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Remarks by Scott Hodge to the Tax Fairness Conference

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Panel Topic: "Corporates or Citizens—Who Should Bear the Burden of Taxation?"

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Thank you for inviting me to bring a non-European perspective to the important question of who bears the burden of corporate taxation.

I'm sure you've all heard the simple axiom, corporations don't pay taxes, people do. It's no different from the concept that a pack of cigarettes doesn't pay tobacco taxes, smokers do. Similarly, cars don't pay gasoline taxes, drivers do, and houses don't pay property taxes, homeowners do.

But that axiom addresses only the question of who directly pays the tax. The question for this panel is which party bears the economic burden of the corporate income tax—workers, shareholders, or consumers?

I tend to think that over the long term, workers bear the lion's share of the corporate tax, and in my talk this morning I'd like to use the United States as a case study on how workers are ultimately harmed by bad corporate tax policy.

I think one of the most important guides to understanding these issues is a study written by economists at the OECD in 2008 under the simple title of "Tax and Economic Growth.[1]

OECD economists set out to determine which taxes were most conducive to economic growth or, conversely, which taxes were most harmful for growth.

After reviewing the economic literature and studying the economic performance of countries, they developed a hierarchy of tax harm. Corporate income taxes were found to be the most harmful taxes for economic growth, followed by individual income taxes, and consumption taxes, with property taxes found to be the least harmful to growth.

1 Asa Johansson, Christopher Heady, Jens Arnold, Bert Brys and Laura Vartia, *Tax and Economic Growth:* Economics Department Working Paper No. 620 (July 11, 2008), https://www.oecd.org/tax/tax-policy/41000592.pdf

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Why this ranking? It has to do with the mobility of the factor in the economy. Capital is the most mobile factor in the economy, and thus most sensitive to high tax rates. Workers are less mobile and, thus, slightly less sensitive to high tax rates. For example, if my employer moves my factory to Singapore to take advantage of their low corporate tax rate, it is very difficult for me to follow that job to Singapore.

Consumption is less sensitive to tax rates because it is far more local in nature, while property (or land) tends to be much more immobile, thus less sensitive to tax. This is not to say that consumption or land are insensitive to taxation, just less so than capital and labor.

The lesson from this research is that because capital is so mobile, the more you try to tax it, the more you turn it into a fugitive resource and, thus, shift more of the burden of corporate taxation to workers. Over the long term, workers ultimately bear the burden of corporate taxation.

Despite these lessons from OECD's research, few countries have tried harder to tax corporations and prevent tax avoidance than the United States. Many of you may find this welcome news, but I'm here to share with you the unintended harm that these policies have had on our working-class households.

While every other country on earth has cut their corporate rates to attract this mobile capital, the United States has stubbornly maintained the same 35 percent corporate tax rate for the past 30 years, and now has the highest corporate tax rate in the industrialized world.

While other countries moved to territorial tax systems, the United States has stubbornly maintained our worldwide tax system, which requires companies to pay tax in the countries where they sell their products and then pay additional U.S. tax when they repatriate those earnings.

Not only can U.S. companies not easily recover their foreign profits, they can't recover the full cost of their capital investments. An ideal tax system would allow companies to recover 100 percent of the cost of their capital investments. But the United States has one of the least generous cost recovery systems in the OECD, making investments in machinery, manufacturing, and industrial buildings less attractive.

We not only tax our companies at the highest rate in the world, we tax their shareholders at a globally high rate too. Our 56 percent combined rate on dividend income is the third highest in the OECD.

As a side note, I should mention that, according to the OECD, the U.S. has the most progressive personal income tax system of any industrialized nation. The top 10 percent of taxpayers in the U.S. pay a larger share of our tax burden than do the top 10 percent in any OECD country, while our poor pay the lowest share of income taxes than do the poor in any other country.

The consequences of this effort to squeeze more tax revenues from U.S. corporations has been anything but successful. Corporate tax collections have fallen to less than 2 percent of GDP and the U.S. now has the fewest number of corporations than at any time over the past 45 years. The U.S. has 1 million fewer corporations today than when the number of corporations peaked in 1986, which proves the economic truism that when you tax something, you get less of it.

