Research Policy* 29:4-5 (2000): 449-469.

18 Zhao Chen, Zhikuo Liu, Juan Carlos Suarez Serrato, and Daniel Yi Xu, "Notching R&D investment with corporate income tax cuts in China," *American Economic Review* 111:7 (2021): 2065-2100.

19 Dominika Langenmayr and Rebecca Lester, "Taxation and corporate risk-taking," *The Accounting Review* 93:3 (2018): 237-266.

20 Eric Zwick, "The costs of corporate tax complexity," *American Economic Journal: Economic Policy* 13:2 (2021): 467-500.

The first result is that improvements in overall tax competitiveness are linked to stronger growth. Once standard economic controls are included, the relationship between the aggregate *ITCI* score and GDP per capita growth becomes statistically significant and remains robust across specifications. This suggests that countries that improve the neutrality, simplicity, and investment-friendliness of their tax systems tend to perform better economically.

The second result is that the growth effect is not evenly distributed across taxes. When the aggregate index is broken into its five pillars, the corporate tax pillar is the only component that consistently shows a statistically robust positive relationship with GDP per capita growth. Consumption tax competitiveness is positive in some models but not consistently significant. Individual income tax competitiveness does not display a robust measurable growth effect in the sample period. Property taxation is occasionally positive but not consistently significant. Cross-border tax rules do not show clear short-run independent effects.

The third result concerns magnitude. In the static specifications, a one-point improvement in the corporate tax competitiveness score is associated with roughly 0.07 percentage points higher annual GDP per capita growth. In the dynamic models, where lagged effects are taken into account, the cumulative three-year effect rises to around 0.16 percentage points. This means a one standard deviation increase in the corporate category score (14.3 points over the observed period) translates into roughly 1 percentage point higher annual GDP per capita growth and 2.29 percentage points over three years for a one standard deviation improvement.

These numbers are meaningful in the current European context. Many advanced economies have real per capita growth rates close to 1 to 1.5 percent annually. An improvement of 0.1 to 0.2 percentage points sustained over time would materially strengthen living standards, fiscal balances, and debt sustainability.

The fourth result concerns timing. The impact of corporate tax competitiveness is not confined to the year of reform. Instead, it builds gradually over time. The contemporaneous effect is positive, but the medium-term cumulative effect is larger and estimated more precisely after several years. This is consistent with the way firms make decisions. Investment planning, financing, and implementation usually take time.

These lessons are especially relevant in Europe today. Many countries face pressure to finance aging populations, defense spending, climate investment, and debt reduction while also seeking stronger productivity growth. In that context, governments may have limited room for large tax cuts but have substantial room for better tax design.<sup>21</sup>

## What Role Can European Harmonization Play?

There is a widespread belief in EU policy circles that differences in tax policy across Member States pose obstacles to economic growth, suggesting coordinating policy at the European level as a solution to reduce cross-border frictions. While that can be true in certain cases, such as reducing double taxation and administrative burdens due to insufficiently coordinated withholding tax practices, supporting

<sup>21</sup> Alex Mengden, "A Competitive Tax Code Doesn't Have to Sacrifice Revenue," Tax Foundation, Mar. 9, 2026, <https://taxfoundation.org/blog/tax-competitiveness-government-revenue/>.

sustainable economic growth often requires more than a streamlined policy: it requires the harmonized policy itself to be more economically efficient relative to the status quo of Member States.

Unfortunately, the design features that make tax policy more growth-friendly have not been the focus of recent proposals, compromising their potential to support European economic growth and politically standing in the way of harmonization itself.

For example, the European Commission has recently proposed the so-called 28<sup>th</sup> Regime with the goal of making scaling across all jurisdictions of the Single Market simpler for start-ups by allowing them to operate under a single rule set valid in all Member States.<sup>22</sup> The proposal does not include a tax element that could have clarified open key questions about the taxation of stock options and replicated best practices across the European Union.<sup>23</sup>

The prior BEFIT proposal aimed at establishing a fictitious tax base to ease the screening of businesses with cross-border operations for transfer pricing compliance. If implemented, it would have also set an incentive for Member States to align their domestic corporate tax base with the BEFIT base to avoid duplicative compliance costs.

An evaluation of the BEFIT base using data from Tax Foundation Europe's *European Tax Policy Scorecard* shows that adopting the harmonized proposal would have only improved capital cost recovery provisions for 7 of the 27 Member States relative to current national rules, while weakening cost recovery in 20 Member States.<sup>24</sup> Since capital cost recovery is the most direct and effective way in which corporate taxation affects the cost of capital investment, the BEFIT draft exemplifies a neglect of the key trade-offs in tax policy design present in current harmonization proposals.

