

Border Adjustment as Tax Policy and as Macroeconomic Policy

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Conference: “Border Tax Adjustment and Corporate Tax Reforms”

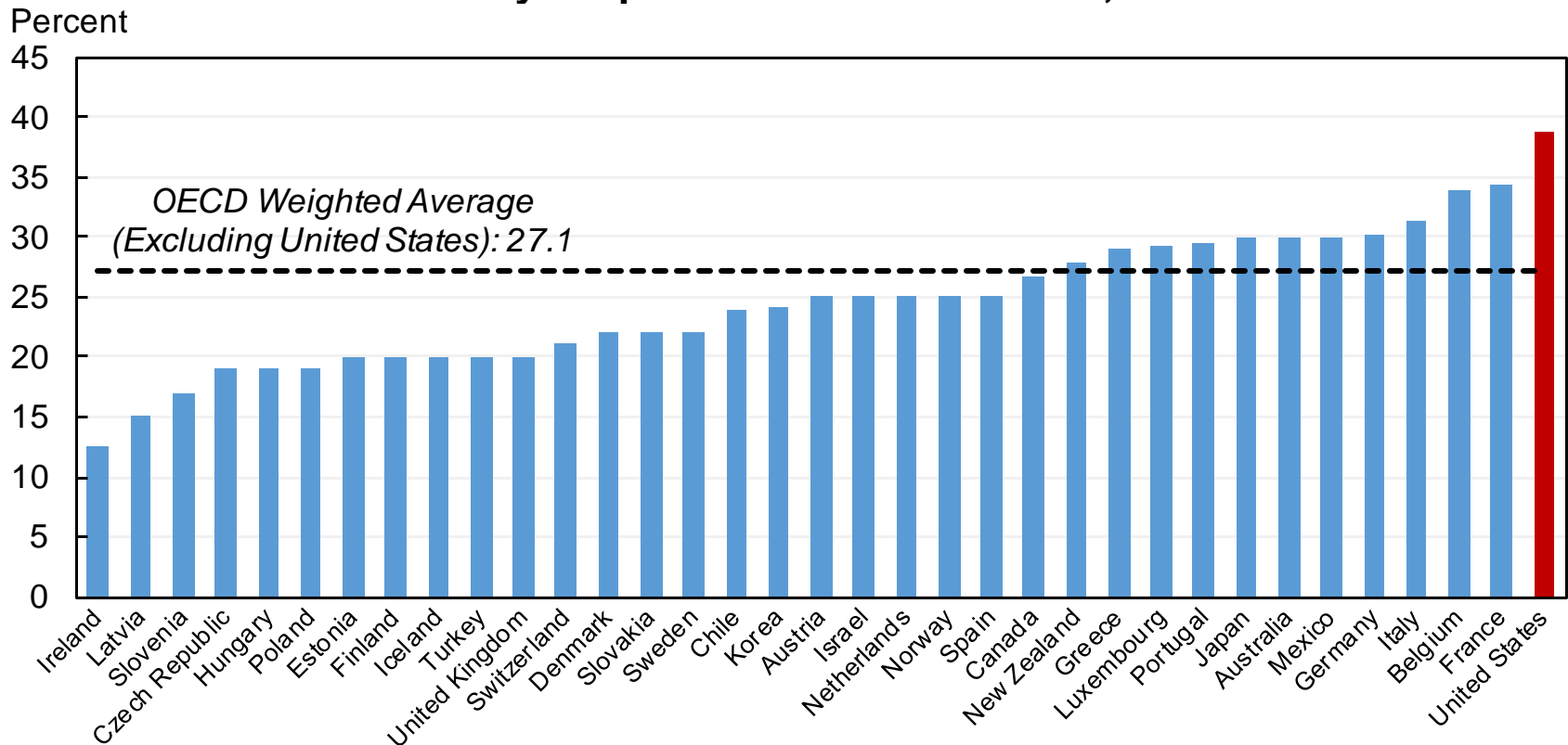
Washington, DC

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Concern #1: Our Business Tax System is Broken, As Evidenced by High Statutory Rates...



