The Portman Solution

By Diana Furchtgott-Roth


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In this article, Furchtgott-Roth explores Sen. Rob Portman's ideas for solving America's fiscal crisis, including fundamental corporate tax reform.

Sen. Rob Portman, an Ohio Republican who was a member of the deficit reduction supercommittee, has devoted substantial time to thinking about what can be done to put America on a sound fiscal track. In a compelling address at the American Enterprise Institute (AEI) on November 28, he delivered an honest assessment of the major challenges to the American economy.

Most importantly, Portman persuasively explained why the corporate tax offers a solution. By making our economic system more competitive globally, America will attract more investment and create more jobs.

At a time when many politicians avoid tough tax and spending issues in favor of clichés, Portman soon will outline details of a substantive plan to lower the corporate tax rate and allow America to regain competitiveness. Christine Mangi, Portman's press secretary, told me that the corporate tax reform proposal is still being drafted. Contrary to some reports, it is not a copy of the proposal released by House Ways and Means Committee Chair Dave Camp, R-Mich.[1]

Readers of these pages understand Portman's arguments. For some of us, they verge on the obvious. But the average American does not understand the connection between taxes and employment. That is why politicians who can spell it out clearly deserve a medal for intelligence and honesty.

Portman's efforts come none too soon. Last month America celebrated a reduction in the unemployment rate from 9 percent to 8.6 percent, even though an additional 315,000 people withdrew from the labor force and the average duration of unemployment reached an all-time high of 40.9 weeks.

It's hard to recall, as we celebrated the decline, that four years ago the unemployment rate was 4.7 percent. How times have changed. We are fast approaching a "new normal" of permanently higher unemployment with a disenfranchised class of unemployed, low-skill workers.

In contrast, while Germany's unemployment rate in 2007 was 8.7 percent, it is 6.5 percent now.[2] Germany did not have a stimulus plan — it had an austerity plan. And over the past four years it has cut back on total unemployment benefits rather than expanding them.

In his speech Portman said, "In 2007, that fiscal year, the budget deficit was $161 billion, about one-eighth of today's deficit, representing about 1.2 percent of the economy. A major difference was that discretionary spending, the non-emergency annually appropriated spending of Congress, was 17 percent lower in FY 2007 than it is today."[3]

No austerity for America. The supercommittee failed to cut even $1.2 trillion of federal spending over the next 10 years.

One challenge, according to Portman, was the expansion of the committee's mandate caused by President Obama's request to find a way to pay for another $447 billion in stimulus spending. Portman said that Democrats and Republicans worked together "with seriousness of purpose" and that failure was disappointing.

Republicans on the supercommittee did offer to get rid of $250 billion worth of tax expenditures by reducing exemptions and itemized deductions for top income earners, Portman said. Revenues would

[1]For prior coverage, see Michael Beller, "Portman Plans Bill to Shift U.S. to Territorial Tax System," *Tax Notes*, Dec. 5, 2011, p. 1199, *Doc 2011-24867*, or *2011 TNT 229-4*.

[2]Using Labor Department data adjusted to U.S. concepts.

[3]*See* American Enterprise Institute, "Moving Forward Post-Supercommittee — Senator Rob Portman's Remarks and Panel Discussion," Nov. 28, 2011, at 4.

have gone to lowering tax rates for all income earners. But the Democrats on the committee refused.

Portman emphasized that America faces twin challenges of poor economic and fiscal policies, and restoring fiscal health. He cited economists Kenneth Rogoff and Carmen Reinhart, who, in a February 2011 National Bureau of Economic Research paper entitled ''A Decade of Debt'' concluded that once gross public debt exceeds 90 percent of GDP, an economy will lose one or two percentage points of GDP growth compared to baseline.[4] In the United States, that diminished growth rate would lead to about a million fewer jobs annually.

If the Rogoff-Reinhart numbers are correct, then America will not just suffer the loss of a million jobs in one year, but a loss of a million jobs per year for the foreseeable future.

Revenues are projected to rise to 18 percent of GDP, near historical norms, but spending is forecasted by the nonpartisan Congressional Budget Office to go beyond 24 percent — possibly up to 50 percent of GDP in coming decades.

