Hearing on Reaching America's Potential: Delivering Growth and Opportunity for All Americans

Questions for the Record

Question from Chairman Brady

Question:

Dr. Hassett, in your written testimony you specify a number of studies published in the American Economic Review which demonstrate a strong relationship between taxes and economic growth. Would you please expand upon that list by citing other similar high-quality research? In addition to an expanded bibliography, we would welcome any comments or analysis you would like to include that may highlight the findings of that research.

Beyond the articles in the American Economic Review mentioned in the testimony, other studies pointing to the same conclusion come from other economics journals. Turning to the German experience in the Oxford Economic Review, Hayo and Uhl (2014) use this "narrative approach" to examine German data spanning 1974 to 2010. They estimate that a tax increase of 1% of GDP cumulatively lowers output by as much as 2.4% over eight quarters. In aggregate, therefore, the estimated output effects from "narrative approach" analyses of the U.S., U.K., and German contexts evince a remarkable level of stability, ranging only from 2.4% over eight quarters in the case of Germany to 3% over ten quarters in the case of the U.S. context. Lopes (2016) replicates the approach and the results with data for Canada.

Other studies of the economic effects of tax reforms pivot away from the standard version of the "narrative approach" and instead emphasize the distinction between average and marginal tax rates, the latter of which tend to be the most relevant for policy discussions. Constructing a time-series of average marginal U.S. federal income tax rates from 1912 to 2006, Barro and Redlick (2010) repurpose a variation of the Romer and Romer (2010) identification strategy to construct an instrument for changes in average marginal tax rates (AMTRs). They find that a decrease in the AMTR of 1% increases per capita GDP by .5% after a period of one year. Deploying a vector autoregression, Mertens (2015) estimates a peak output effect from a 1% decrease in the AMTR on real GDP of 1.5%, though the sample includes only changes to personal tax rates and, in the interest of avoiding anticipation effects, excludes tax reforms with an implementation gap between time of legislation and time of implementation of one year or more. In conclusion, then, this diverse and variegated body of evidence from the economics profession points to a common and shared conclusion: lower taxes increase growth. Anyone who asserts that there is no evidence supporting a large impact of tax policy on the economy is either misinformed about the literature, or dishonest.

A full bibliography for both these studies and those in the American Economic Review is below.

Bibliography

Barro, Robert J. and Charles Redlick. “Macroeconomic effects from government purchases and taxes.” *The Quarterly Journal of Economics*. 126 (2011): 51-102.

Cloyne, James. "Discretionary tax changes and the macroeconomy: new narrative evidence from the United Kingdom." *The American Economic Review* 103 (2013): 1507-1528.

Favero, Carlo, and Francesco Giavazzi. 2009. “How Large Are The Effects of Tax Changes?” Cambridge: National Bureau of Economic Research Working Paper 15303.

Hayo, Bernd, and Matthias Uhl. "The macroeconomic effects of legislated tax changes in Germany." *Oxford Economic Papers* 66.2 (2014): 397-418.

Hebous, Shafik. "The effects of discretionary fiscal policy on macroeconomic aggregates: a reappraisal." *Journal of Economic Surveys* 25.4 (2011): 674-707.

Questions from Rep. Boustany

Question 1:

Lead in:
Last year, I led a movement by this committee to reauthorize the Temporary Assistance for Needy Families (TANF) program. Throughout hearings and discussion drafts we focused on the need for welfare reforms to increase labor force participation, work and upward mobility.

The need to see this work move forward, seems nothing short of timely and extremely critical. Just last week Louisiana's Association of United Ways announced that more than 40 percent of individuals in Louisiana can’t afford the basic necessities of life. That statistic further cements the fact that our nation's economy and anti-poverty programs aren't working as well as they should to help people move up the economic ladder.

Question:
Dr. Holtz Eakin, as you know, last year we held numerous hearings highlighting the fact that welfare recipients can sometimes find themselves in a situation where working more doesn't necessarily pay more. In your opinion, has the economic recovery been different for low wage workers?