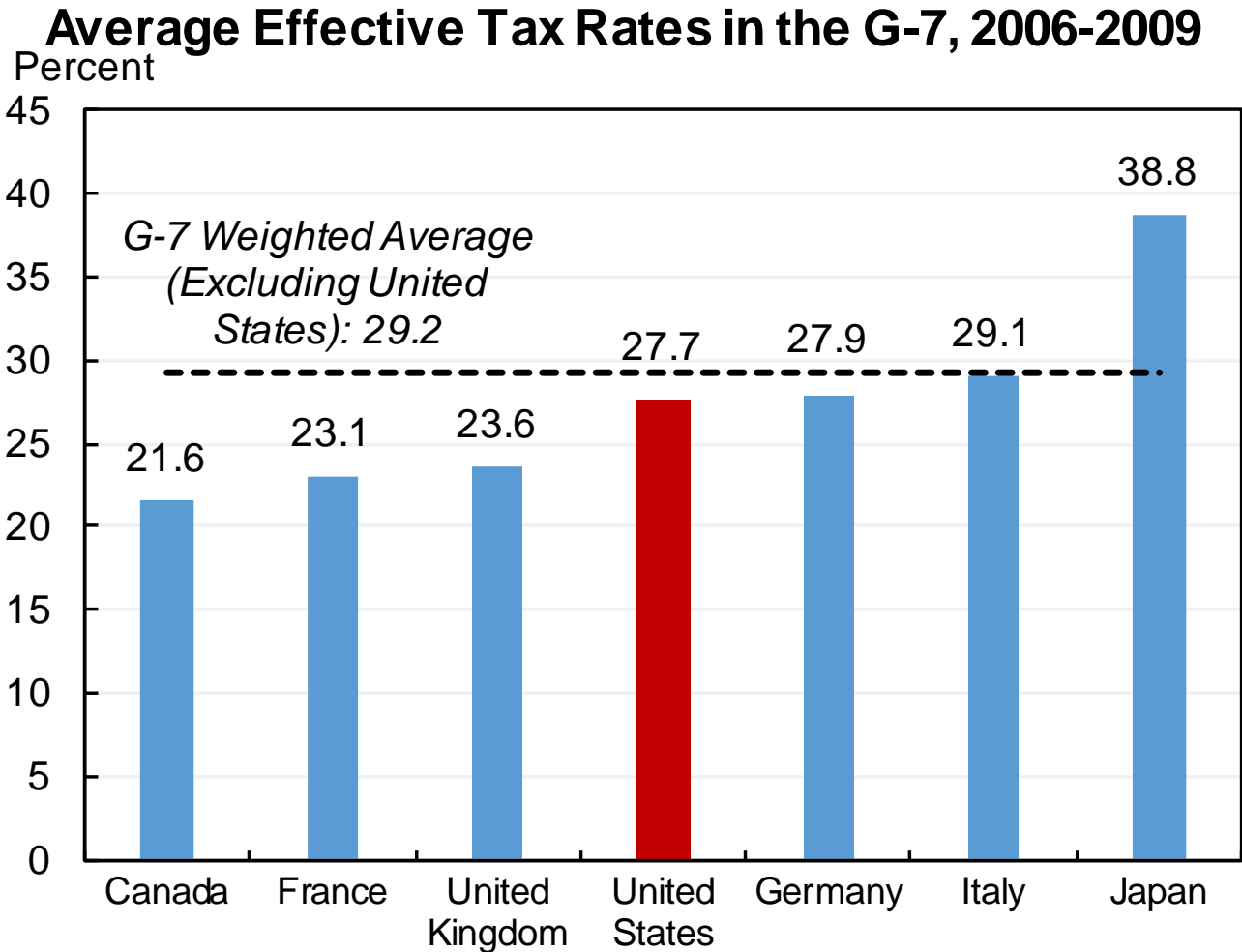
Statutory Corporate Income Tax Rates, 2016



Note: Combined central and sub-central (statutory) corporate income tax rate given by the central government rate (less deductions for sub-national taxes) plus the sub-central rate. OECD average is calculated using gross domestic product (in current U.S. dollars) in 2015 (latest year available for all countries) as weights.

Source: Organisation for Economic Co-operation and Development; national sources via Haver Analytics; author's calculations.

...Without Commensurately Higher Effective Rates, Indicative of the Narrow Tax Base...