Spending of that magnitude is too large to be fed by tax increases. Columbia University Prof. Glenn Hubbard, my former boss as chair of the Council of Economic Advisers, has calculated that paying for Obama's spending would require tax increases of 60 percent over the next quarter-century. According to Portman, ''That would probably make even my most aggressive Democrat counterparts on the Super Committee blush.''

No blushing needed, because those problems can be solved by a growing economy, and lowering the corporate tax rate is one of the easiest ways to do that, especially because it is likely to have bipartisan support.

America's federal corporate tax rate is among the highest in the world. Portman has proposed lowering the top corporate tax rate to 25 percent from 35 percent, and removing deductions and credits. Although Portman did not list any specific tax expenditures, they could include accelerated depreciation schedules for machinery, expensing for business equipment, and rapid write-offs for solar and wind power and oil exploration.

Support for curtailing tax expenditures comes from many sources, such as Martin Feldstein, the distinguished Harvard economist and president emeritus of the National Bureau of Economic Research. He has written that limiting tax expenditures would reduce the deficit by hundreds of billions of dollars annually without raising tax rates, and therefore would not affect the incentive to work, save, or expand businesses.[5]

Under the current corporate tax system, many corporations can legally avoid paying any taxes; most recently, General Electric Co. made headlines for doing that. The Portman plan would make it practically impossible for corporations with net profits to avoid taxes.

How to structure the changes in tax expenditures is the big question. Many companies have built their businesses around tax expenditures and will object to their removal. Who would win and who would lose?

Limits on interest deductibility would affect real estate. Limits on research write-offs would affect pharmaceuticals. And, of course, any simplification would affect the accounting industry.

Lower corporate rates would encourage more entrepreneurs (which economic studies show create a substantial portion of new jobs) to come to the United States. With the corporate rate lower than the individual rate, they would be inclined to file taxes as corporations.

Portman has proposed that the United States move to a territorial tax system, like other major industrialized countries. Corporations would be taxed only on income earned in the United States. Companies' earnings in foreign countries would be taxed by those countries, but not taxed a second time by our government. A territorial tax system with lower rates would let corporations return more revenue to America and encourage more economic growth. Estimates of cash held overseas range from $1 trillion to $1.5 trillion.

Tax Notes columnist Martin A. Sullivan testified before the Ways and Means Committee on November 17 that ''there is one benefit of moving from the current system of deferral to a territorial system. It would eliminate the problem of 'trapped' foreign profits.''[6]

No one knows what the repatriation rate would be with a lower U.S. tax, but it would be higher than it is now, adding to investment and employment.

Cisco Systems Inc. CEO John Chambers and Oracle President Safra Catz have proposed reducing the tax on repatriated earnings to 5 percent. If even half of the $1 trillion held abroad were to come

[4]*See* the Rogoff/Reinhart paper, *available at* http://papers.nber.org/papers/w16827. For further information on the paper, see http://www.bloomberg.com/news/2011-07-14/too-much-debt-means-economy-can-t-grow-commentary-by-reinhart-and-rogoff.html.

[5]*See*, *e.g.*, Martin Feldstein, ''The Tax Reform Evidence From 1986,'' *The Wall Street Journal*, Oct. 24, 2011.

[6]*See* Martin A. Sullivan, ''Let's Promote the Competitiveness of All American Businesses,'' *Tax Notes*, Dec. 5, 2011, p. 1175, *Doc 2011-25091*, or *2011 TNT 233-1*.

back to the United States, that would create $500 billion in stimulus, and Uncle Sam would get $25 billion in tax revenues.

Portman told the AEI audience that the CBO has scored his plan as revenue neutral, although his office was not able to send me the calculations. It also was scored by the Joint Committee on Taxation.

One major question for any tax proposal is its likelihood of passage. With Senate Finance Committee Chair Max Baucus, D-Mont., interested in corporate tax reform, it has a real chance.

Further, corporate tax reform is in many ways easier than individual tax reform, because the difference between American and international tax rates is so glaring. People like the idea of taking away deductions and requiring all corporations, including GE, pay tax on their net profits.

Fundamental tax reform offers the best chance of jump-starting America's growth rate, spurring job creation, and getting us out of our fiscal mess. Kudos to Portman for taking it on.