THE NEED FOR PRO-GROWTH TAX REFORM

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

HEARING HELD IN WASHINGTON, DC, SEPTEMBER 14, 2011

Serial No. 112–14

Printed for the use of the Committee on the Budget

Available on the Internet:
www.gpo.gov/fdsys/browse/committee.action?chamber=house&committee=budget

U.S. GOVERNMENT PRINTING OFFICE

68–156 PDF WASHINGTON : 2012

For sale by the Superintendent of Documents, U.S. Government Printing Office
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CONTENTS

THE NEED FOR PRO–GROWTH TAX REFORM

WEDNESDAY, SEPTEMBER 14, 2011

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE BUDGET,
Washington, DC.

The Committee met, pursuant to call, at 10:00 a.m., in room 210, Cannon House Office Building, Hon. Paul Ryan, [Chairman of the Committee] presiding.

Present: Representatives Ryan, Garrett, Campbell, Calvert, Price, McClintock, Stutzman Lankford, Black, Ribble, Mulvaney, Huelskamp, Young, Amash, Woodall, Van Hollen, Schwartz, Kaptur, Doggett, Blumenauer, McCollum, Yarmuth, Pascrell, Honda, Ryan of Ohio, Wasserman Schultz, Moore, and Castor.

Chairman RYAN. The hearing will come to order. Welcome all to an important hearing. Thank you. I will start with a brief opening statement and then turn it over to my friend, Mr. Van Hollen. And then we will listen to our witnesses.

The purpose of today's hearing, in conjunction with the conversation we had with Mr. Van Hollen, is to highlight the need for pro-growth tax reform. Our economy is currently suffering from the reluctance of job creators to invest, expand, and hire workers in the United States. For several years, Washington has filed a now discredited playbook. If businesses will not invest, then the government should expand its reach. But letting the government pick winners and losers and the market only adds to the debt, wastes taxpayer dollars, promotes crony capitalism and ultimately fails at sustainable job creation.

For evidence, look no further than Solyndra, a solar panel company that received $500 million in stimulus-funded loan guarantees. Last month, Solyndra filed for bankruptcy and laid off its employees. Another idea we have been trying for the last three years under first President Bush and then President Obama is short-term tax rebates on the theory that these temporary windfalls will encourage people to go out and spend more money.

Look, I do not object to letting people keep more of their own money. I clearly think that is a great idea. But one-time rebates and short-term tax policies do not give businesses the confidence that they need to make the kinds of long-term investments to create jobs. That is why, of all the proposals the president has put forward in his latest speech, the most encouraging was his support for making the corporate tax code fairer, simpler, and more competitive. This is a sign of encouragement. We should extend these reforms to the entire U.S. tax code. A world-class tax system should be fair, simple, and competitive. And right now, the U.S. tax code fails miserably on all three counts. The World Economic Forum recently downgraded the United States from fourth to fifth in its annual competitiveness rankings. The reason? Under the section titled, Most Problematic Factors for Doing Business, our unfair, complex, and uncompetitive tax code was right there at the very top. We need to close loopholes that distort economic activity and those loopholes that also reward politically well-connected at the expense of the hard-working small businessmen and women of America. We need to simplify the tax code by reducing the number of brackets so that people spend less time and money figuring out how to comply with the tax code. And we need to lower rates to encourage economic activity, to allow our businesses to compete on a level playing field against those in countries where the corporate rates are much lower. Unfortunately that list includes every developed country except for Japan.

There is a growing bipartisan consensus for this kind of common sense tax reform. The president's bipartisan fiscal commission made very clear that a revamped tax code with a broader base and lower rates was critical to economic growth. That is one reason why House Republicans included in our budget these reforms in the path to prosperity: lower rates in a broader base to help get our economy growing again. Unlike the high-cost government spending proposals now circulating in Washington, fundamental tax reform could be done with no budgetary cost and it would provide many immediate and long-lasting economic benefits.

In today's hearing on the need for such a reform, we will hear from three terrific witnesses. In addition to experts Scott Hodge of the Tax Foundation and Diane Lim Rogers of The Concord Coalition, we have a witness today from the world of business, Michael Wall of Case New Holland, which is headquartered in Racine, Wisconsin. Mr. Wall can speak first-hand about the effects of tax policy on business decisions and job creation in the United States. I am looking forward to hearing from all of you on a topic that is critical to laying the foundation for sustained economic growth and job creation. With that, I yield to the ranking member, Mr. Van Hollen.

[The prepared statement of Chairman Paul Ryan follows:]

PREPARED STATEMENT OF HON. PAUL RYAN, CHAIRMAN, COMMITTEE ON THE BUDGET

Welcome all, to this important hearing.

The purpose of today's hearing is to highlight the need for pro-growth tax reform.

Our economy is currently suffering from the reluctance of job creators to invest, expand, and hire workers in the United States.

For several years, Washington has followed a now-discredited playbook: If businesses won't invest, then the government should expand its reach.

But letting the government pick winners and losers in the market only adds to the debt, wastes taxpayer dollars, promotes crony capitalism, and ultimately fails at sustainable job creation.

For evidence, look no further than Solyndra, a solar-panel company that received $500 million in stimulus-funded loan guarantees. Last month, Solyndra filed for bankruptcy and laid off its employees.

Another idea we've been trying for the last three years, under Presidents Bush and Obama, is short-term tax rebates, on the theory that these temporary windfalls will encourage people to go out and spend more money.

I don't object to letting people keep more of the money they've earned. But one-time rebates and short-term tax policies do not give businesses the confidence they need to make the kinds of long-term investments that create jobs.

That is why, of all the proposals the President put forward in his latest speech, the most encouraging was his support for making the corporate tax code fairer, simpler, and more competitive.

We should extend these reforms to the entire U.S. tax code. A world-class tax system should be fair, simple, and competitive—and right now, the U.S. tax code fails miserably on all three counts.

The World Economic Forum recently downgraded the United States from fourth to fifth in its annual competitiveness rankings. The reason? Under the section titled, "Most problematic factors for doing business," our unfair, complex, and uncompetitive tax code was right at the very top.

We need to close loopholes that distort economic activity—and that reward the politically well-connected at the expense of the hard-working small businessman.

We need to simplify the code by reducing the number of brackets, so that people spend less time and money figuring out how to comply with the code.

And we need to lower tax rates, to encourage economic activity—and to allow our businesses to compete on a level playing field against those in countries where corporate tax rates are much lower. Unfortunately, that list includes every developed country except for Japan.

There is a growing bipartisan consensus for this kind of common-sense tax reform. The President's bipartisan Fiscal Commission made clear that a revamped tax code with a broader base and lower rates was critical to economic growth.

That's one reason House Republicans included similar reforms in our budget, The Path to Prosperity—lower rates and a broader base to help get our economy growing again.

Unlike the high-cost government spending proposals now circulating in Washington, fundamental tax reform could be done with no budgetary cost, but would provide many immediate and long-lasting economic benefits.

At today's hearing on the need for such reform, we will hear from three terrific witnesses.

In addition to tax experts Scott Hodge of the Tax Foundation and Diane Lim Rogers of the Concord Coalition, we have a witness today from the world of business, Michael Wall of Case New Holland, headquartered in Southern Wisconsin.

Mr. Wall can speak first-hand about the effects of tax policy on business decisions and job creation in the United States.

I am looking forward to hearing from all of you on a topic that is critical to laying the foundation for sustained economic growth and job creation.

With that, I yield to the Ranking Member, Mr. Van Hollen.

Mr. VAN HOLLEN. Thank you, Mr. Chairman. And thank you for bringing us together in this hearing. I want to thank all of our witnesses. You know, there are a lot of committees in Congress that just look at one subject matter area or several subject matter areas. You have got The Transportation Committee, you have got The Education Committee. The advantage of The Budget Committee is it allows us an overview of the budget. And we had a number of hearings in this committee, very important hearings that looked at some of the impact on the budget of the rising costs of some of the programs, health care programs in the country, Medicare, Medicaid, others due to changing demographics and other factors including the high cost of health care. And we have looked at a number of other parts of the budget.

I think also as we look at the deficit situation that we are confronting, especially as it grows in the out-years, we have to look at the role of revenue and figure out what is the best way to raise and generate that kind of revenue as we approach a budget that deals with both the spending side as well as the revenue side of the picture. And I am glad the chairman mentioned the Simpson-Bowles Commission because I think they did put a lot of ideas on the table for how we can simplify our tax code. I would point out that at the same time they used a considerable part of the savings they generated through their tax reform to reduce the deficit which is obviously a very important component of our overall economic strategy.

Now, we had the first hearing of the so-called Joint Committee yesterday, and Dr. Elmendorf, the head of CBO, testified and he made two really important points. One was he reinforced the point of earlier hearings in this committee about the rising out-year costs that we face. He also made the point that if this Congress were to adjourn right now for 10 years and just let current law kick in, you would actually reduce the deficit by over $4.5 trillion simply by allowing the old Clinton tax rates to go into effect and a couple of other changes. And, you know, people talk about going big, let's do something big, I just want emphasize the point if Congress packed its back and went into hibernation for 10 years, you would exceed the target of those bipartisan commissions.

Now, I am not advocating that we do that, and I do not think anybody is. And Simpson-Bowles and Rivlin-Domenici did not. But I am advocating the fact that we need more revenue if we are going to avoid very deep cuts to things like Medicare. I mean, we have seen proposals that make dramatic impacts on Medicare beneficiaries. And I think that those are frankly asking Medicare beneficiaries to pay too big of a burden for things that they have already invested in. So the trick is to devise a tax system through tax reform that both encourages growth but also deals with the revenue piece and is done in a fair way and a balanced way. There is no doubt that the tax system is chockfull of special interest provisions, many on the corporate side. A lot of us do not think, for example, that some of the big oil companies should be getting big taxpayer subsidies at a time they are doing just fine and why do they need that extra handout from the taxpayer. You have a lot of other provisions in the tax code that are absolutely unnecessary and especially on the corporate tax side, there is a very strong argument to be made obviously in reducing the overall rate and somehow doing it in a way that expands the base. And I think there is room for common ground.

On the individual side of the tax code, there is also room to look at those areas; Simpson-Bowles did. It gets even a little trickier on the individual side but some of the same arguments can certainly be made. So I hope this is actually an opportunity to try and find some common ground as we go forward, recognizing, again, that Simpson-Bowles, Rivlin-Domenici, Gang of Six, all these other bipartisan groups found a way to both reform the tax code that made it, I think, more efficient in many ways, but also recognized the role that the revenues play as part of a balanced approach to reducing our deficit. And after all, that is what this committee has spent a lot of time looking at is the out-year deficit situation.

In closing, I would just point out that yesterday Dr. Elmendorf pointed out that there is absolutely no contradiction between trying to take measures in the short term to try and boost a very fragile economy and try and reduce the deficit over a longer period of time. And he specifically pointed out that a CBO study had found that if you look at different tax policy provisions, that providing relief at this point on the payroll tax holiday, on the employee side especially, would provide obviously a little bit more money in the pockets of consumers. And one of the main reasons businesses are not hiring is they do not have people out there purchasing their goods and services. So to the extent that people now have a little bit extra cash in their pocket, that would help boost the economy along with other measure like the infrastructure investment. And again, that is not my testimony alone. That was also a point made by Dr. Elmendorf.

So, Mr. Chairman, I am actually hoping that this discussion can actually steer us in the direction ultimately of some common ground on these issues.

Chairman RYAN. Great. Thank you, Mr. Van Hollen. We will start with Mr. Wall, then Mr. Hodge, then Ms. Rogers. Mr. Wall?

STATEMENTS OF MICHAEL WALL, VICE PRESIDENT OF TAX CASE NEW HOLLAND; SCOTT HODGE, PRESIDENT, TAX FOUNDATION; DIANE LIM ROGERS, CHIEF ECONOMIST, THE CONCORD COALITION

STATEMENT OF MICHAEL WALL

Mr. WALL. Good morning, Chairman Ryan, Ranking Member Van Hollen, and distinguished members of the committee. My name is Michael Wall. I am vice president of Corporate Tax for Case New Holland. I would like to thank you for this opportunity today to testify on behalf of CNH. I applaud your leadership in holding this timely hearing on the need for pro-growth tax reform that will increase the nation's international competitiveness and be a driving force for job creation in America.

CNH manufactures the tools used to shape the world, from machinery for building roads, and schools, for equipment for growing and harvesting food. CNH is perhaps the most geographically diversified manufacturer and distributor of agricultural and construction equipment in the world. We are present in approximately 170 countries with significant operations in the United States.

In 2010, CNH's manufacturing in the United States accounted for over $7 billion in annual revenues. And CNH exported 34 percent of our U.S. production to global markets. CNH employs 10,800 people in the United States, and we are a majority-owned subsidiary of FIAT Industrial.

Given CNH's unique perspective of having manufacturing, distribution, and research facilities across the world, we believe that substantially lowering the U.S. corporate tax rate, while preserving essential business growth incentives, will significantly improving American business competitiveness and incentivize foreign investment in the United States.

Unfortunately, there is effectively a 14 percent incremental tax burden between combined 39.2 percent U.S. federal and state tax rate versus the 25 percent average tax rate for the OECD countries. In fact, virtually every industrialized country except the United States has lowered its corporate tax rate over the last 20 years. These countries chose to lower their corporate tax rate to attract and retain capital and prove the competitiveness of its economies and provide pro-growth environment for job creation.

CNH's summary view is that the U.S. corporate tax reform should include the following key aspects. First, significantly lower the U.S. corporate tax rate. Second, consider appropriate modifications to certain corporate tax expenditures in a fiscally responsible manner. Third, adopt the territorial tax system for the United

States. In pursuing fundamental corporate tax reform, CNH believes it is imperative that corporate tax reform does not discriminate against U.S. subsidiaries or foreign-domiciled companies. Recognizing that foreign investment is an engine for job growth and economic recovery, President Obama recently issued a statement in June highlighting the importance of foreign investment in the United States and reaffirmed the United States longstanding commitment to open investment policies.

CNH believes that the U.S. corporate tax rates should reduce to 25 percent or lower to grow the U.S. economy and achieve a competitive corporate tax rate with our international trading partners. CNH greatly commends this committee for including a 25 percent corporate tax rate in its fiscal year 2012 budget legislation. I note that a 20 percent federal corporate tax rate combined with the average state tax rate would result in a U.S. corporate tax rate equal to the 25 percent average corporate tax rate in the OECD.

CNH recognizes that a fundamental corporate tax reform providing for a reduced corporate tax rate may be coupled with modification of certain corporate tax expenditures in a fiscally responsible manner. As Congress considers specific corporate tax reforms, CNH believes that the retention of an accelerated tax depreciation and the tax credit for increase in research activities are vitally important for the sustainable U.S. economic growth and should be retained in any final corporate tax reform legislation.

The United States is one of only eight remaining OECD countries and the only G-7 country that maintains a worldwide tax system that taxes U.S. companies on income earned and foreign countries on the repatriation of those earnings to the United States. The other seven OECD countries with a worldwide tax system have an average corporate tax rate of 21 percent, which is substantially lower than the U.S. corporate tax rate. CNH's view is that the United States should adopt a territorial tax system with an exemption for dividends paid from active, foreign-source income to ensure the competitive tax system in line with our trading partners.

In conclusion, CNH believes that significantly reducing the U.S. corporate tax rate in conjunction with the adoption of a territorial tax system will make the United States more competitive with other countries, significantly increase investment in the United States, and lead to much needed job growth for the American people. On behalf of CNH, I again thank you for providing this opportunity to share CNH's view on fundamental corporate tax reform. CNH looks forward to working with this committee and the Congress in considering these vitally important issues. I am pleased to answer any questions the committee may have. Thank you very much.

[The prepared statement of Michael Wall follows:]

PREPARED STATEMENT OF MICHAEL G. WALL, VICE PRESIDENT OF CORPORATE TAX, CASE NEW HOLLAND INC.

Good morning, Chairman Ryan, Ranking Member Van Hollen, and distinguished Members of the Committee. My name is Michael Wall and I am Vice President of Corporate Tax for Case New Holland Inc. ("CNH"). I want to thank you for the opportunity to testify on behalf of CNH this morning. I applaud your leadership in holding this timely hearing on the necessity of fundamental U.S. corporate tax reform that will increase the competitiveness of the U.S. corporate tax system to attract investment in a competitive global market and be a driving force for job creation in America.

CNH manufactures the tools used to shape the world, from machinery for building roads, bridges, schools and hospitals, to equipment for growing and harvesting food. Formed in 1999 through the merger of New Holland and Case Corporation, CNH unites two renowned international companies with roots dating back to the 1800s. Today, CNH is one of the world's leading manufacturers of agricultural combines and tractors as well as a leader in the markets for hay and forage and specialty harvesting equipment. In the construction industry, CNH maintains a top position in backhoe loaders and a strong position in skid steer loaders in North America and crawler excavators in Western Europe. CNH comprises the heritage and expertise of three agricultural brands: Case IH; New Holland Ag; and Steyr and three construction equipment brands: Case Construction Equipment; New Holland Construction; and Kobelco.

CNH is perhaps the most geographically diversified manufacturer and distributor of agricultural and construction equipment in the world. CNH is present on six continents and in approximately 170 countries with a network of approximately 11,300 dealers, including more than 2,000 dealers in the United States, as well as 40 manufacturing facilities located throughout Europe, North America, Latin America, and Asia. CNH has manufacturing, distribution, and research facilities in 32 countries, including the United States with locations in Arizona, California, Georgia, Illinois, Indiana, Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, Oregon, Pennsylvania, Texas, and Wisconsin. CNH had global revenues of over $15.6 billion in 2010. CNH employs over 10,800 people in the United States; however, this number does not include the significant number of employees of our 1,300 plus U.S. suppliers and dealer network. CNH is a majority-owned subsidiary of FIAT Industrial S.p.A., a public company whose capital stock is listed on the Italian Stock Exchange (FI.IM).

As an American subsidiary of a foreign domiciled company, CNH is representative of a large group of inbound corporations making substantial direct investments in the United States. However, because of our historic tax structure in the United States, we share many of the same policy goals and concerns as U.S. based multinational corporations. This hearing comes at a critical time when the United States is at an economic crossroads, facing serious fiscal challenges at home, historically-high levels of annual federal deficits, excessive federal debt, and an increasingly competitive global landscape for attracting and retaining investment. As CNH and other American businesses make plans to invest and hire, we look to the United States to adopt sound economic and tax policies that will drive economic growth. To grow the United States economy, there must be comprehensive reform of the U.S. corporate tax system to make it more competitive with our international trading partners.

This Congress's work on fundamental tax reform is vital to ensure that the United States adopts a competitive corporate tax system to attract and retain capital in a global marketplace. While many of the United States international trading partners have substantially lowered their corporate tax rates to encourage business investment and job growth, the United States has the second highest corporate tax rate among the Organization for Economic Cooperation and Development ("OECD") countries.

CNH'S UNIQUE GLOBAL PERSPECTIVE

Given CNH's unique perspective of having manufacturing, distribution, and research facilities in 32 different countries, we believe that substantially lowering the U.S. corporate tax rate, while preserving essential business growth incentives, will significantly improve American business competitiveness and incentivize foreign investment in the United States. In 2010, CNH's operations in the United States accounted for over $7 billion in annual revenues and CNH exported 34% of our U.S. production to global markets. CNH's U.S. operations are helping the United States reach the National Export Initiative goal of doubling exports by the year 2015. For example, our tractor plant in Racine, Wisconsin, exported 40% of its production so far this year.

As CNH seeks to expand its global operations, the relative competitiveness of a country's corporate tax system is a key financial consideration. Unfortunately, there is effectively a 14% incremental tax burden between the 39.2% combined U.S. federal tax rate of 35% and the additional 4.2% average state applicable tax rate, and the 25% average corporate tax rate for the OECD countries, which negatively impacts America's ability to attract and retain capital in a competitive global marketplace.

Unlike the 1960s and 1970s, the United States is no longer the sole dominant global player and American businesses operate in a fiercely competitive global marketplace. While many of the U.S. international trading partners have substantially lowered their statutory corporate tax rates as an incentive to encourage business investment and job growth, the United States is burdened with an uncompetitive corporate tax system in this increasingly competitive global landscape. In fact, virtually every industrialized country except the United States has lowered its corporate tax rate over the past 20 years, but the United States has resisted this trend and actually increased its corporate tax rate, creating a less-hospitable environment for business and job creation.

Although the United States has a vibrant commercial market and an exceptional labor force, an uncompetitive corporate tax system and the increasingly unpredictable regulatory environment are strong negatives that companies take into account when looking to expand their global operations. An indisputable fact is that the U.S. manufacturing base and jobs have been steadily decreasing over the last three decades due to a variety of reasons, which include extraordinarily high corporate income taxes. International trading partners have dramatically lowered their corporate tax rates in recent years, and these countries are winning the global competition to attract business investment and jobs. For example, the United Kingdom lowered its corporate tax rate from 28% to 26% in 2011, and over the next three years, the United Kingdom will further reduce its corporate tax rate by 1% each year until it reaches 23% in 2014. The United Kingdom explicitly chose to lower its corporate tax rate to improve the competiveness of its economy and provide jobs for its workers.

While there is a general consensus in Congress to level the playing field and use the savings to lower the corporate tax rate, as expressed by President Obama in his 2011 State of the Union address, there is a divergence of views as to the specific details to achieve this objective. CNH's summary view is that U.S. corporate tax reform should include the following key aspects to stimulate Gross Domestic Product ("GDP") growth and create jobs in the United States:

Lower the U.S. corporate tax rate;

Consider appropriate modifications of certain corporate tax expenditures to broaden the base; and,

Adopt a U.S. territorial tax system.

Recognizing that foreign investment is an important engine for U.S. job growth and economic recovery, President Obama recently issued a statement highlighting the importance of foreign investment in the U.S. economy and reaffirmed the United States' longstanding commitment to open investment policies. This statement and the subsequent Executive Order to establish the SelectUSA initiative to attract greater business investment is a good first step in making the United States a better place for global companies to do business, but much more is left to be done, including fundamental reform of the U.S. corporate tax system. In pursuing reform of the U.S. corporate tax system, CNH believes it is imperative that the reformed corporate tax system not discriminate against U.S. subsidiaries of foreign domiciled companies, which would further reduce the levels of investment in the United States that might otherwise be available to enhance job creation.

NEED TO LOWER THE U.S. CORPORATE TAX RATE

The United States has an extremely uncompetitive combined federal and state applicable tax rate of 39.2%, which is the second highest among the OECD countries. Japan is the only OECD country with a slightly higher corporate tax rate (39.5%) than the United States, although Japanese officials had announced Japan's intention to drop its statutory corporate tax rate by 4.5% before the March 2011 earthquake caused the reduction to be deferred. Please see Exhibit A titled "OECD Corporate Tax Rates" for the combined corporate tax rates for OECD countries for the 2010 tax year.

The National Commission on Fiscal Responsibility and Reform narrative recommended lowering the U.S. corporate tax rate to a range of 23% to 29%. CNH believes that the U.S. corporate tax rate should be reduced to 25% or lower to achieve a competitive U.S. corporate tax system consistent with the 25% OECD average tax rate. In our view, the 25% U.S. corporate tax rate included in the House Budget Committee Fiscal Year 2012 Budget is necessary to achieve a competitive U.S. corporate tax system that will stimulate the U.S. economy and create jobs. An analysis by the Milken Institute in 2010, Jobs for America, concluded that reducing the U.S. combined federal and state corporate income tax rates to the average of OECD countries would increase real GDP by 2.2% (or $376 billion) and create 2.1 million private sector jobs by 2019.

CNH has substantial business operations in the United States, Australia, Brazil, Canada, India, and many countries in the European Union, including Austria, Belgium, France, Germany, Italy, Poland, and the United Kingdom. As CNH looks to expand its capacity to meet growing demand and create jobs, the after-tax earnings and cash flow from operations is a major factor in considering locations to expand operations. A comparative view of the combined national and sub-national corporate tax rates for 2010 for the major countries that CNH operates illuminates the significant lack of competitiveness of the U.S. corporate tax rate and highlights the inability of the United States to keep pace with its international trading partners to lower its corporate tax rate over the last twenty years.

COMPARATIVE ANALYSIS OF OECD COMBINED NATIONAL AND SUB-NATIONAL CORPORATE TAX RATES FOR 2010 IN MAJOR COUNTRIES WHERE CNH OPERATES

Country	1990	2010	Change in rate
United States	38.7%	39.2%	0.5%
Australia	39%	30%	(9%)
Austria	30%	25%	(5%)
Belgium	41%	34%	(7%)
Brazil	42%	34%	[1] (8%)
Canada	41.5%	29.5%	(12%)
France	42%	34.4%	(7.6%)
Germany	54.5%	30.2%	(24.3%)
India	63%	34%	[1] (29%)
Italy	46.4%	27.5%	(18.9%)
Poland	n/a	19%	
United Kingdom	34%	28%	(6%)

[1] Non-OECD country.

The OECD average corporate tax rate has dropped by nearly 16 percentage points from 41% in 1990 to 25% in 2010. Whereas, the United States has actually increased its tax rate by 0.5% during this timeframe, principally from a one percentage point increase in the federal corporate tax rate in 1993 offset by a change to the average state applicable tax rate. It is important to note that even by lowering the U.S. corporate federal tax rate to 25%, the combined federal and state applicable tax rate would still be higher than the 25% OECD average tax rate, but within the range of a competitive corporate tax rate.

As the Joint Committee on Taxation ("JCT") staff has recently stated, "the best way to encourage increased investment in the United States (by foreign or domestic investors) is to increase the after-tax return to investment, and that outcome is more efficiently achieved by, for example, lowering the U.S. corporate income tax rate than by narrower policies such as the facilitation of earnings stripping." Source: JCT, Present Law and Issues in U.S. Taxation of Cross-Border Income, September 6, 2011, JCX-42-11, page 59. In a 2005 study, the JCT compared individual income tax reductions and corporate income tax reductions and concluded that a reduction in the corporate income tax had the greatest impact on increasing long-term economic growth, due to increased capital investment, and increased labor productivity. Further, recent research by the OECD concludes that the corporate income tax has the most adverse impact on economic growth than any other tax.