Note: G-7 average is calculated using gross domestic product (in current U.S. dollars) as weights.
Source: Council of Economic Advisers (2015).

...And a “Stupid Territorial” System for International Taxation That Distorts While Raising Little/No Revenue



U.S.-Controlled Foreign Corporation Profits Relative to GDP, 2010

| Country | Foreign Corporation Profits Relative to GDP (Percent) |
|------------------------|--|
| Bahamas | 104 |
| Bermuda | 1,578 |
| British Virgin Islands | 1,009 |
| Cayman Islands | 1,430 |
| Cyprus | 13 |
| Ireland | 38 |
| Luxembourg | 103 |
| Netherlands | 15 |
| Netherlands Antilles | 25 |

The Resulting Variable Tax Rates Cause Capital Misallocation, Financial Fragility, and Other Distortions



Effective U.S. Corporate Tax Rates

| <i>Average Effective Actual Rate</i> | |
|---|-----|
| Utilities | 10 |
| Wholesale and Retail Trade | 27 |
| <i>Effective Marginal Tax Rates on New Investment</i> | |
| Equity-Financed | 35 |
| Debt-Financed | -5 |
| Corporate Business | 29 |
| Pass-Through Business | 24 |
| In the United States (Hypothetical) | 30 |
| In a Low-Tax Country (Hypothetical) | -24 |
| In a High-Tax Country (Hypothetical) | 13 |
| Business | 27 |
| Owner-Occupied Housing | -2 |

The Net Effect of These is Meaningful, But Not So Large As to Override Other Concerns



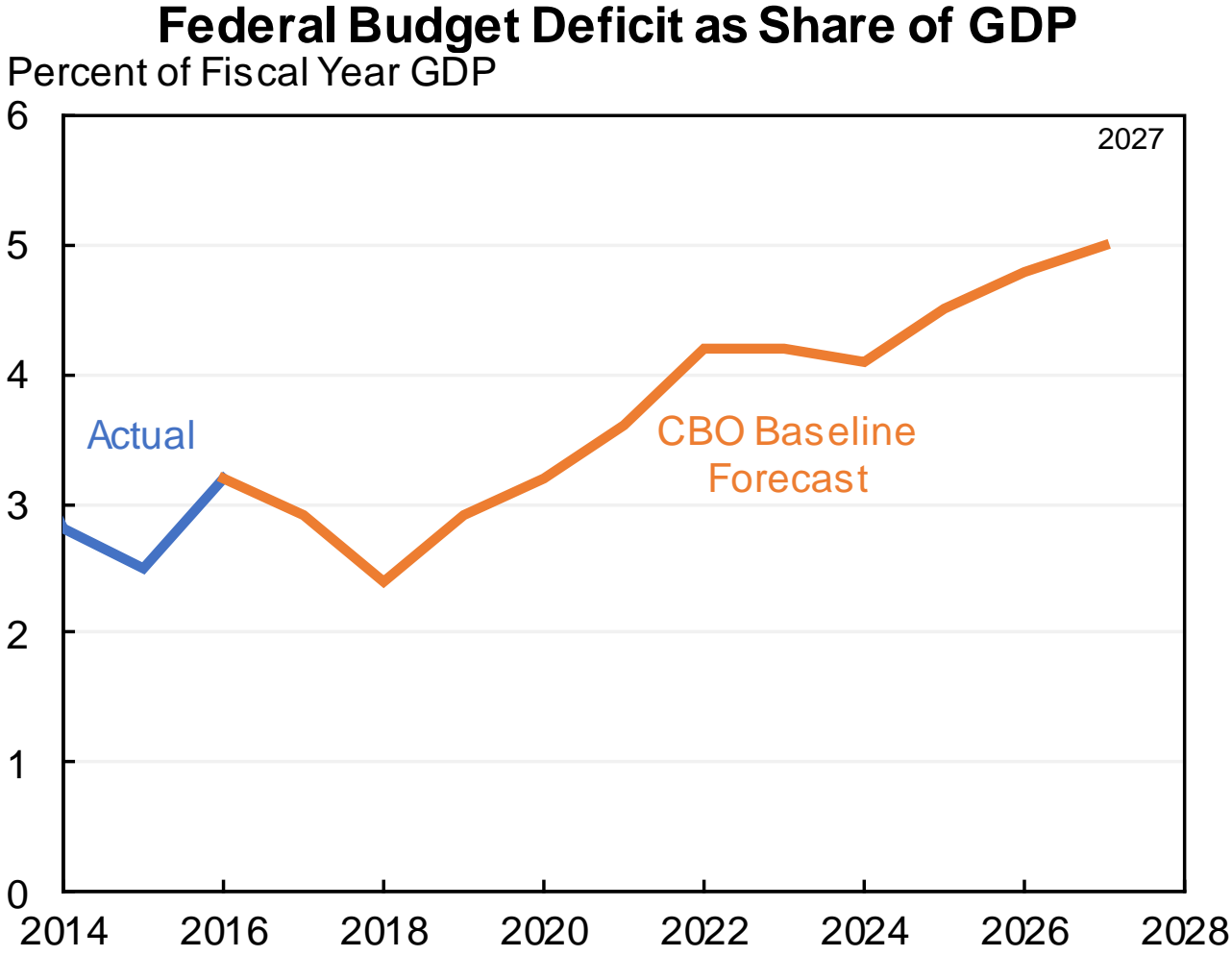
Select Estimates of the Effect of Tax Reform on the Level of Output

