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United States Senate

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August 11, 2011

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Barack Obama
President of the United States of America
The White House
1600 Pennsylvania Avenue, NW
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Dear Mr. President:

I am writing to express my concerns with your definition of tax reform. There is no doubt that our tax code is badly in need of reform. It currently imposes unacceptable compliance and economic costs on individuals and businesses. So it makes sense to look at tax reform at a time of anemic economic growth and job creation to alleviate the inefficiencies created by the current tax code and to help get our economy back on the right track.

I am very concerned that, under the guise of tax reform, you intend to increase revenues to pay for more spending. In your public statement on Monday, August 8, you stated that we need to combine the spending cuts included in the debt ceiling increase deal with "tax reform that will ask those who can afford it to pay their fair share." You made no mention of lowering tax rates, broadening the tax base or other reforms such as transitioning to a territorial tax system to ensure that the United States remains competitive in the global marketplace.

My concerns have only increased after seeing statements made by others in your party. Senator Bill Nelson published a piece in Politico that seems to echo your position. He states:

> "In addition to the spending cuts Congress just made, we need tax reform. And by tax reform, I mean closing loopholes, special interest tax breaks and corporate subsidies. It's just plain wrong to be protecting tax breaks for oil companies and to be rewarding businesses that ship jobs overseas."

I fear many people have been intentionally conflating tax expenditures with tax loopholes in order to score cheap political points. Tax expenditures are defined in the Congressional Budget Act of 1974 as lost federal income due to provisions in the tax code that exempt or reduce taxes for certain groups, products or activities. Unlike tax loopholes, which provide unintentional benefits and are used to game the system, tax expenditures were intentionally passed by Congress for certain policy goals, such as encouraging employer-provided health insurance or home ownership, so they are also called tax incentives. Since they help achieve goals set by Congress, they are not loopholes.

During my tenure in the Senate, first as Chairman and then as Ranking Member of the Finance Committee, I worked hard with colleagues from both sides of the aisle and both houses of Congress to shut down loopholes and curb abuses. However, any revenue raised from closing loopholes or shutting down abuses were used to provide tax relief – not to pay for more spending. If there are more true loopholes to be closed, they should be closed in the context of tax reform and reducing the debt.

The 1986 tax reform law eliminated some expenditures and closed some loopholes but the savings realized was used to lower rates and simplify the tax code overall. Also, these changes were negotiated over at least two Congresses and with significant leadership by President Reagan and his Treasury Department staff. All those involved in that effort, including me, know that difficult choices were made. But, they were made after lengthy debates and much negotiation. The limited timeframe provided to the new "super committee" of Congress does not appear sufficient to accomplish true tax reform

Twenty-five years since the tax code was last overhauled, globalization has changed the U.S. economy and the tax code certainly has not kept up. I dispute Senator Nelson's position that the tax code rewards "businesses that ship jobs overseas." The reality is that the U.S. now has one of the highest corporate income tax rates in the world and still retains a worldwide system of taxation. These factors alone encourage companies to keep billions of dollars in the countries where they are earning that money. But it's also important to understand that American companies are also going to where their customers are. Companies like Proctor & Gamble and John Deere have a significant presence in Iowa but they are also increasing manufacturing where consumers and farmers need their products. These companies should not be penalized for their success overseas, especially when such success improves the companies' operations here.

In the Senate Finance Committee, we recently heard testimony from Chief Executive Officers (CEOs) of four of the largest American companies competing overseas. The message from these CEOs was clear – they need a lower rate and certainty to compete overseas. While they seemed to agree that they would be willing to give up some of the tax incentives for guaranteed lower rates, they also highlighted the challenges we face if we just adopt a slash and burn approach. For example, some countries are able to offer lower corporate tax rates while retaining incentives like the research and development credit.

The National Bureau for Economic Research (NBER) issued a paper last year titled "Large Changes in Fiscal Policy: Taxes Versus Spending". The paper, authored by two Harvard economists, states that: "As far as reduction of large public debts the lesson from history is reasonably optimistic. Large debt/GDP ratios have been cut relatively rapidly by sustained growth." The authors go on to explain, however, that the growth rates experienced in the 1990s or after World War II are not likely. As a result, they turn to answering the question of whether taxes or spending can spur growth.

The paper examined "the evidence on episodes of large stances in fiscal policy, both in cases of fiscal stimuli and in that of fiscal adjustments in OECD countries from 1970 to 2007." Its findings, summarized below, should be extremely informative for the current debate.

> "Fiscal stimuli based upon tax cuts are more likely to increase growth than those based upon spending increases. As for fiscal adjustments, those based upon spending cuts and no tax increases are more likely to reduce deficits and debt over GDP ratios than those based upon tax increases. In addition, adjustments on the spending side rather than on the tax side are less likely to create recessions."

Since this study focuses on "fiscal policy episodes" in OECD countries, it is important to highlight that the OECD member countries have an average marginal statutory tax rate of approximately 25 percent - a full 10 percent lower than the United States'. The CEO of PMC-Sierra testified that his company is competing in Asian countries where the tax rate is as low as 15 percent.

Without a doubt, economic growth will help reduce our deficit and debt problems. It is our responsibility to spur that growth, in part, by reforming the tax code to level the playing field for American companies. These companies – the ones that invent and have money to invest – are the ones that are going to create jobs here in the United States. Extending the payroll tax holiday for employees or further extending employment benefits are not going to create jobs or stimulate the amount of economic growth we need to improve our economy.

Tax reform in a global economy is a serious task. There are complex issues to be considered. These include a comparison of the rates and incentives provided by the countries we are competing with for jobs. A serious task needs serious leadership. Demagoguery of tax incentives may provide good political sport but it does not provide the strong leadership needed for the serious task of reforming the tax code to secure America's competitiveness in the global economy.

Former House Majority Leader Gephardt and Former Treasury Secretary Baker – two of the architects of the 1986 tax reform legislation – appeared before the Joint Committee of Taxation on April 6, 2011. Both had sage advice to dispense including that presidential leadership is essential to striking a bipartisan, bicameral deal on tax reform like they did with President Reagan in 1986.

I ask that you heed their recommendation and take responsibility for the tone and tenor of the tax reform debate you are setting. Serious leadership is needed for this important and critical task. With unemployment and growth rates where they are, the country cannot afford the kind of "tax reform" you are promoting.

Sincerely,

Chuck Grassley

Charles E. Grassley
United States Senator