Unedited Event Transcript

Conference: Border Tax Adjustment and Corporate Tax Reforms

Panel 1 Participants:
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Adam Posen: Thank you. So, I'm coming at this as not a tax person. I'm a macro policy person. I do fiscal policy but not tax code or putting it in economic terms, I dropped out of public finance second year in grad school and took monetary economics instead.

But I think sometimes it's good to have a different perspective. So, in my tribe of monetary economists, there was a great mistake made by a few central bankers that, oh well there would be no problem with securitization on the effect on loan quality. It must be efficiently gaining when there were of course people from a more microfinance perspective who were warning central bankers this might not work the way you thought it would and of course it did not.

I think there's a similar issue here. Public finance people, distinguished finance people like Doug and Gary but many others who have been cited in this debate understandably like central bankers with inflation consider tax efficiency really important, that’s what they study. And they consider that the effects of tax code on macro outcomes must be important, that’s what they care about.

And Congress people love talking about tax because it's the one thing they really control. They can’t pass laws and bills most of the time, but they can sure as hell get tax expenditures and special tax goodies, and go to their constituents and say, “I did this.”

And of course, there is a huge political aspect in a good sense of outrage over these images of American R&D being booked abroad of other countries, in Ireland; others going out and grabbing headquarters. It is unjust on the face of it. The whole thing is aesthetically very displeasing whether you're a Congress person, a voter or especially an academic who sees this very inefficient single tax system.

But sometimes ugliness is only skin deep. And as a macro person, I care about things like growth rates, starting at the same place as Doug;

productivity growth, the exchange rate over the long term, employment. Tax reform would help with these things, but not that much.

Once you’ve realized that it's a finite thing, it's not the be all and end all despite the amount of excitement about it because it happens to be the one thing Congress can get done.

Then, you start saying the gains are finite, what are the costs? And there like Gary, Gary says, “Well, the border tax adjustment or the [inaudible 0:51:03] is a cost worth paying.” I take the opposite view. From a macro perspective, from a broad tax perspective, the amount of revenue you're going to get is very low, the amount of distortions you're going to create is very high, the amount of trouble you're going to create for the US and the world economy is very large, and the distributional effects are not trivial. They're actually very harmful.

So, if you want to have your huge corporate tax cut, I don’t particularly view that as a huge priority, but I accept that that’s what the majority in Congress is going to pass. You should pay for them a different way and you should not be using the destination based cash flow tax or the border adjustment tax or anything like that to pay for it.

Let me go through this. I'm very grateful to [inaudible 0:51:54] who did a lot of work to help me get the Garrison charts on short notice. I'm very grateful to my colleague Bill Cline who couldn’t be with us today. He's off in New Zealand visiting family. But, we published his new policy brief like Gary’s, different views and I basically, 95% agree with Bill’s. So, I encourage you to read that policy brief.

Let me get started. This is the average effect of tax rate as estimated by Pricewaterhouse Coopers or PwC across countries. Japan, which has huge trade surpluses has a much higher tax rate. Switzerland which has huge trade surpluses has a much lower tax rate. Germany which has a huge trade surpluses has basically the same effective tax rate. It's fascinating in macro we have this thing called the Lucas Critique that you don’t assume a policy has its affects just because it's stated to have its effects.

The question is, what on net happens when corporations react? So, I'm not going to get into all the niceties or non-niceties of transfer pricing of booking things in different countries and all. The net tax rate is what we care about. And there are subtleties and Gary mentioned the issue pass through, but the bottom line the US effective corporate tax rate in corporations is not that out of whack.

So what about the impact on things we actually care about because the tax rate is just a means to an end? So, what we've done here is take in four groups of countries. The blue left most column is the US, the red is the average of a group of the other advanced economies essentially the OECD minus Turkey, Mexico, Israel and Chile. Sorry, Jose. The green is the average of the three countries that have the lowest statutory tax rate. And the purple is a different set of three.