CNH is equally concerned about the tax rates imposed on our suppliers, dealers, and customers. Although CNH is a Subchapter C corporation, many of our suppliers, dealers, and customers operate as Subchapter S corporations, partnerships, and limited liability companies, so that these pass-through entities pay U.S. taxes on their owners' individual income tax returns. While some commentators advocate taxing large pass-through entities as Subchapter C corporations, CNH opposes subjecting pass-through entities to the "double-taxation" regime of Subchapter C corporations because this would be tantamount to a large business tax increase on an important segment of entrepreneurs that fuel U.S. economic growth. CNH's view is that Congress should also lower U.S. individual tax rates and broaden the tax base as part of fundamental U.S. tax reform consistent with the general principles of the National Commission on Fiscal Responsibility and Reform report.

ELIMINATION OR MODIFICATION OF U.S. CORPORATE TAX EXPENDITURES

CNH recognizes that fundamental corporate tax reform providing for a reduced corporate tax rate may be coupled in the legislative process with the elimination or modification of certain corporate tax expenditures in a fiscally responsible manner.

CNH, like many corporations, can accept the elimination or modification of certain corporate tax expenditures if necessary to effectuate a fundamental and fair corporate tax reform, but only to facilitate a 10 percentage point or more reduction of the U.S. corporate rate. Naturally, there is a divergence of views within the business community over which corporate tax expenditures should be modified. While Congress may be forced to make difficult choices in this process, it is of vital importance that the corporate federal tax rate be reduced to 25% or less. CNH strongly believes that the stimulus provided by a significant reduction of the U.S. corporate tax rate would spur U.S. business activity across all sectors of the economy, increase GDP growth, and have a significant beneficial impact on all aspects of the Nation's economy.

As Congress deliberates on fundamental corporate tax reform, CNH believes that retention of accelerated tax depreciation of property and the tax credit for increasing research activities are vital corporate tax expenditures that promote sustainable U.S. economic growth. It is important to note that many of our international trading partners' tax systems also employ the accelerated depreciation and research tax credit incentives. CNH's view is that maintaining accelerated tax depreciation encourages capital expenditures and demand for durable goods, which has been embraced by Congressional policymakers as sound pro-growth business tax provisions. Once a leader in promoting innovation, the United States now ranks 24th out of 38 OECD countries in terms of the competitiveness of its research and development tax incentives. CNH's view is that the permanent extension of the research and development tax credit is essential to encouraging domestic investment in cutting edge technology to keep the United States competitive in a global economy. According to the Milken Institute report, Jobs for America, if the research and development credit were strengthened and made permanent, total manufacturing employment would increase by 270,000 by 2019.

ADOPTION OF A U.S. TERRITORIAL TAX SYSTEM

The United States is one of the eight remaining countries in the OECD that maintains a worldwide system of taxation that taxes U.S. companies on the income they earn in foreign countries upon repatriation of the earnings to the United States. Under current tax law, U.S. companies must factor in the higher rate of U.S. tax it will pay on its foreign earnings when these earnings are repatriated to the United States, which makes U.S. companies less competitive relative to the global competition. This can be exacerbated because although the United States allows a foreign tax credit, such that these repatriated earnings are not subject to "double taxation," often times U.S. companies are unable to fully credit the foreign taxes due to the intricacies of the foreign tax credit calculation. A territorial system would tax U.S. companies only on the income they earn in the United States with an exemption for dividends received from foreign subsidiaries.

CNH's view is that the United States should adopt a territorial tax system with an exemption for dividends paid from active foreign-source income to achieve a competitive U.S. corporate tax system that is in line with our international trading partners and consistent with the recommendations of the National Commission on Fiscal Responsibility and Reform report. All other G-7 countries and 26 of the 34 OECD countries have adopted a territorial tax system that largely exempts active earnings from home country taxation. The eight OECD countries that do not have a territorial tax system are Chile, Greece, Ireland, Israel, Korea, Mexico, Poland, and the United States. Excluding the United States, the other OECD countries that have a worldwide tax system with a foreign tax credit regime have an average corporate tax rate of 21%. In just the past two years, both the United Kingdom and Japan have switched to territorial tax systems to improve the competitiveness of their tax systems and provide more jobs for their economies. Please see Exhibit B titled "OECD Countries with Territorial Tax Systems" for the home country tax treatment of foreign-source dividend income received by resident corporations.

Some commentators have expressed concerns that the implementation of a territorial system may create new incentives to move certain U.S. operations offshore. Based upon our considerable experience as an internationally based company with very extensive U.S. operations, CNH disagrees. We strongly believe that a territorial system coupled with a substantially lower U.S. corporate tax rate would provide tremendous incentives for increasing operations in the United States for both U.S. based and foreign based companies.

CONCLUDING REMARKS

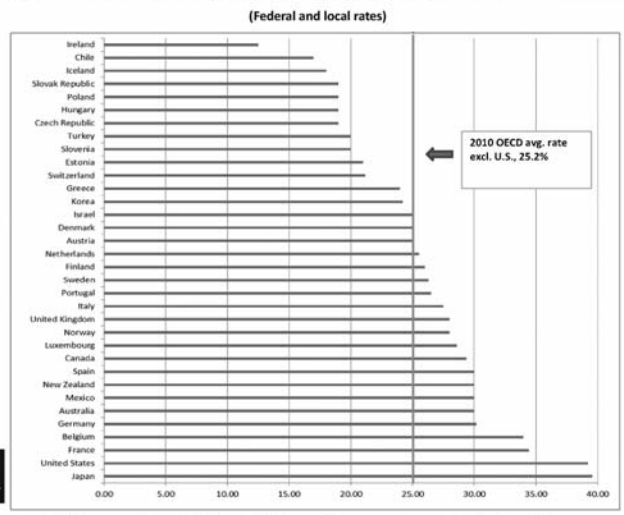
Many countries have aggressively reduced their corporate income tax rates in an effort to attract and retain high-quality job-creating investment, which U.S. policymakers should keep in mind as they consider fundamental corporate tax reform to enhance American competitiveness and attract investment in the United States. CNH believes that reducing the U.S. statutory corporate tax rate to 25% or lower, in conjunction with the adoption of a territorial tax system, would make the United States more competitive with other countries, which would significantly increase investment in the United States and lead to much needed job growth.

The broad uncertainty faced by American businesses today includes tax policy in need of reform and an increasingly unpredictable regulatory environment, which has led to a general lack of corporate confidence. Reforming corporate tax policy and removing regulatory uncertainty is necessary for long-term financial planning and capital investments, which are critical for job creation in the United States.

I am pleased to answer any questions you may have, and thank you for this opportunity to share CNH's views on fundamental corporate tax reform. CNH looks forward to working with this Committee and the Congress in considering fundamental corporate tax reform proposals that will increase America's competitiveness, attract and retain capital in a competitive global market, and be a driving force for job creation in the United States.

OECD Corporate Tax Rates

Combined Corporate Tax Rates for OECD Countries, Tax Year 2010



FIAT INDUSTRIAL

Testimony of Michael Wall – Committee on the Budget – U.S. House of Representatives – September 14, 2011 Exhibit A

OECD Countries with Territorial Tax Systems

Home Country Tax Treatment of Foreign-Source Dividend Income Received by Resident Corporations			
Exemption (26 of 34 OECD Countries)			Foreign Tax Credit
Australia	Germany	Portugal	Chile
Austria	Hungary	Slovak Republic	Greece
Belgium	Iceland	Slovenia	Ireland
Canada	Italy	Spain	Israel
Czech Republic	Japan	Sweden	Korea
Denmark	Luxembourg	Switzerland	Mexico
Estonia	Netherlands	Turkey	Poland
Finland	New Zealand	United Kingdom	United States
France	Norway		

FIAT INDUSTRIAL

Note: Some countries limit dividend exemption to substantial shareholders (e.g., 5% or 10% owners). In some cases, dividend exemption is limited to treaty countries that impose corporate income tax above a minimum rate. A few countries (e.g., Belgium, France, Germany, Italy, and Japan) exempt 95% rather than 100% of foreign dividends. The average tax rate for OECD countries with a foreign tax credit regime is 21%, excluding the U.S.

Testimony of Michael Wall – Committee on the Budget – U.S. House of Representatives – September 14, 2011 Exhibit B

Chairman RYAN. Thank you, Mr. Wall. Mr. Hodge?

STATEMENT OF SCOTT HODGE

Mr. HODGE. Thank you, Mr. Chairman, Mr. Van Hollen. I appreciate the opportunity to talk to you today about how fundamental tax reform can improve America's long-term economic growth and our global competitiveness.

Since 1937, the Tax Foundation has stood for the immutable principles of sound tax policies. Now taxes should be neutral to economic decision-making. They should be simple, transparent, stable, and they should promote economic growth. In other words, they ideal tax system should do only one thing, and that is to raise a sufficient amount of revenues to fund government activities with the least amount of harm to the economy. And by all accounts, the U.S. tax system is far from that ideal. In fact, Mr. Chairman, the economic research suggests that the U.S. corporate and individual tax systems are undermining the nation's long-term economic growth.

OECD economists have studied the impact of taxes on economic growth for the largest capitalist nations, and they have determined that high corporate income taxes and high personal income taxes are the most harmful taxes for long-term economic growth, followed by consumption taxes and property taxes. And this should be a red flag to all of us, because when it comes to corporate taxes, the U.S. has a Neiman-Marcus tax system while the rest of the world has moved toward a Wal-Mart model of corporate taxation. Not only do we have the second highest overall corporate tax rate among the leading industrialized countries at over 39 percent, but we were one of the few remaining countries, as Mr. Wall mentioned, that has a worldwide tax system. And the economic research tells us that cutting the corporate tax rate will not only help the country on a long-term growth path, but it will lead to higher wages and higher living standards.

One of the reasons the Japanese moved to a territorial tax system is because they found out that a high corporate tax rate combined with a worldwide tax system creates a lockout effect that discourages the repatriation of foreign earnings. And so moving to a territorial system will break down the Berlin Wall that is keeping more than a trillion dollars in foreign profits abroad.

Now, with all deference to Warren Buffet, OECD research has also found that the U.S. has the most progressive income tax burden among all the leading industrialized nations. The top 10 percent of taxpayers in the United States pays a greater share of the income tax burden than their counterparts in any other industrialized country. And our low-income Americans have the lowest income tax burden of any industrialized country. And I think it is also pretty well known that about half of all American households now pay no income taxes because of the generosity of credits and deductions in the code.

And the research shows that the more a country tries to make an income tax system progressive, the more it undermines the factors that contribute most to economic growth. And that is such things as investment, risk taking, entrepreneurship, and productivity.

And while it is easy to cartoon the richest fat cats, America's rich are actually are successful entrepreneurs and business owners. And because of the growth in entrepreneurship over the past 30 years, there is actually more business income that is being taxed under the individual tax code than under the traditional corporate tax system. And so what that tells us is that cutting the top individual income tax rates for these dynamic individuals and entrepreneurs will lead to higher productivity gains, which then translate into higher economic growth.

Let me wrap up by saying that with deficit now at $1.5 trillion, it is tempting to look at closing loopholes and tax reform as an opportunity to raise more revenues for the government. But the primary goal of tax reform should be to promote long-term economic growth and to increase the living standards for all Americans, not just to raise tax revenues for the government. And if the byproduct of increased economic growth is more tax revenues, then that is a win-win.

Now I understand there is clearly a tension in the United States between the desire for a simpler tax code and one that also ensures fairness and equity. So I would suggest that we develop a new way of thinking about equity and the tax code. We should strive to build a consensus around three basic concepts. First, an equitable tax system should be free of most of the credits and deductions, and it should not micromanage individual or business behavior.

Secondly, an equitable tax system should apply a single flat rate on most everyone equally. And that way every citizen pays at least something to the basic cost of government.

And lastly, an equitable tax code should be simple, and it should have dramatically lower rates than what we have today, in the low 20s, I think, by most accounts. And the government could raise about the same amount of revenue that it does today.

I believe that such a tax code would actually generate a more predictable and stable revenue stream to fund government programs as opposed to the roller coaster system that we have today. And, most importantly, such a tax code would be conducive to long-term economic growth and higher living standards for all Americans. And that is one of the keys of fixing the long-term fiscal crisis that is facing America today.

And thank you very much. I appreciate the opportunity and would answer any questions that you have.

[The prepared statement of Scott Hodge follows:]

PREPARED STATEMENT OF SCOTT A. HODGE, PRESIDENT, TAX FOUNDATION

I am Scott Hodge, president of the Tax Foundation. Thank you for the opportunity to speak to you today about how comprehensive tax reform can boost America's long-term economic growth and improve our global competitiveness.

Founded in 1937, the Tax Foundation is the nation's oldest non-partisan, non-profit organization dedicated to promoting economically sound tax policy at all levels of government.

We are guided by the immutable principles of economically sound tax policy which say that: Taxes should be neutral to economic decision making, they should be simple, transparent, stable, and they should promote economic growth.

In other words, the ideal tax system should do only one thing—raise a sufficient amount of revenues to fund government activities with the least amount of harm to the economy.

By all accounts, the U.S. tax system is far from that ideal.

INTRODUCTION

The U.S. tax system is in desperate need of simplification and reform. Over the past two decades, lawmakers have increasingly asked the tax code to direct all manner of social and economic objectives, such as encouraging people to buy hybrid vehicles, turn corn into gasoline, save more for retirement, purchase health insurance, buy a home, replace the home's windows, adopt children, put them in daycare, take care of Grandma, buy bonds, spend more on research, purchase school supplies, go to college, invest in historic buildings, and the list goes on.

The relentless growth of credits and deductions over the past 20 years has not only knocked half of all American households off the tax rolls, it has made the IRS a super-agency, engaged in policies as unrelated as delivering welfare benefits to subsidizing the manufacture of energy efficient refrigerators. I would argue that were we starting from scratch, these would not be the functions we would want a tax collection agency to perform.

Ironically, but perhaps not surprisingly, the sectors suffering the biggest financial crises today—health care, housing, and state and local governments—all receive the most subsidies through the tax code. The cure for what ails these parties is to be weaned off the tax code, not given more subsidies through such things as the First Time Homebuyer's Credit, Premium Assistance credits, or more tax free bonds.

While tax cuts will always curry more favor with voters than creating new spending programs, Washington needs to call a truce to using the tax code for social or economic goals. Indeed, the tax base has become so narrow that trying to accomplish more social goals via the tax code is like pushing on a string.

Washington can actually do more for the American people by doing less. The solution lies in fundamental tax reform—as has been suggested by parties as diverse as Chairman Ryan and President Obama's National Commission on Fiscal Responsibility and Reform, chaired by Erskine Bowles and Alan Simpson. As many studies have shown, Americans could be taxed at lower rates—and the government could raise the same amount of revenue—if the majority of tax expenditures were eliminated.

That said, the primary goal of fundamental tax reform should not be raising more money for government. The primary goal should be improving the nation's long-term economic growth and lifting American's living standards.

Path breaking research by economists at the OECD suggests that the U.S. corporate and individual tax systems are a major detriment to our nation's long-term economic growth. In a major study analyzing the impact of various taxes on long-term economic growth, they determined that high corporate and personal income tax rates are the most harmful taxes for long-term economic growth, followed by consumption taxes and property taxes.

Unfortunately, as many of you many know, the U.S. has the 2nd highest corporate income tax rate among industrialized nations and, this may surprise you, the U.S. has the most progressive personal income tax systems among industrialized nations.

The economic evidence suggests that cutting our corporate and personal income tax rates while broadening the tax base would greatly improve the nation's prospects for long-term GDP growth while helping to restore Uncle Sam's fiscal health. More importantly, these measures will lead to higher wages and better living standards for American citizens. And that should be the number one priority of any tax policy.

Let's consider corporate and individual tax reform one at a time.

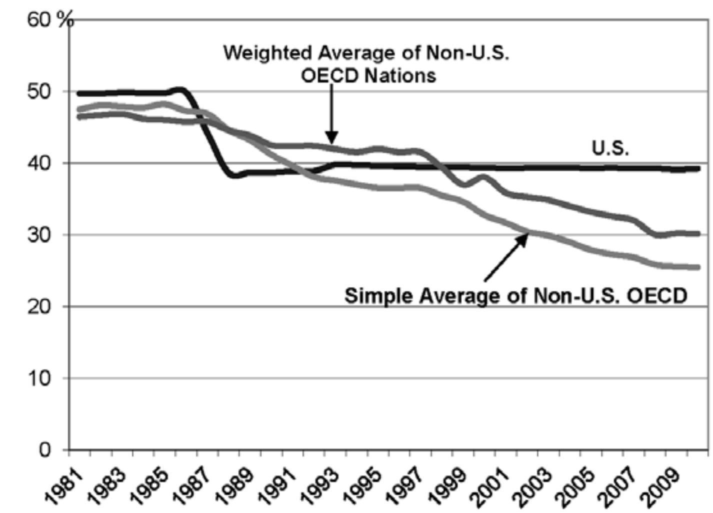
CORPORATE TAX REFORM CAN IMPROVE U.S. COMPETITIVENESS AND LIVING STANDARDS

When it comes to corporate taxes, the U.S. has a Neiman Marcus tax system while the rest of the world has moved toward a Walmart model of corporate taxation. In contrast to our high-rate, narrow base, and worldwide model of corporate taxations, the basic tenets of this new model are lower tax rates, a broader base, and the exemption of foreign earnings.

In just the past four years alone, 75 countries have cut their corporate tax rates to make themselves more competitive. And, reports the OECD, "there has been a gradual movement of countries moving from a credit [worldwide] to an exemption [territorial] system, at least in part because of the competitive edge that this can give to their resident multinational firms." [1]

The U.S. remains far behind on both of these trends. Not only do we have the second-highest overall corporate tax rate among the leading industrialized nations at over 39 percent—only Japan has a higher overall rate—but we are one of the few remaining countries to tax on a worldwide basis.

Figure 1: The Statutory U.S. Corporate Tax Rate Compared to OECD Averages 1981 to 2010



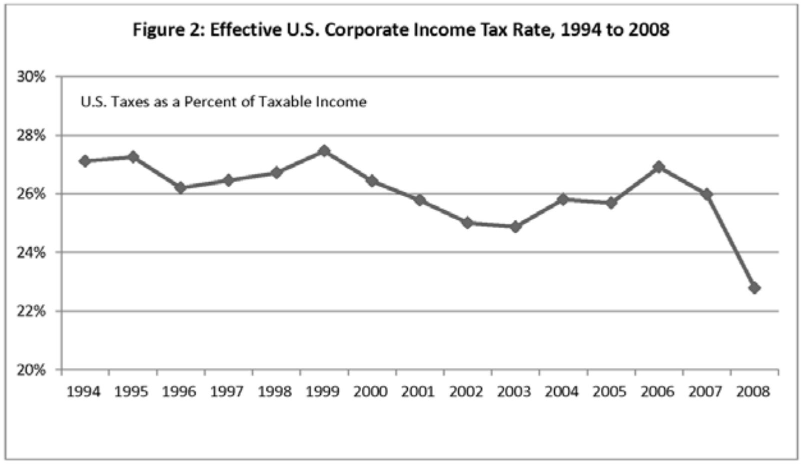
Source: Tax Foundation calculations based on OECD and IMF data

Our largest trading partners—Canada, Great Britain, and Japan—have already taken steps to make themselves more competitive. For example, Great Britain lowered its corporate tax rate on April 1st of this year, from 28 percent to 26 percent as a first step toward the goal of having a 23 percent rate in 2014. On January 1st, Canada lowered its federal corporate tax rate from 18 percent to 16.5 percent. Next year the rate will fall to 15 percent. Japan was scheduled to cut its overall corporate rate by 5 percent until the tragic earthquake derailed the government's legislative agenda. Japan's move would have left the U.S. with the highest overall corporate tax rate in the industrialized world.

As important as are differences in tax rates, however, all three of these countries have effectively moved toward a territorial or exemption form of taxing the foreign profits of their multination firms. Indeed, of the 34 OECD member nations, 26 have either a full territorial system or exempt at least 95 percent of foreign earnings from repatriation taxes. The U.S. remains the only country in the OECD with a worldwide system and a corporate rate above 30 percent.

While some critics charge that U.S. corporations pay far less than the statutory tax rate because of the plethora of credits and deductions, a review of IRS data shows that the effective U.S. tax rate for all corporations averaged 26 percent between 1994[2] and 2008. The effective U.S. tax rate varied across years, ranging from 27.5 percent in 1999 to 22.8 percent in 2008.[3]

However, these figures only account for U.S. income taxes paid on domestic profits and repatriated foreign earnings. When foreign taxes are included—U.S. corporations pay $100 billion annually in income taxes to other governments on their foreign profits—the overall tax rate on large multinationals is close to the U.S. statutory rate of 35 percent. Averaged for all corporations, the overall effective corporate tax rate is between 32.1 and 33 percent.



The benefits of making our corporate tax system on-par with the rest of the world's systems cannot be understated.

Here are just a few of the benefits of corporate tax reform:

Cutting the U.S. corporate tax rate will help put the country on a long-term growth path. Economists at the OECD determined that the "corporate income tax is the most harmful tax for long-term economic growth" (emphasis added), not only because it increases the cost of domestic investment, but also because capital is the most mobile factor in the global economy, and thus the most sensitive to high tax rates.

Indeed, the report found that "Corporate income taxes appear to have a particularly negative impact on GDP per capita." [4] Lowering statutory corporate tax rates, they determined, "can lead to particularly large productivity gains in firms that are dynamic and profitable, i.e. those that can make the largest contribution to GDP growth." [5] OECD economists speculate that this could be because these are the firms that rely most heavily on retained earnings to finances their growth.[6] Higher taxes mean fewer retained earnings, which means less growth.

Cutting the corporate tax rate will lead to higher wages and living standards. In a world in which capital is extremely mobile but workers are not, most studies find that workers bear 45 percent to 75 percent of the economic burden of corporate taxes. In one such study, an economist at the Federal Reserve Bank of Kansas City used cross-country data to study the effect of corporate taxes and their interaction on the gross wages of workers. She found that "labor's burden is more than four times the magnitude of the corporate tax revenue collected in the U.S." [7]

According to her model, a one percentage point increase in the average corporate tax rate decreases annual gross wages by 0.9 percent. Translated to U.S. corporate tax collections and wages, this means that a $10.4 billion increase in corporate tax collections would lower overall wages by $43.5 billion.[8]

The overwhelming body of economic evidence suggests that cutting the U.S. corporate tax rate will benefit U.S. workers through higher wages, which translate into higher living standards.

Cutting the corporate tax rate will boost entrepreneurship, investment and productivity. Studies show that the corporate income tax hinders entrepreneurship, risk, and investment. Indeed, a study by Jens Arnold and Cyrille Schwellnus supports the notion that corporate taxes are "success taxes" which "fall disproportionately on firms that are contributing positively to aggregate productivity growth." [9]

Perhaps a worrisome sign for the U.S., they found that firms in relatively profitable industries "have disproportionately lower productivity growth rates in countries with high statutory corporate tax rates." [10] The corporate tax has the biggest impact on firms that are on the way up as opposed to those that have plateaued or are on the way down. In other words, companies that are "in the process of catching up with the technological frontier are particularly affected by corporate taxes." [11]

A key factor for the health of the overall economy is the extent in which investment leads to new technology which, in turn, improves productivity. But, "high corporate taxes may reduce incentives for productivity-enhancing innovations by reducing their post-tax returns."[12] Thus, if U.S. lawmakers want to increase the amount of innovation in the country, a good first step would be to cut the corporate tax rate.

Moving to a territorial system will eliminate the "lock-out" effect. A significant amount of economic research has shown that the willingness of multinational firms to bring home foreign profits is highly sensitive to the level of repatriation tax rates. A 2007 study by Foley et al., found that repatriation tax burdens induce firms to hold more cash abroad.[13] They determined that "the median firm facing above average [repatriation] rates holds 47% of its cash abroad, but the median firm facing below average rates holds only 26% of its cash abroad. This figure suggests that repatriation tax burdens increase foreign cash holdings relative to domestic cash holdings."[14] It should be no surprise, thus, that by most accounts U.S. multinational firms are holding as much as $1 trillion in foreign earnings abroad, in part because of the high toll charge to bring the money back to the U.S.

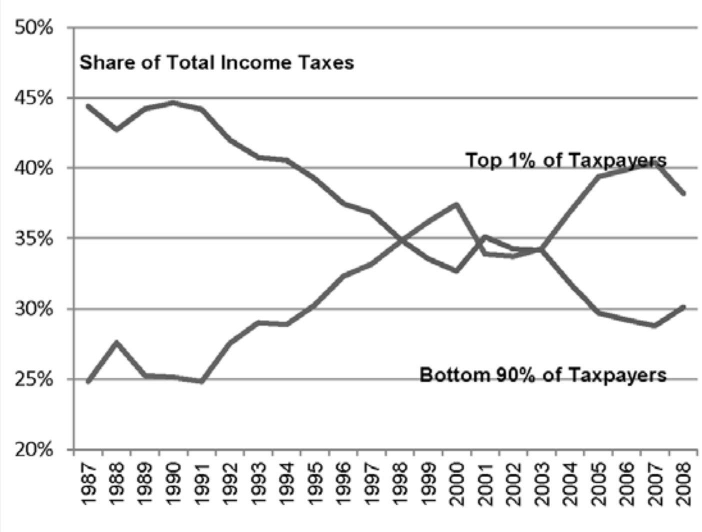
But in a finding that should particularly worry U.S. lawmakers, Foley et al. found that "technology intensive firms appear to be particularly sensitive to repatriation tax burdens," as well as those with "strong growth opportunities," and those with high levels of R&D expenditures.[15] Thus, the "new economy" firms that contribute substantially to economic growth are those that are the most dissuaded from reinvesting their foreign profits back into the U.S.

INDIVIDUAL TAX REFORM CAN BOOST ENTREPRENEURSHIP, PRODUCTIVITY AND GROWTH

President Obama has consistently called for higher tax rates on upper-income taxpayers. But the economic evidence suggests that this would be very detrimental to the country's long-term economic growth. Indeed, OECD economists determined that high personal income taxes are second only to corporate income taxes in their harmful effects on long-term economic growth. And it will shock many Americans to learn that we already have the most progressive income tax burden among the leading industrialized nations.

What that means is that the top 10 percent of U.S. taxpayers pay a larger share of the income tax burden than do their counterparts in any other industrialized country, including traditionally "high-tax" countries such as France, Italy, and Sweden.[16] Meanwhile, because of the generosity of such preferences as the EITC and child credit, low-income Americans have the lowest income tax burden of any OECD nation.

Figure 3: Tax Burden of the Top 1% of Taxpayers Now Exceeds the Share Paid by Bottom 90%



Indeed, the study reports that while most countries rely more on cash transfers than taxes to redistribute income, the U.S. stands out as "achieving greater redistribution through the tax system than through cash transfers." [17] Remarkably, the most recent IRS data for 2009 indicates that nearly 59 million tax filers—42 percent of all filers—had no income tax liability because of the credits and deductions in the tax code.

