

Tax Foundation's "Tax Policy Podcast"
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Scott A. Hodge: "Thank you for tuning in to the Tax Foundation's weekly tax policy podcast. I'm Scott Hodge, president of the Tax Foundation. Joining me today is Douglas Holtz-Eakin. Doug is the former director of the Congressional Budget Office and is currently the director of the Maurice Greenberg Center for Geo-Economic Studies at the Council on Foreign Relations. Thanks for joining me Doug."

Douglas Holtz-Eakin: "My pleasure."

Hodge: "Could you tell me a little about the Greenberg Center? I understand that it's a new project of yours. What's its mission and what will you be focusing on in the future?"

Holtz-Eakin: "The Council has, correctly I believe, come to the realization that economics is a central part of international relations, national security policy, and foreign policy in general. The Greenberg Center's mission is to investigate those aspects of economics where not knowing the foreign policy setting will probably lead you to get the wrong answer, or, the flip side, those foreign policy questions where not having a sufficient economics grounding would also lead you to make mistakes."

Hodge: "You know, we everyday are bombarded by all kinds of stories, either from Lou Dobbs or headlines in the Washington Post about outsourcing, corporate inversions, runaway plants, India, China, and so-forth. From your perspective, what are some of the most serious policy issues undermining US competitiveness?"

Holtz-Eakin: "I think the most grave danger on the horizon is, number one, the rising protectionist sentiment, as evidenced by things like Mr. Dobbs, which is true not just in the United States, but is true worldwide. The United States has been a world leader in opening global markets to reduce barriers to trade. One can think of the past 75 years as the long slow process of unwinding catastrophically bad tariffs during the Great Depression. One would hope we didn't do a U-turn on the success we've made in seven decades because it obviously takes a long time to unwind them. I think that's a big concern. Past that, I think the US has to focus on energy policy, following the Wall Street rule of thumb that diversification is a way to lessen risk from both a national security and economic perspective. And, finally, we have been very successful in the United States at innovation, at using the innovative ideas of our research community to drive new technologies. Maintaining that in a global economy, I think, is a big policy issue. An example would be what will be the internet of the future and will our policy in the United States support competitiveness internationally?"

Hodge: "Well, you know Congress has been taking a look at this, and, in fact, the House Ways and Means Committee had a hearing on international corporate tax law. They're beginning to look very seriously at reforming the US corporate tax system and there are

obviously a lot of elements to that, not only the way that the law works itself but also things like the US corporate tax rate. And a lot of people have been talking and suggesting that the US needs to move toward a territorial tax system. What does that mean in sort of layman's terms and why do economists see it as an important step towards fundamental reform?"

Holtz-Eakin: "In layman's terms, you have a choice you can either tax your citizens on their income regardless of where in the world they might earn it or you can tax the people who are in the United States for the income they earn in the United States regardless of whether they're citizens or not. We, in a relatively unusual way, have chosen the first of those. Most of the world has chosen the second. And I think that thinking about a territorial tax system is a really central part of thinking about tax reform because you can no longer pretend the United States operates in a global vacuum. Its tax policy has to be thought out with regard to its global entanglements. And a territorial system has some advantages from the viewpoint, particularly, of business taxation. A big tradeoff has to do with business headquarters locations decisions. Many people forget that a business can choose where to have its headquarters. They were not always American firms and they do not necessarily always have to be American firms. If you think everyone's always an American firm and you choose a territorial tax system, critics immediately say 'well, that means that they're not going to get taxed on income they earn in Europe or Japan or wherever it may be, and that's a giveaway.' But, if you recognize that firms outside the United States can now locate in the US to take advantage of an advantageous business climate it brings to the US new investment, the best jobs, headquarter jobs, and the research and development that comes with those headquarter jobs. So it's a key part of any tax reform."

Hodge: "Well, you know they're a lot of people in the corporate community who are not as thrilled with that sort of an idea and I think many people point back to the 1986 reforms which ended up shifting the tax burden away from individuals and onto corporations. And I think a lot of people fear that at the end of the day fundamental tax reform will lead to an increase in taxes on corporate America and a territorial system might do that. In fact, the way the Joint Committee on Taxation has outlined the territorial system, it would lead to a big tax increase on corporate America. How do we reassure these folks that fundamental tax reform will eventually end up being beneficial to them and not just a big tax hike?"

Holtz-Eakin: "An income tax is a tax which is a threat to businesses. Businesses are organized to maximize the return to shareholder capital. If we're trying to tax that return at an aggressive rate then businesses have every reason to be afraid. Tax reforms that would be desirable for the United States would not focus on an income tax, they would tax consumption. And households consume, not businesses, so one piece of reassurance is to keep your eye on the right kind of tax reform: one which focuses on the taxation of consumption. That's one of the reasons the Joint Committee scores this as a revenue raiser. We're importing capital from abroad to finance a consumption that's beyond our current income, our current ability to pay for it. If we choose to focus on consumption, and choose to make it revenue neutral, then you can keep rates down and have the right

base. That's the recipe."