But anyways, it's two different ways of the lowest tax rate countries. It makes almost no difference to capital share and GDP. It seems to make a difference to TFP growth, but that’s actually because we're using pre-crisis data.

If you start looking at tax rates during the crisis, of course, there are all these loses that were incurred during the crisis that were incurred during the crisis that reduced the effect of tax rates. So, that’s not fair.

R&D expenditures as a [inaudible 0:54:17] GDP despite the supposedly horrible effects of this on R&D and investment are still much higher in the US than anybody else and that’s private R&D not military.

And then, of course, the US is the only one that has a huge current account deficit on average. It's not just because of the tax code. If you step back a minute, no matter how many natural experiments public finance economists run, it's very hard to see that the US corporate sector is somehow holding back the US economy or the US economy is desperately in need of change.

So, we actually do collect a relatively low share, but who cares? The interesting question also though is efficiency of tax collection. So, let’s go back to this idea of if we change tax code to repatriate everything.

We now have an estimate that $2.6 trillion of US multinational company profits are held overseas. The last time we did a tax holiday repatriation was 2004. There were estimated to be $804 billion profits then and about $362 billion were repatriated.

So, if we net this out, the total accumulation of profits abroad by our friends in the multinational sector over the last 12 years is a flow of 1.4 trillion, which is real money. Some of that actually is from a legitimate reason but let’s go to the extreme and assume that it's all just profit shifting. That’s about $40 billion a year of lost tax revenue which again is real money but let’s get serious.

The total tax revenue of the US Government averages $2.6 trillion a year. So, we're talking about 1/65 of the US tax revenue is potentially at stake if you max out what you get from getting these profits to be booked at home. Worth doing? Yes. Worth sacrificing huge cost for? No.

So, let’s start talking about the cost. So, in theory we just do this nice thing. We say US has a big trade deficit. We have a 20% tax on the border and at imports, 100 billion in revenue. But that’s wrong.

The first thing is, it's very uneven in what gets covered. There's huge things like tourism, like education, like hospital services, like internet services that would not be covered under this. So, it's a huge share of revenue foregone.

It's also very distortionary of course because what you're doing therefore is taxing only certain sectors and not others, which again, every tax does that to some degree, but biasing it very concentratedly on particular sectors is not good tax reform even for public finance economists, let alone for macro people.

Moreover, if we're going to premise this whole thing as Doug and Gary and many others essentially have on cynicism about Congress that there's only so much they could do and we need to what's politically feasible, let’s be realistic. Are they really going to have no exemptions to this tax in order to get it through or are they going to pick a certain couple of industries like say oil refining -- I have nothing against oil refining. I have good friends who are oil refiners. My father grew up working for Shell. But, just as an example right?

Oil refining is massively hit by this tax and they have Congress people and Senators who represent those districts and imagine they go to Ryan and Brady and say, “I want a carve out or else I'm not going to support this.” And Ryan and Brady say, “Oh God! All right.” Then, the amount of revenue you're getting goes down and then the amount of distortion you're getting goes up because the burden goes more on the remaining import affected sectors. So, let’s not fantasize about this being neutral; let’s not fantasize about this being a money machine. It is neither.

I asserted the other day, oh good, [inaudible 0:58:08] range. In my printed version, this is a set of basically, 18 US economy based into 18 industries. The three red circles, what it does is it plots. The Y axis is the amount of imported value added in the final demand. These are industrial sectors. The X axis is the average value added.

Essentially, it's a plot of how much high-end manufacturing versus low-end manufacturing. The further you go to the right, the higher-end value added manufacturing. The further you go up, the more imports essentially supply chain complexity affects them.

The three circles going clockwise are motor vehicles, computers and electronics, chemicals. Those are three of the most advanced, R&D intensive, highest paying, highest value added industries in the US, in the world, and they have three of the most, in fact the most, import content in what they do. You go to the lower left corner, you get things like wood products and metal extraction.