| Source | Policy Change | Short-Run | Long-Run |
|---------------------|--|-----------|-----------|
| Treasury (2006) | President's Advisory Panel on Tax Reform | | |
| | Simplified Income Tax | 0.0 - 0.4 | 0.2 - 0.9 |
| | Growth and Investment Tax | 0.1 - 1.9 | 1.4 - 4.8 |
| Altig et al. (2001) | Stylized Revenue-Neutral Tax Reforms | | |
| | Proportional Consumption Tax | 6.3 | 9.4 |
| | Flat Tax with Transition Relief | 0.5 | 1.9 |

Note: Output measure is (in order of preference if multiple measures are reported) national income, real gross national product, and real gross domestic product. Time period for short-run effects varies across studies, but (in most cases) is an average over several years in the first decade. Long-run effects typically reflect estimates of the change in the steady-state level of output.

Source: Furman (2016).

Concern #2: The Medium- and Long-Run Deficit

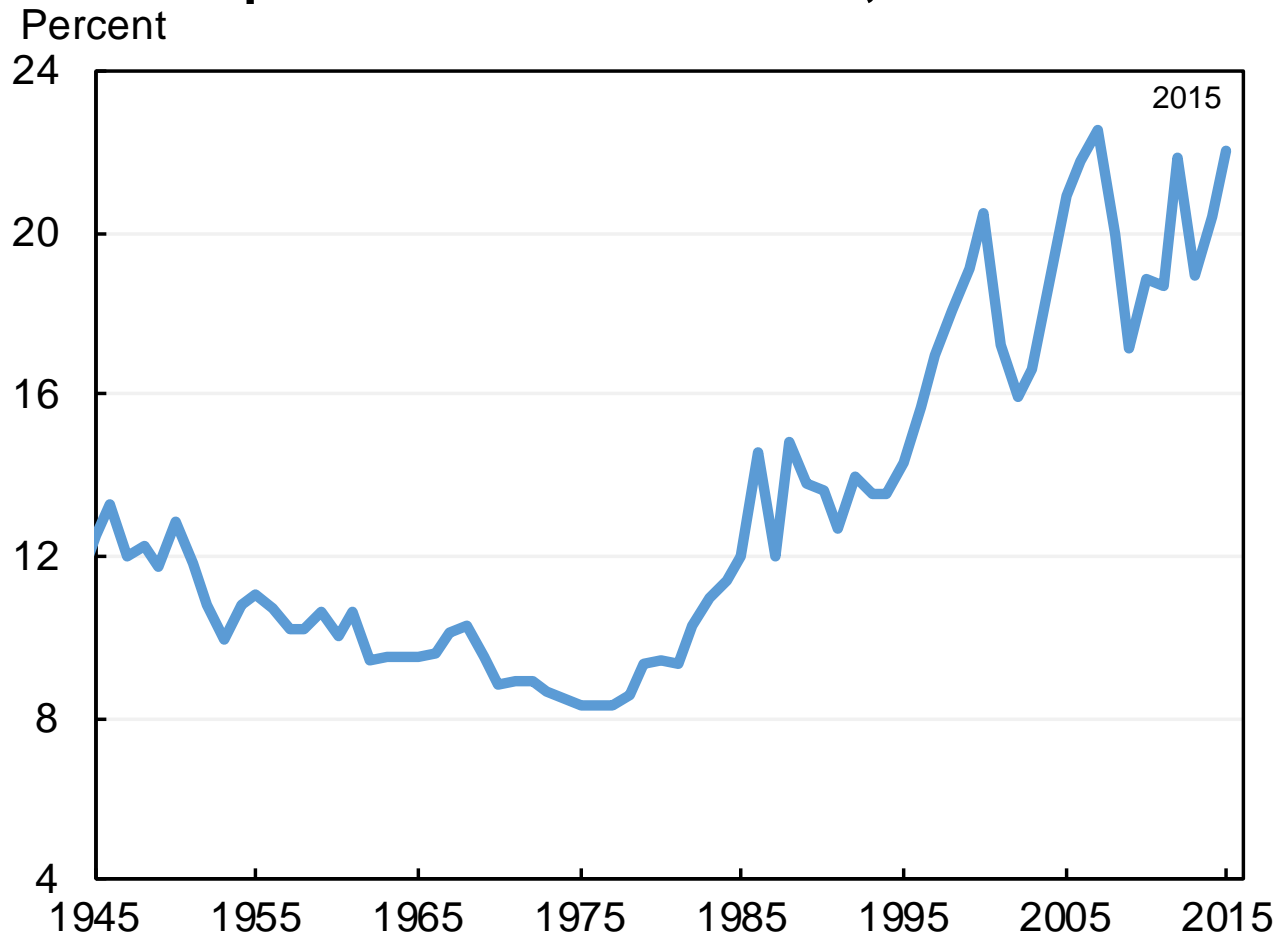


Source: Congressional Budget Office.



Concern #3: High Levels of Inequality

Top 1 Percent Income Share, 1945-2015

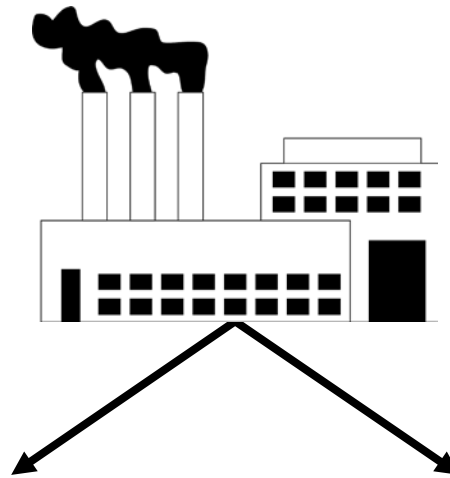


Some Weak or Fallacious Arguments for Destination Basis/Border Adjustment



- 1. Everyone else is doing it, so we should, too.**
- 2. It improves U.S. competitiveness.**
- 3. It is a necessary part of a cash flow/consumption tax.**
- 4. It raises revenue in the budget window.**

