

[The Bill Walton Show](#)

Episode 9 – Taxing and Spending

Speaker 1:

Romina.

Romina Boccia:

Yes.

Speaker 1:

It's Michel?

Bill Walton:

Michel, yeah.

Speaker 1:

Michel.

Romina Boccia:

It's Adam.

Speaker 1:

Not Norbert.

Romina Boccia:

No. It's Adam Michelle, but they're not related.

Speaker 1:

How did that happen? You're both from New Orleans?

Bill Walton:

Yeah, I'm sure we're related at some-

Marie:

Doesn't he come from Louisiana as well?

Bill Walton:

Yeah, we're both from the New Orleans area. We've tried to trace it out, we can't find any connection but I feel like it's got to be there.

Speaker 1:

Yeah, good. What is our date today?

Bill Walton:

It is the 21st.

Speaker 1:

21st, okay. All right, so Common Ground with Bill Walton, September 21. That's for sync purposes everybody.

Romina Boccia:

Okay, when do you want me to go? Okay.

Speaker 1:

Do a couple of things, making sure that you guys can hear me. Can you hear me now?

Marie:

Yes, I can.

Bill Walton:

Yes, I can.

Speaker 1:

Okay. Bob, is it okay? Get this plugged in here. Okay, so Bill, everybody, have a great show, looking at the camera, I'm managing and when you're ready.

Bill Walton:

I'm here today to talk about Washington, D.C.'s favorite pastime: taxing and spending. With me, to explore these topics, are two experts in economics from Heritage Foundation, Romina Boccia, who's a leading fiscal and economic expert at the Heritage Foundation on government spending and the national debt. She's been introduced frequently as an economist who speaks English, although Romina reliably informs me she was born in Germany, and therefore this makes it a double win.

Bill Walton:

She's been widely published and quoted, magazines, New York Times, Wall Street Journal, The Atlantic, Bloomberg, on and on, the list is endless where she's been speaking out on economic issues. Before Heritage, she was with the Independent Women's Forum and she holds a master's degree in economics from George Mason University and among her other pastimes, she's an avid rock climber.

Romina Boccia:

That's right, thank you.

Bill Walton:

Adam Michel is a tax policy and federal budget expert at the Thomas A. Rowe Institute for Economic Studies at the Heritage Foundation, where I might add, I'm also a trustee. He focuses on the economics of taxation, international tax competition and the federal budget. Before this, he was at the George Mason University, worked on a broad range of topics on federal fiscal policy and he was also an

associate at the Competitive Enterprise Institute. They both have MAs in economics from George Mason University and Adam is also a rock climber. Adam-

Adam Michel:

We have that in common.

Bill Walton:

Do you want to talk about rock climbing first? Did you teach each other to climb rocks or did you-

Romina Boccia:

No.

Adam Michel:

Found independently, I think I actually ran into Romina at the rock climbing gym multiple years ago. We'd met in a different capacity and I was like, "Oh, I know her," and we're both passionate about getting outdoors and enjoying rock climbing.

Bill Walton:

Well, dealing with the federal budget and taxes is a lot like climbing rocks or a cliff, more likely, the fiscal cliff.

Romina Boccia:

That's right.

Bill Walton:

Let's give an overview of where we are. We want to talk about taxes and spending and what we're doing now to fix the tax code and take a look at spending of this year, but let's back up. How big is the federal budget as a percentage of GDP, how much do we collect in taxes, where do the taxes come from?

Romina Boccia:

Yeah, overall, the federal budget spends about four trillion dollars annually and we take in about 3.3 trillion dollars in tax revenues. In terms of GDP, you're looking at 1/5th of our economy is dedicated to federal spending. Of course, if you add in state and local, you'll get a much larger share that goes to government. Just focusing on federal, the tax burden is about 17 percent of GDP but it's rapidly rising.

Romina Boccia:

I brought you a little gift here, our federal budget in pictures and there's also a website, FederalBudgetInPictures.com, and one of the charts that it shows how taxes and spending have always fluctuated somewhat, but the problem we're facing is that our spending is projected to grow to really unsustainable heights that would require massive increases in taxes.

Bill Walton:

Well, if I did the math right, I think that you're spending in tax numbers, we're still operating at about a 650 billion dollar deficit.

Romina Boccia:

That's correct.