The contributions of tax policy design to capital investment and economic growth should be the primary concerns of policymakers on their own merits. As a secondary concern, for harmonized tax policies to be politically viable in the union, they also need to be economically attractive for most Member States to vote for or to independently align their domestic tax policies with.

Like prior drafts for a common corporate tax base, the BEFIT proposal failed this test and was not adopted despite its potential benefits for streamlined transfer price screening.<sup>25</sup> The success of a potential 28<sup>th</sup> regime will rely not only on Member State approval but also on private businesses gaining an economic benefit from adoption and voluntarily opting into the new scheme. Making business taxation simpler and more efficient for the regime by drawing on Member State best practices could contribute significantly to this success.<sup>26</sup>

Historically, the tax policy of individual European countries has improved in tandem with harmonization when the first countries in Europe replaced their harmful turnover taxes with VATs, followed by harmonized VAT legislation on the European level, and its adoption by new Member States joining the

22 European Commission, "EU Inc.: A new harmonised corporate legal regime," Mar. 18, 2026, [https://commission.europa.eu/topics/business-and-industry/doing-business-eu/company-law-and-corporate-governance/eu-inc-new-harmonised-corporate-legal-regime\\_en](https://commission.europa.eu/topics/business-and-industry/doing-business-eu/company-law-and-corporate-governance/eu-inc-new-harmonised-corporate-legal-regime_en).

23 Alex Mengden, "Distributed Profits Taxation Would Be a Good Role Model for the EU's 28th Regime," Tax Foundation, Jan. 29, 2026, <https://taxfoundation.org/blog/distributed-profits-tax-eu-28-regime/>.

24 Sean Bray and Alex Mengden, "European Tax Policy Scorecard: Capital Cost Recovery under BEFIT versus Current Member State Policies," Tax Foundation, Oct. 25, 2023, <https://taxfoundation.org/blog/eu-capital-cost-recovery-befit/>.

25 Sean Bray and Alex Mengden, "CCCTB vs. BEFIT: How Have the Proposals Changed?," Tax Foundation, Oct. 20, 2023, <https://taxfoundation.org/blog/ccctb-befit-eu-corporate-tax-base/>.

26 Alex Mengden, "Distributed Profits Taxation Would Be a Good Role Model for the EU's 28th Regime," Tax Foundation, Jan 29, 2026, <https://taxfoundation.org/blog/distributed-profits-tax-eu-28-regime/>.

EU.<sup>27</sup> The European project's foundational mission to enable the free movement of goods, services, and capital has not ended with the removal of tariffs between Member States but retains important work in addressing tax policies that infringe on the EU's fundamental freedoms today.<sup>28</sup>

For tax policymakers at the EU level to contribute to economic growth and usher in a new era of European competitiveness in tandem with Member States, they should refocus policy design on the key efficiency attributes of new harmonization proposals and re-orient them towards the gold standard of economic theory and Member State best practices.<sup>29</sup>

## Conclusion

Due to increasing geoeconomic tensions, policymakers are looking for ways to support economic growth and make the European economy more competitive. Making economic growth a priority when designing tax policy requires policymakers to consider improvements to the corporate tax structure beyond the statutory income tax rate. For Europe, where growth has often been modest and fiscal pressures are mounting, the challenge is not simply to tax less; it is to tax more efficiently. In tandem with Member States, policymakers at the EU level can play a constructive role but should choose wisely when to channel efforts into harmonization and ensure that any coordinated approach reflects both sound economic principles and Member State best practices.

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27 Garrett Watson and Daniel Bunn, "Learning from Europe and America's Shared Gross Receipts Tax Experience," Tax Foundation, Feb. 12, 2019, <https://tax-foundation.org/blog/europe-america-gross-receipts-taxes/>.

28 European Commission, "Commission decides to refer Hungary to the Court of Justice of the European Union for failing to abolish its retail tax regime," Apr. 29, 2026, [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_26\\_919](https://ec.europa.eu/commission/presscorner/detail/en/ip_26_919).

29 Alexander Klemm, "Why and How to Tax Corporate Income," in *Corporate Income Taxes under Pressure*, International Monetary Fund, Feb. 26, 2021, <https://elibrary.imf.org/display/book/9781513511771/ch002.xml>.