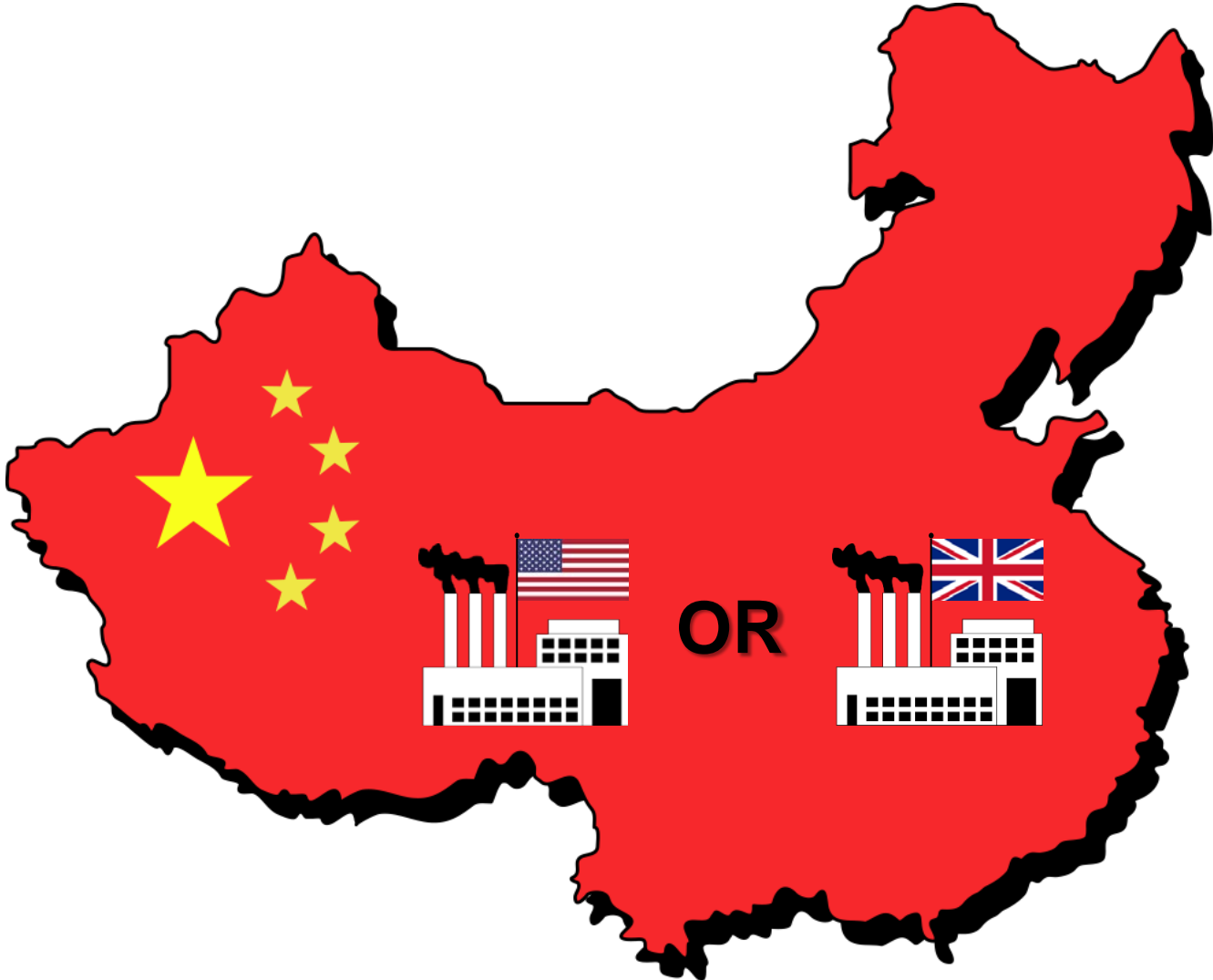
Capital Export Neutrality → Worldwide



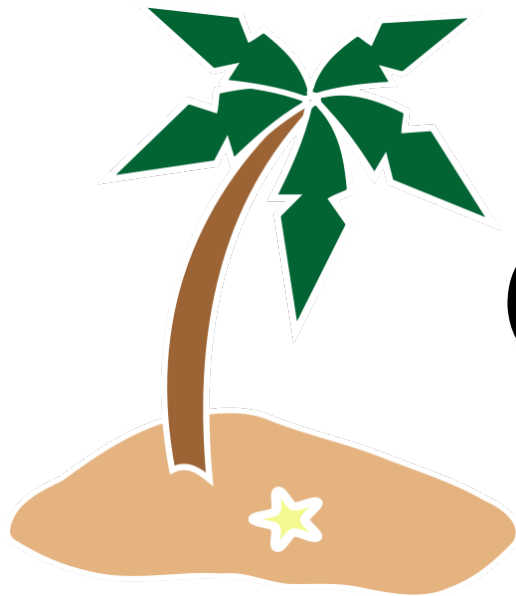
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