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Congress vs. realities

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Assume you own a store that sells CDs for $4 per pack. You notice fewer people are buying from you, because most of your competitors sell CDs for $2.50, and some discounters charge only $1. The average junior high school student can figure out that the correct competitive response is to lower your price, not increase it, but many members of the U.S. Congress seem unable to grasp this elementary concept — more on this below.

On July 26, Treasury Secretary Henry Paulson held a conference to which he invited many leading tax experts (both Republicans and Democrats) — tax lawyers, tax accountants, and tax economists. Some represented academics, think tanks and companies; others, such as former Federal Reserve Chairman Alan Greenspan, were past senior government officials.

The Treasury background paper for the conference, "Business Taxation and Global Competitiveness," noted that: "Since 1980, the United States has gone from a high corporate tax-rate country to a low-rate country ... and ... back again to a high-rate country today."

Business people can establish corporations almost any place on the globe they choose, even though they may produce or sell their products in only dozens of countries. Other things being equal, they logically will choose a country with a lower rather than higher rate of corporate tax.

There has been much hew and cry about corporations moving out of the U.S., but what should be of even greater concern is that new companies increasingly are not incorporating or going public here. The U.S. is losing global corporate market share because of both its higher tax burden and its excessive regulations (such as the Sarbanes-Oxley Act).

European Union countries now have an average corporate tax rate of less than 25 percent. Ireland is at 12½ percent, and some of the newer EU members have rates as low as 10 percent, while the U.S. corporate rate (federal and average state) is 39 percent. From the time of the Reagan economic revolution until the last couple of years, the United States, on average, grew much faster than its European competitors. But as the Europeans have begun reforming their economies and reducing corporate tax rates, they have started growing more rapidly than the United States.

The U.S. also taxes corporations at a much higher rate than sole proprietorships and various forms of partnerships, including LLCs (limited liability companies). The result is unincorporated businesses constitute a much larger share of all businesses in the U.S. than in all other major countries, with the sole exception of Mexico.

The bizarre result of the U.S. noncompetitive tax rate is that the government gets far less revenue than it would if it lowered the rate.

If the U.S. lowered its rate, more corporations would set up shop in or return to the U.S. And many business people would choose corporate rather than noncorporate forms of ownership.

Finally, there would be more business investment in the U.S. if the rate were lowered. As it can be seen in the accompanying chart, many countries enjoy much higher corporate profits as a share of gross domestic product, with even lower corporate tax rates than the U.S. (If Wal-Mart can figure out it makes larger total profits with lower prices, why can't Congress figure out we would be better off with lower tax rates — the "price" government charges?)

Corporate Tax Rates and Tax Ratios

Country	Statutory Corporate Tax Rate 2005	Corporate Tax/GDP (Average 2000-2005)
Austria	25%	2.6%
Finland	26%	4.3%
France	34%	3.4%
Spain	28%	3.2%
UK	30%	4.9%
US	39%	2.2%

Serious scholars, such as Kevin Hassett of American Enterprise Institute, have produced studies showing the U.S. would probably increase revenues from the corporate tax by cutting the rate to as low as 26 percent. Broadening the corporate tax rate base by reducing the many preferences and complications in the system (which the conference scholars agreed was desirable) would allow an even further substantial reduction in the tax rate, perhaps to as low as 15 percent in my judgment, without any short term revenue loss. Over the long run, getting rid of the corporate tax completely should be the goal, because it taxes capital multiple times and substantially reduces workers' wages.

Yet despite this evidence of the harm caused by high U.S. corporate tax rates, the reaction by many in Congress is to increase corporate taxes even more. The Democrats, with their new "pay-go" rules, pretend these new taxes will "pay" for the additional spending they want, when in truth these higher taxes drive more business out of the U.S., reducing both tax revenues and new jobs. For instance, at the end of July, Rep. Lloyd Doggett, Texas Democrat, added business tax increase provisions to "fund" more spending to the already bloated farm bill.

Jack Kemp was famous for saying, "You can't love the employee, and hate the employer." The encouraging news is that serious people, such as Mr. Paulson, understand the problem. But, the open question is, will the Treasury, the rest of the administration, and the wiser and responsible heads in Congress be sufficiently aggressive in explaining to the American people the folly of the way we are heading and take the necessary actions to reverse course?

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