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CONGRESSIONAL HEARING SUMMARY

COMMITTEE: Senate Finance Committee – Full Committee

SUBJECT: "Tax Reform, Growth and Efficiency"

DATE: February 24, 2015

Members Present

Republicans: Chairman Orrin Hatch (UT), Chuck Grassley (IA), John Thune (SD), Johnny Isakson (GA), Dan Coats (IN), Tim Scott (SC), Rob Portman (OH)

Democrats: Ranking Member Ron Wyden (OR), Robert Casey (PA)

Witnesses

Dr. Michael Boskin
T.M. Friedman Professor of Economics and Senior Fellow
Stanford University

Dr. John Diamond
Fellow in Public Finance
Rice University

Dr. Laura D'Andrea Tyson
Professor of Business and Administration and Economics, Director, Institute for Business and Social Impact
University of California-Berkeley

Dr. Jane G. Gravelle
Senior Specialist in Economic Policy
Congressional Research Service

Overview

On Feb. 24, the Senate Finance Committee held a hearing on tax reform and economic growth. Chairman Orrin Hatch and Ranking Member Ron Wyden agreed that there is strong bipartisan support for tax reform, which is urgently needed to promote economic growth and American competitiveness. The four economists invited to testify before the committee focused their opening statements on the importance of corporate tax reform and its influence on economic performance.

Opening Remarks

Chairman Hatch believes tax reform is essential if the United States wants to get the economy moving and growing again. Mr. Hatch said reform should reduce economic distortions and promote growth, criticizing the administration's aggressive anti-growth proposals. Ranking Member Wyden agreed that the broken tax code, which has produced distortions and put the U.S. at a competitive disadvantage, must be fixed. He added that tax reform should not add more burdens on the middle class. Mr. Wyden concluded that a modern approach must be taken to reform the system so that it could give Americans a chance to get ahead.

In their testimonies, the witnesses expressed broad agreements on the following:

- Tax reform, if done right, has the potential to promote economic growth, improve efficiency, and boost competitiveness;
- The U.S. corporate tax rate is too high in comparison with other developed countries and must be reduced;
- Generally speaking, revenue neutrality is preferred when doing tax reform.

Highlights from Q & A

Corporate Tax Reform. When asked by Chairman Hatch to identify the most damaging aspects of the U.S. tax system, the witnesses agreed that the high statutory rate has been harmful to growth. Ms. Tyson said the U.S. corporate rate is out of line with rates found in other countries – the U.S. corporate rate should be lowered, and special tax preferences should be eliminated to help pay for the rate reduction. Mr. Diamond said the combination of a high tax rate and preferential deductions has exacerbated economic inefficiencies and distortions. He added that lowering rates would help bring income home.

Though most preferential treatments should be eliminated, Mr. Diamond and Ms. Tyson agreed that accelerated depreciation should be retained because it would continue to help encourage new investments. Chairman Hatch also asked the witnesses for their thoughts on corporate tax integration. Mr. Boskin is supportive of the idea, though it might raise some international issues that would need to be addressed.

Citing a statistic where labor bears 70 percent of the corporate tax burden in an open economy, Senator Thune asked the witnesses for their thoughts on rate reduction and its impact on the labor force. Mr. Boskin said a reduction in the corporate rate would boost wages, increase productivity, and create more jobs.

Taxes on Capital and Foreign Earnings. Most of the witnesses agreed that the tax on capital and dividends should be lowered. Mr. Boskin said a high tax on capital would negatively impact capital formation. Ms. Tyson underscored the need to change the way foreign earnings are taxed because multinational corporations are a major source of jobs, productivity, and R&D. She argued that U.S. corporations are highly disadvantaged by the current tax system, and consequently, they have made use of deferrals to deal with these disadvantages. Expressing doubts about the corporate minimum tax, Ms. Tyson said it is time to change the current system where American companies are at a competitive disadvantage compared to their European counterparts, who are able to offer the benefits of “patent boxes” to other multinational corporations. She proposed a move to the territorial system with necessary anti-abuse measures in place. Ms. Tyson concluded that it would be beneficial to lower rates, broaden the base, and end deferrals.

Simplification and Revenue Neutrality. Mr. Wyden asked the witnesses how the committee could make tax reform more relevant and more attractive to the average American. He noted that such technical discussions about reform hold little interest for most Americans, such as those who came to his recent town halls. Mr. Wyden suggested that perhaps the discussion should focus more on how reform would lead to the simplification of the filing process. Ms. Gravelle suggested that increasing the standard deduction would help to simplify the process because fewer people would need to itemize their deductions – this would be a good first step to help ordinary people who do not have complicated investments. Mr. Diamond suggested that to create a simpler system, everything should be tossed out, and people should be made to argue why certain provisions should be in the code. Ms. Tyson noted certain provisions that should be promoted (e.g. EITC, child care tax credit, second earner deduction, etc.) would complicate the goal of simplification, however.

On the issue of revenue neutrality, the witnesses generally agreed that revenue-neutral reform would be the preferred approach. Mr. Boskin said that it would be hard to sell tax reform to the public without revenue neutrality. Mr. Diamond added that revenue neutrality was an important assumption but one should think in terms of long-term neutrality as well. Ms. Gravelle said revenue neutrality would make it easier to design reform, but given America’s unsustainable debt position, members might want to use reform to raise revenue because this would have to be done sooner or later. Ms. Tyson added that revenues raisers might be necessary in order to achieve growth in the long-term.

Miscellaneous. On the issue of distortions, Ms. Gravelle would like to see the distortions between debt and equity investments and between business equipment and structures eliminated. When asked what should be a key focus of reform, Mr. Diamond said that providing investment incentive would be more efficient than pure rate reduction. Ms. Tyson noted that the U.S. must make it more attractive for companies to invest and grow their businesses domestically. Mr. Diamond and Boskin also briefly discussed the merits of a consumption tax.