Bill Walton:

Even though I read recently that our tax revenues are an all-time high?

Romina Boccia:

That's also correct, yes. The problem with spending is outpacing tax revenue and is projected to continue to do so and do so by even larger amounts. What's really driving this spending is about 2/3rd of the budget that's growing on autopilot. We did the math, if you just look at the next ten years where the additional spending growth happens, it's in three programs in interest on the debt and a lot of people will know those programs very well and I suspect you do, too.

Romina Boccia:

That's Medicare, Social Security and Medicaid. Those three programs alone and interest on the debt are responsible for 85 percent of the projected spending growth just over the next ten years. If we're talking in terms of percentage of GDP over the long run, 100 percent of our spending and debt crisis is due to these programs and interest on the debt.

Bill Walton:

That doesn't leave a lot leftover for anything else.

Romina Boccia:

That's right.

Bill Walton:

I think, also, the federal reserve is changing its policies and people are expecting interest rates to rise. If interest rates rise, the federal budget's going to be really hurt by the rising interest cost.

Adam Michel:

Yeah, the bigger the debt grows and if interest goes up, it just becomes more and more expensive, compounding out as far as we go.

Bill Walton:

Now, the tax side.

Adam Michel:

Yeah.

Bill Walton:

Break it down. We've got income tax, payroll tax, corporate tax, tariffs, things like that. What percentage comes from which?

Adam Michel:

Yeah, so before we get to that, I think it's important to point out the tax component of what Romina was talking about as ballooning, spending, going out into the future and tax revenue as well is projected to grow. Not as much as spending, but grow a little bit over the future. When we talk about tax reform, it's helpful to start there: that raising taxes really isn't the solution to any of this.

Adam Michel:

Spending is really the problem. Then, if you break down that tax revenue piece, where do we get our revenue from, a majority of it comes from income taxes, so about 47 percent of all tax revenue comes from income taxes. That's-

Bill Walton:

Income taxes from people, not corporations.

Adam Michel:

From people, yeah, so that's what you pay on your wages and in capital gains and dividends taxes. What you pay on investments and then the second bucket is still what people pay, it's payroll taxes.

Bill Walton:

Payroll tax would be FICA, Social Security.

Adam Michel:

Taxes that fund Medicaid-

Romina Boccia:

Yeah, Medicare and Social Security, they're all called FICA, which is very misleading. Federal Insurance Contributions Act, those aren't really insurance programs. They're more like federal benefit programs.

Bill Walton:

Yeah, I don't think people ... set me straight on this. There really is no trust fund. The payroll taxes come in, they're treated as part of the general revenues of the federal government-

Romina Boccia:

That's right.

Bill Walton:

Money's fungible, it goes wherever it's needed.

Romina Boccia:

That's right, so the trust fund does exist on paper but what's important to remember is this is not like a trust fund like you might own or anybody else might own. Rather, it doesn't have any economic assets in it; all it has in it are government debt security. It's an asset for the Social Security Administration. They claim that they have 2.8 trillion in these trust fund assets, but for the taxpayer it's another liability because those are debt securities just like any government debt that people might buy when they buy treasury security, so it's the same thing.

Bill Walton:

Our national debt is, what, approaching 20 trillion dollars. Is that in that 20 trillion dollars number?

Romina Boccia:

Yes, it is. Our national debt consists of two main components. There's a publicly held debt, which is what we borrow in credit markets. That's about 15 trillion of the 20 trillion dollar debt. Then the five trillion, that's what's called intergovernmental debt, which is debt that Congress has borrowed from other government agencies that have trust funds. Social Security is the biggest one.

Bill Walton:

The problem, as Adam points out, is that unless we get the spending under control, there's no amount we can tax to raise the revenue. Now, you recently, you were both cited in a Wall Street Journal opinion editorial on the need to restructure the budget to allow for both reform and tax cuts. Do you want to brief us on what that's about?

Adam Michel:

Tax reform currently relies on the budget and the budget process to move forward and the piece that you mentioned, the current rules, make it so ... bias the government to keep expanding year after year. They currently assume the tax cuts will ... it will go away in the future, but what they don't assume where the government is planning on cutting spending in the future, they don't assume those reductions.

Adam Michel:

They assume that they couldn't possibly actually need to cut spending, so there's a bias in how taxes and spending are counted.