So in other words, if you do a tax that's fundamentally biased against import content, you are taxing the most advanced highest value added sectors in the US manufacturing sphere. And even if these individual companies because of the political lay of the land or because they perceive things as some do that this on balance is worth it to them to get the profit taxed down. As a policy, this is wrong. This is taxing our most competitive highest value added sectors at the expense of our most backward sectors.

The blue rectangle, sell range is textiles and apparel. And I blew that out because as we all know textiles and apparel are at best of a vestigial organ and at worse a parasite on the American body economic. It is the lowest value added of any industry except for wood products. It has huge import content. It's not relevant.

Everybody else, the more value added you have, the more import content you have, the more complex supply chain you have, the more you draw talent and technology from around the world. And therefore, again, this tax would punish the most advanced sectors.

Now, this is actually a preview of Chad Bown's presentation coming up. I'm going to skip the slide because I don't want to scoop him. What I really want to do is just talk about retaliation.

Gary, of course, has forgotten more than I will ever know about the WTO. But again, having run the Peterson Institute for a few years, I do know a little bit about how this works.

So, let me tell you some sort of reality check. The point is, as in Bill Cline's co-quote on the front page of Bill's policy brief, "The Ryan-Brady cash flow tax is a protectionist because it imposes the tax on the entirety of import value, but only on the corporate profit component of domestic production."

I'm not disagreeing with Doug or others about the intent to be neutral, but the fact is the proposal that is on the table is not neutral. As Caroline Freund will discuss after the panel, as Sherman Robinson will discuss in the second panel as well. This is not a VAT. This is different.

And so, when we talk about WTO, it may be as Gary says, this is too big. It's not going to go to the WTO. And when we talked about WTO consistency, everybody can hire a lawyer who says it is or it isn't consistent.

The key point going back to where I started this conference, not this talk, is the rest of the world exists. They are not going to roll over just because the US says, "We're doing this and we think we have a case." There will be retaliation. And as the precedent shows, the retaliation doesn't have to be in the form of a 3-year long WTO case and it doesn't have to be in exactly the same field, but it is likely to be close to one to one.

It is also ridiculous not to pretend there's no context to this. Even free traders like Congressman Brady who we've had speak here in the Institute, God bless him, are going at this in a context where the Trump administration is actively threatening its trading partners.

And so, the idea that in the abstract well maybe this isn't such a big aggression has to be seen in the context of what the reality is. Whatever the noble intent of the congressional people, the idea that this will not be escalating retaliation with large harms to the US is incorrect.

Rolling with Americans, Gary points out quite rightly a key aspect of this is the exchange rate, but that's not only the aspect. Jason Furman and along with Catherin Russ and Jay Shambaugh published a recent piece one of the last things they did at CEA looking at the impact of tax on some low-income Americans versus high-income Americans.

And as Bill Cline and many in this building have argued through the years because low-income Americans consume such a large part of their income and they buy the products that are at the low-end things like clothes and cheap electronics, but also cars, they suffer the most from tax.

And Catherine Russ just recently posted online a summary of using that data to look at the impact of a border adjustment tax on income groups. There are various assumptions. You can go online and look at it, but essentially this pattern is real. If you do a border adjustment tax, it is going to hit the weakest, poorest Americans very hard.

This is drawing on my colleague Jacob Kirkegaard's work. Obviously, a VAT is adopted in many other countries and is regressive in every country its adopted. In every other advanced economy, the amount of redistribution and the amount of protection for workers is far higher.

So, there's the United States. The bottom axis has left to right. How much of your VAT goes to general government revenues, the GDP? The up to down, the vertical axis is how much you're changing the GINI coefficient. In other words, how much you're redistributing after tax.

The point is, the US is lower VAT and very low on redistribution. Canada and Switzerland were not quite Brazil, good for us. But as you see, if you leave the US out of it, essentially, as you move up the VAT ranks, you have more redistribution because, of course, if you put a VAT on with no redistribution, no free health care, no free education, people suffer.

Again, you can’t divorce this from the context. You can’t do an abstract. Well, other countries have a VAT so it must be okay. It's not okay. Other countries it's okay because they protect their people.

