

- Announcer:* Welcome to the Tax Policy Podcast, produced by The Tax Foundation in Washington. Visit us online at www.taxfoundation.org.
- Scott Hodge:* Hello, I'm Scott Hodge, president of The Tax Foundation. Welcome to another Tax Policy Podcast. My guest today is Alex Brill. Alex is a research fellow at the American Enterprise Institute. He served as a senior advisor and chief economist on the Ways and Means Committee at the U.S. House of Representatives from 2000 to 2007 and prior to that, he served on the staff of the President's Council of Economic Advisors at the White House.
- Thank you for joining me, Alex.
- Alex Brill:* Thank you, Scott. Glad to be here.
- Scott Hodge:* Well, you and your colleague Kevin Hassett wrote a fascinating study recently looking at corporate tax rates across OECD countries and the effect that that has on a country's tax revenues-- what economists call the "Laffer Curve." There are a lot of us that have heard of the "Laffer Curve" but may not know what it is. Can you tell us a little bit about it and why it matters?
- Alex Brill:* Sure, sure. And the curve's a pretty important concept and one that I think, from a theoretical perspective, pretty much everyone agrees with although there's a little bit of empirical debate. First, it's "Laffer," L-A-F-F-E-R, not "laugher" as in the sense of "I just told a good joke." This is Art Laffer, who first sketched this out on the back of a napkin over drinks here in Washington a few decades ago. And the concept is this, at very low tax rates, additional revenue can be raised by raising those rates, but conversely, if taxes rates are very high, you can get more revenue out of the tax system by actually cutting rates.
- The idea is that you get an inverted U-shaped curve. And generally, economists agree with this concept. I think that most would say that if a tax rate was 99% and you reduced it somewhat from there, you would improve incentives. There would be more work, more investments. People would be less likely to cheat on their taxes and you'd see revenues go up. Similarly if rates were in the single digits, you might be able to raise revenues by jacking those numbers a little bit.

Scott Hodge: So at some point, there's a disincentive rate, I guess you'd call it, that once you get beyond that, you're just simply not going to raise any more revenues.

Alex Brill: Exactly, exactly. And the question then becomes, "Well, where is that rate?" No one would argue, I think, that 99% is too high, but the question for economists is, "Are we anywhere – where are we currently on that curve?"

Scott Hodge: Well, that's I think we need to also look at it in a global context, which is what you've done and there's – I seem to see everyday, another article about some country somewhere, I think it was Malaysia was the last one, to announce it was cutting its corporate tax rate. And you must have seen a lot of that as you were doing your research. What are the trends today and why is it really important that we understand how it affects government tax revenues?

Alex Brill: That's an excellent question and there are quite significant trends. The, sort of classic example when people talk about the idea that a low corporate tax rate might actually bring in more tax revenue, people tend to point to Ireland. Ireland is sort of the classic example in the OECD of a country that has a tax rate that's really out of whack with all their neighbors at about 12%, while most of Europe is at least twice that high. But in fact, what's going on is much more common than that.

Rates – corporate tax rates have declined very significantly over the last few decades. In the early '70s, they were on the average of 45%. Now they're in the '20s. We've seen countries around the world, developed and lesser-developed countries, cutting their rates dramatically over a number of years. And at the same time, the revenue that's being collected from the OECD countries, from the most developed countries, indicates that corporate tax revenues have actually been increasing somewhat since the early 1990s.

Scott Hodge: And what – so, your research has found then, over the last 20 years, that they – I guess you call it the optimal corporate tax rate has really changed quite dramatically in the course of time as everyone is moving to lower rates. Is that how I understand your research?

Alex Brill: That's right. We actually use the term "revenue maximizing" because some people might argue that the optimal tax rate – corporate tax rate -- is actually zero for a number of reasons.

Scott Hodge: I get your point.

Alex Brill: But if your goal is – and this isn't everyone's goal -- but if your goal was to squeeze as much revenue out of the system, you might actually get more with a lower rate. And it's due to, I think, two changes. The first one we discussed already; the fact that rates among our competing trading partners are falling, but the other significant change over the last few decades is that – is capital markets in general. There's tremendous increase in capital mobility. There's simply more trade. There's more cross-border investment. There's more cross-board M&A. There are more inner – mutual funds that buy shares on foreign exchanges. There's more foreign direct investment and that makes investment more sensitive to the tax system of various jurisdictions.

Scott Hodge: So where was the rate 20 years ago and where is that, sort of – where is that rate today? And I guess, then the third question is, where does the U.S. compare to where the rest of the world is?

Alex Brill: Well, the story with regard to the U.S. is simple. There really has been virtually no change. With regard to what's going on around the world, rates are dropping significantly. In the 1990s, they were in the mid 30s. In the late '80s, they were higher. They were over 40% on average. Now the average federal level corporate tax rate is below 30. It's about 28%, while in the United States it's 35%.

Scott Hodge: So we're really out of whack then?