The recovery has been subpar, with especially slow job and wage growth among the low-wage workers. This is in part due to a previously legislated increase in the minimum wage early in the recovery, and as well due to the structure of the social safety net. There are certain elements of the social safety net that discourage work, in part due to short-term benefit tradeoffs. This is visible *among several programs such as Disability Insurance and TANF, where on a dollar for dollar basis, benefit receipts may equal entry-level wages, or at least offer equal value for a recipient's time. But this short-term calculus leaves out future benefits that accrue to work over time. Social safety-net programs that recognize these benefits by incenting work ultimately do a greater service to beneficiaries. Moreover, despite some rhetoric, even entry-level employees find less need for social safety net programs according to recent research completed by AAF.*[1]

Follow up:
Specifically, we released a discussion draft of a TANF reform bill that would revitalize the work requirement for people collecting welfare benefits. The discussion draft proposal ends the credits and loopholes, so states would be required to engage at least 50 percent of welfare recipients in work-related activities, as intended by the original 1996 law. Do you think this kind of reform can actually solve the problem or is it just one necessary piece of the puzzle to get people back to believing the American dream is possible? How would you contrast this approach be for constructive and self-sustaining as compared to the ongoing and aggressive calls by the President and democrats to raise the minimum wage?

The entire social safety net needs to be reformed to better support work. A good start is to return to the original intent of the TANF work requirements.

In contrast, a minimum wage increase is exactly the wrong approach to addressing the need to enhance upward mobility. In effect, raising the minimum wage transfers wage earnings from the low-wage workers who are unfortunate enough to become jobless to the low-wage workers who remain employed.[2] *Indeed, AAF has found that raising the minimum wage would cost 3.8 million low-wage jobs. In total, income among low-wage workers would rise by, at most, $14.2 billion, of which only 5.8 percent would go to low-wage workers who are actually in poverty.*[3] *Instead the U.S. should pursue some specific pro-work policies targeted at this population, such as expansion of the childless EITC, paired with a robust growth agenda to grow the U.S. economy more rapidly.*

Question 2:

Lead in:
It is no secret that the oil and gas industry are critical to the state of Louisiana's economic stability. In fact, Louisiana loses about $12 million every time the price of oil drops $1. This has been felt more so in recent months as the price for a barrel of oil fell below $27 a barrel for the first time since December 2003. In fact, in my hometown of Lafayette we have suffered the greatest number of job losses in the country over the past 12 months - losing 5,100 jobs in total. If those statistics don't highlight just how much the American economy is struggling right now, I'm not sure what does.

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[1] http://americanactionforum.org/research/employment-the-retail-sector-and-usage-of-the-social-safety-net
[2] http://americanactionforum.org/research/higher-pay-fewer-jobs
[3] http://americanactionforum.org/research/counterproductive-the-employment-and-income-effects-of-raising-americas-min

Dr. Holtz-Eakin, in December you highlighted that "*The best energy policy is letting markets work. A great testimony to this is the recent revolution in oil and gas production. It was due to market-driven technological advances that built on some government basic research and further industry development. It would be beneficial for consumers and producers alike if even more market forces were put in to play — namely to permit domestic producers to export crude oil (and accelerate the granting of permits to export liquified natural gas). Unfortunately, the U.S. approach to energy policy has often been to use tax and other policies to tilt the playing field. Wind power and solar power receive tax subsidies, while coal is penalized by the Environmental Protection Agency's regulatory agenda... The past 40 years of U.S. energy policy has consisted too much of federal intervention and micromanagement. The better route forward is to simply rely on the market forces that have delivered so much success in other parts of the economy, and recently in energy as well.*"

Question:
Knowing that you and I share concerns about the negative impact regulations placed on industry by the Administration are having to the overall economy, and that not all tax policy is helpful to the domestic business community, what do you think are the policy decisions we can and should be making right now, from the federal and local level, to implement an energy strategy for our country and to ensure Louisiana and the rest of the US is prepared to meet these challenges?

A starting point would be to control the ever-increasing regulatory burden, which has grown by roughly $100 billion annually for the past seven years. These regulations, as well as tax policy, distort the energy sector to the detriment of the American consumer and the economy as a whole. At present, the United States has a patchwork of subsidies and financing mechanisms layered onto federal and sub-national mandates and regulations, which rarely act in harmony to advance a coherent energy policy. Instead, the U.S. should get out of the energy "business," and allow market forces to take greater hold on the energy sector. Allowing U.S. producers to export crude oil is a positive step, but the administration's subsequent oil tax proposal reflects an approach to energy policy that appears rooted in the 1970s.

Question 3:

Lead in:
With more than 95 percent of the world's population and 80 percent of the world's purchasing power outside the United States, future economic growth and jobs for Louisiana and America increasingly depend on expanding U.S. trade and investment opportunities in the global marketplace.

Export growth increases jobs by generating new business for Louisiana's manufacturers, service providers and farmers. It is well known that imports support jobs and keep costs low, helping Louisiana businesses compete and saving Louisiana families real dollars at the cash register. We know this well in Louisiana where more than one in five jobs depend upon international trade. In fact, according to labor statistics Louisiana's trade-related employment grew 2.5 times faster than total employment from 2004 to 2013.

