Written by Veronique de Rugy on December 15, 2016

A Holiday Recipe for Government Growth

Economic research shows that the corporate tax is harmful to workers' wages and overall economic growth. If left to their own devices, politicians still wouldn't be likely to reduce or eliminate the destructive tax. They only act when tax competition — whereby taxpayers shop around for favorable tax environments — forces their hand.

That's why it is alarming that House Republicans — I repeat, House Republicans — are talking about a change to the corporate tax that would insulate it from competitive pressures going forward. The change in the Ryan-Brady blueprint (as in Speaker of the House Paul Ryan and Chairman of the Joint Economic Committee Kevin Brady) would turn the corporate income tax into a "destination-based cash flow tax" with many similarities to European-style value-added taxes. To be sure, it would also lower the U.S. corporate tax rate — which is currently higher than any other in the developed world — and move to a common-sense territorial system in which income would be taxed only in the country where it was earned. It would also alleviate some of the double taxation of savings and somewhat simplify the tax code, even as it could become a compliance nightmare for companies.

But it would be simpler to just do away with the corporate tax altogether. Many people know that, but Republicans continue to appease those who view all money as belonging first to the government by insisting that tax cuts must be "paid for" according to the Keynesian math of the Congressional Budget Office.

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So here's where we are: To pay for their desired cut to the corporate tax rate, Republicans are suggesting a conversion of the corporate income tax into a "cash flow tax," or a consumption tax base with a deduction for payroll. Protectionist "border adjustments" then make it "destination-based" by exempting exports from taxation and denying deductions for imports. The move might be better described as belonging to the idiotic school of export mercantilism, meaning there would be higher prices for consumers (including domestic producers that use imported parts). I can also guarantee that contrary to the promise lawmakers will make about it, this feature would not appreciably boost exports.

But the real danger from the plan comes from how it would change political incentives. Whereas corporate income tax rates have declined throughout the rest of the world as nations compete to keep businesses from fleeing their jurisdiction, the destination-based cash flow tax would be inescapable. If you sell in the U.S. market, you would pay the tax, regardless of where your company is located.

That means that future politicians would have little incentive to keep rates down.

This is just a recipe for bigger government, as Europe discovered when it instituted the very similar value-added taxes. In part because of their regressive nature — yes, VATs hit lower-income taxpayers the hardest — they are revenue engines and have helped fuel the dramatic growth of European governments in recent decades.

Academic supporters of the new tax admit that their goals are to grow government and institute more progressive tax burdens. Republican lawmakers think they need it to trade for lowering the corporate rates, but they ought to know better than to hand future Congresses the means to easily power government growth.

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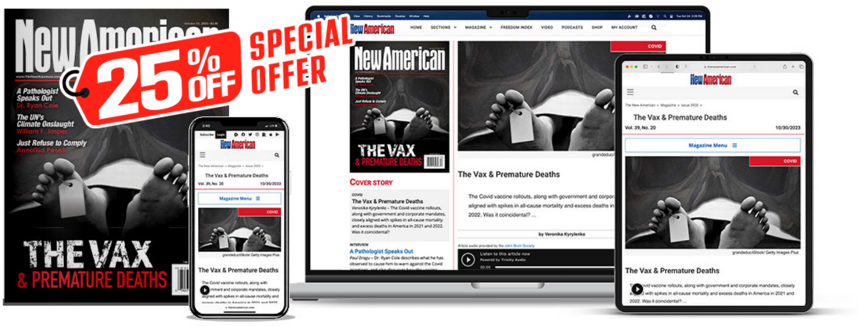

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