Taxation

Imagine you ran a business in an industry that is mildly competitive but not overly so. Your balance sheet is stretched, your debt service is stretched and your bond spreads have widened. Let’s assume that you are solvent and likely to remain a going concern. Also, capital markets are open to you so that default is not an issue.

What do you do on the business front? Cut prices or raise them? If your industry is competitive, demand is likely to be elastic. If you are a monopoly, almost surely you are producing where demand is elastic. If you weren’t marginal revenue would be negative. (This is a feature of monopolies.)

Either way, cutting prices and trying to increase cash flow takes priority over turning a profit, especially for a stressed company.

Now imagine you are a country. Your balance sheet is stretched, so is debt service, your bond spreads have widened. What do you do? Raise taxes? Or lower them?

Before globalization took hold the above argument would not hold. Under increased labour and capital mobility, demand for domicile has become elastic.