Question:

Economists generally agree that trade liberalization, such as through the TPP, benefits Americans. How will the TPP benefit American families? In particular, will it lower costs on basic necessities such as clothes and shoes, which also happen to face high tariffs?

A key goal of TPP is to eliminates or reduce tariffs on goods traded between partner countries, which should benefit families through more affordable consumer staples. TPP should also reduce foreign tariffs on American exports, which can encounter tariffs as high as 100 percent. Reducing both barriers should benefit American workers through enhanced opportunity for trade, and a reduction in costs for certain inputs and household goods. TPP also aims to increase trade in services, an essential element of U.S. trade, accounting for $711 billion of exports in 2014.[4]

Follow up:
In Louisiana the TPP is as much about what is under barges and ships in Gulf Coast rivers as it is about the goods they carry. This is because Louisiana's rivers are in dire need of dredging and the Army Corps of Engineers must continue to invest in maintaining locks and dams if the state is to reap the full benefit of the so-called Trans-Pacific Partnership. How critical do you all believe reliable infrastructure is for the U.S. to recognize the full benefits of TPP or any future trade agreement?

Properly targeted, federal expenditures on infrastructure can enhance U.S. productivity and broadly benefit the American economy. To meet a productivity test, transportation investments should have a greater impact in terms of raising future standards of living than other uses of funds as measured by the return on other market investments. Thus, to ensure the best use of taxpayer dollars, government must channel funding to the projects that offer the highest returns to society. That means choosing programs that do the most to enhance long-term productivity.[5] *Infrastructure projects that ensure access to international markets and trade routes can offer important opportunity for these productivity gains*

Question 4:

Lead in:
The long-term exponential growth in America's entitlement state has had far reaching consequences that we may not fully grasp for years to come, but there is no question for any of my colleagues on this committee, that the financial impact has trickled down to our respective states.

Perhaps most directly impactful on state's financial burdens is the Medicaid program; as everyone likely knows, Medicaid is jointly administered and financed at the federal and state levels, which is not the case for most other entitlement programs, and leaves states at higher financial risk. In fact, like many other states, my home state of Louisiana currently faces a budget gap of roughly $1.9 billion, a figure that would only be further strained by any additional increases in spending.

Question:

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[4] http://americanactionforum.org/insights/primer-the-trans-pacific-partnership
[5] See: https://media.mhfi.com/documents/201507-MHFIGI-Dynamic-Scoring-AAF-PPI-Final.pdf

Dr. Holtz-Eakin, in your testimony submitted for the record, you highlighted the point that increased entitlement program spending has a depressive effect on our nation's economic growth overall, and ultimately leads to the need for increased revenue through tax increases elsewhere.

For states like Louisiana, who may be contemplating expansion of their Medicaid programs following on the recommendations made in the President's health care law, how would you advise Louisiana's new governor and others on the question of whether or not to follow through on expanding their Medicaid programs?

Medicaid has impacts on health policy, budget policy, and economic policy. Beginning with the latter, Medicaid is poor economic policy. A recent estimate by AAF found that a nationwide Medicaid expansion would result in a direct net loss of up to $174 billion in economic growth nationwide over ten years and the loss of over 206,000 full-year-equivalent jobs for the years 2014 to 2017.

Medicaid is questionable budget policy. The ACA's Medicaid expansion layered $824 billion in entitlement spending onto an already unsustainable federal budget, that left unchecked will harm future economic growth. [6] *States have to be cognizant that the Medicaid expansion is not "free" and that the terms may worsen in the near future.*

Finally, states are much better situated to determine their low-income health policies than is the federal government.

Follow up:
If you would advise against expansion, can you elaborate as to why Medicaid program expansion is not ultimately cost-efficient or successful at achieving the President's purported goals of expanding coverage to ensure ***timely*** access to high-quality healthcare services?

Perhaps more important than its budgetary implications, is the failure of Medicaid to deliver quality care to the neediest Americans. There is evidence that Medicaid coverage does not increase overall health or reduce emergency room use.[7] *Indeed, Medicaid coverage arguably leads to the worst health outcomes because reimbursement rates for providers are so low that it makes non-emergency room care virtually inaccessible.*[8] *As noted above, states may have much better solutions on their own.*

Lastly, can you describe for me what you think the long-term financial impact would be on a state like Louisiana, with its $1.9 Billion budget gap, if the decision was made to expand Medicaid?