Bill Walton:

I don't understand, though. What's that called, the baseline?

Romina Boccia:

Yeah, so we have a current law and a current policy baseline, which sounds very wonky but basically what it means is that when Congress puts the budget together then whatever tax reform proposal they're going to look at is going to get scored against that budget baseline. That's how we're going to find out how much the tax plan reduces, hopefully not increases, taxes. In order to determine that baseline against which the tax plan will be scored, they can use two primary methods.

Romina Boccia:

The current law baseline assumes that any tax policies that are currently scheduled to expire, like the tax extenders, if you've heard of those, that they will indeed expire and therefore this baseline assumes higher revenue numbers. When it comes to spending increases that would need to happen in order to be able to pay, say, benefits from the Medicare and Social Security program beyond what the trust fund allows, Congress assumes, "Well, there's no way that we would ever cut this spending," so they assume that their spending increases and-

Bill Walton:

We don't have any courage to cut something now, so we know we're not going to have courage to do it sometime in the future.

Romina Boccia:

That's basically it, yeah. They assume they're going to raise taxes and increase spending, so we really, truly have a tax and spend budget.

Bill Walton:

We know we're not serious about doing what we were elected to do, so we might as well just build it into their budget.

Romina Boccia:

That's what they do.

Bill Walton:

What is a tax extender? I'm going to keep coming back to it, we've got a lot of terms in this world that I'm not ... what is a tax extender?

Adam Michel:

The tax extenders are a revolving package of different tax provisions that Congress says are going to last for so many number of years, so we're going to have this tax change for five years and then they have to extend it if they want that to continue. There's a whole bunch of these and they expire on different time periods. The extenders package is just a package of these tax cuts, essentially, that Congress has to extend year after year.

Adam Michel:

They do extend it year after year and this difference between the current policy and the current law baseline, the current law baseline assumes that Congress won't keep extending these tax cuts. What we've argued for, using a current policy baseline, it takes into consideration that they just continue to extend these so we should build that into our assumptions.

Romina Boccia:

Otherwise you're looking at a half a trillion dollar tax increase that's already built into the baseline, so even if Congress didn't put in place any new tax cuts, they would have to figure out how to raise taxes by half a trillion dollars. That just makes tax reform basically impossible.

Bill Walton:

Where do the tax increases come from? Are they baked into the laws, is it an increase in rates, it's something new that's got to be passed, we're assuming?

Adam Michel:

There are various small provisions that all compile into this one package. The biggest piece, and again, it's another one of these complicated things, but the biggest piece is what they call bonused appreciation, so it's change in how investments are treated in the tax code. Although, again, it's

complicated, what the change does, it makes it easier for businesses to invest here in America. That's what bonus depreciation does, so they assume that this is going to expire.

Adam Michel:

They have extended it year after year, that we should build into the baseline the fact that it will continue to be extended because it's both good policy and makes tax reform easier.

Romina Boccia:

Yeah, it's not rates, it's specific provisions in the tax code.

Bill Walton:

I see. One of the things that's on peoples' minds now is cutting the corporate income tax rate. Where does that stand, what would that do? I think you've written extensively and interestingly about how cutting corporate rates would actually benefit American workers, and that's not intuitively obvious to most people.

Adam Michel:

Yeah, we said that income taxes make up a share of the federal budget, a big share, but corporate taxes make up about 10 percent of the revenue that we bring in. Although that's a small dollar value on paper in the big scheme of things, the corporate tax is the biggest drag on economic growth. We currently have the highest corporate tax rate in the developed world, when you take in average state rates, we're at almost 40 percent tax rate on our corporations.

Adam Michel:

This has been pushing businesses overseas, you may have heard of inversions where this is making it hard for businesses to invest in America. The measure of investment, capital per worker, we're at about eight percent below the historic trend. This is a big reason why we haven't seen job creation at the levels that we should. It's why wage growth has been relatively stagnant, so cutting the corporate tax rate is a big and important piece of getting America working again and getting the economy moving again.

Bill Walton:

The OECD, we think of the European Union as not pro-business, but they've cut their corporate rates from 45 percent in 1986 to something like an average of 22 percent now, 21 percent, and we're at 35 and as you pointed out with ... we're roughly twice the level of taxation.

Adam Michel:

Yeah.