Hodge: "Well, at the end of the day whatever Congress comes up with will have to be scored by the Joint Committee and in partner with the Congressional Budget Office. You were on a panel last week which I was at and it was a very interesting panel on dynamic scoring. And you talked about your belief in dynamics and you actually introduced some elements of at least dynamic analysis while you were at the CBO. Tell us a little bit more about that and is dynamic scoring feasible, I guess is the bottom line, and is it desirable?"

Holtz-Eakin: "I like dynamic scoring because of the scientific foundation. It forces the policy analyst, the legislator, the president, who's looking at any piece of legislation to think past the budget to its impact on the economy and from that impact back onto the budget. And it transforms as a result any budgetary question into an economic policy question. Good economic policy then will be rewarded by dynamic scoring. That's the reason why I'm in favor of it. Can we do it? Well, we can do it better or worse depending on the particular proposal, but, more importantly, is Congress ready to consume it? And only when Congress has been properly educated on how dynamic scoring works, works out a set of protocols that would actually fit in the budget process to make it feasible to do it on a regular basis, then they'll be ready to go forward, and then dynamic scoring can be a real live option instead of just an addendum or a piece of policy analysis that can be attached to legislation."

Hodge: "Well, I suppose one of the things working against the idea of dynamic scoring is the fact that a lot of people oversold it, and sold it as tax cuts paying for themselves, which I think all of us in the profession think is a little bit of an oversell, and I think any reasonable person would understand that tax cuts don't necessarily pay for themselves. On the other hand, I've been interested in a couple of recent studies, one, an article by Martin Sullivan in Tax Notes, and then Michael Devereux, who's a professor at Warwick University, showing that all of the European countries that have been cutting their corporate tax rates have actually seen their corporate tax revenues level off and, in some cases, go up. So, in those instances, cutting taxes has not necessarily led to a cut in revenues, sort of turning things on their head. Is there a lesson for us here moving forward with fundamental tax reform here in the United States?"

Holtz-Eakin: "I think there are a couple of lessons. Lesson number one is that the corporate rate matters. And we could have a fine discussion of my preferred territorial system versus a worldwide system, but if the tax rate is zero, it doesn't matter. And so keeping tax rates low guarantees you interfere as little as possible with business decisions. That's central. Second lesson is that, while I don't believe tax cuts pay for themselves, and I would be among those that you listed who would say, 'jeez, good tax policy matters, and it'd be nice to get better tax policy, but I wouldn't expect it to raise revenue,' there may be some situations in which, at least over a temporary period, you get a sufficient relocation of economic activity on top of the beneficial investment affects that you might actually reap some transitory gains. I'd be surprised if you could make a case that would last forever but it's worth looking at carefully because understanding the implications is the first order of business."

Hodge: "Well, I'd like to wrap up today with shifting gears a little bit to the spending side of the budget which obviously is what the CBO spends most of its time looking at. And, of course, one of the biggest threats to tax reform is out of control spending. We've seen spending grow extraordinarily rapidly over the last few years and you were very vocal when you were at the CBO about runaway spending, especially entitlement spending. What are some of the threats that we face most and what can we do about it?"

Holtz-Eakin: "It's a tremendous irony that I spent two decades of my career as a tax economist and have found that that matters so little compared to what we're on schedule to spend on Social Security, Medicare, and Medicaid. Social Security gets all the attention. We're spending about four cents on the national dollar now; it'll go to about seven cents on the national dollar after the baby boom retires - a rise of over fifty percent. But Medicare and Medicaid are also about four cents right now, and if you repeat the cost growth of the past four decades and layer on the baby boom retirement, those programs go from four to twenty cents on the national dollar - and that's the current size of the entire federal government. That simply cannot happen and how we choose to not have it happen is a central question for the federal government. And the extent that we control it, to keep it from getting to big, it will place less pressure on raising revenue. The Medicare actuaries have this optimistic scenario in which those programs go from four to twelve, they triple in size. Even that would force us to raise taxes, if you're a Republican or Democrat or a Martian, and that's the central threat to tax reform."

Hodge: "Well, and everyday we delay is a day that makes it worse to try to fix these problems. So it's going to be interesting to watch Congress over the next few years and see if they can come to grips with these problems. Doug, thank you very much for joining me today. I really appreciate it, to talk about these very important issues."

Holtz-Eakin: "Well, I want to thank you for the chance to be here, and the Tax Foundation for the good work that it's done over the years. My pleasure to be onboard."

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