Over the long-term, it is basic math that increasing the Medicaid-eligible population will increase future liabilities. While the ACA promises to cover the bulk of this expansion, future Congress are

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[6] https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/50252-Effects_of_ACA_Repeal.pdf
[7] http://americanactionforum.org/insights/more-insurance-shouldnt-lead-to-more-emergency-room-visits-but-it-might
[8] http://americanactionforum.org/testimony/the-affordable-care-act-after-five-years-wasted-money-and-broken-promi

not bound to any current financing structure. We have even seen States experience cost increases in the short term, being held hostage by maintenance-of-effort provisions that force state Medicaid agencies to continue paying for temporary programs that have long since expired.[9]

Question 5:

Lead in:
As many of my colleagues on this committee can attest, the constituents in each of our respective states have been "white-knuckling" the wheel of a stagnant economy, trying to hang on until things "get better". In fact, my home state of Louisiana closed 2015 ranking 48th in the U.S. for positive economic growth, alongside a 6.3% unemployment rate well above the national average of 5.0%, and 0.0% wage growth

Louisiana, alongside every one of the 50 U.S. states, serves as a major hub for international business across many industries. There has been an exponential growth in inversions, and mergers and acquisitions activities, most recently the sale of Johnson Controls to Ireland-based Tyco, as well as the sale of U.S.-based Baxalta to Ireland-based Shire. Following the loss of these two major U.S. companies alongside the many others that preceded them, this is only further evidence to support the critical need for tax reform.

Dr. Holtz-Eakin, in your submitted testimony you made the accurate and astute observation that economic growth is positively correlated with a very tangible result for American families: *"The Congressional Budget Office projects the U.S. economic growth to average only 2.1 percent over the next decade…This rate of growth is below that needed to improve the standard of living at the pace typically enjoyed in post-war America…**More rapid growth is not an abstract goal; faster growth is essential to the well-being of American families**."*

Question:
Dr. Holtz-Eakin, given the concrete connection between our nation's economic growth, and therefore the well-being of American families, do you believe international tax reform to address the increasing inversions and mergers-and-acquisitions activities will have a positive economic effect that trickles down to small business and American families?

Well-designed tax reform does offer the promise of stronger economic growth and better international competitiveness, and as noted in the testimony, can boost wages and employment. Tax reform proposals offering these gains should be favorably by the Committee. In the current environment, the Committee would also do well to avoid considering tax policies that may harm an already weak economic recovery. Some proposals in Congress would hasten the departure of some U.S. firms, eroding the U.S. tax base and taking high-wage jobs along the way.

Follow-up:
Can you explain how America's loss or retention of these large U.S.-based companies going forward stands to impact availability of jobs across the 50 United States and D.C.?

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[9] http://americanactionforum.org/testimony/the-affordable-care-act-after-five-years-wasted-money-and-broken-promi

The combination of growing markets abroad and the maintenance of a highly uncompetitive tax code has resulted in, and is projected to continue to induce equity flight abroad. Estimates suggest that roughly 15 percent in U.S. based capital is at risk of moving overseas. Anti-inversion laws that include management and control tests such as some before this Congress would push the capital overseas and headquarters jobs would follow suit. According to a recent estimate by AAF, the largest American firms have nearly 299,000 headquarters employees, many of which would be at risk for having their positions relocated abroad. If roughly 15 percent of U.S. based market capital is at risk, it suggests a proportional overseas relocation of 42,000 U.S. jobs.[10]

Furthermore, how does the loss of major U.S. headquartered companies to our foreign counterparts ultimately impact everyday American families like those in my home state of Louisiana?

According to research from the Harvard business school, "corporate headquarters in the United States are about twice the size of European counterparts yet appear to be more effective."[11] *Losing these corporate entities means losing thousands of jobs, often high-paying managerial jobs that offer a sizeable tax base to a community and relatively higher standards of living. Moreover, major corporate headquarters play an outsized role in their local communities – one need not look beyond donors to local civic, educational, and health institutions to appreciate the impact that losing a corporate resident can have on a local community.*

Question 6:

Lead in:
As many of my colleagues on this committee can attest, the constituents in each of our respective states have been "white-knuckling" the wheel of a stagnant economy, trying to hang on until things "get better". In fact, my home state of Louisiana closed 2015 ranking 48th in the U.S. for positive economic growth, alongside a 6.3% unemployment rate well above the national average of 5.0%, and 0.0% wage growth

Louisiana, alongside every one of the 50 U.S. states, serves as a major hub for international business across many industries. There has been an exponential growth in inversions, and mergers and acquisitions activities, most recently the sale of Johnson Controls to Ireland-based Tyco, as well as the sale of U.S.-based Baxalta to Ireland-based Shire. Following the loss of these two major U.S. companies alongside the many others that preceded them, this is only further evidence to support the critical need for tax reform.