Bill Walton:

Which is why companies are leaving the United States, which is known ... what do we call them, inversions?

Adam Michel:

Inversions, yeah.

Bill Walton:

What's an inversion? That sounds like a very sinister word, there.

Adam Michel:

It does. You're correct. As businesses have been able to move around the world and we've become more global in where we get our things from and travel costs have gone down, this has made it easier for businesses to do business in other countries and all other countries have responded by lowering their corporate tax rate as it creates an incentive for businesses to leave their country.

Bill Walton:

Didn't Burger King move to Canada?

Adam Michel:

Yeah, so this is one of those inversions that you talked about. Burger King moved their headquarters from the United States to Canada, purely because Canada has a more favorable business environment and as you mentioned, all the OECD countries, Europe, Canada, Mexico, Japan have all lowered their corporate tax rates over the last several years and that's left the United States high and dry and one of the least favorable business climates in the world.

Bill Walton:

I want to talk about how we pay for tax cut on corporations and the process in a minute, but I want to stick with what the benefits are. Let's say we cut the corporate rate to 18 percent. What happens?

Adam Michel:

Cutting the corporate rate to 18 percent, 15 percent, just lowering the corporate rate, we've seen time and time again across countries, across the US states, that that benefit is passed onto workers through higher wages and often significantly higher wages. Most of that benefit goes to workers and the way that it happens is a little complex and possibly counterintuitive, but lowering the corporate tax rate means that more investment will come into the United States.

Adam Michel:

An investment is things like machines from the outside of the states-

Bill Walton:

That's from outside the United States, we become a tax haven in effect because we're more attractive.

Adam Michel:

Yeah. It means people, investors, want to do business here and those investments in machines and equipment and new farm equipment, new research and development, these are things that people, American workers, work with to become more productive and to create more products that-

Bill Walton:

Well, doesn't the left say, "Look, they're not really going to do that, they're just going to give CEOs a raise and pay out dividends to shareholders." Is there evidence that what you're saying is-

Adam Michel:

Yes, so we've seen that as corporate rates have been brought down around the world and over the past several decades we've seen this happen. There's many natural experiments and we see over and over again in the data that a lower corporate tax means higher wages for workers. It's about 75 to over 100 percent of the cost of the corporate tax actually gets passed on to workers through lower wages.

Bill Walton:

We were researching a show and I've got thousands of pages, it seems, on taxes and budgets. It's overwhelming.

Romina Boccia:

We've got more where that came from.

Bill Walton:

Okay, well, my library, I've got an extra shelf, we can fill it out there. Hey, Kevin Hassett could be a real friend to this idea. Kevin was at AEI and he's now chairman of the Council of Economic Advisors, so he's in the White House and he has done a lot of work on this, what you're talking about. There's been a study of European countries and they've lowered their corporate tax rates and there's a tremendously high, positive relationship between lower corporate taxes and higher wages.

Bill Walton:

Do you want to comment some more on that?

Adam Michel:

Yeah, I believe it's Kevin's study that he did while he was at AEI shows that lowering one dollar reduction in the corporate tax rate can result in up to a 400 percent increase in wages. I'm sorry, if you lower the corporate tax by one dollar, you get a four dollar increase in wages, so the cost of the corporate tax is more than just the money that the government is taxing away. There's a lot of economic inefficiencies that it causes as well.

Adam Michel:

Lowering the corporate tax, it's not just a dollar for dollar thing-

Bill Walton:

There's a multiplier effect.

Adam Michel:

There's a multiplier effect there.

Romina Boccia:

Make no mistakes, corporations would very well want to increase salaries for their CEO and provide more money to their shareholders, but they don't have a choice in the matter. What happens is as you get more investment, there's also more demand for workers, so workers are able to bid up the price of their labor, so it just happens automatically through the economy if you will. The invisible hand at work.

Romina Boccia:

I think that's what makes some of these proposals so difficult, that all of this happens without anybody planning it. It doesn't matter what the corporation wants to do with the tax cut, it gets distributed to the workers in the form of higher wages because they become more productive, there's more demand for these workers, there's more investment.

Bill Walton:

That would happen now because unemployment is low, there are millions of jobs that are available, that they're dying for people with talent to fill and they're empty. You're right, there would be a trend in that direction and we need it. I was reading something here, the average hourly wage for manufacturing workers was 20 dollars and 83 cents in June of 2006. What is that, 11 years ago? It's only up a dollar since then.