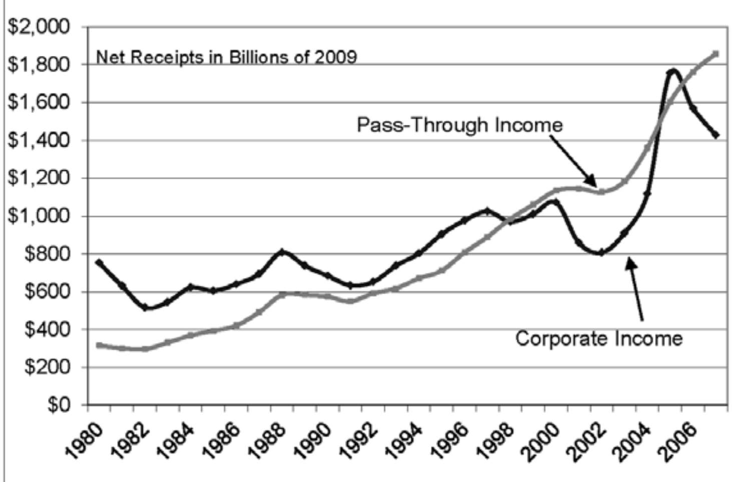
With deference to Warren Buffett, the share of the income tax burden borne by America's wealthiest taxpayers has been growing steadily for more than two decades. Figure 2 compares the share of income taxes paid by the top 1 percent of taxpayers to the share paid by the bottom 90 percent of taxpayers.

The chart shows that, as of 2008, the top 1 percent of taxpayers paid 38 percent of all income taxes, while the bottom 90 percent of taxpayers paid just 30 percent of the income tax burden. By any measure, this is the sign of a very progressive tax system.

What are the harmful effects of progressivity? The economic evidence is quite clear that there is a "non-trivial tradeoff between tax policies that enhance GDP per-capita and equity." [18] Meaning, the more we try to make an income tax system progressive, the more we undermine the factors that contribute most to economic growth—investment, risk taking, entrepreneurship, and productivity.

Individual Tax Reform Must Go Hand-in-Hand with Corporate Reform. It may surprise people to learn that the corporate tax system is no longer the primary tool for which we tax businesses in America. As Figure 4 below shows, more business income is currently taxed under the individual tax system than under the traditional corporate income tax system. It is also interesting to note that for the first time in the history of the tax code the top corporate tax rate and the top individual rate are the same (35 percent). These are key reasons why the individual and corporate tax systems should be reformed together. The neutrality principle dictates that the tax code not bias the way corporate and non-corporate businesses are taxed.

Figure 4: Income Earned by Pass-Through and Corporate Businesses: 1980 to 2007



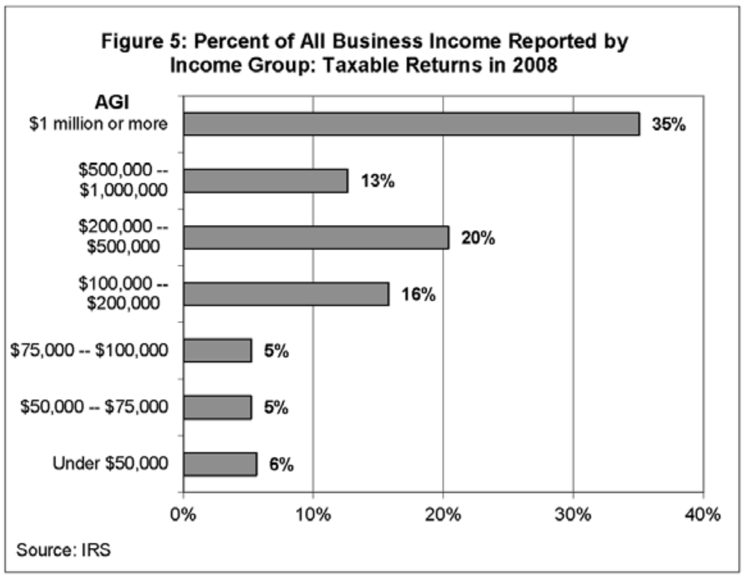
Source: IRS, Statistics of Income

There has been a tremendous growth in "flow-through" private businesses such as sole proprietors, S-corporations, LLCs, and partnerships over the past thirty years. Between 1980 and 2007, for example, the number of sole proprietors grew from 8.9 million to more than 23 million, and the number of S-corporations and partnerships (which include LLCs) grew at a faster rate from 1.9 million to more than 7 million. There are now three and one-half times as many pass-through firms as traditional C-corporations.[19]

America's "rich" are our successful entrepreneurs and business owners. While some people dismiss the effect of high tax rates on business by citing the fact that only 2 or 3 percent of business owners pay tax in the top two brackets, the more economically relevant question is how much business income is earned by those in the top tax brackets.

While there are millions of small businesses in America, Figure 5 shows that only about 16 percent of all private business income is earned by taxpayers with adjusted gross income (AGI) below $100,000. Another 16 percent of private business income is earned by taxpayers with AGI between $100,000 and $200,000.

However, fully 68 percent of private business income is earned by taxpayers with AGI above $200,000—the target range of President Obama's proposed tax rate increases. Some 35 percent of all private business income is earned by taxpayers with AGIs above $1 million.



Another way of looking at the distribution of business income is to see how many taxpayers at the highest tax brackets have business income. According to Tax Policy Center estimates, more than 74 percent of tax filers in the highest tax bracket report business income, compare to 20 percent of those at the lowest bracket. As Table 1 below indicates, more than 40 percent of private business income is earned by taxpayers paying the top marginal rate.

While these high-income business owners may be relatively few in number, the data makes it very clear that increasing top individual tax rates would directly impact America's successful private business owners and entrepreneurs.

Table 1: Distribution of Business Income by Statutory Marginal Tax Rate, 2011 Baseline: Current Policy Plus Administration's Upper-Income Tax Proposals					
Statutory Marginal Income Tax Rate	Number of Tax Units Reporting Business Income (Thousands)	Percent of Total Reporting Business Income	Percent of Bracket Reporting Busines Income	Amount of Positive Business Income (Billions)	Percent of Total
Non-filers	981	2.7	4.9	$ 3.1	0.3
0	9,201	25.5	31.4	$ 59.5	6.2
10	4,951	13.7	19.9	$ 45.9	4.8
15	10,777	29.9	21.7	$ 113.1	11.8
25	6,180	17.2	26.2	$ 114.2	11.9
26 (AMT)	932	2.6	46.8	$ 37.5	3.9
28 (Regular)	1,082	3.0	36.4	$ 48.6	5.0
28 (AMT)	1,028	2.9	59.7	$ 113.5	11.8
36	272	0.8	65.7	$ 39.0	4.0
39.6	622	1.7	74.2	$ 388.2	40.3
All	**36,026**	**100.0**	**23.2**	**$ 962.5**	**100.0**

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0509-5).

Cutting Individual Tax Rates Can Boost Productivity and Economic Growth. After extensive study of the impact of tax reforms on economic growth across the largest capitalist nations, OECD researchers determined that "a reduction in the top marginal [individual] tax rate is found to raise productivity in industries with potentially high rates of enterprise creation. Thus reducing top marginal tax rates may help to enhance economy-wide productivity in OECD countries with a large share of such industries * * *"[20]

Indeed, OECD researchers find that lower tax rates and higher productivity gains translate into higher economic growth:

For example, consider the average OECD country in 2004, which had an average personal income tax rate of 14.3% and a marginal income tax rate of 26.5%. If the marginal tax rate were to decrease by 5 percentage points in this situation, thus decreasing the progressivity of income taxes, the estimated increase in GDP per capita in the long run would be around 1%.[21]

With our large entrepreneurial and non-corporate sector, such studies suggest that the U.S. could see substantial productivity and GDP gains from lower personal income tax rates.

Tax reform will also reduce complexity and dead-weight costs to the economy. In its 2010 Annual Report to Congress, the National Taxpayer Advocate identified tax complexity as the most serious problem facing taxpayers and the IRS, and urged lawmakers to simplify the system.[22] It is estimated that tax compliance costs taxpayers an estimate $163 billion each year. The corporate tax system alone costs American businesses about $40 billion per year—roughly equal to the cost of hiring 80,000 workers at $50,000 each.

According to a recent Tax Foundation study, the "deadweight" costs, or excess burden, of the current individual income tax is not inconsequential, amounting to roughly 11 to 15 percent of total income tax revenues. This means that in the course of raising roughly $1 trillion in revenue through the individual income tax, an additional burden of $110 to $150 billion is imposed on taxpayers and the economy.[23]

One of the other ways that tax reform can lead to greater economic growth is by liberating taxpayers, businesses, and investors from these burdensome compliance and deadweight costs.

CONCLUSION

The U.S. tax system is in desperate need of simplification and reform. To be sure, with the deficit now topping $1.5 trillion, many lawmakers may look at eliminating tax "loopholes" and simplifying the tax code as an opportunity to raise more revenues. But increasing the share of the economy going to tax collections should not be the primary goal of tax reform. The primary goal should be to promote long-term economic growth and better living standards for the American people. If the byproduct of increased economic growth is more tax revenues, then that is a win-win.

But there is a real tension in the U.S. between the desire for a simpler tax code and one that insures fairness and equity. To be sure, tax reform that broadens the base while lowering marginal tax rates could create the appearance of giving "tax cuts for the rich," an anathema to many.

As we move forward to overhaul the tax system, I suggest that we develop a new way of thinking about equity in the tax code. We should strive to build consensus around these basic concepts:

- An equitable tax system should be free of most credits or deductions and not micromanage individual or business behavior.
- An equitable tax system should apply a single, flat rate on most everyone equally. That way, every citizen pays at least something toward the basic cost of government.
- An equitable tax code should be simple—which would save all of us time, money and headache and would save the economy the deadweight loss of the current system.
- An equitable tax code should have dramatically lower rates than we have today—in the mid-20s by most accounts—and the government could still raise the same amount of revenues.

I believe that such a tax code would actually generate a more predictable and stable revenue stream to fund government programs as opposed to the roller coaster revenues we have today.

And, most importantly, such a tax code would be conducive to long-term economic growth, which is one of the keys to fixing the long-term fiscal crisis facing the country.

Thank you, I'm happy to answer any questions you may have.

ENDNOTES

[1] Tax Policy Reform and Economic Growth, OECD Tax Policy Studies, No. 20, OECD Publishing (2010), p. 138.

[2] This is the year the top corporate tax rate was raised from 34 percent to 35 percent.

[3] William McBride, "Beyond the Headlines: What Do Corporations Pay in Income Tax?" Tax Foundation Special Report No. 194, September 2011, p. 2.

[4] Asa Johansson, Christopher Heady, Jens Arnold, Bert Brys and Laura Vartia, "Tax and Economic Growth," Organization for Economic Cooperation and Development, OECD Economics Working Paper No. 620., July 11, 2008. p. 43.

[5] Ibid. p. 9.

[6] Tax Policy Reform and Economic Growth, OECD Tax Policy Studies, No. 20, OECD Publishing (2010), p. 135.

[7] R. Alison Felix, "Passing the Burden: Corporate Tax Incidence in Open Economies," October 2007, p. 2.

[8] Ibid. p. 20.

[9] Jens Arnold and Cyrille Schwellnus, "Do Corporate Taxes Reduce Productivity and Investment at the Firm Level? Cross-Country Evidence for the Amadeus Dataset," CEPII, Working Paper No. 2008—19, September 2008, p. 31. The concept of "success taxes" was first suggested by Gentry and Hubbard (2004).

[10] Arnold and Schwellnus, p. 4.

[11] Ibid. p. 10.

[12] Ibid. p. 9.

[13] C. Fritz Foley, Jay C. Hartzell, Sheridan Titman, Garry Twite, "Why Do Firms Hold So Much Cash? A Tax-Based Explanation," February 2007, p. 3.

[14] Ibid. p. 19.

[15] Ibid. p. 16.

[16] "Growing Unequal? Income Distribution and Poverty in OECD Countries," Organization for Economic Cooperation and Development, 2008. p. 112. *http://dx.doi.org/10.1787/422013187855. Here income taxes refer to both personal and social insurance taxes.*

[17] Ibid.

[18] Tax Policy Reform and Economic Growth, p. 22.

[19] Scott A. Hodge, "Over One-Third of New Tax Revenue Would Come from Business Income if High-Income Personal Tax Cuts Expire," Tax Foundation Special Report No. 185, September 2010, p. 4.

[20] "Tax and Economic Growth," p. 9.

[21] Ibid. p. 25.

[22] National Taxpayer Advocate's 2010 Annual Report to Congress. *http://www.irs.gov/advocate/article/0,,id=233846,00.html*

[23] Robert C. Carroll, "The Excess Burden of Taxes and the Economic Cost of High Tax Rates," Tax Foundation Special Report No. 170, August 14, 2009.

Chairman RYAN. Thank you. Welcome back, Diane, a good friend and familiar face of the committee. The microphone is yours.

STATEMENT OF DIANE LIM ROGERS

Ms. ROGERS. Chairman Ryan, Mr. Van Hollen, members of the committee, thank you for giving me the opportunity to testify before you today on the issue of pro-growth tax reform. I work for The Concord Coalition, a group that is been dedicated to the cause of fiscal responsibility for two decades now. As such, I feel that we cannot consider tax reform in isolation from the rest of the federal budget, especially within this committee. That being said, the views that I express today are my own and not necessarily the official position of the Concord Coalition.

This hearing is titled The Case for Pro-Growth Tax Reform. Well, I think that is un-controversial. I am for pro-growth tax reform as well as my other two colleagues here today. The issue, I think, is what exactly does a pro-growth tax reform look like. And it is not so simple. I think that we are used to hearing that all we have to do to fix our fiscal situation is grow the economy and what it takes to grow the economy is lower taxes. But there is some causation that runs the other way, too. And unfortunately that makes the challenge of creating a tax reform that is good for the budget a little more difficult.

Tax cuts all have benefits. Everyone loves tax cuts. Tax cuts are going to benefit some businesses, some households. The problem is that when times are tight like they are for us in terms of finding funds for the government to be able to conduct its business, when times are tough we have to weigh costs against benefits. So just having benefits from tax cuts is not enough. We have to know that it passes a cost-benefit test.

Here are a few reasons, a few basic reasons, why it is not so easy to grow the economy by just cutting taxes and reducing revenues. The number one reason is because deficit financed tax cuts, they sort of like dig a hole into the ground first and with the hope that we will leap out of the hole from the growth that it produces from private sector activity. The hole that I am talking about is the decrease in public saving. National saving is the sum of public plus private saving. So if you deficit finance the tax cut, you start with a negative change to public saving, so you have to hope that there is enough of a positive change in private saving to more than offset that in order to get a net increase in national saving. National saving is the key to supply-side longer-term economic growth. So that is why, unfortunately, you start from a little hole, or a pretty big hole, because it is a dollar-for-dollar decrease in public saving as soon as you deficit finance a tax cut.

Second, how the taxes are cut matters. What matters for supply-side incentive affects are marginal tax rates. So the structure of the tax change we are contemplating really matters in terms of how much economic growth over the longer term in terms of aggregate supply in the economy can you expect. The problem is that a lot of our tax cuts have more of a cut in average tax rates rather than tax rates at the margin. If we cut taxes at the margin, we have to ask the question, How big are the incentive affects likely to be? There is a lot of uncertainty about that. A lot of households and businesses do not even react to marginal tax rates as much as they react to cash flow. And yet, marginal tax rates and those incentive affects on labor supply and savings are what matters for the kind of growth that I think we are all hoping for.

Third, in an economy recovering from recession, the binding constraint in the economy in terms of making it bigger is not the supply-side of the economy because we have plenty of productive capacity right now. The binding constraint is that we are not putting enough of that productive capacity to work. So it is a demand side constraint. So unfortunately, right now, we have to figure out how to increase the demand for goods and services first before we can start to worry about how the tax code can encourage labor supply and saving.

Our experience with the Bush tax cuts unfortunately has demonstrated each of these challenges well. Because we deficit-financed all of the Bush tax cuts, we have seen a huge decrease in national saving. Private saving did not increase dramatically to help offset that drop in public saving.

Secondly, they have not been very effective at increasing the supply side of the economy. We have not seen big increases in the incentive for people to work or increase their personal saving.

And third, the Bush tax cuts are really not a very good kind of tax cut in terms of short-term stimulus, in terms of providing a lot of increase and demand for goods and services. They do not have high bang for buck, as economists say. So if you look at CBO's list of the kinds of tax cuts that are most stimulative to demand, you will find the Bush tax cuts are at the bottom of the list of tax cuts.

Economists agree that the federal budget is on an unsustainable path and that for the continued health of the economy, deficits must eventually come down. Even if we do not reduce deficits right away in the next couple years as we are still recovering, a credible plan to reduce deficits over the next 10 years is really essential, not just to long-term economic growth, but for the short-term stability of the economy, the confidence of our global investors.

Tax policy has to be part of the solution. It is true that the greatest pressures on the federal budget over the next several decades are certainly in the entitlement programs. That is very easy to see. It is very easy to understand. Medicare and Social Security are programs that go largely to the retirement age population. The retirement age population is growing, and on top of that, per capita health costs are growing. So we all know that story. We all know that is the driver of the long-term outlook.

Unfortunately, it does not mean that we cannot bring taxes into the solution just because they are not responsible for the bulk of the problems going forward. It is very difficult for me to imagine that our society would actually be willing to cut spending enough to keep taxes at as low of a level as they are at currently or even historically over the past 40 years.

The historical average level of revenues to GDP has very little bearing on what the right level of revenues is going forward. And those who oppose raising revenues as shared GDP are often convinced that this will increase the size of government. But I would urge you to look at the myriad of tax expenditures in our tax code that amount to over $1 trillion a year. And consider that unfortunately they are not just tax loopholes, but they are probably more appropriately considered tax entitlements.

There are many policies. I am going to urge you to stick to the current law baseline for revenue levels as a goal. As Mr. Van Hollen mentioned, that is way bigger than even a grand bargain would call for in the task of the super committee, but I urge you to set that as a goal because it would allow us to have some impetus for tax reform for a revenue-neutral type of tax reform relative to current law. If we wish to extend expiring tax rates, we can choose to extend that, but let's try to pay for it by base-broadening or by finding spending cuts or revenue increases elsewhere. There are ways we can do it other than doing nothing. We can go the big route which is fundamental tax reform. We can go the do it to the rich route, which is raise taxes only on the right, but I think for the purpose of this committee concerned with pro-growth tax reform, what you want to do is focus on base-broadening tax reform that can keep rates low and stick to something closer to current law revenue baseline.

So I elaborate on these points in my written testimony. And I thank you for the opportunity, and I am happy to take your questions.

[The prepared statement of Diane Lim Rogers follows:]

PREPARED STATEMENT OF DIANE LIM ROGERS, CHIEF ECONOMIST, THE CONCORD COALITION

Chairman Ryan, Mr. Van Hollen, and Members of the Committee: Thank you for giving me this opportunity to testify before you today on the issue of "pro-growth tax reform."

I work for the Concord Coalition, a group that's been dedicated to the cause of fiscal responsibility for two decades now—through both the "thick" and "thin" of federal deficits! As such, I think tax reform should never be considered in isolation of the rest of federal budget policy, and that bias will be clear in my testimony. Nevertheless, the views I express here are my own and do not necessarily represent the official position of the Concord Coalition.

This hearing is titled "The Case for Pro-Growth Tax Reform." Well, the "case" for pro-growth tax reform is easy and non-controversial—as achieving a stronger economy makes pursuing any other social goals easier (deficit reduction, higher and fairer standards of living, greater investment in higher quality public goods and services, etc).

The disagreement is over what makes a given tax reform "pro-growth."

Growing the economy through tax policy isn't as simple as "cutting taxes" to reduce overall tax burdens. Tax cuts all have benefits, but the first thing one learns in an economics class is in a world of scarce resources, we maximize well being by weighing costs against benefits, and at the margin starting from where we are right now. Tax cuts that might benefit particular households and businesses don't necessarily pass society's cost-benefit test, even based on a narrower and naive goal of maximizing GDP because:

(i) If deficit financed, the direct reduction in public saving will typically outweigh any positive response from private saving, so national saving and economic growth falls. This is the biggest factor preventing simple cuts in overall tax rates from being "pro growth" over the longer term.

(ii) How taxes are cut matters: marginal tax rates are what matters for supply-side growth effects (increases in incentives to work and save), and those responses depend on how large the change in marginal rates (we're starting from relatively low rates), how large the responsiveness ("substitution effects") of households and businesses to those rates (often pretty small), and how other factors (such as "income effects") may swamp those responses to price changes.

(iii) In an economy still recovering from recession, we have to worry about getting back to "full employment" (where we are putting all of our productive capacity to use) before turning to growing the productive capacity of the economy over the longer term. Tax policies that help increase demand for goods and services (and hence businesses' demand for workers) can be quite different from those that increase the supply of labor and capital.

Our experience with the Bush tax cuts has demonstrated each of these challenges, as their major contribution to record-high deficits clearly reduced national saving and economic growth, were not very effective at growing the supply side of the economy (even according to the Bush Administration's own Treasury Department), and are not the kind of tax cuts that provide high "bang per buck" in a recessionary economy.

Economists agree that the federal budget is on an unsustainable path and that for the continued health of the economy, deficits must eventually come down to levels lower than the growth rate of the economy (allowing the debt/GDP ratio to be stabilized). Even though a sizeable level of deficit spending over the next one or two years can be justified to support the economic recovery, a commitment to bring down deficits to lower, more sustainable levels over the next decade is essential not just for longer-term economic growth but for shorter-term economic stability (via the confidence of global investors in the U.S. economy).

Tax policy has to be part of the solution. It is true that the greatest pressures on the federal budget in the decades to come are in the entitlement programs because of the aging of the population coupled with rising per-capita health costs. But it is hard to see how our society would choose cuts in real, per-capita benefits of the magnitude necessary to both achieve sustainable deficits and keep revenues at the historical average. And even if we would choose to do so, we would never do it very soon; entitlement reforms would have to be phased in much more slowly than tax reforms could take effect.

The historical average level of revenues/GDP has very little bearing on what the right level of revenues is going forward. The right level of revenues is that which is adequate to pay for the government we desire. (And the right size of government is that which we are willing to pay for.) Given the dramatic changes in the structure of our population and the continued growth and evolution of our economy, it is difficult to see how what was right over the past 40 years—and it wasn't even quite adequate then—could be right over the next 40 years.

Those who oppose raising revenue usually assume higher revenues will lead to larger government. But the holes in our income tax base—the special exemptions, deductions, credits, and preferential rates—amount to over $1 trillion/year (about 90 percent of this in the individual income tax and 10 percent in the corporate), nearly as much as all of discretionary spending combined.[1] "Filling out" the tax base by reducing these tax expenditures would level out and support lower marginal tax rates (reducing the economic distortions caused by taxes), and reduce both the deficit and the effective size of government, all in a progressive as well as more generally "fair" manner. Thus, this type of tax reform—broadly applicable to both the individual and corporate income tax systems—is consistent with the goals of both Republicans and Democrats and ought to be the easiest area to find bipartisan agreement on policies to reduce the deficit.

Adjusting the CBO current-law baseline to construct the Concord Coalition's "plausible baseline" (a "business as usual" projection) triples the ten-year deficit from $3.5 trillion to $10.4 trillion—with $5.7 trillion of the $6.9 trillion difference due to tax policy and the plethora of expiring, deficit-financed tax cuts in current law.[2] The current-law baseline level of revenues achieves an economically-sustainable level of deficits over the next 10-20 years according to CBO. So whatever we do on the tax policy front, we should commit to achieving current-law revenue levels.

There are many tax policies that would be consistent with the current-law baseline level of revenues. I have characterized the three main approaches as: "do nothing" (let the Bush tax cuts expire as scheduled at the end of 2012), "do it big" (broaden the tax base by reducing tax expenditures, paying for lower tax rates), and "do it to the rich" (such as via a surtax on millionaires and/or large corporations). Each approach has different relative advantages regarding their economic effects and political attractiveness. The best economic effects would come from increases in revenue accomplished through progressive base broadening/reduced tax expenditures. We could do any combination of the approaches, and all would be encouraged in practice with a commitment to strict, no-exceptions, pay-as-you-go rules—on new or extended tax cuts and not just spending increases. This commitment is something the debt limit deal's "super committee" could propose right away to get us on the path to sustainable deficits.

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[1] Donald B. Marron, "How Large Are Tax Expenditures?", Tax Notes, March 28, 2011 (*http://www.urban.org/uploadedpdf/1001526-Expenditure-Estimates.pdf*).

[2] See "The Concord Coalition Plausible Baseline," updated August 2011: *http://www.concordcoalition.org/concord-coalition-plausible-baseline.*

I elaborate on some of these points in the sections that follow, which draw largely from the recurring column I write for Tax Notes magazine, published by Tax Analysts.

THE NITTY-GRITTY ON TAX CUTS AND THE ECONOMY

Constructing smart tax policy within the broader context of fiscal responsibility requires recognizing the connections and tradeoffs between tax rates, tax bases, revenues, public and private saving, and economic growth. The theory behind supply-side tax policy suggests that reducing tax rates encourages taxpayers to work and save and thus is good for the size of the tax base and for revenues. But in practice, tax cuts rarely pay for themselves, as the more extreme Laffer curve version of supply-side economics would suggest. We experienced higher revenues and budget surpluses following the tax rate increases enacted under the Clinton administration and lower revenues and high deficits following the tax cuts under the George W. Bush administration. In looking for economically efficient ways to raise revenue, there's room to improve the existing income tax base before we play around with the rate structure or add new tax bases. A tax cut needs to do more than provide just some marginal benefit; there must be enough benefit to make the cut worth its cost, relative to competing demands. If reducing tax rates encourages economic activity but doesn't pay for itself (such as with a rate cut that increases the deficit more than it encourages private saving), it's not necessarily good for the economy.

There is no policy area where conservatives and liberals are further apart than tax policy. Conservatives argue that tax cuts that raise returns to saving and investment, or increase the rewards for work, are always good for the economy, in good times and in bad. Liberals argue that tax cuts primarily raise the incomes of the rich and squeeze out benefits for the poor, and are the worst type of fiscal policy when the economy is in a recession. Both sides neglect the adverse long-term economic effects of any type of tax cut that is deficit financed.