Alex Brill: We're really out of whack just by, sort of, holding things constant here in the U.S. and doing nothing, the rest of the world is moving forward with lower rates and we're getting further and further out of whack.

Scott Hodge: So what are the implications to this then, I guess, either for the U.S. economy overall or for jobs, or for those who care about tax collections, what's the implication here for federal tax revenues?

Alex Brill: Well, we ran dozens of regressions looking at about 30 countries over about 25 years and we broke that up into five-year increments. So we found out in the first five years, what were the revenue-maximizing tax rates for those 30 or 29 countries. What was it in the second five years? Where is it in the third five years? From that work, what we discovered is, not surprisingly, as tax rates fall, the revenue-maximizing tax rate has fallen as well and in general, for the OECD – in general for developed countries -- the revenue-maximizing tax rate appears to be about 26%.

Now, does that mean that the U.S. would get more revenue if we cut our rate from 35 to 26? It's hard to make that leap because the U.S. is a little bit different than Portugal and Luxembourg and Italy and France and the other countries in the OECD. We're much larger than those and therefore depend much more on our own internal capital. So you can't say with certainty that we'd get more revenue if we cut our rate 10% than we get right now. But it certainly suggests from looking at about 700 observations that it's highly probably that we could get more with less.

Scott Hodge: Well, you know a lot of people dismiss that whole notion that tax cuts somehow pay for themselves. But is it possible that in this case that can actually be the case?

Alex Brill: It's possible. It's not certain. If, according to a conventional revenue estimate that you might get from the U.S. Congress's Joint Committee on Taxation, a 7.0 cut in the U.S. corporate tax rate would, by those measures – that estimating methodology -- cost about \$50,000,000.00 to \$60,000,000.00 a year. What we're suggesting is that it's feasible that that's really far off the mark. I can't say with certainty. We'd only know if we tried, but it's more likely than not that it's going to cost less than that, not more than that.

Scott Hodge: Well, I want to finish up with two questions. I guess, based on your research then, where should the U.S. rate be? And then, looking forward, where – are we going to be constantly chasing lower rates as the rest of the world continues to cut theirs? Or are we just gonna continue to fall behind?

Alex Brill: I think in the near term, if we don't do something, we are going to continue to fall behind. As you noted, it's every couple of weeks that we read in the tax press that another country has cut their rates. What we saw through the data is that there are lots of examples of rates falling and few examples of revenue falling. So I think that that trend is going to continue and we're going to continue to fall further behind over the next few years unless we address the corporate tax rate here.

There are a lot of consequences of that. As the differential between our rate and their rate grows, there's more incentive for investment to be abroad. There's more incentive for – there's less incentive for the money to come back into the U.S. What that means for jobs is a little bit uncertain because there's some

evidence that when firms invest more abroad, they actually invest more here in the U.S. as well. But it certainly does make U.S. corporations focus less on their business and more on tax-planning strategies as they try to take advantage of the lower tax rates around the world. That's going to have negative consequences for tax revenue in the U.S. and it's causing distortions that are inefficient.

Scott Hodge: Where then should the U.S. rate be? Should we – is 25% for the federal rate seem reasonable or too low or too high?

Alex Brill: It's hard to argue that it would be too high based on some of the literature and some of the theories suggesting that the right rate is zero. But I think because it's hard to know exactly, I think a reasonable approach might be a phase-down in the U.S. corporate rate. We could put ourselves on a path that was taking the rate down over time. We could see what happens to corporate tax receipts and we could see what happens in the rest of the world. But to drop the rate a point a year until we can't drop it anymore might be one place to start.

Scott Hodge: Well, being the last question – being a veteran Capital Hill staffer, how do you build bipartisan support for something like this? Is it possible?

Alex Brill: It may be possible and in fact, from a political perspective, the Democrats may have an easier time at getting this done than the Republicans. In fact, there's been a little bit of buzz in some of the press that this is an issue that even the Ways and Means Committee chairman, Charlie Rangel, is at least looking at – the corporate taxes, if it was part of larger package that solved some other problems that are big concerns for him.

It's going to be difficult. We're facing a lot of fiscal challenges over the next few years and while I could argue that the revenue costs may not be the same as the official numbers that they get in Congress, my numbers don't matter. We have a budget process. We have a scoring process in Congress. Those are the official numbers and those models would need – whether or not those numbers are accurate, those are the numbers that Congress has to work with. So it's important that we look hard at the system by which we're providing revenue estimates to Congress and the scoring process, what we call “dynamic scoring,” is important here. And that will help. Reforms there will help clear the way for Congress to move forward in this area.

Scott Hodge: Well, you know, Nixon went to China and Bill Clinton eliminated welfare as we know it, so maybe it is possible that Charlie Rangel could lead the way on this. Alex, this has been fascinating. I appreciate your time and thank you for joining me today.

Alex Brill: Thank you. Thanks for having me on.

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