Finally, let’s talk about the dollar. So as many of you who are aficionados of this know, the whole idea is that because this is neutral, the dollar then appreciates enough to offset all this, and that has all kinds of wonderful effects.

Companies that are heavy on imports gets to still buy the imports, households don’t suffer as much, retaliation even is less from abroad because other countries say, “Well, what I lost on that hassle, I gained on the exchange rate.”

The problem is and I've read this multiple times and we discussed it a lot internally, this is a classic example of economists assuming the result. This is the assume-a-can-opener story in live action.

Very distinguished economists got there and say, “We know that the casual tax is neutral.” If the casual tax is neutral, the savings minus investment balance must not change. The savings minus investment balance must not change and exports become more competitive, something must offset it. Ipso facto, the exchange rate must compensate. The problem is this is completely unrealistic. This assumes the result.

Of course, savings are going to change because the whole bloody point of this thing is to raise revenues to account for the ability to pass the rest of the tax package. And even if I say the revenues aren’t large, I still say there's revenues, so savings goes up.

If Doug and many other people are right, and the point of this is to improve corporate profitability, corporate allocation, corporate investment, investment must go out. I'm not talking about the direction of S minus I, I'm just telling you it sure as hell ain’t fixed. Moreover as we've mentioned, there's a huge disparity across sectors and a huge disparity across income classes. There is no way in the real world that this is neutral and has no effects on savings or investment behavior.

More often, no household is going to see this. And by the way, there's not a single retailer at the moment that supports the Institute. This isn't paid for. It's not a lie that retailers are going to be able to go out there and say to their constituents, their customers, "Sorry, I'm putting up prices because of those guys who put up those taxes." That's not going to be a false perception.

So, the idea that savings minus investment will remain neutral is patently absurd and therefor the effect on the exchange rate is completely indeterminate. And it is likely, Joe Gagnon will do his assessment later today. In my view, it is likely it appreciates a small amount and this is completely swamped by other factors.

Why is it swamped by other factors? The dollar exchange rate is not determined by trade balances. It's the global reserve currency. There's huge flows involved. People invest in the US. People invest in treasuries. People invest in intervening the currency. People are invoicing this currency.

Just a reminder of the scale. The daily turnover in foreign exchange markets is $4.4 trillion a day in dollar trades. The amount of imports and exports in the US in dollar terms is $408 billion per month. In other words, the currency flows driven by non-trade, non-tax factors are 300 times those driven by those factors. You really think this is going to have a predictable large sustained effect on the value of the dollar in such an environment? It's also kind of strange to me to think that this is essentially an argument that the dollar has been undervalued for decades because we don't have a VAT.

Even though Fred Bergsten isn't with us today, I don't think many of us will stand up and say the dollar has, on average, been undervalued for years. It doesn't seem to me that the VAT is determining terribly much of what's going on here.

Most importantly, if the dollar doesn't move then all other costs grow. The income loss is bigger, the distortion across sectors is bigger, the likelihood of retaliation is bigger.

There's a number of other ways, better ways you can raise revenue. In my seventh term as an adviser to the CBO, they put out a great publication Doug used to oversee annually offsets reducing the deficit. There are many things that would be much more efficient, much more constructive, and in a world where we're talking crazy politics, I'm not sure the people of the Congress should be thinking in terms of responding to white rural middle class anger by doing a corporate tax cut to raise consumer prices.

What is politically feasible may actually be taxing high end health insurance like mine. Increasing the excised taxes on fuel, especially taxing carried interest on ordinary income. And since we're only talking about raising 50 billion to 100 billion here, we can get there through those means instead.

So, with all due respect to my friends in the public finance profession, the impact of tax efficiency in US public macro outcomes is only of secondary importance. The actual revenues you're going to get by doing this DBCFT are very limited. They're real, but they're limited.

The cost getting revenues through these means are manifold. Congress has better alternatives to raise revenues to offset this. Please use those instead. Thank you.

[Transcription ended at 1:11:36]