The debate is confusing because not all tax cuts are created equal, and the economic effects of those tax cuts differ across three dimensions: (1) the condition of the economy; (2) how the policy affects relative prices (substitution or incentive effects) versus real incomes (income or distributional effects); and (3) how the cost of the policy is paid for. When evaluating the effects of any particular tax cut on the economy, one should ask the following questions.

A. WHERE'S THE BINDING CONSTRAINT?

In a cyclical downturn, increasing aggregate supply (the productive capacity of our economy) won't do any good, because the problem isn't too little capacity, but too much idle capacity. To increase the level of economic activity, or GDP, we need to increase demand for goods and services so that more of current supply is used. Think of the uses or demand side of the GDP equation—C + I + G + (X-M)—and contemplate what the government's fiscal policy can do to increase consumption (C), investment (I), or net exports (X-M) indirectly via tax cuts and other subsidies, versus increasing direct government purchases of goods and services (G). In terms of the boost to GDP, tax cuts and subsidies are automatically handicapped relative to direct spending, and unless they produce multipliers of greater than 1, they will fall short of the success of dollar-for-dollar direct government purchases.

But in a full-employment economy, fiscal policy is ineffective in increasing demand-side GDP because supply is the limiting factor. GDP can be increased only by encouraging growth in the stock of those productive resources—the supply side of the economy. In this case, we need to ask how we can use fiscal policy to increase incentives to work or to save. How can fiscal policy be reformed to reduce any of the preexisting disincentives and distortions to economic decisions created by current policy?

B. WHAT KIND OF TAX CUT IS IT?

Tax cuts typically generate two types of effects on the microeconomic decisions of households and businesses: a substitution effect whereby relative prices are changed to encourage substitution into more lightly taxed activities and away from highly taxed ones, and an income effect whereby the higher cash flow to those receiving the benefits of the tax cut generates a change in their economic activity.

1. Substitution effects and supply-side tax policy. In a full-employment economy, tax policy's effect on relative prices is more important than it is in a recessionary economy. Marginal tax rates are what affect choices concerning the sources and uses of income. Tax cuts that reduce the marginal tax rates on labor or capital income will encourage substitution into greater labor supply or saving, boosting incomes and GDP. Tax cuts without any effect on marginal tax rates, in contrast, do im-

prove incentives at the margin. An example of a tax cut that reduces average tax rates and boosts average after-tax returns without reducing the marginal tax rate is that of raising the contribution or income limits on tax-preferred savings accounts. Because many higher-income taxpayers are already maxed out on the tax-preferred options, and might continue to be even after the higher limits, increasing the availability of the tax subsidy for those households can cause shifting of existing savings (moving money out of taxable accounts into tax-free ones) without necessarily creating any new savings. The policy would generate positive income effects for these taxpayers even without any substitution effects.

Empirical research on the significance of substitution effects shows that higher-income households are more responsive to changes in marginal tax rates than lower-income households, probably because they can fine-tune their work hours more easily, and because the relative price change itself is usually larger at higher income levels given the progressive, graduated rate structure of the federal income tax. In fact, many lower-income households are entirely exempt from the federal income tax and so are completely unaffected by changes in marginal income tax rates. This has encouraged economists to suggest that flat rate tax systems (with a single marginal tax rate above some exemption level of income) would generate positive and sizable supply-side effects on labor supply and saving. But hold that thought, because how much the tax cut would cost in terms of lost revenue and the deficit would affect the supply side of the economy as well.

Increased supply-side incentives can also be achieved by reducing differences across marginal tax rates on different sources and uses of income. Broadening the income tax base by reducing tax expenditures would raise the overall average tax rate but would do so by raising marginal tax rates only on those sources and uses of income that are currently undertaxed in the definition of taxable income. By reducing the tax advantage to those currently undertaxed forms of income, the substitution effects away from higher-taxed income would actually be reduced and that type of income would be encouraged, even as the economy-wide average tax rate rises.

Must one be a supply-side economist to believe in the existence of these supply-side types of responses? No. Economists of all stripes broadly agree in the theory that households and businesses respond to relative price changes when those agents are given the opportunity and have the capacity to do so. Economists also agree that marginal tax rates matter in terms of their incentive effects. The debate over how valuable to the economy supply-side tax policy can be is largely over how large those substitution/incentive effects are in the real world, relative to the other economic effects of tax policy.

2. Income effects and demand-side tax policy. In a recessionary economy, the income effects of tax policy matter more. The distribution of the dollar benefits of a tax cut will affect how much the demand for goods and services is stimulated. Tax cuts focused on the top marginal tax rates don't deliver anymore dollars to lower-income households who have the highest propensities to consume. The effect on relative prices matters less than the effect on the levels and distribution of after-tax income. In fact, an economy-wide tax cut isn't a prerequisite of a successful demand-side tax cut. Consider a purely hypothetical and purely redistributive (income-effects-only) Robin Hood policy that increases taxes on the rich and gives the proceeds to the poor. This would increase aggregate demand in the economy by simply shifting income away from savers toward non-savers. Note that this is quite contrary to the optimal strategy in a supply-side tax cut designed to increase labor supply and saving.

Perhaps even more curious, fiscal policies that might seem ineffective or unjustified in terms of incentive effects (such as Social Security cost of living adjustment makeups for seniors, tax breaks for new homeowners, and the "Cash for Clunkers" program) might nonetheless have a high bang per buck in terms of stimulating aggregate demand in a recessionary economy. Even if those policies actually do nothing to encourage the economic activity they're ostensibly designed to, as long as they steer dollars to households with high marginal propensities to consume, they can nevertheless turn out to be pretty effective in stimulating demand.

On the flip side, we shouldn't worry much about higher taxes having large dampening effects on demand if those tax increases are mostly on higher-income households with low marginal propensities to consume. We also shouldn't be too concerned about the potential recessionary effects from tax increases that would take effect only after the economy is back to full employment.

The timing of tax cuts matters. At either the business level or household level, temporary tax cuts are likely to have a greater stimulative effect on the demand for goods and services than permanent tax cuts, because the timing of transactions is relatively easy to change—according to University of Michigan economist Joel

Slemrod's hierarchy of responses.[3] A temporary tax cut will generate a large effect as the qualified activity is shifted forward whenever a tax cut has a deadline, even if the same tax cut, because it is only temporary, has a much smaller or negligible long-term effect on the components of aggregate supply.

C. HOW IS THE TAX CUT BEING FINANCED?

1. Deficit financing sometimes helps and sometimes hurts. In a recessionary economy, deficit financing will increase the countercyclical stimulative effect of any particular tax cut on aggregate demand by promoting consumption of goods and services in excess of personal incomes. But that doesn't mean any deficit-financed tax cut (or spending) makes for the best stimulus, because there are longer-term economic costs still associated with the deficit—the debt has to eventually be repaid in higher taxes or reduced spending in the future. That puts limits on the amount of deficit-financed stimulus that's economically justified. We want to maximize the economic bang for the buck in deficit-financed stimulus, so fiscal responsibility requires that we determine a level of deficit spending we deem worth it, put high bang-per-buck spending or tax cuts at the front of the line (ranking fiscal policies from most effective to least), and draw the line at the credit limit we've implicitly established.

In a full-employment economy, however, deficit financing represents a dollar-for-dollar decrease in public saving, making it harder for the tax cut to increase national saving unless private saving is encouraged by more than the cost of the tax cut. This is not quite as high a standard as the tax cut paying for itself (as proposed by the Laffer curve)—which is 1/t times as hard (t being marginal tax rate on private returns to saving). This is why the Bush tax cuts have been evaluated as a net negative for economic growth by William Gale and Peter Orszag within the first few years of the Bush tax cuts, and by Gale more recently.[4] It also explains why increased tax rates during the Clinton administration coincided with higher, not lower, economic growth.

The choice to deficit finance now does not permanently avoid a tougher choice. Deficit-financed tax cuts do not pay for themselves, and they imply inevitably higher taxes or lower spending in the future. This intergenerational redistribution is another economic effect of the tax cut.

2. On the other hand, paying for the tax cut sometimes hurts and sometimes helps. In a recessionary economy when the goal is increasing current consumption, offsetting the cost of the tax cut with spending cuts or tax increases will reduce the net stimulative effect on aggregate demand for goods and services. The more the offset affects lower-income households (those most constrained), the larger the negative effect. Paying for a tax cut going to primarily high-income households with a cut in spending that benefits primarily low-income households would likely be contractionary, not stimulative.

In a full-employment economy, however, finding budgetary offsets to the cost of a tax rate reduction is likely to be better for encouraging aggregate supply and boosting GDP than deficit financing. That's because the deficit reduces public saving dollar for dollar, while empirical evidence has shown that the adverse effect of the offsetting policy on private saving is likely to be something less than dollar for dollar.

D. TAX CUTS MATTER, BUT AREN'T ONE SIZE FITS ALL

So are tax cuts good for the economy? It depends. As countercyclical policy during a recession, deficit-financed tax cuts can help stimulate demand, but deficit-financed spending is likely to be even more effective if it is deliberatively targeted toward lower-income households. As supply-side policy during periods of full employment, tax cuts are most effective if they increase incentives at the margin to work and save—that is, by reducing marginal tax rates or leveling rates across different forms of income—but any deficit financing is likely to produce a net negative effect on national saving.

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[3] Joel Slemrod, "Tax Systems" in NBER Reporter, Summer 2002 (*http://www.nber.org/reporter/summer02/slemrod.html*) and "Income Creation or Income Shifting? Behavioral Responses to the Tax Reform Act of 1986," American Economic Review, 85(2), May 1995 (*http://www.jstor.org/pss/2117914*).

[4] William G. Gale and Peter R. Orszag, "Bush Administration Tax Policy: Effects on Long-Term Growth," Tax Notes, October 18, 2004 (*http://www.taxpolicycenter.org/UploadedPDF/1000698—Tax—Break—10-18-04.pdf*) and William G. Gale, "Five Myths about the Bush Tax Cuts," Washington Post, August 1, 2010 (*http://www.washingtonpost.com/wp-dyn/content/article/2010/07/30/AR2010073002671.html*).

That's why a revenue-raising (relative to current policy) tax reform that reduces or levels out effective marginal tax rates and broadens the tax base at the same time is such a win-win-win formula:

Win #1: It attends to the economy's needs. In a full-employment setting, revenue-raising tax reform encourages supply-side private-sector economic activity without generating offsetting reductions in public saving. In a recessionary economy, raising revenue primarily from higher-income households minimizes any dampening effect on short-term demand for goods and services, while supporting greater levels of high bang-per-buck fiscal stimulus.

Win #2: It creates the right price incentives and distribution of income. By focusing on lower marginal tax rates and a broader, more neutral tax base achieved through reducing tax expenditures, it reduces the distortionary effects of tax policy on economic decisions, creating the right kind of substitution/relative price effects to maximize its economic effectiveness, while also generating income effects that can be helpful as countercyclical policy.

Win #3: It doesn't increase the deficit. As a deficit-neutral tax cut, it avoids the direct decrease in public saving that is harmful in a full-employment economy, without requiring alternative budgetary offsets that would reduce other and perhaps more stimulative forms of deficit spending when the economy is still recovering from a recession.

Tax cuts are always an attractive option in the political world where budget constraints are often ignored. But in the real world and in real time—where budget constraints bind and opportunity costs matter—policymakers must be mindful of the fact that the effectiveness of any particular tax cut depends on our economic circumstances and goals and how those mesh with the structure of the tax policy.

HOW REDUCING TAX EXPENDITURES WOULD MAKE FOR A "GRAND BARGAIN" ON TAX REFORM

The most basic role of taxation is to collect funds to pay for publicly provided goods and services, including subsidies for private-sector activities. But we also spend much of those public funds through the tax system via tax expenditures. The special provisions in our federal income tax code—exemptions, deductions, credits, or preferential tax rates—that reduce tax burdens on specific groups are economically analogous to direct spending and have a total cost of about $1 trillion per year—as much as all discretionary spending combined. If we are to bring greater fiscal discipline to the federal budget, we'll need to carefully evaluate the structure of our tax system in terms of the economic merits of the various provisions, weighing costs against benefits, just as we do when evaluating spending-side programs. Are the tax expenditures justified as having higher net benefits than other spending programs that are being cut? In some cases, are we actually promoting specific activities via tax expenditures that run counter to other fiscal policy goals? If budget analysts started accounting for the longer-term growth of different types of tax entitlements just as we project the growth of different categories of more traditionally defined discretionary and mandatory spending, we would likely find these tax preferences are some of the fastest-growing components of federal spending. And because tax expenditures are created by cutting holes out of a progressive income tax base, their benefits go disproportionately to higher-income households, making them a more palatable target for cuts than most other forms of spending.

Thus, reducing tax expenditures is a strategy that I believe is an essential component of any bipartisan solution to the deficit problem.

Make a Venn diagram of all the specific proposals that the various deficit reduction commissions, study groups, and task forces came up with, regardless of their political leanings, and what does the intersection of the proposals look like? It's big, fundamental, and worth lots of money. That intersection is the proposal to raise more revenue by broadening the tax base. Of all the ways to significantly reduce the budget deficit, base-broadening tax reform has the qualities most likely to appeal to Democrats and Republicans alike.

Reducing tax expenditures is like the fiscal policy version of the old Miller Lite beer commercial: It tastes great and it's less filling. Here's why:

Spending-side blame shouldn't rule out tax-side solutions. Although the largest projected changes to the federal budget come from rapidly increasing spending on federal entitlement programs, once we consider the reasons for that increase it's unreasonable to think the solution is to just stop it. Given the demographic pressures of an aging population (which we cannot change) and rising per capita healthcare costs (which we don't yet fully understand how to change), a spending-side-only strategy would mean drastic cuts in real, per capita benefits, which I don't believe either political party really wants. Given the level of real entitlement benefits that our society wants to maintain, the problem is as much that revenues can't keep up as it is that spending is growing too fast. That means our historical experience with the level of revenues as a share of our economy (averaging 18 to 19 percent of GDP) is not a guide for what we will need in the future, especially considering that those past levels of revenues haven't even proved adequate to cover spending and have recently sunk to historic lows of just 15 percent of GDP.

Raising revenue by reducing tax expenditures would shrink, not expand, government. The Republican pledge on taxes has always been touted as a small-government stance. But some of the most fiscally conservative members of the Republican Party—including Senator Tom Coburn of Oklahoma—now recognize that there's no simple correlation between the level of revenues and the size and reach of government, given the prevalence of tax expenditures. Federal tax expenditures currently total $1.3 trillion annually—almost exactly as much as all discretionary spending combined.[5] While it's not realistic to imagine eliminating all tax expenditures—or raising that $1 trillion-plus even if we could because of behavioral responses and the likelihood we'd see some eliminated tax expenditures appear on the direct spending side of the budget—the potential to cut significant levels of subsidies on the tax side of the budget is still huge. President Obama's fiscal commission made that point when it proposed a "modified zero" approach to deficit-reducing tax reform, illustrating the trade-off between a broader tax base (the broadest of which would zero out all tax expenditures) and the marginal tax rates needed to achieve a specified level of deficit reduction.[6]

Reducing Tax Expenditures Both:

"Tastes Great" (Democrats like)	and	"Less Filling" (Republicans like) because it . . .
Reduces deficit on tax side	and	Cuts government subsidies/"tax entitlements"
Raises revenue	and	Reduces size of government
Enhances progressivity	and	Increases economic efficiency
Avoids cuts in high bang-per-buck, short-term stimulus spending	and	Reduces longer-term deficit to encourage higher saving and economic growth

And tax expenditures don't just imply larger government because of the higher tax rates required to finance the rest of government; they expand government's influence on the economy. Tax expenditures subsidize some economic activities over others. In recasting those tax subsidies in terms of what they would look like if they were run through the spending side of the budget, Donald Marron and Eric Toder of the Tax Policy Center (TPC) estimate that the implied level of government spending rises from roughly 18 percent of GDP to 24 percent.[7] Republicans who continue to claim that any type of revenue increase would expand government are obviously missing this point.

Reducing tax expenditures is a progressive solution that defies the equity-efficiency trade-off. Raising taxes progressively (a Democratic priority) does not have to mean raising marginal tax rates on the rich and increasing the distortionary effects of taxes on economic decisions (a Republican concern). A TPC analysis has shown that raising the needed additional revenues to achieve fiscal sustainability from only the top 2 to 3 percent of the population, without any base broadening, would mean that increases in the top federal income tax rates would have to be prohibitively large—getting to Laffer curve levels in excess of 75 percent.[8]

Because tax expenditures poke holes in a progressively structured income tax system (with graduated marginal tax rates), filling in at least a portion of those holes would raise revenue (and cut subsidies) progressively, while smoothing out, instead of exacerbating, the dips and bumps in the tax policy playing field. By reducing tax expenditures, we can achieve a progressive change in tax policy that would avoid the trade-off with economic incentives and growth. Moreover, the progressive rate structure that causes tax expenditures to disproportionately benefit the rich also ex-

[5] Marron, "How Large Are Tax Expenditures?", op. cit.

[6] "The Moment of Truth," report of the National Commission on Fiscal Responsibility and Reform, December 2010 (*http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12—1—2010.pdf*).

[7] Donald Marron and Eric Toder, "Measuring Leviathan: How Big Is the Federal Government?", presentation for Loyola Law School conference on tax expenditure reform, January 2011 (*http://events.lls.edu/taxpolicy/documents/PANEL2MarronToderSizeofGovernment-presentationFinal01-06-11.pdf*).

[8] Rosanne Altshuler, Katherine Lim, and Roberton Williams, "Desperately Seeking Revenue," Tax Policy Center, January 2010 (*http://www.taxpolicycenter.org/publications/url.cfm?ID=412018*).

plains why these tax-side subsidies will grow dramatically in real costs over time as real incomes grow. Just as real bracket creep pushes more and more income into higher marginal tax brackets over time, it will push more and more economic activity into more-tax-preferred status. The single largest tax expenditure in the federal budget, the exclusion of employer-provided healthcare, will grow especially dramatically in cost over time—and the benefits will get more skewed toward higher-income households—as its value rises with the rise in per-capita healthcare costs as well as the growth in real incomes.

Reducing tax expenditures is an inherently progressive policy strategy and can be made as progressive as we want it to be through the use of caps and phaseouts, such as in Obama's proposal to limit the value of itemized deductions to a maximum 28 percent rate. That makes it clear that reductions in tax expenditures are more easily tailored to the progressivity goal if they are modified via the personal income tax, a direct tax on households based on their directly observable levels of income. The healthcare reform bill's approach to paring back the tax expenditure subsidizing employer-provided healthcare—by imposing an excise tax on high-end insurance plans to be paid by the insurance companies (but whose ultimate burden will be felt by households that purchase expensive insurance plans regardless of their income level)—is a prime example of how political concerns can turn good intentions into suboptimal policy.

Reducing tax expenditures would address both near- and longer-term economic concerns. There are two sides to achieving fiscal sustainability: the ways we spend, and the means to pay for it. Just mechanically reducing the deficit by cutting spending or raising taxes in any old way is not enough. The policies that reduce the deficit must be thoughtfully crafted to promote a strong economy, both in the short term as we continue to need demand-side stimulus to speed the recovery from an unusually severe recession, and over the longer term, when we should focus on increasing our productive capacity, or the "supply side" of our economy.

It's difficult to find a deficit reduction strategy better suited to addressing both types of economic concerns than reducing tax expenditures. Because tax expenditures disproportionately benefit higher-income households, who are much less constrained and save large fractions of their income, paring back those benefits would be far less damaging to the short-term demand for goods and services than cutting other forms of government spending, which disproportionately benefit lower-income households. And because of the efficiency gains and reduced distortions that come from a broader tax base, reducing tax expenditures is a far better way to raise revenue and reduce the budget deficit (increasing public saving) while minimizing any adverse effects on private sector economic activity (which could come from the alternative of raising marginal tax rates). A base-broadening, tax-rate-leveling, revenue-raising tax reform is a sure thing in terms of boosting national saving and longer-term economic growth through increases in both public and private saving.

Cutting tax expenditures is the 'tastes great and less filling' approach to solving our fiscal problems. Even though achieving deficit reduction is naturally unpleasant business, there's something for both sides of the aisle to like about doing it by cutting tax expenditures. Bottoms up!

STICKING TO PAY-AS-YOU-GO RULES TO ACHIEVE SUSTAINABLE DEFICITS

For revenues to play any meaningful role in deficit reduction, policymakers will have to set a revenue target somewhere far closer to—ideally, precisely at—current law. The best outcome would be if policymakers agree to strict, no-exceptions, pay-as-you-go rules on expiring tax cuts, which by definition would require current-law levels of revenue. That would allow enough deficit reduction to achieve fiscal sustainability over the medium term of the next 10 to 20 years—long before any entitlement reforms would significantly affect spending levels.

Achieving current-law levels of revenue does not necessarily require letting current law play out—which would be easy, by the way, because Congress and the administration could just go home and do nothing. Here are three broadly different tax policy strategies that could each be consistent with the current-law baseline:

1. *Do Nothing.* Allow all expiring tax cuts to expire as specified under current law. That would mean reverting to Clinton-era marginal tax rates.
2. *Do It Big.* Extend some or all of the marginal tax rates under the Bush tax cuts, but fully offset the costs of extending the low rates by broadening the tax base and reducing some tax expenditures (for example, limiting itemized deductions or reducing the exclusion of employer-provided health benefits). This is the fundamental tax reform approach.
3. *Do It to the Rich.* Extend some or all of the Bush tax cuts—particularly those that affect middle-income taxpayers (lower tax rates, child tax credit, marriage pen-

alty relief)—and fully offset the costs by imposing an extra tax on the very rich, such as a surtax on households with incomes in excess of $1 million.

How do the three strategies compare in terms of economic effects? Theoretically it seems they would not be as different in their effects on the shorter-term, demand-driven recovery as on longer-term, supply-side growth. Pursuing the second or third option might do less damage to near-term demand than the do-nothing approach. But none of those income tax increases would threaten the recovery as much as the alternatives of spending cuts or letting the payroll tax cut expire.

All three tax policies would achieve the same amount of deficit reduction based on static revenue estimates. But are there potential differences in their dynamic effects on the economy's productive capacity? The higher marginal tax rates under the do-nothing approach are not likely to have much of a disincentive effect on labor supply or saving—as we learned the last time we lived through the Clinton tax rate increases. Those marginal income tax rates, peaking at 39.6 percent, are still relatively low by historical and international standards.

Option 2's fundamental tax reform approach of keeping much of the marginal rate structure while broadening the tax base is best for supply-side effects and overall economic efficiency, because the distortionary effects of taxes on economic decisions would be minimized. Option 3's strategy of raising rates just at the very high end of the income distribution means marginal rates at the top would have to go up substantially more, but it's unclear that the economic incentives of the rich to earn more income would be changed that much as long as their marginal tax rate were still far from 100 percent. Warren Buffett certainly disputes this worry.[9]

Combining all three approaches is possible, too, and makes the revenue target easier to achieve without having to take any one option to an extreme. For example, we could let the top tax rates expire or at least come up a bit (rather than letting all rates expire), reduce some tax expenditures in progressive ways (without eliminating them), and even add a new top bracket around the millionaire level, as suggested by Bruce Bartlett,[10] without having to raise the top rate to the problematic levels suggested by the Tax Policy Center's "Desperately Seeking Revenue" analysis.[11] Increasing the capital gains tax rate to something closer to that on ordinary taxable income could represent a combination of options 2 and 3—reducing a tax expenditure (the preferential rate) that disproportionately benefits the rich. In fact, various bipartisan deficit reduction groups, including both the Bowles-Simpson (President's) commission and the Rivlin-Domenici (Bipartisan Policy Center) task force, have suggested raising capital gains and dividend tax rates under the individual income tax as a way of paying for lower marginal rates under the corporate income tax.[12] This sounds like raising some tax rates to lower other tax rates, but in fact, it's another application of the guiding principle of economically-efficient, fundamental tax reform: broadening the tax base—in this case by bringing more capital gains and dividend income into the definition of "ordinary" taxable income—to allow reductions in the highest marginal tax rates (here, the top corporate rate, now at 35 percent).

What are the potential differences among those paths politically? Of course, option 1 emphasizes a do-nothing Congress (so why bother keeping them on their job?); option 2 (fundamental tax reform) means policymakers will have to work much harder at actual policymaking and requires more public education, engagement, and support of those efforts; and option 3 is susceptible to the class warfare and redistribution criticisms and partisan battles. I think the politics suggests that some combination of all three ways of getting to current-law baseline revenue levels is probably best.

Must we go all the way to the current-law revenue baseline? Achieving the grand bargain on deficit reduction and going bigger than required with revenues would give us more of a cushion to allow for future waivers of pay-as-you-go rules for truly stimulative tax policies (or spending) that would better qualify as emergency spending. We need to change the question from, "Do we want the Bush tax cuts?" to, "Are the Bush tax cuts the best way to spend $2.5 trillion over 10 years—for any purpose, be it short-term stimulus or to encourage longer-term economic growth?"

[9] Warren Buffett, "Stop Coddling the Super-Rich," New York Times, August 14, 2011 (*http://www.nytimes.com/2011/08/15/opinion/stop-coddling-the-super-rich.html*).

[10] Bruce Bartlett, "Buffett May Be Right But the Top Tax Rate Is Wrong," The Fiscal Times, August 19, 2011 (*http://www.thefiscaltimes.com/Columns/2011/08/19/Buffett-May-Be-Right-but-the-Top-Tax-Rate-is-Wrong#page1*).

[11] Altshuler, Lim, and Williams, op. cit.

[12] Howard Gleckman, "Should We Cut Corporate Taxes By Raising Rates on Investors?" Tax Policy Center, TaxVox blog, March 29, 2011 (*http://taxvox.taxpolicycenter.org/2011/03/29/should-we-cut-corporate-taxes-by-raising-rates-on-investors/*).

Whichever way we get there, setting our revenue standards to the current-law baseline would get us the more balanced approach to deficit reduction that Americans desire, bring revenues high enough to keep deficits at an economically sustainable level over the medium term (while we continue to work on gradual entitlement reforms), and leave us more flexibility in tax and spending policy to better address and not worsen the ailments in the near-term economy.

Note that revenue levels have huge potential in deficit reduction but aren't the most important factor in determining tax policy's role in stimulating (or contracting) the economy. Big overall revenue losses don't necessarily translate into big increases in the demand for goods and services (and hence the creation or maintenance of jobs in a recessionary economy), if the tax cuts go disproportionately to high-income households and businesses that are least likely to immediately spend their tax cuts. Setting a goal of boosting revenues to current-law levels to be achieved by increasing the overall progressivity of the tax system is therefore likely to both reduce the deficit and provide more effective support for the still-fragile economy. In fact, if some combination of the different approaches to getting to the current-law baseline were taken, we could easily gain enough revenue to be able to apply it to both reducing deficits to economically sustainable levels and temporarily providing more stimulative deficit-financed tax cuts or spending.

