Center for Strategic Tax Reform

As Tax Reform Goes, So Goes The Nation
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By Ernest S. Christian

The fate of the Republicans' signature reform of the tax code in 2017 will be an early indication of how well President Trump and the GOP Congress work together in remaking federal law and policy on a broad front.

Consistent with Republican orthodoxy, the GOP "Blueprint" for tax reform authored by Speaker Paul Ryan and Ways and Means Chairman Kevin Brady now includes dramatic cuts in personal and business income tax rates like those President Trump campaigned on.

Having helped to craft President Reagan's historic tax cuts in 1981 and labored in the vineyards of tax reform ever since, I admiringly call the Blueprint the best-crafted, most politically sophisticated and economically powerful tax reform proposal ever to see the light of day in Washington. If it is not enacted and signed into law largely intact, something is terribly amiss.

Border tax adjustments for imports and exports are the linchpin that holds Blueprint tax reform together and enables its dynamic combination of low tax rates and first-year expensing of U.S. plant and equipment to produce a huge boost to GDP and jobs growth — while remaining revenue neutral beyond the budget window and, therefore, eligible to be passed by a simple majority vote of Congress under reconciliation rules. Care must be taken not to start rearranging the Blueprint's highly interdependent parts.

The border tax adjustments are on their own merits good tax policy and result in a good deal for America. Right now, we have a bad deal in international taxation.

At present — because we have no border adjustments — the U.S. subsidizes imports (and importers) of foreign-made products by excluding them from U.S. tax even though the foreign country of origin has already excluded them from VAT tax. Conversely, the U.S. taxes exports (and exporters) of American-made products even though the foreign country of destination will tax them again.

The Blueprint will fix the problem by excluding export sales from the U.S. tax base and including imports in it. Importers will no longer be subsidized and exporters will no longer be penalized with double taxes. That amounts to a good deal for America.

The tax revenue from the import adjustment will more than pay for the export exclusion — and even better, most or all of the economic burden of the import tax will fall on foreigners who own or work for companies that wish to sell products into the U.S. market. Distinguished economist Martin Feldstein argued in these pages on Jan. 6, 2017, that because of induced changes in currency exchange rates, the entire burden falls on foreign labor and capital.

Whether exchange-rate changes occur that quickly or powerfully is perhaps problematic — but in a more humble and prosaic way, Economics 101 tells us that even with no exchange-rate changes, all or part of the economic burden will fall on would-be foreign sellers into the U.S. market that must lower their prices to absorb import taxes in those cases where there is (or quickly can be) a comparable American-made product.

The day President Trump signs historic Blueprint-based tax reform into law, America will become the best place to be for doing high-tech and low-tech business around the world. Indeed, the gold rush is already on by U.S. and foreign-owned companies alike. So powerful is the allure of Blueprint tax reform, and so certain are business leaders that President Trump will sign it into law, companies formerly being driven away from America are already announcing new investments and jobs in this country.

As a result of President Trump's big carrot/big stick policy, America will gain a much larger portion of the world's stock of physical and intellectual capital and good-paying jobs. And, here again, border tax adjustments play a key role. Companies can stay in (or move to) America, invest at a low-tax cost in plant and equipment and create jobs for Americans, while selling their products to a more prosperous consumer market in the U.S., or they can export their products tax-free all around the world.

American companies can build plants abroad and bring those profits back home tax-free for investment in America — but if they sell automobiles or other products from those foreign factories back into the American market, they will encounter the import tax adjustment or worse.

Border adjustments for imports and exports are not optional: They are mandatory if tax reform is going to work properly and create the most jobs and income growth. Indeed, without border tax adjustments we may not get comprehensive tax reform at all.

Christian is a veteran Washington tax lawyer who was the Treasury Department's Tax Legislative Counsel and Deputy Assistant Secretary for Tax Policy in President Gerald Ford's administration.