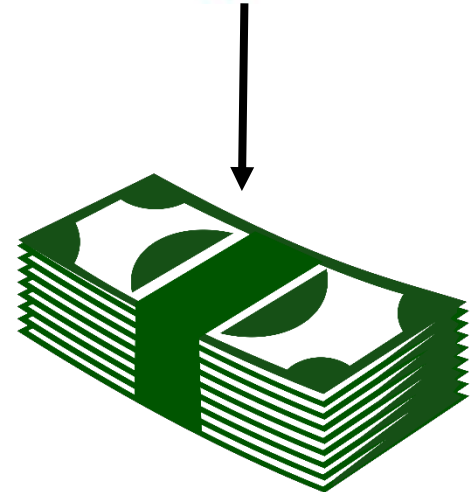
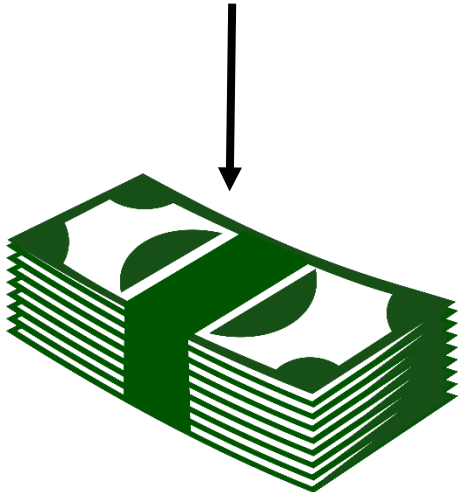
Capital Ownership Neutrality → Territorial