We've made the U.S. such an unattractive place to do business that more than 80[2] U.S. companies have moved their headquarters offshore to countries such as Ireland, the Netherlands, or Switzerland. This has happened despite numerous laws enacted to prevent such relocations or to make them extremely costly.

Companies find that it is no longer tax-effective to make things in the U.S. any more. Manufacturing has increasingly migrated out of the U.S. to lower-cost, lower-taxed jurisdictions, such as China. The brain jobs—engineering, finance, marketing—stay in places like Silicon Valley, while the working-class jobs move overseas. Our loss has been China's gain.

Our worldwide tax system, which imposes a second layer of tax on repatriated foreign profits, simply encourages companies to leave those profits abroad. U.S. companies now have an estimated $2.6 trillion in profits permanently reinvested abroad[3]—much of which is invested in factories, facilities, and operations in the European Union. Our loss has been the EU's gain.

But the real victim of America's corporate tax system are American workers, not the tax collectors. The wages of working-class Americans have stagnated for more than a decade. Even after a recent 5.2 percent increase in median incomes, wages are still below 1999 levels after adjusting for inflation.[4]

Despite our globally high corporate tax rate and the most progressive income tax system, the U.S. has one of the highest levels of inequality of any OECD nation.

So what lessons should we take from this about designing corporate tax systems?

I think countries should spend less time trying to chase down the last Euro or dollar of tax revenue from corporations and more time designing tax systems that are friendly to the types of capital investment that boost productivity, lift real wages, and improve living standards for working-class people.

Lower corporate tax rates are fine, and they have been effective in attracting the most mobile capital, such as intellectual property and patents. But, lower rates do not seem to be as effective at attracting physical capital. Our research suggests that the policy that can incentivize investment in physical capital is allowing companies full or 100 percent expensing of capital investments.

We've used our macroeconomic tax model to analyze the major tax proposals that are being debated in the U.S. today. Our model shows that 100 percent expensing of capital investments is probably the single most significant tax change lawmakers could make to encourage economic growth. By making the tax-cost of new investment basically zero, full expensing could grow the long-run size of the U.S. economy by 4.2 percent, boost wages by 3.6 percent, and create 808,000 full-time jobs.

In fact, we find that moving to full expensing for corporations would have twice the impact on the U.S. economy as a simple corporate tax rate cut. More importantly, it promotes real productivity

2 https://www.bloomberg.com/graphics/tax-inversion-tracker/

3 http://www.washingtonexaminer.com/untaxed-offshore-earnings-of-us-companies-rises-to-26-trillion/article/2603249

4 https://www.census.gov/content/dam/Census/library/publications/2016/demo/p60-256.pdf

gains which, in turn, leads to higher living standards for workers.

The United Kingdom is a good example of a country that chose lower corporate rates at the expense of less capital investment.[5] In order to offset the revenue loss from cutting their corporate tax rate, the UK reduced allowances for cost recovery. As a result, London has become a haven for banking and finance while the industrial-northern regions of the country have languished. In recent years, employment growth in the North of England has been half the rate of growth in London and the South.[6]

The UK is not the only European country to make this trade-off at the expense of workers' incomes; the results may just be the most glaring.

Conclusion

I understand that the prevailing sentiment at this conference is that governments need to do more to get companies to "pay their fair share of taxes" and to use redistribution to address inequality.

There are two directions you can go in tax policy, increase redistribution or promote productivity.

Redistribution may make us feel better and it may even give the appearance of reducing inequality. But redistribution is really a placebo; it does nothing to raise real incomes and living standards of working people. The U.S. tax code gives out over $200 billion per year in refundable tax credits to low-income families, yet incomes continue to stagnate. What good is a tax credit if your income is shrinking?

Promoting productivity helps everyone. Smarter corporate tax policies can create a climate that is conducive to the kind of capital investment that creates jobs, boosts worker productivity, and raises real wages and living standards.

Isn't that the kind of inclusive growth that all of us could support?

Thank you for your time and attention.

5 https://taxfoundation.org/can-learn-uks-corporate-tax-cuts/

6 https://taxfoundation.org/trading-longer-asset-lives-lower-corporate-tax-rates-united-kingdom/