Thus, sticking to the current-law revenue baseline really isn't that hard to do, and there are lots of opportunities for our policymakers to actually make better tax policy while doing it. It starts with a simple commitment to strict pay-as-you-go rules on expiring tax cuts, something very easy for members of the debt deal's "super committee" to do right away.

CONCLUSION: IMPROVING TAX POLICY AND THE FISCAL OUTLOOK AT THE SAME TIME

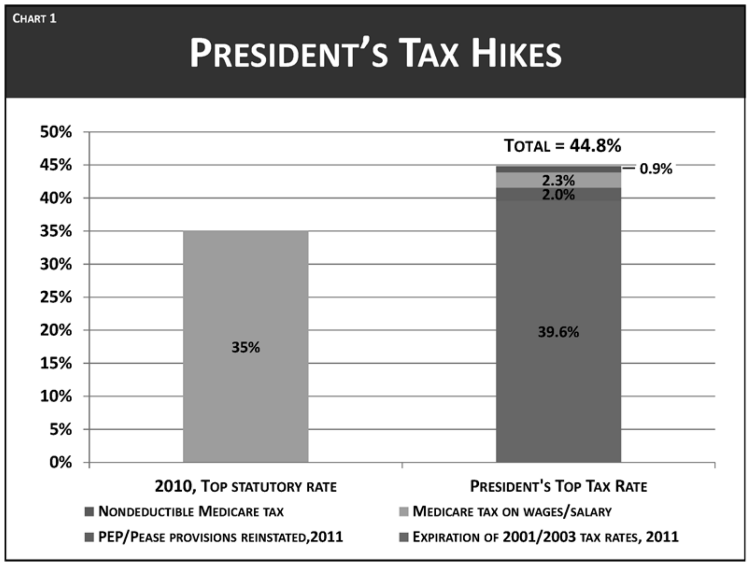
Politically arbitrary labels such as the choice of budget baselines matter a lot, because politicians need these simple metrics to demonstrate their success as policymakers. Republicans will always want to be known as the tax cutters, while Democrats will always push for more progressive taxation. Setting a goal of sticking to the current-law revenue baseline, which is achieved by base broadening rather than higher rates, is a way of honoring the seemingly inconsistent tax policy goals of both parties. It seems reasonable that policymakers should start from a current-law standard, because making changes relative to current law is their legislative responsibility, after all, even if the policy-extended baseline is a more accurate reflection of "business as usual."

Economically, however, it doesn't matter if we view such tax policy as raising revenue relative to a current-policy baseline or as keeping revenue constant relative to a current-law baseline. All that matters is that the policy raises enough revenue to keep deficits at an economically sustainable level—where the economy's growth has a chance to keep up with the growth of the debt—while minimizing the distortionary effects of taxation.

No matter how one might choose to interpret it—as a policy change consistent with Republican goals of reducing tax rates and government's interference with market decisions, or as one consistent with Democratic goals of reducing the deficit by progressively raising revenue as a share of our economy—this type of bipartisan tax reform will be crucial to achieving fiscal sustainability. Admittedly, a couple decades from now when the results of any entitlement reforms begin to materialize, we might discover that revenue neutral relative to current law still won't be enough revenue for the long term. But for now I think it's a big enough goal for the tax side of the budget to aspire to, while holding the spending side of the budget to a tight enough constraint to require and inspire some significant progress there, too.

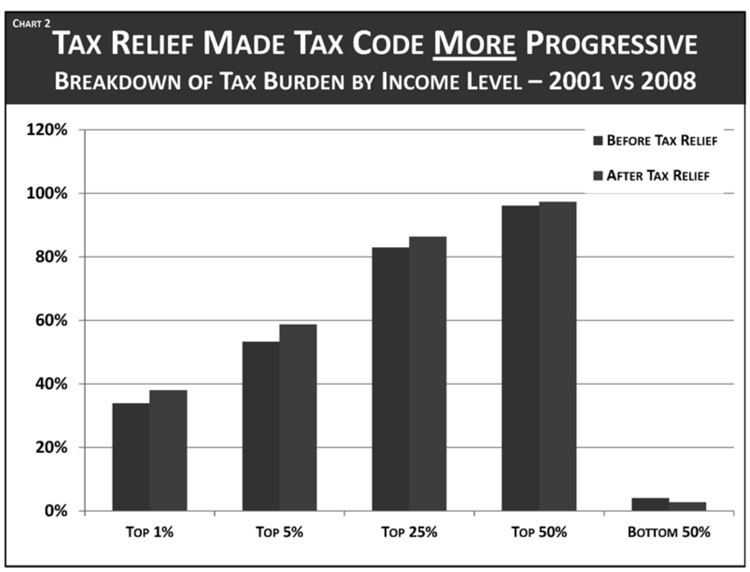
Chairman RYAN. Thank you, Diane. I appreciate it.

If you could bring up Chart 1 for me, please.



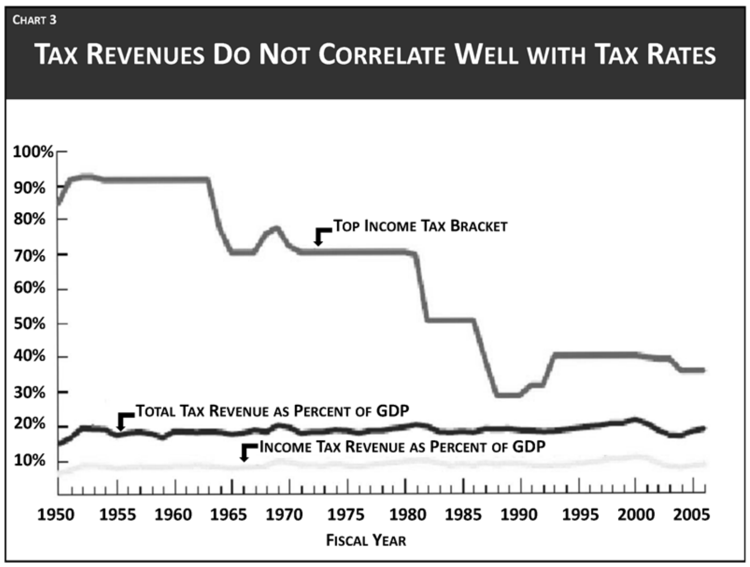
In thinking about all of this, I think it is interesting to just look at some of the economic data. I think we are beginning to achieve a consensus that lower rates are conducive to economic growth. Here is where we are headed in 2013 under current law, current law as has been proposed by the president and passed by the president. So our top rate, on the individual side, is going from 35 up to effectively 44.8 percent. So we are seeing a steep increase and, as Mr. Hodge mentioned, the pass-through entities: sub's s, LOC s, they are going to see a steep increase in their rates.

Go to Chart 2, please.



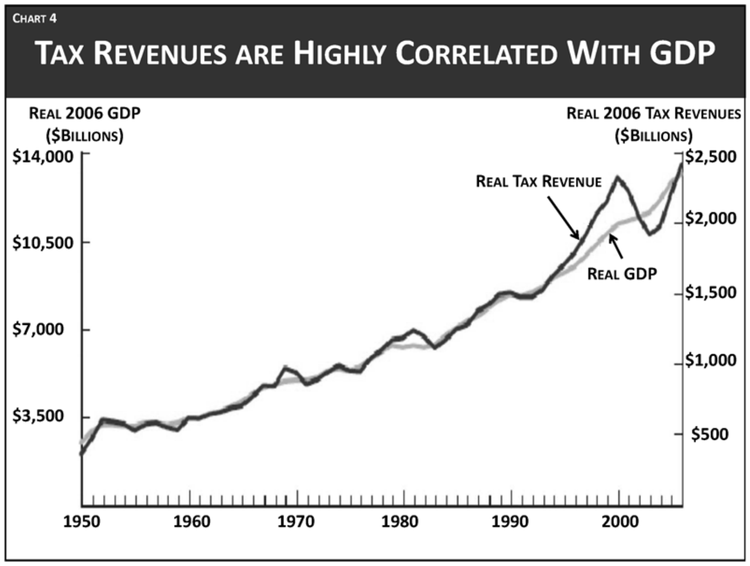
And the thinking behind this is that the wealthy should pay their fair share, meaning pay more. Well, I think the evidence is pretty interesting here, which is take a look at the distribution of the tax burden before and after the 2001 tax cuts. In 2001, the top one percent, the top five percent paid less of the income tax burden than they do after those tax cuts. So looking at data from as a share of the tax burden with lower top margin rates, the top 5 percent, the top 25 percent, the top 15 percent, the top 1 percent, pay a larger portion of the tax burden than they did with higher income tax rates before those rates were reduced in 2001. I think that is just interesting data.

Go to Chart 3, please.



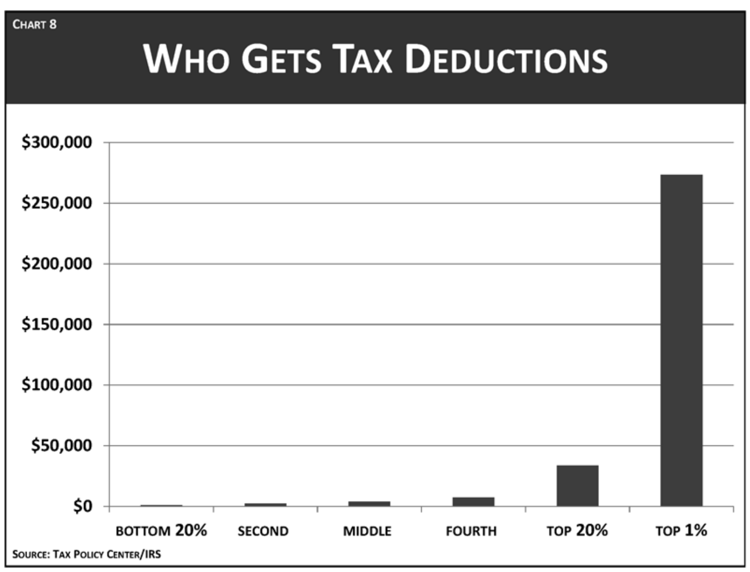
When we take a look at the data from post-World War II on, what we find is our revenues as a percent of GDP are remarkably stable. It is income tax revenues as a percentage of GDP, total tax revenues percent of GDP have been pretty much level. But take a look at our top income tax brackets, our top income tax rates. So those income tax rates do not dramatically call for the change in revenues.

Go to Chart 4, please.



What really drives it is economic growth. If the economy's growing, revenues are growing even at these lower income tax rates. And what we have learned is lower income tax rates is conducive to higher growth and therefore higher revenues. We are not saying everything pays for itself. That is not the case. What we are also showing is the higher income earners actually bear a larger proportion of the tax burden when we go down that path.

If you could go to Chart 8.



This is the one where I think there has got to be some area of bipartisan consensus here. This is the individual's side. Who benefits from the, quote, unquote, loopholes or the tax shelters? Well obviously it is disproportionately to the side of the top one percent. The average is about $300,000 of those who are able to claim and benefit from shelters. So for every dollar that is parked in an income tax shelter, that is a dollar that is taxed at zero. If you take away the tax shelter but keep the rate really high, then we are hurting our economy from a competitiveness standpoint. But if you lower the rate and take away the loophole, that dollar that was parked in shelter taxed at zero is now taxed at something and you get more income from that income source, or from that taxpayer. So I think these are just interesting facts that ought to be worth considering.

And so, let me ask you, Mr. Wall, on the corporate side of things, from the perspective of job creators, which is more beneficial? Temporary measures that attempt to stimulate demand over the short term or permanent reforms to incentivize and boost returns and job creation in places like Racine, Wisconsin, and throughout the U.S.? What do you think is better for your planning purposes as to whether or not to hire or not workers in Racine?

Mr. WALL. Thank you, Chairman. From our perspective as a business, we are looking for stable, permanent, pro-growth tax reform. Temporary incentives are temporary as the name implies. When we look to make capital investments, we look at that return on investment, a five-year cash flow analysis. Right now there is so much uncertainty with the tax code, there is not a permanent structure to really make us make intelligent decisions on where we expand our operations. So, to answer your question, temporary is not helpful for us. We are looking for permanent, stable, fundamental reform.

Chairman RYAN. If we did such as you suggest, bring our effective rate down to 25 percent, go territorial, would that encourage you to add jobs in your U.S. operations?

Mr. WALL. Absolutely. If you saw my written testimony, for CNH we operate in 32 countries, and you see the comparative rates in my written testimony, companies choose to expand operations for a myriad of reasons or factors. Taxes are a significant component. The after-tax return on the earnings and the cash flow is an important consideration. So, to your point, if the U.S. were to lower the rate to 25 percent and go territorial, it would be incentive for us to expand capacity in the United States and add jobs.

Chairman RYAN. Ms. Rogers, let me ask you, because we are talking about distribution so much these days, those calling for higher tax rates often stress the need to make the wealthy pay more, pay their fair share is how it usually is said. Well, first of all, for instance, under the president's policies, deficits are set to rise by $9.5 trillion over the next 10 years, and that is the baseline. The top three percent of Americans by income, those earning $250,000 or more which we know more than half are these business, they have a total annual income of about $2.3 trillion. Even if the government confiscated 100 percent of that income, it would only fund the government for about six months this year. So, mathematically, is there any way to keep pace with the current spending promises by just raising taxes on this group of taxpayers?

Ms. ROGERS. Mathematically, possibly. I do not know. Economically, that would not be a wise strategy. There is a tax policy center analysis that was very useful, done about a year or two ago, called Desperately Seeking Revenue. And in that analysis, the Tax Policy Center asks the question, What if we tried to reduce the deficit to economically sustainable levels by just raising taxes on the rich? Okay, so you can take a look at that analysis, and what troubled me about that analysis was that if you just raised tax rates, if you were stuck with our tax base that is full of holes, which is a big qualification; I hope we do not have to be stuck with it. But if you were stuck with our tax code that is full of tax expenditures, loopholes, preferences, you would have to raise marginal tax rates in the upper brackets to the 70 to 80 to 90 percent marginal tax rate level. Now should we do that? No, I think all economists would say that is getting into dangerous territory. Even economists like me who do not consider myself a supply-side economist, but we are all supply-side economists to some extent in that we believe that incentives at the margin matter. When you get to rates that high, the disincentive affects start to outweigh the positive benefits of getting more revenue and reducing the deficit. So I do not suggest that you through it in that strategy.

Chairman RYAN. What I am trying to get at, for instance, Dr. Orszag and Dr. Romor, after leaving the White House, said that higher taxes in the middle class are inevitable. And so, what I am trying to get at is are people being honest when they say we can keep pace with the current spending promises just by raising taxes on the rich?

Ms. ROGERS. In my opinion, I do not think they are being smart. I think that mathematically it is possible to raise taxes just on those people above $250,000 by just raising marginal tax rates. Do I think that that is the best way to do it? No.

Chairman RYAN. Mr. Hodge, real quick. Mr. Van Hollen and I are trying to keep our time limits so other members have time. Modeling: The rule of thumb around here with joint taxes, for every percentage point decrease in the corporate rate is about $10 billion a year on an annual scoring basis; so, on a 10-year number, $100 billion per point. What do you think is more accurate from more of a reality-based, macroeconomic feedback models, what do you think the actual costs, assume the base stays the same for the sake of this, what do you think is more on the mark?

Mr. HODGE. Far less, Mr. Chairman, I think that we are on the wrong side of the Laffer curve on the corporate tax rate and that even if we were to bring the federal rate down to around 25 percent, which would still, when you add state taxes, be higher than the OECD average, I think it would be a net gain for the United States Treasury.

Chairman RYAN. Okay, thank you. Mr. Van Hollen.

Mr. VAN HOLLEN. Thank you, Mr. Chairman. Just to the point you raised about the share that upper income earners pay, I would point out that the reason for that, the principal driving factor is the huge growth in incomes of the folks at the very top relative to the stagnant wages in the middle class. That is what is driving the fact that folks at the very high end are paying proportionately more now. And if you look at the charts, it is almost off the charts. And that is an issue that I think we need to deal with from an economic point of view, because I think it actually has economic growth consequences as well as questions of tax fairness.

Mr. Hodges, have you had a chance to look at the Simpson-Bowles tax reform proposal? I assume you have.

Mr. HODGE. Yes. Yes, I have.

Mr. VAN HOLLEN. And what is—what is your reaction to that?

Mr. HODGE. Well, I think it was a great document for moving the ball forward on both reforming some of our major entitlement programs as well as the tax system. I can pick nits with many of the specific proposals in there. I do not think that setting aside $80 billion a year in revenues from tax reform is the way to go, but I think in general principles, they did a fantastic job in moving the agenda forward in fundamental tax reform and entitlement reform.

Mr. VAN HOLLEN. Okay, now with respect to their proposal on tax reform, one of the recommendations they made as part of bringing down the rates was also to harmonize the rates for capital gains and ordinary income. I assume you are agreeing with that as part of an effort to bring down the rates as well.

Mr. HODGE. I would not, Mr. Van Hollen. I believe that capital gains and dividends are a double taxation on corporate income. In fact, if you look at OECD data specifically on dividend taxation, the United States has the fourth highest overall tax rate on dividends of OECD nations. And that is even after we have reduced individual rates over time. So I would prefer to keep taxes on capital lower and bring down those individual rates.

Mr. VAN HOLLEN. That is interesting because the chairman made the point that the very wealthy benefit the most from these tax preferences and deductions. The primary reason that the wealthy benefit most is because of the capital gains treatment right now. In fact, if you look at the others, you have a lot greater impact on middle income taxpayers. So if you take that off the table as part of tax reform and harmonizing the rates, you do not get one of the major benefits that the chairman just talked about with respect to tax reform.

Let me, Mr. Wall, if I could ask you what is the effective corporate rate that your company pays right now?

Mr. WALL. The effective tax rate for Case New Holland in the United States is 39 percent. We generally are in the range of the high 30s.

Mr. VAN HOLLEN. Okay. Are you organized as an's corporation?

Mr. WALL. No. We are a subchapter C corporation.

Mr. VAN HOLLEN. Okay. Now, because I think there is a general agreement that the corporate tax rate in the United States at 35 percent needs to come back down in order to be competitive, but I was also interested in your testimony, you talked about the importance of the number of the current deductions that are available, for example, the R&D tax credit and accelerated depreciation. So my question is have you looked at the Simpson-Bowles proposals with respect to corporate tax rates? And what, if any, of the deductions in the tax code would you be willing to give up as part of an effort to do this in a revenue neutral way? Or maybe you think we should do it by adding to the deficit?

Mr. WALL. With respect to the Bowles-Simpson report, I have looked at it. The 23, 29 percent rate that they are advocating, I think the 25 is the appropriate rate, as with my testimony. With respect to your question, which corporate tax expenditures should be modified in order to facilitate a 10 percent reduction in the rate, as I indicated in my written testimony, I think it should be done in a fiscally responsible manner. I have not seen a legislation package so it is very difficult for me to answer that question without seeing the totality of which corporate expenditures may be modified.

Mr. VAN HOLLEN. Right. See, this is always the rub. I mean, this is the rub. Everyone wants to talk about this in general concept both on the corporate side and the individual side about lowering the rates and expanding the base. But I am just asking you as a businessman, since we should lower the rates which I agree with, but I am assuming you do not want to add to the deficits given where we are. Given your operations, which of the deductions would you be willing to get rid of? And if the answer is you need more time to look at it, I understand that. But that is what the Congress has to grapple with, and there are winners and losers in that. As we all know, GE, with huge profits, actually got tax rebates. So maybe Mr. Hodge, have you looked at the corporate tax proposals in Simpson-Bowles and which deductions if any would you be willing to eliminate or preference?

Mr. HODGE. Well, the Treasury did a sort of a thought experiment a few years ago. And in their thought experiment eliminated all the corporate tax loopholes, and they are only about $100 billion a year in so-called loopholes for the corporate community, by the way. And the individual tax code has nine times as much. So we are talking about a pretty small amount. And they found that you could only reduce the corporate tax rate from 35 percent to maybe about 28 or 29 percent, which takes the United States from having the second highest overall corporate tax rate down to about the fourth. So that is a lot of pain for very little gain. We need to go much further if we are going to cut the corporate rate down to a competitive level. That means thinking outside of the box and moving away from a revenue-neutral concept here and think more broadly.

There are a number of provisions in the corporate tax code that should be eliminated, and whether it is subsidies for windmills and so forth, but I should say that if you look at the IRS data, the effective corporate tax rate in the United States on average over the last 18 years has been about 26 percent on domestic and foreign repatriated earnings. And that does not include the taxes that corporations pay abroad which is about $100 billion a year. So the average overall effective tax rate is around 33 percent on average.

Mr. VAN HOLLEN. Another question. First of all, I thought your testimony was very useful in making the point that when we are talking about's corporations, not C corporations, that you mentioned two facts. One is the Joint Tax Committee data, which shows that only three percent of taxpayers are in the category, Over $250,000, right. And you do not dispute that figure?

Mr. HODGE. No, there are only two percent of all taxpayers that have incomes above that amount.

Mr. VAN HOLLEN. Exactly. And you pointed out that despite the fact that there are only about two to three percent taxpayers in that category, it does account for a huge amount of the income.

Mr. HODGE. Yes. That is our most successful private businesses.

Mr. VAN HOLLEN. But, but most of them are not what we would consider small businesses or mom and pop s, right?

Mr. HODGE. Nope.

Mr. VAN HOLLEN. Okay. I just think it is an important point because we often hear in this Congress that changes in those rates, 35 to say 39 percent, going back to 39 percent which is what it was during the Clinton administration, would somehow be hurting all these mom and pop small businesses. But, in fact, they include any businesses organized as's corporations, which includes businesses like Pricewaterhouse, KBR, Bechtel, right?

Mr. HODGE. Many of those are organized's corps, yes.

Mr. VAN HOLLEN. Right. I just hope we will put that aside and then we will discuss it based on those. Now, it is also a fact that the 39 percent rate was in place during the Clinton administration, beginning in the early 1990s. And we obviously saw a booming economic period. I am not saying increasing marginal tax rates somehow generates economic activity. Of course, it does not. Of course, it does not. But the fact is there are a whole slew of factors that people take into consideration when they are making their decisions. And, as the other testimony you heard suggests, and the evidence of history suggests that small changes in those tax rates do not make a big difference. Now, here is what I want to just ask you in closing. The territorial issue: I am going to read to you just an article from somebody who worked at Disney as a top executive. And maybe the two gentlemen could respond to this, being from the perspective of somebody who is in the business. Actually, if I could ask all three of our witnesses to respond. It says:

I am a card-carrying Republican who thinks that the deferral tax loophole is bad policy for two reasons. It rewards companies for moving property and jobs overseas, and it is unfair to corporations that keep jobs in the United States and then must shoulder a disproportionate share of the cost of government.

It goes on to point out that GE's effective rate was 7.4 percent well below the U.S. rate of 35 percent, largely because of shifting around with their foreign operations. And then I am just going to read this paragraph and then ask you to respond.

Now let's compare the Walt Disney Company from which I retired in January. Disney, their most recent Form K shows an effective tax rate of 34.9 percent, dramatically higher than GE s. The reason is that unlike GE, Disney has kept its income-producing property and its jobs in the United States. Is not one of the dangers of going to a sort of pure territorial system that a U.S. company, rather than investing here in the United States, would choose to take that same operation overseas at a much lower tax rate?

Mr. HODGE. No. In fact, the global trends have been in just the opposite direction. The reason actually that the United Kingdom moved to a territorial system is because companies were moving out of their country. And when they started moving toward a territorial system, those companies started coming back. And Japanese have found, as I mentioned in my testimony, that their worldwide system created this lockout effect, trillions of dollars worth of yen were being locked out of their country. When they moved to a territorial system, those yen started flowing back. And the reason that we have more than $1 trillion sitting offshore in corporate profits is because we have this Berlin Wall that has been created by the worldwide system.

Mr. VAN HOLLEN. I know my time is up, but the point that he was making was that you can address that issue by getting rid of the relaxed deferral agreement, but that is his point. I know my time is up.

Mr. HODGE. Or it will put U.S. companies at a disadvantage and then a harmful effect on U.S. jobs will be immediate.

Mr. VAN HOLLEN. I guess in the interest of time, I am going to ask the others. I will talk to you afterwards. Thank you.

Chairman RYAN. Mr. Garrett?

Mr. GARRETT. Thank you. Mr. Hodge, with regard to your corporate tax code, currently you said we are at number one or number two as far as corporate tax rates; corporate tax rates or tax burden?

Mr. HODGE. Tax rates.

Mr. GARRETT. Tax rates. Okay.

Mr. HODGE. The top margin rate of 35 percent added to the state rate puts us over 39 percent, which is the second highest.

Mr. GARRETT. So the pushback to that often is while we may be at the first or second in the top's rate, but we are not necessarily be at the top tax burden because of all the corporate loopholes that are out there. So how do we compare, vis-a-vis the other countries as far as our overall corporate burden when you consider the fact you have $100 billion worth of corporate loopholes?

Mr. HODGE. Well, the $100 billion actually does not lower the effective rate all that much. As I mentioned over the last 18 years, the average effective rate for all U.S. corporations has been about 26 percent. And then when you add the taxes they pay abroad which is about $100 billion a year, their global effective tax rate is about 33 percent. So they are paying close to the U.S. statutory rate.

Mr. GARRETT. Well, did you say if you did away with them, it would go all the way down to what?

Mr. HODGE. You can only lower the rate maybe to about 28 or 29 percent, and that includes bonus depreciation, which we would not want to eliminate.

Mr. GARRETT. Okay. And so if we did that, our standing in the world would be approximately what?

Mr. HODGE. We would be fourth highest in the OECD.

Mr. GARRETT. Okay. As far as rates are concerned, but burden level basically remains the same because it is one shift to the other.

Mr. HODGE. Right. I mean, the U.S. is collecting about three percent or about four percent of GDP is in corporate tax collections is below the OECD average; that is true. And so we have a high rate and low collections, which makes a lot of sense. That is why we have this Neiman-Marcus system. You know, Neiman-Marcus is very small. Wal-Mart is very big. And then they are doing it on volume, whereas Neiman-Marcus is trying to do it on price. And you can see who won.