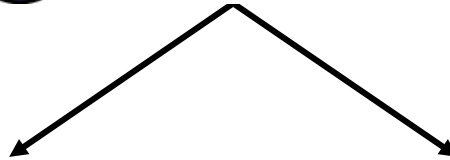
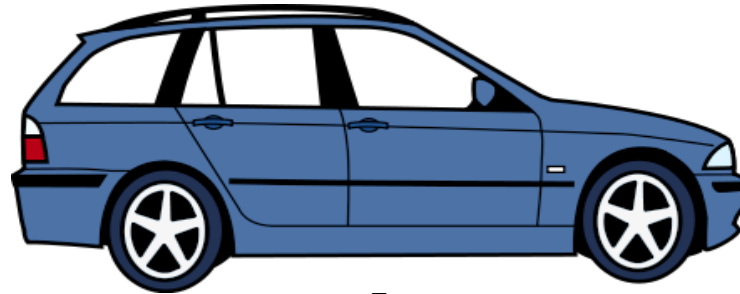
Profit Location – Neither System is Perfect



OR



The Tax Policy Argument for Destination Basis: Sales Less Affected by Taxes



&



Summarizing the Tax Policy Argument for Destination Basis/Border Adjustment



Comparison of Selected Tax Systems

| | Where to Locate Production | Who Owns a Given Subsidiary | Where to Report Profits | Where to Locate HQ |
|--------------------------|----------------------------|-----------------------------|-------------------------|--------------------|
| <i>Current: Deferral</i> | x | x | x | x |
| <i>Worldwide</i> | ✓ | x | ✓ | x |
| <i>Territorial</i> | x | ✓ | x | ✓ |
| <i>Minimum Tax</i> | ✓/x | ✓/x | ✓/x | ✓/x |
| <i>Destination Basis</i> | ✓ | ✓ | ✓ | ✓ |