Bill Walton:

We've had a dollar raise in the last 11 years. We certainly need to be doing something about this.

Romina Boccia:

I wonder if that takes into account all the non-wage compensation that workers get, because one of the things we've also found is that a lot of the increase in wages has been consumed by mandated government benefits. That's where we come to the aspect of-

Bill Walton:

Interesting. This is a headline number, not the underlying numbers.

Romina Boccia:

I wonder what he's looking at there, yeah. Healthcare has been a big driver of consuming workers' wages because, keep in mind, Bill, any benefit that a company is mandated to give to its workers comes directly out of wages. We know this. Workers end up paying for both sides of the payroll tax. It's not true that employers pay the other half.

Bill Walton:

What the employee sees is not much of a raise, what the employer sees is a big increase in cost.

Romina Boccia:

In cost, absolutely.

Bill Walton:

Associated with hiring.

Romina Boccia:

Yeah.

Adam Michel:

This feeds into some of the inequality numbers that we see as well. If you look at just how the wage changes over time, the difference between the rich and the poor have expanded but if you build in the healthcare piece as healthcare costs have ballooned, those trends move much closer together because healthcare costs are such a larger portion of a low income person's total compensation package.

Adam Michel:

A lot of these numbers are hard to interpret unless you're looking at the whole picture.

Bill Walton:

Are there also, in addition to healthcare costs, compliance costs, OEOC costs, whatever costs are associated with employing somebody that have also gone up that are masking these numbers, because I haven't really thought about it the way you're describing it.

Romina Boccia:

Yeah, certainly on the regulatory side and there's been a lot of movement now with discrimination, lawsuits against big companies that factors in as well. Google is now being sued for, potentially, discriminating against its female employees and so we've got a lot of regulations on the book that add to the cost of labor and compliance costs that companies face. I think, still, lowering the corporate rate is going to have a big impact on our economy and at least help to disperse some of the drag that we experience due to a really bad and outdated tax code.

Romina Boccia:

Together with regulatory reform, you could see a tremendous increase in economic growth.

Bill Walton:

Now, one thing that is true, though, is we've got a headline rate, 35 percent. A lot of corporations aren't paying 35 percent. The poster boy for not paying 35 percent, I think, was GE a few years ago where they made on their general accepted accounting principles number, the one they show to the public, was I don't know how many billions of dollars and they paid zero taxes. What's the actual affective rate of the United States? Is it anywhere near 35?

Adam Michel:

When we talk about the affective rate, are we talking about anything other than headline rate you described, it's like a choose your own adventure. You can make up numbers to make whatever case you want. Whether you're looking at marginal affective rates or average rates or rates just for large international, multi-national companies are different than small businesses that are here. Just how is it in the United States.

Adam Michel:

What's important is that variation between the zero GE rate that you mentioned and then the company that does have to pay that, the 35 percent rate, that variation is also distorting for the economy. The promise of tax reform is that we can lower that headline rate and make it so that businesses don't have that huge variation, that everyone pays a low affective rate.

Bill Walton:

I've been on the business side of the table. You're basically saying to me if it's 35 percent, I'm going to pay tax lawyers a lot of money to make sure I can find some deductions, I can get income offshore, I can do all these various things to get that rate down to something lower. If the rates say 15 percent, it's going to be worth a lot less to me to expend those resources in order to get it there. Is that the explanation?

Adam Michel:

Yes, the savings, if the rate is lowered, for the business to game the system is much less. It's more likely that they'll be able to put those resources to more productive activities like investing in research and development. Raising wages for their workers. Things that grow the economy rather than paying tax lawyers to figure out how to game the system.

Bill Walton:

All my good friends who are tax lawyers in the D.C. area, they're very smart people. I'm sure they could find something else to do.

Adam Michel:

Think if all of their brain power was put towards something that wasn't gaming the system but was instead going towards productive activities that would be expanding our GDP rather than shrinking it.

Bill Walton:

Well, the corporate taxation, there's something I want to dig into because I don't think it's ... we have businesses and then we have corporations. We've got a corporate code which taxes corporations at the corporate level and income, and then we've got businesses that don't operate as C-CORPS, which is what that section of the code is and they're not taxed at the business level. They're taxed at the personal level and they're called pass-through companies.