Question:
Dr. Hassett, given the concrete connection between our nation's economic growth, and therefore the well-being of American families, do you believe international tax reform to address the

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[10] http://americanactionforum.org/research/the-economic-risks-of-proposed-anti-inversion-policy

[11] http://hbswk.hbs.edu/item/international-differences-in-the-size-and-roles-of-corporate-headquarters-an-empirical-examination

increasing inversions and mergers-and-acquisitions activities will have a positive economic effect that trickles down to small business and American families?

Answer: *When it comes to corporate taxation, the evidence for the existence of this "free lunch" from international tax reform that would benefit American workers and small businesses is strong.*

The United States has the highest official or "statutory" corporate tax rate of any country in the OECD. But many who dispute the need for broad pro-growth tax reform would point out that the "effective" tax rate paid by corporations is lower than this official legislated rate, due to tax credits etc. Still, even if one accounts for the many loopholes in the tax code that corporations exploit and examines the "effective" rate that U.S. corporations pay rather than the statutory rate legislated by Congress, U.S. corporate tax rates remain elevated relative to those in other OECD countries. International tax reform to address inversions would entail lowering the U.S. corporate tax relative to the tax rate in other countries, in order to make the U.S. a relatively more attractive tax jurisdiction. To be sure, other countries might well follow suit, and the disadvantage of having relatively high rates might reemerge. But the competition between countries for capital is a force that drives rates toward their optimal level. We should play the game by reducing rates, and we should celebrate its existence. Right now we are on the sidelines, and our firms and workers are suffering because of it.

However, if there were successful international tax reforms that rendered the U.S. a relatively "less expensive" place to do business relative to its OECD peers, American workers and American small businesses would benefit. Such reform would mute the incentive that now motivates firms to undertake inversions and mergers-and-acquisitions activity that effectively results in an inversion. This would save the jobs that firms take with them abroad when they engage in these activities and shift their tax jurisdiction to, say, Ireland. Small businesses, too, would benefit. One channel would be through the reinvigoration of local economies that would result from the presence of the additional jobs in a local economy; the local tailor would do better when there are more men wearing suits to corporate jobs than when those jobs are offshored to Ireland for tax purposes. A second channel would be through effects that may be mediated by business-to-business economic activity that occurs along the supply chain; as corporate offices remain in the U.S. rather than invert to Ireland, they would be buying, say, office supplies and food from local producers in the U.S. rather than local producers in Ireland. And the employees of the big multinational would learn valuable business skills, and then start new firms on their own.

Follow-up:
Can you explain how America's loss or retention of these large U.S.-based companies going forward stands to impact availability of jobs across the 50 United States and D.C.?

Furthermore, how does the loss of major U.S. headquartered companies to our foreign counterparts ultimately impact everyday American families like those in my home state of Louisiana?

Answer:

Going forward, the loss or retention of large U.S.-based companies stands to have a significant impact on the availability of jobs in the 50 states and D.C. In today's globalized economy, America must compete as a tax jurisdiction to attract mobile businesses and the jobs they bring with them. And, as many members of this Committee are likely aware, businesses and corporations cast a "vote with their feet" as they choose to locate in a given jurisdiction. Today, businesses are voting against the status quo of American tax policy when they "invert" and move to a new jurisdiction, taking jobs with them. Unfortunately, then, it is the American worker—the American voter—that suffers when corporations vote against America's corporate tax policy. Whether this trend continues or abates depends on whether the U.S. undertakes the tax reforms that are necessary to ameliorate the powerful economic incentives that are today driving corporations and the jobs they create away from the 50 states and D.C. There is no natural limit to this process. It might well be that, in the fullness of time, every U.S. multinational will invert. The economic incentives to do so are that powerful.

The loss of major U.S. headquartered companies ultimately has a devastating impact on everyday American families like those in Louisiana. The absence of these jobs at corporations prevents families from enjoying the income and economic stability that families in America have traditionally had the opportunity to enjoy. There is a voluminous literature that relates unemployment to maladies as wide-ranging and profound as the future earnings of children and the incidence of suicide. The retention of corporations and the jobs they provide is a matter of dire importance and grave stakes for families in every state in the U.S., including Louisiana.