Mr. GARRETT. Okay, thank you. Going to one of the chairman's initially comments. He was commenting on what the president said that we do need to do corporate tax code reform, which is a good thing. The president spoke of, I think you said, fairness, simpler, and more competitive. And there was an article I think a week or two ago in National Review on this topic of competition and competitiveness, that there is too much focus on competitiveness. And I may not be saying it exactly correctly, but the focus should not be to try to make our economy more competitive, rather more productive. Because you can have a more competitive system simply by switching the tax code around to say that Mr. Wall's business is more competitive vis-a-vis international trade by giving you additional corporate benefits or tax cuts, what have you. You are now more competitive versus your trading outside this country. But that is really not what we are trying to do here, right. We really need to not have competition, but increase of productivity for your company. Right?

Mr. HODGE. Well, I think that by lowering the rate we will increase productivity. And so, by making the U.S. more competitive, U.S. companies will become more productive and more competitive as well. So what is good for the economy will be good for them as well.

Mr. GARRETT. Okay. And Ms. Rogers, you were making the comment as far as what we need overall as far as our budget is concerned is some certainty even if not to be made now with regard to cost savings because of the economic morass that we are in but over the long period of time. And if you provide that certainty over the long period of time that that will provide what? More productivity and investment in the economy now?

Ms. ROGERS. Well, I think it is important to get our budget outlook in control or the short term just because it increases the confidence of global investors in the U.S. economy and keeps interest rates low.

Mr. GARRETT. I thought you said something about that maybe not making those cuts right now but rather as long as you have a plan in place, that over a period of time, so that provides the certainty. Maybe I heard you wrong.

Ms. ROGERS. No, that is right. I mean, you might be surprised that The Concord Coalition, the deficit hawk organization is not demanding that deficits be cut right now, but we are not. We are demanding fiscal responsibility right now which might mean whatever deficit spending we are doing at the moment, that we make sure it has high productivity, high bang per buck in terms of the stimulus. And over the longer term, that we have got a plan in place to get to more economically sustainable deficits.

Mr. GARRETT. Well, so two quick questions. One is there any history to show that if we make any projections now for the future as far as not making the cuts today but plan to do them in the future that they actually get implemented?

Ms. ROGERS. No, we do not have a good track record on that. And that is why I am hoping that The Budget Committee can commit to some serious budget discipline rules such as strict pay-as-you-go.

Mr. GARRETT. And the second thing is as far as the short-term fixes that we do right now, both parties have done this. President Bush did this with tax package where we got what? Sent out checks basically of $250 or something like that to a family. The new administration is saying the same thing. Let's do some short-term tax fixes as far as payroll taxes, what have you. What is the history? Whether Republicans or Democrats tried to do this, do you see long-term results from this or are they just really blips in the economy of that period?

Ms. ROGERS. No, I do not think that the payroll tax holiday, the payroll tax cut, is designed to be a long-term growth tax cut. It is designed to stimulate demand. So the reason why CBO lists payroll tax cuts as one of the more effective tax cuts to increase demand is because it tends to go to lower and middle income households who are most cash-constrained. So if you are trying to get more spending on goods and services immediately, you are best giving the cash to people who are constrained and will spend it all when they get it.

Chairman RYAN. Mr. Blumenauer?

Mr. BLUMENAUER. Thank you, Mr. Chairman. I always find these conversations interesting how they shift over time. I am not persuaded that the tax rates are the drivers when we look at how the economy performed so much better in era of higher taxes on business and, in fact, on individual rates. I think we would lust after economic productivity improvements that we saw, and we were involved with the 10-year experiment when Ronald Reagan harmonized capital gains. We have been involved in a 10-year experiment, and it has not produced stellar economic results, but I want to focus just on three items.

One, dealing with the complexity; we talk about the tax loophole as only being $100 billion, but it seems to me that they contribute to a much higher cost. We have been told by this committee; we have been told before Ways and Means. It is $162 billion a year to comply with the tax system that we have now. And the leakage through evasion or purposeful forgetting or just that complexity is a couple hundred billion dollars every year. So those two numbers combined far exceed what our super committee friends are arm wrestling over for the next 10 years; $3.5 trillion, you would be happy people. And we would be breathing easier, and the economy would be working better.

I am looking at two items that may get us a little faster, would look for brief response, because I do not have much time. The first deals with the value added tax, because those countries you are talking about that have lower statutory rates collect a lot of business income through a value added tax, and, in fact, pay more in overall tax than business in the United States in all but I think one of those countries. What is your reaction to a value added tax to kind of level the playing field and maybe buy some corporate tax reform? Any interest on any of the three of you?

Ms. ROGERS. I will take that one first. I think eventually we are headed toward needing to consider new tax bases, including an add on value added tax, maybe carbon based taxation, but I think that the first step in leveling the playing field of taxation is to look at the existing income tax code, so I think there is plenty of room to broaden the tax base.

Mr. BLUMENAUER. I wanted to zero in on the other two gentlemen very briefly. Any interest in exploring a value added tax as a way to buy it down?

Mr. HODGE. If the corporate income tax could be eliminated altogether, lye poured on it so it did not grow back up, then I would consider value added tax.

Mr. WALL. Congressman, my comments on it would be as you can see where we operate, most of the jurisdictions we operate do have a VAT. I think it is important to note the United States has a consumption based tax at the state level, the sales and use tax. We would be happy to look at any type of reform proposal that may include that in order to achieve fundamental corporate tax reform.

Mr. BLUMENAUER. Thank you. Let me put one other item on the table because there is one area in terms of user fees that would make a huge difference. Right now, we are beefing up our transportation trust fund. We have transferred $35 billion of general fund into it because it is in a downward spiral, and it is about to really collapse with electric vehicles, with hyper-efficient diesel. Simpson-Bowles suggested raising the gas tax. A gas tax has been part of the Ronald Reagan; he actually signed a nickel a gallon in 1982. The Clinton 1993 had a gas tax. We have had the petrochemical tax on Superfund expire, and so that cost has been shifted to private business. Any interest in looking at user fees to try and fill some of this gap?

Ms. ROGERS. Sure.

Mr. HODGE. I prefer to see the Highway Trust Fund to turned back over to the states, along with the taxing authority to be able to fund it.

Mr. WALL. The scope of my testimony is on corporate tax reform, so on a user fee at the individual; it is beyond the scope of what I will comment on.

Mr. BLUMENAUER. Mr. Chairman, in fact, you have received a request to you and Mr. Van Hollen from Mr. Simpson and myself to perhaps have a little attention to user fees, the Highway Trust Fund. That is a deficit that is yawning and is going to create bigger problems in the future.

Chairman RYAN. Happy to work with you. We have got a pretty busy fall schedule, but we would definitely be happy to work with you, just like this hearing was originated with the request from Mr. Van Hollen.

Mr. BLUMENAUER. Super. Thank you, Mr. Chairman.

Chairman RYAN. Mr. Calvert.

Mr. CALVERT. Thank you, Mr. Chairman. I would like to focus a little bit on the backbone of America's economy, our small business community or what exists of it today. As you know, small businesses provide 55 percent of all jobs in the private sector, produce roughly half of the privately generated GDP of this country. It does not take rocket science to understand that when small businesses grow and succeed, the entire economy as a whole benefits, including revenue.

As a person who was actually in small business, whatever, how you define small business in this country, I can tell you any smart business plan takes into account the current economic outlook, tax and regulation policy when you guide your decision process about how you are going to invest, how you are going to spend, and how many people you are going to hire.

As we all know, the current outlook in the country on business is dismal, especially in California, where I come from. And I believe the administration's tax policies are in effect contributing to a lack of confidence in the small business community because you cannot make long term decisions based upon knowing that taxes are going to be increasing in 2013 and other costs. In fact, according to the National Federation of Independent Businesses, their August report, the Small Business Optimism Index fell the sixth month in a row, and only 11 percent, 11 percent, of small businesses plan on hiring new workers over the next three months. I think that is about as low as it has ever been historically.

Nearly 75 percent of small businesses pay taxes under, as you know, under the individual income tax system. Tax hikes aimed supposedly at the rich, as proposed by the Obama administration, would end up hurting successful small businesses because roughly 50 percent of these small business profits are taxed at the top two individual tax rates. These questions are for everybody. Do you think raising taxes on these small businesses is the right strategy in a slow growth, high unemployment economy? And secondly, what are some of the best ways we can provide confidence and certainty to the small business community through tax reform?

And I look at regulations as a form of tax also. We look at these increasing regulations taxing these small businesses in order to comply to these oncoming regulations, so we will start off with the gentleman from Case.

Mr. WALL. Thank you, Congressman. With respect to your specific question on pass-throughs, subchapter S corporations partnerships, as you can see from our written testimony, we have 1,300 suppliers and dealers that do operate as pass-throughs. From our perspective, we would not want to see more stress on our suppliers. My testimony also talks about there is some discussion on whether or not we should treat pass-through entities as subchapter C corporations, subject under the double taxation regime. We would not think that is advisable.

Mr. CALVERT. Can I ask a question to you gentlemen on your suppliers? How many of your suppliers have gone bankrupt in the last two years?

Mr. WALL. Congressman, I do not have the exact number, but we have suffered suppliers going bankrupt. There has been a number. I think you had two questions, right? One was in terms of confidence, I would say in my testimony, in terms of small business, I think tax reform; that certainty is really what we need. Some stable, certain, fundamental tax reform, and in terms of regulation, I will read the paper, look at the National Labor Relations Board, EPA. I do commend the Congress administration for looking closer at the regulatory burden, but that is, I believe, creating a crisis of confidence in the corporate community.

Chairman RYAN. Mr. Hodge.

Mr. HODGE. Congressman, one of the things that sets our economy apart and our country apart from every other country is the dynamism of our non-corporate or pass-through sector, all of these private business owners. And as I mentioned in my testimony, more than half of all business income in America is now being taxed under the individual tax code, and as you mentioned, a lot of that is at the top marginal rate, and so by increasing taxes on those more dynamic entrepreneurs and businesses, I think would have a chilling effect on the economy for the long term.

And it is just the opposite of what we should be doing. And according to all the economic research, including that of the OECD, looking across all countries, cutting those rates is the way to go right now and the way to spur those dynamic companies and to improve the overall dynamism of the country.

Ms. ROGERS. I would just caution that while cash flow is needed by everyone in the economy right now, it has got to come from somewhere, and if we deficit finance tax cuts right now, it does not remove its cost. So the immediate cost is the drop in public saving, the increase in the deficit. If you care about long term growth, that is going to offset any benefit you get from increased private sector activity over the longer term.

Mr. CALVERT. I would just make a point, Mr. Chairman, that cash flow is a nice concept, but I know a lot of businesses today that have a negative cash flow. They are going out of business as the gentlemen from Case pointed out. Bankruptcies are record high in this country.

Chairman RYAN. Thank you. Mr. Honda.

Mr. HONDA. Thank you, Mr. Chairman and Ranking Member Van Hollen. Thank you to our witnesses also for being here today. The irony of the challenges posed by our debt and deficits is that if Congress did nothing and allowed the current law to run its course, the deficit would be reduced by over $4 trillion. This would mean bringing rates roughly back to where they were during the Clinton presidency, a period when the economy added over 20 million jobs and we created a budget surplus.

My question to Ms. Rogers is that it has been argued by my Republican colleagues that the only way to grow the economy is to cut rates even further. If this is true, then why is it that the country prospered under Clinton's rates and then how would you explain that?

Ms. ROGERS. I was actually on the Council of Economic Advisers the last year of the Clinton administration, and I wrote the section of his economic report that talked about the merits of fiscal responsibility. One thing we learned about the Clinton era tax increases is that while we were a little bit worried that that might have some adverse effect on private incentives to work and save, in the end, the increase in public saving far outweighed any slight decrease in private saving. It was very minimal, the adverse effect on the private sector.

So the net result was an increase in national saving, and national saving is the key driver to longer term economic growth. So that is the simple reason why even though marginal tax rate increases do have a dampening effect on labor supply and saving, we did not see very much. Empirically, it turned out that that effect was very small, relative to the increase in public saving, the reduction of deficits that turned to surpluses. That was very good for the economy.

Mr. HONDA. So following up on that, the term of "fiscal responsibilities" seems to have been said by each of the witnesses. In your definition, how would you define fiscal responsibility?

Ms. ROGERS. My definition of fiscal responsibility is getting the most we can out of the resources that we have in our economy, both publicly and privately, and so fiscal responsibility in the short term, in terms of the government sector, means that while we are trying to support the still-recovering economy, we are trying to get the most out of our money so that we are devoting our resources toward policies that will increase demand by a lot relative to their cost. Over the longer term, we need to come up with policies that reduce the deficit but are also favorable to economic incentives, so keeping marginal rates low by broadening the base. You can still raise revenue without hurting incentives for the economy to grow.

Mr. HONDA. So following up on that, if you were out to allow the current law to run its course, to restart on that path again?

Ms. ROGERS. That is an option. I have said that there are three ways to stick to the current law revenue baseline. One, do nothing. Two, do it big. Do fundamental tax reform that broadens the base if you want to pay to retain some of the Bush tax rates. And three, do it just to the rich. You know, raise marginal tax rates only on the rich. Those are three options, or any combination, and it is up to Congress to figure out what you can tolerate. All of them are taxing revenue increases is the point.

Mr. HONDA. Thank you.

Chairman RYAN. You left some time. Mr. Price.

Mr. PRICE. Thank you, Mr. Chairman.

Chairman RYAN. Dr. Price.

Mr. PRICE. Thank you, and I want to thank the panelists as well. I think this is a helpful conversation and discussion. We are all interested in pro-growth policies. We have a difference of opinion about what results in growth in the economy. Ms. Rogers, I am struggling a bit with this payroll tax notion. You voice support for decreasing the payroll tax, supporting the president's proposal for decreasing it on employers and employees, I understand. Is that right?

Ms. ROGERS. I label it a relatively effective tax cut for increasing demand for goods and services.

Mr. PRICE. And the payroll tax that is being paid by employers and employees that is referred to in these discussions, what is that money used for?

Ms. ROGERS. Well, it goes to the Social Security Trust Fund.

Mr. PRICE. Social Security Trust Fund

Ms. ROGERS. But this is a transfer. If the payroll tax cut would be financed with the rest of the budget, so it is a deficit finance tax cut.

Mr. PRICE. And I just heard you say that you do not support deficit financing for tax cuts.

Ms. ROGERS. That is right. So I like the president's proposal to offset the cost by broadening the tax base.

Mr. PRICE. By increasing taxes.

Ms. ROGERS. By broadening the tax base, and increasing effect of tax rates but without increasing marginal tax rates.

Mr. PRICE. Okay. I think it is important to point out that this payroll tax cut that is being talked about by the president and others is actually a shift. It is just a shift in who is paying for the Social Security benefits.

Ms. ROGERS. Well, it is a shift in the tax burden, you are right, temporary shift in the tax burden, but actually, we could do a revenue-neutral shift in the tax burden. Not that I am proposing this, but if you raised taxes on the rich and cut taxes on the poor, that would actually be stimulative to the economy. That is not what I am proposing to do, but I am just illustrating the fact that you can keep average tax rates constant, and redistribute the tax burden and actually achieve one result in the short term, maybe a different result in the longer term.

Mr. PRICE. Actually, that is more consistent with our budget did that we passed through this committee and through the House is we broadened the base and lowered the rates. I want to move on to the issue of territorial taxation because I think this is incredibly important and Mr. Wall, you mentioned that you are in Wisconsin. So overseas to you is not overseas, is it? Is it just over the border?

Mr. WALL. Correct.

Mr. PRICE. So competition that businesses see in states such as yours have to look to what the rate is in Canada and decide whether or not you are going to house a facility in Wisconsin or Canada, correct?

Mr. WALL. That is an excellent point, Congressman. In my testimony, the countries that we operate in, as I mentioned before, when we look to expand capacity, it is a myriad of factors. Taxes is one of them. Logistical cost is another. When you are shipping large truckers and combines halfway across the ocean, you can imagine logistical costs are very high, but with respect to your specific point, you could put capacity in Canada and shipping southbound would not eat you up on logistical cost.

Mr. PRICE. Right, and it is a whole lot easier, and their tax rate is about 10 percent less than ours.

Mr. WALL. That is exactly right.

Mr. PRICE. Yes. Mr. Hodge, I was interested in your comments about the consumption tax, and you appended your statement to say that if we did away with corporate income tax, that you would supportive of a VAT tax. Is a consumption tax not like a national retail sales tax? If we do away with all income tax for both individuals and corporations, is that not a way to truly invigorate the economy by aligning our taxation with our form of commerce?

Mr. HODGE. Well, most economists would agree that we want to move toward a consumption base in our tax system, and there are many ways that we can do that. You can do it through an end stage retail sales tax, you can do it with a value added tax, but also, a flat tax, like a Steve Forbes style flat tax, is also a consumption tax because it has removed savings and investment from the tax base. So there are many ways you can sort of skin the consumption tax cat and get there.

I would be more preferential to a flat tax than moving toward a VAT because I think that there as many problems with that as we see in sales taxes at the state level, but we should certainly be moving away from income-based taxes toward a consumption base.

Mr. PRICE. And let me revisit the territorial issue with you as well, because you said that actually having a territorial system of taxation increases business activity here, and can you expand on that and why that is?

Mr. HODGE. I am sorry, say that again?

Mr. PRICE. That having a territorial taxation would increase business activity in the United States.

Mr. HODGE. Well, it would lead first and foremost to a great deal of repatriation of foreign profits that are now trapped abroad, and that companies are reluctant to bring back to the United States to pay this enormous toll charge that we have set up to bring their own money back and invest in the United States. So I think that moving toward a territorial system would bring a flood of dollars back to the United States. They could be invested here, creating jobs, and R and D, and what have you. It is their money, but we have set up such a toll system for them to bring it back that the incentives are just simply in the wrong direction.

Mr. PRICE. Thank you. Thank you, Mr. Chairman.

Chairman RYAN. Thank you, Dr. Price. And like we often say in Wisconsin: overseas, we refer to Lake Superior. It is Illinois. Ms. Schwartz.

Ms. SCHWARTZ. Okay. Thank you. I appreciate this conversation. I wanted to bring it back to what I think is in some ways a bit of a broader view about tax policies. As we go forward, I think it was said by each of you that we are pro-growth. We think that economic growth is certainly very important to get ourselves out of where we are right now, but we need to understand what that takes. And to understand that, I think that the context within other issues we are dealing with, I think it was as Lim Rogers actually talked about the deficit reduction and the need for fiscal responsibility, so I would say we cannot really not talk about corporate taxes or even individual tax reform without an understanding of this broader context of the need for revenue and then the need to reduce the deficit.

Certainly, the concept that if we just lower taxes for the wealthy, particularly for wealthy corporations, that will in fact create jobs, which is a point, very clearly. If in fact that had worked, we would not be in this situation we are in. And so the concerns that I would have about the notion that the unpaid for tax breaks that were given during the last decade, the Bush tax cuts as we refer to them. Tax cuts for the wealthy, tax breaks for corporations that they would produce jobs. This failed to materialize. The fact that there are large unpaid for tax cuts did not lead to jobs creation the last decade has given us a staggering wage stagnation, which has made a very big difference to consumer demand, which of course industry needs because if consumers are not buying your products, you do not make them. So that has had huge consequences.

The lack of consumer spending and now, of course, the excessive borrowing that consumers are now saying, I cannot do anymore, which is a good thing, has actually created incredible stagnation in the economy. You could add to that the political uncertainty, the almost default on our debts created uncertainty in the investor community. Investor confidence went to essentially zero. In August we had a stunning turnaround from what we had seen as job growth over the last year and a half. New jobs every month to zero jobs because the investor community, the corporate Americans, the people whose jobs said, We cannot risk it, we do not know what is going to happen, if in fact we are going to potentially see government default on our international loans.

So, my question, particularly given what I have just heard from particularly Mr. Hodge and Mr. Ryan, is that the answer to this is to reduce corporate taxes and in fact, Mr. Ryan suggested quite deliberately and I think that Mr. Hodge did as well, the answer is to increase taxes for the middle class, that individual tax rates, eliminating tax provisions of deductions, for example. I think Mr. Ryan suggested that we reduce tax benefits for saving, retirement savings, that would be a way to pay for the lowering of the corporate tax rate. It seems that that would be the wrong way to go. And I support lowering the corporate tax rate and broadening it, getting rid of the special interest loopholes that in fact may do no good anymore and are certainly not stimulating the economy.

So, my question is, in fact, and I will address this to Ms. Rogers, is it important for us to look at tax reform in the context of deficit reduction, in the context of how do we give middle class Americans more dollars to create that consumer demand so you can actually make products and sell it to them. And even as we look at corporate tax rates and international competitiveness, that we do that again in the context of what creates jobs in the short term. There was a great New York Times article this morning about the president's jobs package, leading to potentially two percent additional economic growth and a couple million jobs. That is not something to put aside, so what can we do both in looking at the short term demands for job creation, the requirements for fiscal responsibility and the requirement of additional revenue is part of how we get out of the debt we are in. If you could in just a little less than in a minute, give us your opinion about whether that is the right context to be looking at this.

Ms. ROGERS. Well, I think we absolutely have to be talking about the deficit effects on the deficit, even the short-term. I think that it is possible to broaden the tax base without overly burdening middle class households. Just because we are talking about looking at the tax expenditures within the individual income tax and those benefit all income tax payers, not just the rich. It does not mean we have to eliminate those tax expenditures, there are ways of limiting those tax expenditures in ways that are very progressive. So the president's proposal to limit itemized items to 20 percent is an example of how you could pare back on some tax expenditures without burdening the middle class.

Ms. SCHWARTZ. Thank you.

Chairman RYAN. Thank you. Mr. Lankford.

Mr. LANKFORD. Thank you. Witnesses, thank you all for being here. This is very helpful and this is a good conversation for us to have in a bipartisan manner, to be able to talk through the issues. This is something we kick around a lot on the floor, a lot in the hallways, and we need to be able to determine what does that mean by dealing with tax code and tax policy and broadening the base and lowering the rates and all these things are great terms, but getting a chance to walk through some of the dynamics of that with you all is very helpful. So I appreciate the time that you all put into doing this.

So let me continue on a conversation that has already started on the issue of repatriation. I have multiple questions on this and I have not had the opportunity to hear your comments on that. What are your initial comments on the territorial versus global system? And two issues, and I am going to come back to everyone on this, one is that one-year, two-year repatriation or just wiping it out completely and just moving to a completely territorial system versus global system on how we handle international business earnings.

Ms. ROGERS. So, on international and corporate tax reform, I think it follows the same principles as the rest of the tax system in that if we are talking about ways to reduce the effective rates of taxation on businesses, we have to worry about what is happening to revenue levels. We cannot just count on the growth to make up for the loss of revenue.

Mr. LANKFORD. Let me just clarify, because I do want to have a conversation with this, back and forth. That is assuming that companies are going to bring those assets back at some point and they will be taxed at the 35 percent rate or whatever rate it is. So, is that what you are counting as a loss? Is the assumption that they will eventually bring it back or is the assumption they made that money in Canada, they are going to leave it in Canada, it is never coming back? Which one is your assumption on that?

Ms. ROGERS. Well, probably somewhere in between. I mean whenever we give a tax break to do anything, there is some incentive for the business to do what it is we are encouraging them to do. We do not know what their response will be and part of that lower tax receipt is a response to businesses shifting activity to lower tax activities. So, some of that tax cut is going to take effect in the form of lower revenue and we have to worry about that.

Mr. LANKFORD. So would it be better to leave the higher rate and just let it play out and allow companies that have investments overseas to leave it overseas, maybe they will bring it back, maybe they will leave it there, but just allow it at the same rate, is that your recommendation?

Ms. ROGERS. I do not know. I do not want to make a recommendation on that proposal. I just want to caution that it sounds to me like that is narrowing the tax base or reducing taxes and we have to worry about whether it is worth it is cost.

Mr. LANKFORD. Thank you, that is fair enough, Mr. Hodge.

Mr. HODGE. Well, I think we can learn some experience here from both Great Britain and Japan, which are the two largest and most recent countries to move to a territorial system, and for two very different reasons. One, Great Britain was actually seeing the flight of companies leaving Great Britain because they had a high corporate rate and a world-wide system. So they left to Ireland and Switzerland and Netherlands to seek some relief from that. And the minute that they moved towards a territorial system, they saw some of those companies intending to come back to Great Britain.

Japan had a very different experience, as I mentioned earlier. They saw this locking out effect, of which their world-wide system was keeping profits abroad, largely in Asia, some here in the Unites States, and when they moved to a territorial system, they saw some of those profits starting to come back to Japan. I think we suffer many of the same consequences that both of those countries are seeing and that is the reason we ought to move very, very swiftly to a territorial system. So that we can unlock that locking in effect that is trapping all of those profits abroad that should be here and invested in the United States.

Mr. LANKFORD. Okay, let me make a follow-up, just take this back and forth. Several months ago Timothy Geithner was actually seated in that same seat, we had this same conversation. I know you are sitting in the secretary's chair. We had the same conversation about territorial taxation or global taxation. The president was very impassioned in his state of the union address and dealt with corporate taxes, about lowering the rate and broadening the base, but had not talked about territorial versus global. I had asked the secretary about that. He did not give me an answer one direction or another on a preference on that. That was an interesting dialogue to me and I have still yet to be able to hear from the administration's perspective on that. I do not know if anyone has heard the administration be able to state a perspective on this other than just lowering the rate and broadening the base. The issue comes down to what we were just talking about before. Is it a loss of tax revenues to be able to deal with repatriation issue, number one? And let me go ahead and skip to number two on that, is it better to do just permanent, or is it better to say until we can get to one or two year repatriation, just exemption?

Mr. HODGE. Well, I am always reluctant to support any sort of temporary measures because I think whether it is temporary, back-to-school holidays, sales tax holidays or payroll tax holidays, that is bad tax policy. It creates uncertainty in the tax system and it violates most of our principles of tax policy. But the sooner that we move to a territorial system, the better off the U.S. Economy will be and the more competitive U.S. businesses will be.

Mr. LANKFORD. Okay, thank you Mr. Chairman, I yield back, and Mr. Hodge, I apologize for running out of time on that.

Chairman RYAN. Ms. Moore?

Ms. MOORE. I want to thank each and every one of you for your appearance here today. In particular, I want to thank Mr. Wall for being here. I have had many meals from the Case Company, my father worked there for 40 something years, my uncle has worked there for several years and I have a great affection for the Case Company. And I want to thank Mr. Hodge for being here and Dr. Rogers for being here as well.