Bill Walton:

How would you fix the relationship between the C-CORPS and the pass-throughs?

Adam Michel:

Part of the discussion right now in tax reform is, right now, we're trying to just lower the corporate rate and lower the rate for pass-throughs, but ideal tax policy is to treat all businesses the same. That would be something like eliminating the corporate tax and just having all of that income taxed at the individual level.

Bill Walton:

Shareholders would be taxed the same way business owners are taxed.

Adam Michel:

Exactly. Yeah, then there would be no difference between C-CORPS and the pass-throughs that you mentioned. Right now, there's all sorts of tax reasons to be one or the other and the tax code shouldn't be driving business decisions in that way. We should just be able to let our businesses make economic decisions and not have to think about the tax code.

Bill Walton:

So much capital gets allocated because of the bells and whistles, carrots and sticks in the tax code.

Adam Michel:

Exactly. That's what tax reform should really focus on, is how do we get these biases out of the tax code? Our current tax code makes it harder to save and invest than it does to spend your money now.

Bill Walton:

As we talk about this in the fall of 2017, tax reforms on everybody's mind ... I say tax reform, are we looking at anything else in the code that would be something besides rates? Are we talking about the expenses, are we talking about depreciation? What else is in there that should be on the table?

Romina Boccia:

Full expensing should definitely be on the table. It depends on what table you're talking about. If it's on that table right now. There seems to be some misunderstanding and folks who believe that we have to make a choice between either better expensing policy or lower rates, but really they go hand-in-hand because expensing is one of those things that really drives investment. That is a key driver of economic growth.

Romina Boccia:

What we have right now is a very unfair system of complicated depreciation schedules put together by IRS bureaucrats who somehow know the economic life of any given asset and assume that it hasn't changed significantly over time as our economy has shifted in many important ways. Full expensing would mean that in the year in which you make an investment, you buy cameras, for example, you should be able to fully deduct those rather than having to keep track over how many years and just writing off a portion of that.

Romina Boccia:

You also don't get the full value of the deduction right now because we don't take into account the value of your money, any investment you make today, you spend that money now, that money is worth more today than ten years from now.

Bill Walton:

Let me understand this. We've got the cameras here for this show, we buy the cameras, depreciation schedules says they're going to last five years, when in reality the technology's going to change so fast that these are going to be obsolete, technologically speaking, in a year, yet I'm still depreciating over five years and that's happening in a lot of places.

Romina Boccia:

That's right.

Bill Walton:

Instead, we take the full value, we'd write it off for this year's taxes and the tax alignment would be with the actual use of the asset.

Romina Boccia:

Yes.

Adam Michel:

That current system effectively makes it more expensive to invest than it otherwise should be, so expensing levels the playing field, making all investments equally attractive and making investment more attractive than it currently is. Even more importantly ... not more importantly, but equally importantly, it reduces complexity significantly. You no longer have to track that camera over five years, or a building over 39 years.

Adam Michel:

The business community spends, I think it's 23 billion dollars each year complying with just depreciation schedules, which is this expensing piece we're talking about. Just moving to full expensing means that all that money can, again, as we are talking about, be reallocated to something other than figuring out how much money you need to send to Washington at the end of the year.

Romina Boccia:

This is a change that would really benefit all businesses, including small businesses that operate through the personal income tax code as pass-throughs and other entities.

Bill Walton:

Like my corner dry cleaner.

Romina Boccia:

Absolutely, and I think it's even more important for those types of businesses because they don't have the money to pay fancy lawyers to keep track of all their equipment and depreciate it over time on the proper IRS schedule. They have to do all that themselves, and that imposes a huge compliance burden for them and hours and hours of keeping track of all these items.

Bill Walton:

Over time, I guess I've become more of a populist because if you look at things like the tax code, it disproportionately burdens the people who can't afford to play the games that the big companies can play. The big companies also have all their lobbyists here in town, so you've got this big inertia factor built in. They don't want any change, and the people they're benefiting don't have a voice here.

Adam Michel:

The cost of complying with this system is relatively similar for a big business and a small business. If you're depreciating the same asset, you have to go through that same complex number of steps, but a small business, it's a much larger piece of their total operating cost that has to be dedicated to this. It's a bigger burden on smaller businesses.