Some Tax Policy Concerns with Destination Basis



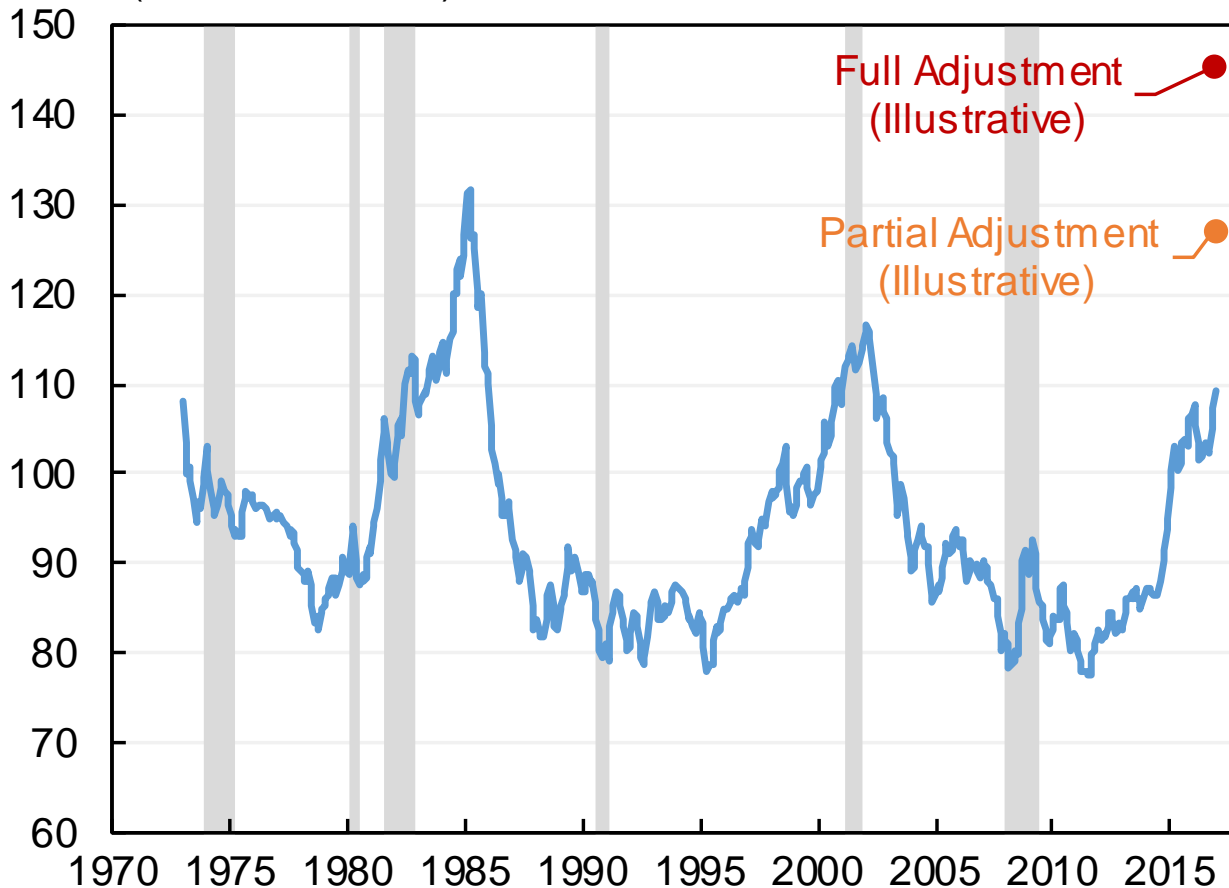
- 1. Direct sales to consumers, tourists and retirees**
- 2. More firms with unrecoverable losses**
- 3. Impact on global tax system from incentive to shift income**
- 4. Treatment of financial transactions**

Large Exchange-Rate Adjustments (or Lack Thereof) Would Have Global Repercussions



Real Trade-Weighted Dollar (Major Currency Index)

Index (Mar-1973 = 100)



Questions on WTO Legality and Sanctioned/Unsanctioned Responses



- **One indication of magnitude comes from Bown (2017), import restrictions (trade effects) formula: \$220 billion in retaliation**
 - China: \$46 billion
 - European Union: \$42 billion
 - Mexico: \$30 billion
 - Canada: \$28 billion
 - Japan: \$13 billion
 - Six other countries: \$4 billion or more

Border Adjustment Does Not Raise Long-Run Revenue—Using It as a “Payfor” is Deficit-Increasing



Plausible Illustration of Long-Run Fiscal Effects (NPV, Percent of GDP)

| | Ten Years | Permanent |
|---|------------|---------------------|
| Border Adjustment | 0.4 | 0.0 to -0.3 |
| Portion of Rate Reduction Financed by Border Adjustment | -0.4 | -0.4 |
| <i>Net Fiscal Impact</i> | <i>0.0</i> | <i>-0.4 to -0.7</i> |



Long-Run Impact on Households: Need Dynamic Distributional Analysis

- **Cannot answer the most important question without knowing:**
 - Direct incidence of taxes
 - Impact on before tax incomes
 - Indirect incidence of financing tax cuts
- **All are very difficult and depend on the plan *as a whole*.**
- **Would raise concerns if:**
 - Static distribution was regressive (e.g. large reductions in top rate)
 - Proposal was a net-present-value tax reduction—because ultimate financing unlikely to be progressive
 - Significant reduction in tax rates on market power and luck

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