Let me get right in to my questioning with Mr. Wall. You are pushing for this territorial system and apparently Mr. Hodge thinks this is a good system as well. I guess my question would be, first of all, how much of this $3 trillion we hear about, 3 or $4 trillion, that companies have sitting on the side, how much would you say that Case has sitting on the side, waiting for tax certainty?

Mr. WALL. Thank you Congresswoman. I think it is important we give a brief background.

Ms. MOORE. I do not want you to take up all my time.

Mr. WALL. I will be very brief.

Ms. MOORE. I want the number, the amount of money.

Mr. WALL. Insignificant. Our structures, we have very few, a handful, of corporations beneath the United States. We are a foreign investment in the United States, so when I advocate territorial, it is not a significant benefit for our company. To me, it is our prudent tax policy, which I put it in my written testimony.

Ms. MOORE. Okay, thank you so much. Mr. Hodge, I am really grateful to you for the $500 per child tax credit that you indicate that you pushed for in the contract for the people during the Newt Gingrich era. We have all seen reports as recently as today or yesterday that one in six people are poor in America. So I am wondering how your view of consumption based tax or flat based tax, how do you think that that will fair on the poor? And, indeed, children are the poorest among the population. How does that square with your view that we ought to move to consumption based taxes?

Mr. WALL. Well, I think you probably know that half of all Americans pay no income taxes and many of those people actually get refundable tax credits through things like the $500 tax credit. We are giving out a little over $100 billion in refundable tax credits this year to people who pay no income tax. So that is actually a larger amount than all the corporate loopholes combined.

Ms. MOORE. So if one in six people are poor, and they have to consume, they have to buy bread and washers and dryers and they have to have stoves and refrigerators, how would a consumption based tax, do you think, how would they fare under that proposal? Would they not be more poor people? What if we were to move to a flatter tax?

Mr. WALL. I do not think consumption taxes would drive people into poverty, but I think anyone who consumes anything would pay a sales tax for the consumption.

Ms. MOORE. Okay, thank you, thank you very much. Mr. Wall, I want you to respond to Dr. Rogers indication that if we were to move to a territorial system, that we could not be certain whether or not those dollars would actually be used to invest here in the United States. We would lose the revenue but there would be no certainty that those monies would be used for investment. Like now, money is sitting on the sideline, and corporations are profitable, but they are not re-investing. So what could you say to that point?

Mr. WALL. Congresswoman, my response would be as Mr. Hodge indicated, the lock-out effect, trillions of dollars, if there was a patron holiday, or whatever Congress deemed appropriate, money would come back and companies are in the business of investing that money.

Ms. MOORE. Thank you, thank you. Dr. Rogers, I have not been for the just tax for the rich thing; I say we let all of the Bush-era tax cuts expire and get rid of all of them. Can you respond to that economist model?

Ms. ROGERS. Well, yes, I kind of agree with you, but I am speaking on my own behalf when I say that. The Bush tax cuts have a cost over 10 years of over two and a half trillion dollars without counting interest costs.

Ms. MOORE. And they do not help the poor as much as they do the rich.

Ms. ROGERS. That is right, and that does not count the AMT relief that we needed to pass every year to offset some of the facts of the Bush tax cuts. So, put those together and the CPO says that is $4 trillion, over 10 years.

Ms. MOORE. That would solve my problems right now. Get over George W. Bush.

Ms. ROGERS. Or either, I mean, what I have been trying to stress is that sticking to that current law baseline does not require that we stick to current laws. So if there are parts in the Bush tax cuts that both Democrats and Republicans like and want to keep, what it suggests is that we just try to find a way to pay for it. If we really want to keep them, they must be worth off setting its cost with some other types of base-broadening tax reform.

Chairman RYAN. Thank you Dr. Rogers, thank you Ms. Moore. Mr. Ribble.

Mr. RIBBLE. Thank you, Mr. Chairman. Ranking Member Van Hollen, and thank you for calling for the hearing this morning. Mr. Wall, it is good to see you. I am from Green Bay. Feel free to expand up in the 8th District any time you like.

Mr. WALL. No problem.

Mr. RIBBLE. And so, it is good to be here. Ms. Rogers, was it last December that the Bush rates were extended?

Ms. ROGERS. Yes.

Mr. RIBBLE. So it is really the Obama rates, correct?

Ms. ROGERS. Yes, you can call them the Bush-Obama tax cuts now.

Mr. RIBBLE. Thank you very much.

Ms. ROGERS. I have talked about them that way, in fact.

Mr. RIBBLE. I mean, we seem to reinvent history here. Those rates were extended under President Obama, most recently. I do want to ask Mr. Hodge a question though. You mentioned in your testimony that the tax cut code ought to be simple, transparent and equitable. Those were the three words I think you said. Am I describing them accurately?

Mr. HODGE. Well, not equitable. I talked about a new way of looking at equity, but the tax code should be transparent, it should be simple, it should be neutral to economic decision making.

Mr. RIBBLE. Okay, this is the tax code, roughly 10,000 pages here. Would you say it is simple?

Mr. HODGE. No, we have actually used that as a doorstop.

Mr. RIBBLE. I have been using it as a paperweight in my office. But Ms. Rogers, would you call it simple?

Ms. ROGERS. No.

Mr. RIBBLE. No. Mr. Wall?

Mr. WALL. It is not simple.

Mr. RIBBLE. It seems to me that every time Congress, and I have only been here nine months, so I do not have all the historical perspective on how it got here, but it does seem like every time Congress decides to simplify it, we add 500 or 600 pages of complexity. Is that kind of how you see it too, Mr. Wall?

Mr. WALL. Yes, Congressman.

Mr. RIBBLE. Yes. Mr. Hodge?

Mr. HODGE. Absolutely.

Mr. RIBBLE. And, Ms. Rogers?

Ms. ROGERS. Yes.

Mr. RIBBLE. Yes. Now, that is my fear, is that we are going to kind of nibble around the edges here, not really do any real true tax reform and we are going to end up in an effort to simplify something, make something more complex, more inequitable, more difficult for Americans to figure it all out. It just costs a God-awful amount of money for most Americans to even file their tax returns, now I cannot even imagine what it is like for a company like yours. But there is a tax on a tax. Who pays corporate taxes? I mean, where do you get the money the pay those corporate taxes from? Do you borrow it, or where do you get that money?

Mr. WALL. Corporate taxes are levied out of the company's profits. It is a tax on labor, it is a tax on capital formation.

Mr. RIBBLE. So you get those profits from selling product?

Mr. WALL. Absolutely.

Mr. RIBBLE. And those profits build in the taxes into the cost of the products? Would you sell your products for less money if your taxes were at a lower rate?

Mr. WALL. If our taxes were at a lower rate, the market advantage, probably.

Mr. RIBBLE. Yes, I mean, at the end of the day, for the most part, really, consumers pay all taxes. Every dollar of tax that is paid, is paid by consumers. You are going to pass it on. I ran my own roofing company for years and years, and roofing costs more when taxes are higher, costs less when taxes are lower.

Mr. Hodge, looking at the flat rate that you mentioned, equitable taxes should apply a single flat rate on most everyone equally. That way every citizen pays at least something toward the basic cost of government. I think Representative Moore makes a valid question here, not so much on the consumption side, but on a flat tax rate. How would you structure a flat tax rate so as to not penalize lower income or poor families?

Mr. HODGE. Well, let me just premise that by saying that I think we have too many people right now who are not paying any income taxes whatsoever and thus not contributing to the basic cost of government. They are consuming government, they are reaping great benefits from it, but they are not contributing to it. And I think that is a problem both fiscally and also for our nation's democracy. That more people benefit from our government than are actually contributing to it. And there are many ways to protect them and we do have a standard deduction and so forth, but we have simply knocked too many people off the tax rolls in recent years. The tax code has always protected the very poor, and that goes back to 1913, but I do think right now we have too many people who are paying nothing and contributing nothing to the cost of government and actually they are getting a check back from the IRS. They are looking at April 15th as payday rather than tax day.

Mr. RIBBLE. Thank you very much, and thank you to all three of you for spending some time with us this morning. Mr. Chairman, I yield back.

Chairman RYAN. Mr. Pascrell.

Mr. PASCRELL. Thank you, Mr. Chairman. Mr. Chairman, I want to commend you and Mr. Van Hollen and the witnesses today, in both sides of the aisle, but what I consider to be one of the most civil discussions about a very serious topic. Neither party is privy to virtue one what we are trying to do. And the book that was held up before by the gentleman from Wisconsin, what percentage of that tax code is there to protect the very two or three percent of the people we are talking about at the top of the scale? They have hundreds and hundreds of attorneys. The average guy, like you or like me, somewhat, they do not have any lawyers to deal with these things. And I think that is something we ought to address. We are talking about increasing the number of pages in the tax code over the years, every president said they were going to shrink it, every Congressman is going to shrink it; it only got worse because they are a lot smarter than we are. Those lawyers have gotten all kinds of concessions and unless we address that, and you know what, Mr. Chairman? I got to give the tea party credit. As your wing of the party, we have our wings, you have your wings, and they brought this subject, if they only understand all the facts rather than just having blinders on, I think they would understand what we are dealing with and that is, the rich got richer and the poor got poorer. That is an oversimplification, Mr. Chairman, but that is true.

My friend from Oklahoma, who talked about repatriation, we tried this in 2004: 105, 110, companies. Chamber Watch in April of this year was very specific about the fact that no jobs were created. None. Zero. In fact, of those 105 major companies who took advantage of that repatriation with five and a quarter percent coming back on tax, on what was coming back into this country. Many of them, not most of them, many of them had tax cuts. Not only did they have tax cuts they cut jobs. So, we need to put things in context to see how these things really turn out.

Now, the other side, your side Mr. Chairman, cut taxes, we joined you in some of them, tax cuts in 2000, 2001, 2003 made predictions, just like Mr. Obama made predictions in his team, both of them totally wrong about what was going to happen if we cut taxes in 2001, 2003 how many jobs would be created. You had to create 5 million jobs and we know it was less than half of that. Both sides do not know what they are talking about. And I would rather listen to the people in this room, than the folks from Yale or Harvard who have been giving me advice over the last 12 years. I can learn more in this room, God Bless you, in terms of boots on the ground, in terms of boots on the ground than I can learn in a minute in any of those folks that we have been listening to. We have got the protocol and the models wrong. And if you look back into the Financial Times at those series of articles back in 2003, you will see what was predicted and what really came out. And that it is why it was very disappointing. And the Democrats were obviously happy that they did not create the jobs; I am being cynical now, back in 2001 and 2003, and just as many folks on your side hopefully do not see an increase in jobs, and we will get that guy in the White House, whatever it takes. I would rather listen to the folks in this room, Mr. Chairman.

Now, Ms. Rogers. Today, I think, contrary to common perception, federal taxes at the lowest level in over 50 years, federal state and local income taxes, and by the way, Mr. Hodge, you may not like it that 50 percent of the people are not paying income tax, but you take a look at all of the other federal taxes that those people pay. Look at it in context, and they pay a higher percentage of what they are worth than those people who are paying income taxes. Please put it in context. Please put it in context. Those people pay other federal taxes, do they not, Mr. Hodge? Do they or do they not?

Mr. HODGE. They do but it is much smaller.

Mr. PASCRELL. Do you know how much the percentage of what they are worth is?

Mr. HODGE. Actually people in the lowest tax bracket, including all of their taxes are in negative effective tax rates.

Mr. PASCRELL. Even when you include the income taxes?

Mr. HODGE. When you include the refundable tax.

Mr. PASCRELL. Well, that is not what I asked you.

Chairman RYAN. Thank you, Mr. Pascrell. On that sunny bipartisan note, we will turn it over to Mr. Huelskamp.

Mr. HUELSKAMP. Thank you, Mr. Chairman. I appreciate the opportunity to ask a few questions of the folks. And I want to come to Mr. Wall for the last question because I to hear from someone outside the room that is actually in the world of creating jobs. I particularly appreciate your testimony so far. One of the first comments and observation that I would like to make and ask a question of Ms. Rogers, is you were talking about sticking to current baseline by the estimates out of my office on January 1, 2013, if as Mr. Van Hollen indicated if Congress took a 10 year vacation and did nothing we would have about $5 trillion in tax increases over the next decade. That is the current baseline if nothing changes. Do you still support sticking to the current baseline and as far as its impact potentially on the economy: a $5 trillion tax increase that that is good for the economy?

Ms. ROGERS. I think it is needed for the economy, for both the medium term and longer term and I think that it does not require reverting to Clinton era tax rates, despite the fact that I do not think that is also very bad for the economy kinds of tax rates. I think that it is an opportunity to commit to a strict version of pay-as-you go rules, which is just to say whatever you want to keep in terms of extended tax cuts you can pay for them, because right now in current law we have committed to an expiration of all the Bush-Obama tax cuts at the end of 2012, so I am just asking that this committee, and Congress more generally commit to pay-as-you-go.

Mr. HUELSKAMP. But you do not believe the president should commit to pay-as-you-go on his payroll tax proposals, is that correct?

Ms. ROGERS. No, I support the idea of offsetting the cost of those as well.

Mr. HUELSKAMP. I read the bill last night, and there is no offset, essentially it is borrowing money, debt payments is what will be the offset. There is no offset in the president's bill; it is borrow and pay later, not pay-as-you-go. The question I would ask, we have $5 trillion tax increase potentially facing if we do not make some progress here.

I appreciate the discussing today, but Mr. Wall, the question I would have for you, and as you talked about certainty, and temporary tax cuts, temporary tax relief, temporary measures as we have seen in Obama's Stimulus 1, Bush Stimulus 1, Obama Stimulus 2. How many years do you need to say that is the kind of certainty I need, and my problem is, as a member of Congress and everybody here is that we cannot bind future congresses. We can try to tie them down into a constitutional amendment, on the balanced budget amendment, but how many years do you need of certainty to say I can make those investment decisions?

Mr. WALL. Thank you, congressman, with respect your question. I would say permanent; what I am advocating is not temporary a stimulus if you will: permanent stable fundamental corporate tax reform. We talked about the corporate taxes that was waged on capital formation, labor and customers. Corporations have the jobs. If the tax rate could be lower, when look at our competitors the OECD would stimulate investment with the United States. I think that would be huge for investment or job creation.

Mr. HUELSKAMP. So, if, by some political miracle, and maybe I am not optimistic enough, the House Republican Budget that presumes fundamental tax reform would pass and become law; and this is the only chamber that has actually suggested that, becomes permanent in this year sometime before January 2013, you would think that is a good enough signal that a future congress could come in on sometime in the next year or two or three or four or five, make changes again, but if you were told we passed it, hopefully it is going to stick, that would be permanent enough for you because that is the problem; they could change it in two years.

Mr. WALL. That is absolutely right. I mean we need the message that it is stable, it is permanent, the other side of the equation I mentioned in my written testimony: regulatory reform. The burden of regulation is loosened up; that is the type of message I think that would instill corporate confidence.

Mr. HUELSKAMP. I appreciate that, and Mr. Hodge, I appreciate you being here as well. What is your expectation of what would happen if we fully implemented the Obama stimulus plan Number 2, how many jobs would that create in your best guess?

Mr. HODGE. Few, if any. Jobs are not created out on temporary measures that can create long term expectations as we have been discussing. And right now, the long term expectations in the business community looking at the economy is very, very poor. And I doubt that even a small incentive would encourage someone to hire someone who could cost tens of thousands of dollars over the long term. If you get a $5,000 tax credit to hire a $25,000 a year worker, that person is going to cost $125,000 over the next five years, so that incentive is relatively small for that long term commitment. And so you ought to be absolutely sure that you have profits and business that is going to allow you to keep that person for the long term, and right now too few businesses have that certainty.

Mr. HUELSKAMP. Thank you. Mr. Chairman and Ranking Member I appreciate the great panel today.

Chairman RYAN. Ms. McCollum

Ms. MCCOLLUM. Thank you Mr. Chairman for the temperature in this room so you and I do not feel so homesick. It is freezing in here. I just want to go back and I think demystify what some of the conversation has been about what people pay for income taxes, who pays and who does not pay. And I am going to give my say. The data is from the Tax Foundation and it shows that in 2008, the average income for the bottom half of tax payers was $15,300. This year, the first $9,350 of income is exempt from taxes for singles and is $18,700 for married couples; that is slightly more than in 2008. And that means that millions of the poor do not make enough money to owe income taxes. It is not a question that they decided not to pay income taxes; many of them do not make enough money to owe income taxes.

And as was pointed out, they do still pay plenty of other taxes: federal, payroll tax, which right now is a holiday for them, so that is the stimulative effect that Dr. Rogers was talking about. They pay gas tax. They are paying sales tax in their states. They are paying utility taxes and other taxes that they have no choice; they have no discretion. If you have water, if you have electric and there is a utility tax on it they are paying it.

And then, when it comes to state and local taxes, the poor bear an even heavier burden than the rich in every state except Vermont; and that is the Institute of Taxation and Economic Policy that did a calculation on the data. Those are not my numbers or anything that has been cooked up.

And this just troubles me. We throw out our good neighbor to the north: Canada. We talk about our strong ally in Asia: Japan. And when we talk about these economic comparisons, we are not talking about how they are fundamentally structured and function different within their business communities. In Canada, businesses do not have the burden of health care the way that your business does here. In Japan, the government decides it is going to work with its businesses to do R&D and by golly, they are going to have the best battery technology in the world and they help their corporations do it.

So, when just kind of start throwing out countries, and Germany does the same thing, we sometimes shorthand things to make it work for the argument that we have. But here is my question. I am very concerned, and I did not vote for the Bush tax cuts, I did not vote for the Obama tax cuts, because I just thought we were too rosy with the scenario about what was going on out there and there was too much uncertainty and too much unpredictability.

And here is my problem: I am willing to cut; I am willing to cut into programs that I think really make a different in investing in our future but we need to do something about our deficit. But what bothers me is when we talk about the income taxes, in particular, it is okay to go out and borrow the money on those. So, my question is, to the panel, do you have anything that shows, anything at all, any studies, that support the notion that tax cuts at this magnitude are ever going to pay for themselves, that will help reduce the deficit, or are we just going to continue to make no investments in our future? And we will start with Mr. Rogers and work down.

Ms. ROGERS. No, I mean, I actually do not think any economist would claim that the tax cuts would pay for themselves, so it has a cost, in other words. So we have to weigh the cost against the benefit, and I think you bring up an important point, which is that we have to start considering not do we like the tax cuts, but do we like them better than alternative uses of that money, because it is a lot of money and there are a lot of investments that government could make or other forms of spending they could make, and we should be weighing those trade-offs instead of just saying we like the tax cuts and we would rather keep them than lose them.

Mr. HODGE. I would be happy to share with you some OECD research looking at the experience of other countries in cutting their corporate taxes while broadening their bases.

Ms. MCCOLLUM. Mr. Hodge that goes to my point. What are those companies putting into R&D? What are those countries doing for health care? I think we need a balanced approach when we talk about that; if that includes everything then I would love to see it.

Mr. HODGE. Well, this research is looking at what are the revenue losses from corporate tax reform and they find out that, generally speaking, that these kinds of corporate tax reductions do not lose as much money for the treasury as were expected and for some reasons it is because of the base broadening.

Ms. MCCOLLUM. Mr. Hodge is referring to the individual income tax when he talked about the tax cuts.

Mr. HODGE. I think that we should be broadening the bases we lowered individual rates as well. There is $900 billion worth of tax expenditures in the individual code; I do not think all of them should be eliminated, but many of them can while we cut those rates. I will be the first to start clicking off the tax expenditures we can eliminate.

Chairman RYAN. Thank you. Mr. Woodall.

Mr. WOODALL. Thank you, Mr. Chairman, and thank you all for being here. Mr. Hodge, thank you for the time you have invested in us in tax policy over the years in the 7th District of Georgia, I appreciate that. Dr, Rodgers, do you think it is important for everybody to have skin in the game? You talked a lot about incentives and that somewhere up there on the margin high rates matter; they affect people's incentives. Low rates, I would argue, also matter. Do we, to keep this American experiment alive, do we all need skin in the game or is it okay to move folks off the tax rolls?

Ms. ROGERS. I, personally, would prefer that most people be on the tax rolls but we already all have skin in the game in one way or another. I mean, I think that focusing our attentions just on who pays federal income taxes is a little bit of a narrow view of who has skin in the game. There are opportunity costs of how we use are funds, and so, in a sense, we all have skin in the game.

Mr. WOODALL. I absolutely agree with you. I think we spend much too much time talking about the income tax, payroll tax is the largest tax; 80 percent of American families pay it and we spend very little time talking about that. Though, when we talk about looking at all of those stages I look at the CBO's report, for example, an effective tax rates. To the point my colleagues were making earlier, yes, according to the CBO, the two bottom quintiles in America have a negative income tax rate. They do have a four percent effective tax rate, but only because the CBO believes that the payroll tax that corporations pay on their employees behalf is actually a cost to the employee; only because the CBO believes that corporate income taxes are a cost to the consumer and making both of those conclusions folks still have skin in the game. Do you share those conclusions? That when we tax corporations with a payroll tax, that is really a cost to workers and when we have the corporate income tax that really goes lots of different places, but goes partially to consumer costs as well?

Ms. ROGERS. The way CBO constructs effective tax rates is it assigns the burden of any tax to ultimately a real person. So you can tax corporations in a legal sense. You can tax businesses in a legal sense. But ultimately, it has to be traced down to some real person, an individual in a household that bears the burden. It can be bearing the burden because you are the employee of a firm that pays the taxes. It could be because you are the purchaser of a product that that corporation makes. Or it could be because it is an income tax directly on the household.

So all CBO does is make certain assumptions based on empirical research about the demand and supply in certain markets to assign the burden to certain households.

Mr. WOODALL. It all comes back to the only taxpayer we have in this country.

Ms. ROGERS. Is real people, yes.

Mr. WOODALL. I have always been interested in a symposium the joint tax committee did back in 1997 that you participated in. I think you were the non-supply sider there. They tried to bring in an entire spectrum of folks.

Ms. ROGERS. Actually, I had a model that was very much a supply-side model.

Mr. WOODALL. It was the Fullerton—what did they call it?

Ms. ROGERS. The Fullerton-Rogers model.

Mr. WOODALL. Fullerton-Rogers model. What I thought was interesting, and for folks who have not ever looked at that symposium, joint tax was trying to figure out how to model consumption tax economy because they just did not have a model that could handle fundamental tax reform, like the fair tax, for example. Economists do not always agree on a lot, but what I thought was interesting about the eight of those groups that participated with you in that study is that absolutely every group said if we moved to a consumption tax model from our current model, the economy would grow faster. That was the one thing you all agreed on. You differed on whether capital stock would grow a little or a lot. You differed on the labor effects, but every single group agreed that under a consumption tax, the economy would grow faster.

Ms. ROGERS. Can I explain a little bit of that though? One thing we learned from that experiment was that when you move from our current income tax system to a broad base consumption tax, what you get a lot of benefits from is mostly the broader base, more than the switch from an income tax base to a consumption tax base.

Mr. WOODALL. Though even the unified income tax that you also modeled that broadened the base did not report the same kind of growth that the consumption tax model with that broader base.

Ms. ROGERS. That is true. That is true.

Mr. WOODALL. Now with my last 15 seconds, Mr. Wall, one of your big competitors, AGCO, is in my district, so I am interested in your industry succeeding, and I am interested in what one of my colleagues asked you earlier. Here we are, we have the president proposing about a half trillion dollars worth of stimulative policy, in his words. Is it your position that however it is that we would distribute that kind of volume of money, something temporary, less valuable to you than something permanent? We live in a give it to me now economy, but you are saying, "Give me something smaller that is permanent, rather than something big that is right now."

Mr. WALL. Congressman, we are in Georgia, as well. But with respect to your question, permanent, stable tax reform. These temporary incentives are not helpful; we look at investment and return.

Mr. WOODALL. Thank you.

Chairman RYAN. Mr. Yarmuth.

Mr. YARMUTH. Thank you, Mr. Chairman. Thanks to all the witnesses. About four or five months ago, I represent Louisville, Kentucky, and we hosted through the Chamber of Commerce in Louisville, a White House business roundtable. There were 30 to 40 businesspeople there, anywhere ranging from Humana to an individual restaurant owner. And for an hour and a half or so, they sat around and talked about what the federal government should do to stimulate the economy and job growth.

In the course of that time, they talked about funding community colleges, investing in infrastructure, investing in R and D, other education spending, immigration reform. Only one person in that entire hour and a half from all those companies mentioned taxes, and he asked a question about property taxes, so obviously the federal government was not involved. Parenthetically, nobody else mentioned regulation changes.

My question to any of you, particularly Mr. Wall, is why do you think that was the case?

Mr. WALL. Why the gentleman mentioned the property taxes?

Mr. YARMUTH. Why not one of them in an hour and a half, 35 or 40 people, ever mentioned taxes?

Mr. WALL. Obviously, I cannot answer for those gentlemen. Our view is we look to invest, it is a matter of circumstances or factors, and taxes is a significant component.

Mr. YARMUTH. I do not know why they did not, either, but they did not. Now there has been a conversation, many people have mentioned it, this issue of planning and how hard it is to plan your business if you are subchapter, for instance, and if the rate may go from 35 percent to 39.6. I had this conversation with a constituent of mine, and so I asked him, is that the biggest variable in your business, that you cannot plan for the potential increase of 39.6? You can know that is the outside that he is going to pay, and that all the rest of the variables in your business are more predictable than that. Would you say that in your business, that all the rest of the variables in your business are more than essentially 10 percent in your tax rate?

Mr. WALL. To your point, the other variables in our business are more variable than the taxes, but I think an important point when my CFA asks me to do a discounted cash flow on an investment, it is a five year window, and I give them an asterisk saying that assumes the tax rate is going to be this, so.

Mr. YARMUTH. But it would not be hard to assume that your tax rate is going to be a maximum of 39.6, and that gives you some parameters, would it not? If you are planning a business?

Mr. WALL. That is correct. When we do analysis, we look at the statutory rates.

Mr. YARMUTH. Thanks. Dr. Rogers, you mentioned, in a response to Mr. Honda's question, you used the term "empirically" as to why job growth was phenomenal when rates were higher. Do I take that answer to mean that there are a lot of factors other than taxes that determine whether taxes actually resulted in job, higher or lower taxes resulted in another effect? That the higher tax rate could have a very different effect under certain other circumstances or different effect under other circumstances? Is that really the gist of what you were saying?

Ms. ROGERS. Yes. Economists talk about taxes having two sorts of effects on economic behavior. There is the fact because you are changing relative prices that if you cut rates on certain forms of activity relative to others, that you encourage people to substitute into those lower tax activities, but then there are always income effects too, as well, which says what are you doing to people's real incomes. So if you are cutting taxes, you are making them feel better off; if you are raising taxes, you make them feel worse off, and we change our behavior. Everyone changes their behavior if you have more income or less income. So it is hard to predict.

Mr. YARMUTH. Right. Well, I am going to tell a little story, which is a true story. I have a brother who is in the barbecue restaurant business. Sonny's Barbecue; I will give him a plug. I am an investor; I have to disclose, although I do not make the business decisions. And my brother is always Republican because he did not want to pay as much tax, and back in 2008, he called me, said, "You know, John, I have decided to support President Obama this year, and all Democrats. I said, Well, that is great, Bob. What was your epiphany? And he said, "I finally decided that if nobody can afford barbecue, it does not matter what my tax rate is."

And he will tell you to this day that a marginal tax rate change of something of the magnitude that is being discussed, and he is a subchapter S, is the last thing he considers in making a business decision. He wants to know whether he can make more money, and then he will worry about how much taxes he pays. And he pays at the highest rate, so I throw that out just to validate what you said. Thank you very much, Mr. Chairman.

Chairman RYAN. Thank you. Mr. McClintock.

Mr. MCCLINTOCK. Thank you, Mr. Chairman. Mr. Hodge, we talk about taxes and deficits as if they are polar opposites, but are not they really identical twins? Is a deficit not simply a future tax?

Mr. HODGE. Indeed, it is, and we are borrowing from our kids to the tune of $1.5 trillion a year, which by definition will mean they will pay higher taxes.

Mr. MCCLINTOCK. Dr. Rogers, would you agree with that?

Ms. ROGERS. Yes.

Mr. McCLINTOCK. Are not taxes and deficits merely the only two possible ways to pay for spending? Is there any other way to pay for spending, other than to tax or a future tax?

Mr. HODGE. I suppose the Fed could monetize it.

Mr. McCLINTOCK. Well, but even that is a tax on the economy, is it not?

Mr. HODGE. Right. Yes.

Mr. McCLINTOCK. It is a tax on those holding dollars by reducing the value of the dollars that they hold. So those are the only two, so we are dealing then with identical twins here. It is not the question of taxes or deficits. It is a question of spending. I mean, apologies to the Clinton campaign, it is the spending stupid.

We look at the Bush and Clinton administrations and the different approaches they took. Clinton raised tax rates, Bush cut them. The difference, though, I think, is Bush, while he was cutting tax rates, was also increasing federal spending dramatically by an astonishing two percent of GDP. Clinton, while he was raising taxes, was also cutting spending by a breathtaking three percent of GDP.

When we look at all of these economic models, and I share Mr. Pascrell's concern that the modeling seems to have been wrong, we ought to be looking at our own experience. Herbert Hoover increased spending dramatically, increased tax rates dramatically, did not work out well. Roosevelt did the same thing. Did not work out well. Harry S. Truman slashed taxes dramatically, slashed government spending even more dramatically, and we had the whole post-war economic boom. And we can go through each of the administrations. It seems to me that it is the spending stoop. Your thoughts?

Mr. HODGE. I believe that we are spending far more than we can ever pay for and I do not believe that current tax policy can ever keep up, with this level of spending, especially health care spending. And I have looked at some of the European experience with value added taxes and those value added taxes are not growing fast enough to pay for their health care spending nor their future entitlements. So they are having to raise those rates as well, and even that is not enough. Tax revenues will not really grow any faster than the economy. So if you have government programs that are growing at three or four or five times the rate of economic growth, your tax revenues will never catch up.

Mr. McCLINTOCK. So revenue is very important but the healthy way of generating revenue is through economic growth, in fact the only source of revenue is prosperity. Is it not?

Mr. HODGE. Indeed.

Mr. McCLINTOCK. Mr. Ribble touched on this, I want to amplify on this a little bit. Who pays business taxes?

Mr. HODGE. Well business taxes are paid by people, and the same way that people pay tobacco taxes, cigarettes do not pay tobacco taxes.

Mr. McCLINTOCK. It seems to me that business taxes can only be paid in one of three ways: by consumers, higher prices, employees through lower wages and by investors, who lower earnings. Those are the 401Ks. So, really, it is not the middle class that bears all the business tax increases that we have been talking about?

Mr. HODGE. Well, all workers, to some extent, bear the cost of corporate income taxes and what we have learned in the global economy where capital is very mobile but workers are not, that workers are increasingly paying or bearing the largest share of corporate taxes.

Mr. MCCLINTOCK. So when you increase the tax burden, in any way, on a business, ultimately it is paid for by consumers, by employees or by investors, mainly 401Ks.

Mr. HODGE. That is correct.

Mr. MCCLINTOCK. We have looked at the enormous amount of money that we spend through the tax codes to bribe people to make decisions that they would not make if they were making them on their own. Just our office came up with about $1.3 trillion, when you include everything. Is not that distorting the economy? Is that not sending dollars to their less productive use?

Mr. HODGE. There is an incredible amount of what we call "dead weight loss" because of all of this in the economy.

Mr. MCCLINTOCK. So should we not be doing away with those but at the same time, reducing the overall tax rates to assure that those taxes are not passed on to a middle class that is reeling under the economy?

Mr. HODGE. We need to free up all of those wasted resources that are now going to either tax preparers or these unproductive activities.

Mr. MCCLINTOCK. One more quick question on the pay roll tax. The tax cuts in December did not affect the tax rates, they maintained the tax rates in place. The change is the payroll tax cut. Is that help to the economy?

Mr. MCCLINTOCK. I do not believe so.

Chairman RYAN. Ms. Castor, you mind just sitting where Gwen was?

Ms. CASTOR. Here we go. Thank you very much, thank you Mr. Chairman and Ranking Member Van Hollen for calling this hearing on tax fairness because I do not think folks at home think there is much fairness in the tax code right now. They see it as Swiss cheese, they look up at Washington and they think that the special interest folks who have the money to hire lobbyist have been able to carry the day and that those big special interests are not paying their fair share. While there are law-abiding citizens just trying to get by and pay the bills and pay their taxes in a fair way.

One of the things I am hearing often is how can it be that the big oil companies, especially that are making the highest profits in the history of the globe, are receiving tax-payer subsidies. So American taxpayers are actually subsidizing, in this day and age of growing debt and deficits, that American taxpayers are having to subsidize those industries. And I know my GOP colleagues have supported that, have guarded that, but at the same time we see American jobs going wanting. And this, frankly, could be put to bed or used by investing in a robust jobs plan. But just so we put some numbers behind it, over the next 10 years, American taxpayers are scheduled to pay oil and gas companies more than $40 billion. That is just to the big five alone, and the big five have reported over one trillion in collective profits over the past 10 years.

Now the president's bi-partisan fiscal commission that the corporate income tax is riddled with special-interest tax breaks and subsidies that are badly in need of reform and I would hold this up as the poster child for reform. These most lucrative companies should not be receiving taxpayer subsidies, especially when the future deficits are projected to be so high and the GOP has put Medicare on the table to end Medicare as we know it. That is not fair and that is not passing the smell test at home.

The fastest and most effective way to reduce the deficit is put people back to work and address tax fairness and failing to address this job situation will compound our economic weakness and our debt and deficit.

So I would like to ask you if we know we have got to move forward and combine a robust jobs plan with greater fairness in the tax code by eliminating these special-interest loopholes, first of all, tell me, if you had to pick one initiative to create jobs what would it be? Right now, if you said this would be the most effective in creating jobs right away.

Mr. WALL. From my perspective Congresswoman, fundamental tax reform. I mean we talked about special-interest loopholes, a lot of those are corporate tax expenditures legislated by Congress to initiate certain economic activity. I am for simplification. Bringing down the rate, and reducing the expenditures in a fiscally-responsible manner.

Mr. HODGE. I would concur with that. I think fundamental tax reform, both bringing down both corporate and individual rates while broadening the base, will do the most for the long-term health of the economy. Ultimately, that results in greater job creation.

Ms. ROGERS. I would ask the Congressional Budget Office to come up with a list, whether it be spending increases or tax cuts that are most stimulative to demand, and I would pursue the ones at the top of that list, whether they be spending increases or tax cuts, and I would commit to pay for it by letting some of the high-end Bush tax cuts, or all of the Bush tax cuts expire in the future.

Ms. CASTOR. Okay so, as part of job creation you are pointing us back to the unfairness in the tax code. So I have highlighted one special-interest loophole that can go with this growing debt, the one for the big oil companies, $40 billion over the next 10 years, name another one. Give us some guides where—give us another loophole tax expenditure that could be closed.

Mr. WALL. Congresswoman, as I have said before, it is very difficult for me to say that without seeing the totality of the package.

Ms. CASTOR. Do you have a favorite out there? How about the gory video games? I mean, we believe in R&D tax credit, but do we cross a line where American taxpayers are subsidizing these violent, gory video games? You can not name one other?

Mr. WALL. As I said Congresswoman, to me, I am for simplification, bringing down the rate, and eliminating the expenditures.

Mr. HODGES. I would eliminate all the so-called subsidies for renewable energy: windmills, solar panels, all of that. Actually, there is about four times as much tax benefits for renewable energy right now than there is for the quote big oil. And actually, I would eliminate, along with that, the tax expenditure for tax-free municipal bonds. There is about 10 times as much benefits going to municipal governments through the tax code than there is through big oil.

Chairman RYAN. Thank you. Ms. Black.

Mrs. BLACK. Thank you Mr. Chairman and again, panelists, thank you for being here today. I know we are little bit over our time, and thank you chairman and ranking member for allowing me to get my question in here. As we are talking about fundamental tax reform, I have been trying to understand, because it is a very complicated code, as seen by Congressman Ribble's book here that it is quite complicated but I want to go to the nomenclature because we keep hearing words that are not defined. In particular, let me go to just what was talked about by Ms. Castor and when we are looking at definitions of whether a subsidy is the same as a tax credit, as a loophole, as a tax expenditure, as a deduction. Can each of you tell me what is the difference between the subsidy and what I think, if you take all those other words, the tax credit loopholes, expenditures and deductions, they seem to be in one pot, the subsidies seems to be in another. Can you give me a clear definition? Are all these the same, are they just synonymous, or do they really have a difference?

Ms. ROGERS. Many of our tax, so-called, tax expenditures, which are the special preferences in the tax code are subsidies that encourage economic activity to be shifted into those sectors that face lower effective tax rates through the complications in the tax code. So I define a subsidy as something that gives a preferential rate, effective tax rate to certain industries or certain types of households or certain forms of income or certain ways of using income.

Mrs. BLACK. So is the child tax credit the same as a child subsidy?

Ms. ROGERS. It does not come close to really subsidizing the cost of having children, but it does help. It is not what I would called subsidy in terms of shifting resources in particular sectors of the economy.

Mrs. BLACK. Mr. Hodge.

Mr. HODGE. Well, certainly the child tax return was not intended to incentivize anything, it was just merely, purely family tax relief. But whether we called something a subsidy, a credit or deduction depends on what your ideal tax base is. And for many of us, things like the tax deductions for savings and so forth, capital gains preferences, are not considered subsidies, because we believe those should not be taxed in the first place, nor ideal tax base. A lot of it does come down to what you believe the ideal is, but there are clearly too many things in the tax code that are intending to incentivize or benefit certain industries over others and that is clearly a violation of tax principles.

Mrs. BLACK. Mr. Wall?

Mr. WALL. Congresswoman, the nomenclature that is used is corporate tax expenditures. My view is Congress legislating incentives to encourage certain types of behavior. Section 199 encouraged domestic manufacturing, so I used the terminology incentive.

Mrs. BLACK. I do think, Mr. Chairman, that maybe that would be something good for us to have, is a list of some of these definitions of the words that we throw around so that we have a very clear idea about what we are really talking about. And I know I have very little time left, but I want to go to another group that we continue to hear, and yet I do not know that I know for sure what the definitions of that really is. When we talk about the rich or the wealthy, or millionaires or billionaires, or poor, do we have clear definitions that fit into the current codes that as we do reform, we have a clear idea about definitions of those words as well.

Ms. ROGERS. Well there is no standard definition for who is rich or middle class.

Mrs. BLACK. Okay, so when we hear folks talk about taxing the rich, or the wealthy, I mean, millionaires and billionaires are a little easier to define. If you are a millionaire, you are a millionaire. If you are a billionaire, we can say here is your income, we know that. So when we talk about the rich, when we talk about the wealthy, when we talk about the poor, it seems that it sets up a lot of the emotional feelings and brings about feelings about whichever side, class warfare or someone feeling like they are being singled out, they have been successful. Again, definitions here do not seem to be clear as we move forward with how we reform our tax code in knowing which poor, wealthy, whatever.

Mr. Hodge, do you want to speak to that really quickly? I know we do not have much time.

Mr. HODGE. I think we need to make a distinction between middle class and middle income. Middle class is a values system of which about 99 percent of all Americans believe that they are in. The middle income is a narrow definition of what middle income is. But most of us believe, and I think most of us rightly think of ourselves as middle class and that is a whole different thing.

Mrs. BLACK. Mr. Wall. Well, Mr. Chairman, I guess I am out of time.

Chairman RYAN. Lunch is coming up. Ms. Kaptur.

Ms. KAPTUR. Thank you, Mr. Chairman. What America really needs is a pro-jobs in the U.S. Tax reform effort. From the figures I have, I am going to put some of these on the record, it has been a great year for corporate America. Caterpillar's second quarter earnings shot up 44 percent to one billion. General Electric's second quarter earnings were up 21 percent, 3.75 billion. Mr. Wall, Case New Holland has been no exception, your company had another great quarter. Hosted in July, profits show your net sales grew by 24 percent and you brought in net sales of 4.9 billion. I mean, you have got to be proud of that. If we look at big oil, it is the same. I mean, BP made 5.6 billion, Chevron's profit 7.7 billion, Exxon, another 10.7 billion.

Now, we are told that these companies are the job creators, so my question is where are the jobs being created? Last month, there was zero private sector job growth. According to Bureau of Labor Statistics, there are 3.2 million job openings, different kinds, around our country, but 14 to 24 million people who are unemployed, who are discouraged, are working three part-time jobs and frankly, burned out, I have these people that I represent, I meet them all the time. We are being told now we need to cut taxes on companies despite their robust earnings and their disinterest in hiring in our country. Maybe some of the witnesses missed the reporting recently that GE paid nothing in taxes. And I must question, how do you cut taxes of companies that pay nothing? This is a really interesting math problem.

So, I think the system is somewhat unfair to the average citizen, in fact, very unfair. And it is unfair to small businesses and those who do pay their fair share. Tax avoidance is not just a factor of one company. In 2009 and 2010 the six largest banks that got America's economy down, including Goldman Sachs, Wells Fargo, Bank of America, and JPMorgan Chase paid an effective tax of 11 percent of their pre-tax earnings. And Goldman raked in $9.6 billion in profit. Its CEO received $64 million in compensation, he is willing to admit. Jamie Diamond at JPMorgan Chase earned $70.3 million as his bank raked in over $17 billion. Yet we live in a world where funds managers like Warren Buffet point out they pay at a lower tax rate than their secretaries. Mr. Hodge, in your testimony, you claim we should lower U.S. statutory tax rates for corporations. I assume you acknowledge the great disparity between what a few companies on Wall Street pay and the tax rates paid by small businesses in places like I represent. Would you support an effective tax rate where those companies would pay the same, the largest financial firms, the GE's of the world, as their hard work pays in my district? Or the bakeries, Strom's bakery? All these different companies. I assume you are not arguing that those who have learned to not pay their fair share should be rewarded by allowing them to do so.

And then, you could wait a second to answer that question. Mr. Wall, I noticed that your company employs over 10,000 people and I hope you agree that job creation needs to be our number one priority. Your company's CEO testified before the House Transportation and Infrastructure Committee last year that every billion dollar spent on infrastructure projects by the government creates about 18,000 jobs. Do you agree with your company's assessment? Do you believe we need to take on the deficit by growing the economy through investment and infrastructure in useful public works? So, first, Mr. Hodge, please.

Mr. HODGE. Well, thank you, Congresswoman. I do not believe that there General Electric represents corporate America anymore than I think Leona Helmsley represents all of us. There are always going to be tax payers, private, personal, corporate that can configure themselves in such a way to minimize their tax burden. But I can look at the overall IRS data, in fact the tax foundation released a study last week looking at actual corporate IRS data. And we find that the effective tax rate for all corporations in America over the last 18 years is averaged around 26 percent. That is after taking all their credits and deductions and loopholes and everything else. And that does not count the taxes they pay abroad.

Ms. KAPTUR. Does that include hedge funds, sir?

Mr. HODGE. It includes all corporations.

Ms. KAPTUR. Do they not pay an 11 percent rate?

Mr. HODGE. In some cases, some hedge funds may pay, if you are talking about carried interest, which is a capital gain. They are paying at a 15 percent capital gains rate.

Ms. KAPTUR. But the hardware in my neighborhood, they pay a 35 percent rate, what is fair about that?

Mr. HODGE. That is the statutory rate which all corporations in America pay, whether they are C corps or's corps. The top statutory rate is 35 percent for all of us.

Ms. KAPTUR. You know the ones that have the big guns here in Washington always seem to push on it, and they make the biggest profits and the other businesses struggle out there.

Chairman RYAN. Thank you, just in the interest of time, and Mr. Ryan. Not this Mr. Ryan, that Mr. Ryan. Thank you.

Ms. KAPTUR. Mr. Chairman, excuse me, could I ask the unanimous consent that Mr. Wall answer my question on infrastructure for the records?

Chairman RYAN. Without objection.

[The information follows:]

RESPONSE BY MR. WALL TO QUESTIONS SUBMITTED BY MS. KAPTUR

Congresswoman Kaptur, thank you for your question regarding investment in infrastructure and jobs. The Congressional testimony you refer to in your question was provided by James McCullough, CEO and President of the Case New Holland Inc. ("CNH") Construction division, in his capacity as First Vice Chair of the Association of Equipment Manufacturers ("AEM") at a hearing of the House Committee on Transportation and Infrastructure held on September 29, 2010. Mr. McCullough was representing the construction equipment manufacturing sector in his testimony. Mr. McCullough in his testimony cites a Federal Highway Administration study that found that every $1 billion invested in highway construction would support approximately 27,800 jobs. See "Employment Impacts of Highway Infrastructure Investment," U.S. Department of Transportation, Federal Highway Administration, *www.fhwa.dot.gov/policy/otps/pubs/impacts/index.htm* (last visited September 23, 2011).

You mention in your question the possibility of taking on the deficit by growing the economy through investment and infrastructure and useful public works. As I stated in my written testimony for this hearing, CNH believes that reducing the U.S. statutory corporate tax rate to 25% or lower, in conjunction with the adoption of a territorial tax system, would make the United States more competitive with other countries, which would significantly increase investment in the United States and lead to much needed job growth. Reforming corporate tax policy and removing regulatory uncertainty are necessary for long-term and sustainable job creation in the United States.

With respect to proposals to increase investment in infrastructure, CNH would need to review a specific infrastructure investment legislative proposal, along with any potential accompanying revenue offsets recommended as part of such proposal, in order to assess whether we believe such a program would enhance the Nation's job and economic growth.

Thank you for allowing me the opportunity to respond to your question.

Mr. RYAN OF OHIO. Thank you, Mr. Chairman. You guys agreed that deficits are future taxes? You guys all agreed that deficits are future taxes. So, is high unemployment inevitably then a future tax? If we have high unemployment, we have deficits and so therefore at some point we are going to have future taxes, right?

Ms. ROGERS. In that sense, yes. In terms of the economy and economic growth, yes.

Mr. RYAN OF OHIO. Mr. Hodge, thank you.

Mr. HODGE. Inevitably, we are going to be paying higher taxes because right now, no amount of revenue is catching up to all of the spending that we are doing.

Mr. RYAN OF OHIO. No, I am just saying, in general, if deficits lead to higher taxes, high unemployment inevitably leads to deficits, so deficits lead to higher taxes so high unemployment leads to higher taxes, right?

Mr. HODGE. Okay.

Mr. RYAN OF OHIO. Is that right? Am I wrong?

Mr. HODGE. Sure. No, that is a complicated argument, but I will go with it.

Mr. RYAN OF OHIO. It does not seem very complicated. If we have high unemployment, we have less revenue going into the Treasury.

Mr. HODGE. Right, we have fewer people working, fewer people paying taxes, ergo, eventually we are going to have to make up the difference.

Mr. RYAN OF OHIO. Okay.

Mr. WALL. Congressman, I agree. Jobs, number one priority. I am advocating corporate taxes reform would be stimulative to the economy.

Mr. RYAN OF OHIO. So, Mr. Wall, you talked about tax rates are a contributor to your decisions that you are making, right? Are not consumer demand and consumer spending also a big part of that?

Mr. WALL. Absolutely, Congressman. As I mentioned, it is a myriad of factors: logistics, quality of labor, where is the market demand, taxes.

Mr. RYAN OF OHIO. High unemployment, wages being stagnant, low consumer spending equals you are less inclined to then make investments. No one is going to buy your product. It just makes sense.

Mr. WALL. I will let my colleagues answer the macro part of it. For our business agricultural equipment is doing well, so we have the demand and we are expanding capacity and jobs.

Mr. RYAN OF OHIO. Regardless of the tax rate.

Mr. WALL. No, actually as I was trying to illustrate in my written testimony, the United States is not a competitive regime. We look to expand capacity around the globe, taxes as I mentioned, is one of the factors.

Mr. RYAN OF OHIO. Let me just ask Mr. Wall and Mr. Hodge. Are we in a liquidity trap now in our country?

Mr. HODGE. In a liquidity trap? To some extent, certainly. But I think it comes back to the demand side, in which if no one is buying, if there is not market, there is no prospects of long-term consumer demand. People are just going to sit and wait, and wait for the economy. Even if you freed up borrowing, if they do not feel like they can expand to meet whatever demand, then they will not.

Mr. RYAN OF OHIO. But if people went back to work, for example, we have a 20 percent unemployment in construction trades right now. If we got that down to five, six, even the national average, nine or 10, would that help us get out of this liquidity trap?

Mr. HODGE. I do not know if any one sector can spur that.

Mr. RYAN OF OHIO. Of course it would not be just one sector. If we got that number down significantly, and it is a large portion, and we hired those people, would that not help us get out of this mess we are in right now?

Mr. HODGE. Well, I would like to see all sectors move up.

Mr. RYAN OF OHIO. Well, I would too, obviously.

Mr. HODGE. Well, I do not know how one would spur one industry over another.

Mr. RYAN OF OHIO. Well, we can have a more direct effect from our end on putting people back to work, if we have a $2 trillion infrastructure deficit in the country. Work has to get done.

Mr. HODGE. Look, the Japanese tried to build infrastructure in order to try to stimulate their economy and it simply did not work. And I think that gold plating the nation's highways is just not necessary. Someone has to pay for that eventually right?

Mr. RYAN OF OHIO. Yes. So why not pay for it now? While we have high unemployment. Because high unemployment leads to deficits and deficits lead to higher taxes. It seems to me it would be better for us. We end up paying lower taxes if we made these investments now because we are going to have to pay higher taxes anyways, because there is unemployment and unemployment leads to deficits and deficits lead to higher taxes so the key to me to keep our taxes low would be to get unemployment down.

Mr. HODGE. I hate to see our kids drive on nice highways but not have jobs.

Mr. RYAN OF OHIO. I have 80 bridges in my district that are deficient, dangerous, all across the country. This is not a waste of money, this needs to get done anyway. So we are not gold-plating any highways. Come to Ohio, nothing is gold-plated, nothing will be. We are just tried to patch the potholes up.

Chairman RYAN. Thank you, Mr. Ryan.

Mr. RYAN OF OHIO. Thanks.

Chairman RYAN. This was a fantastic hearing, I think a lot of members enjoyed the participation and I want to thank our three witnesses for your indulgence from going from 10:00 until past noon. We appreciate it and this hearing is adjourned.

[Questions submitted for the record and their responses follow:]

QUESTION FOR THE RECORD SUBMITTED BY HON. MICK MULVANEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH CAROLINA

QUESTION FOR DIANE LIM ROGERS, CHIEF ECONOMIST, THE CONCORD COALITION

Ms. Rogers, I believe you made a statement during the hearing that increasing taxes on the rich, while also decreasing taxes on the poor by an equal amount, would boost GDP.

If I heard you correctly, how would this revenue-neutral tax rate change on the rich and poor alter GDP, as defined by C+I+G+(X-M)?

RESPONSE BY MS. ROGERS TO QUESTION SUBMITTED FOR THE RECORD

Response to Question Submitted Mr. Mulvaney (SC-05)

Question: "Ms. Rogers, I believe you made a statement during the hearing that increasing taxes on the rich, while also decreasing taxes on the poor by an equal amount, would boost GDP.

If I heard you correctly, how would this revenue-neutral tax rate change on the rich and poor alter GDP, as defined by C+I+G+(X-M)?"

Answer: The statement in my testimony refers to a recessionary (less than full employment) economy, in which case the binding constraint in the economy is the lack of demand for goods and services. (Increasing the supply of productive factors to the economy won't increase economic output because there is not enough demand for the products produced by those factors.) The demand side of the economy is represented as the sum of personal consumption expenditures on goods and services (C), investment purchases of goods and services (I), direct government purchases of goods and services (G), and net exports of goods and services (X-M). Consumption can be increased by cash transfers to households, but unlike the dollar-for-dollar effect of direct government purchases (where a dollar spent goes fully into higher GDP), a dollar of government transfers to households only translates to higher GDP according to the households' marginal propensities to consume (how much of an additional dollar received they will spend). Because higher-income households have lower propensities to consume—i.e., they save larger fractions of their income than lower-income households—then taking a dollar away from a rich household and giving it to a poor household (thus, revenue neutral) would reduce the rich household's consumption less than it would increase the poor household's consumption. Thus, total consumption in the economy is increased when a tax policy redistributes income from higher-income households toward lower-income ones.

This is only valid in a recessionary economy, however. In a full-employment economy, the supply side of the economy becomes the binding constraint. A goal for longer-term economic growth might be to increase the rate of national saving, which increases the supply of capital in the economy. Then the opposite case for the effects of tax redistribution holds: a dollar taken away from a poor household and given to a rich household would likely decrease the poor household's saving by less than it increases the rich household's saving (because poor households hardly save anything). Of course, there are equity arguments that work against such a policy.

[Whereupon, at 12:34 p.m., the Committee was adjourned.]

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