Bill Walton:

This is a bit off topic, and we're not on taxes or spending, but if you look at the impact of Dod Frank, Dod Frank-

Adam Michel:

It's the same thing.

Bill Walton:

Disproportionately benefited big banks and Jamie Diamond and Lloyd Lankfin, I think they stopped saying it because they got in trouble, but they said, "Look, Dodd Frank's been great for us because it's built a moat around our business model where it's too expensive in terms of regulatory costs or capital costs to get into something to compete with us" and who it's hurt are all the community banks.

Bill Walton:

There used to be 100, 150 new ones every year, now I think we've had three in the last seven to ten years. I know we've got a big topic to explore here, so in the corporate side we've got rates, we've got expensing, is there another big item that we ought to be for?

Adam Michel:

Yeah, so the other big piece on the corporate side is moving to what's called a territorial tax system, and this plays in with this scary inversions term that you were talking about earlier. Currently, the United States claims to tax all of the profits earned by our corporations here earned around the world. If Burger King, our earlier example, is earning profits in Canada and they want to bring those profits back to the United States, the US government claims that they should be taxed at the US rate.

Adam Michel:

Where if Burger King was to be headquartered in Canada, as they are now, and they earned profits in the United States and wanted to bring those profits back to Canada, the Canadian government doesn't claim that same right. It makes it more expensive to operate in the United States under the current system.

Bill Walton:

We have a territorial system?

Adam Michel:

We have a worldwide system.

Bill Walton:

A worldwide system, everybody else has a territorial system?

Adam Michel:

Almost every other country uses a territorial system, which is-

Bill Walton:

Not only are our rates too high, but we have a worldwide system.

Adam Michel:

We have a worldwide system, yeah. Our rates are too high, we have a worldwide system and our business tax code just in general is exceedingly complex, which expensing is the third piece there. Where if we could lower our rates, move to expensing and move to a territorial system, we could be a global business destination just on tax parameters alone, not to mention our educated workforce and our property rights protections and all the other amazing things about the United States.

Adam Michel:

Pair that with a great tax system and we would see unprecedented investment, economic growth, job creation.

Bill Walton:

Well, one of the things that I'm trying to explore is why we can't get our growth rate of GDP back to where it used to be, which is in the four percent range. We've been around one and a half percent this year in 2017. Looks like it could be three percent. A lot of that, I think, is based on the optimism, the regulations are going to be less and taxes are going to be less, but that all hasn't happened yet.

Bill Walton:

You're saying if we could do these three things and the corporate tax piece, we could accelerate growth like nothing else could.

Adam Michel:

Tax reform is the biggest piece of getting to that three percent or beyond. There's regulatory reform, you mentioned Dod Frank, other big financial reforms, healthcare reform would go a long way. All of these things together that should be part of the agenda could get us growing at more than three percent. I think Romina might be able to elaborate, but some of our research has shown that it getting back to three percent growth is not even fully returning to the projections that a lot of the government scoring agencies in D.C. say we should be growing at historically.

Romina Boccia:

Yes, we are definitely growing at a much slower rate. It has a lot to do with drag from tax policy, from regulatory policy, but I also want to bring something into the discussion that is a bit more of a difficult topic, which is our national debt. Our national debt is larger than what the economy produced in goods and services last year and is projected to be larger overall than what the US economy is projected to produce.

Romina Boccia:

That is also a real drag on growth, because let's say we get tax reform done this year. Let's say we are even able to cut taxes. Yes, it would certainly boost investment, especially if we do the things we just talked about on the business side. Then, in the long run, unless we get spending under control, there'll be immense pressure to introduce either new taxes or raise taxes again, so if we really want this to last, to reap the full benefits from the regulatory reforms and the tax reforms the president is talking about, we also need to address the spending side.

Bill Walton:

That's tough.

Romina Boccia:

That's tough.

Bill Walton:

Let's talk about .. we've got some time left to talk about it. What are the barriers? We know what the barriers are, but let's break it down into what the policy pieces of this are here in Washington.

Romina Boccia:

There's actually a way that tax reform and spending reform could go hand-in-hand, and I would argue that that would actually be the best way forward. What that would mean is that Congress would use a very powerful tool in their arsenal, which is called reconciliation. Reconciliation is powerful because it allows for a simple majority vote in the Senate that is filibuster-proof, where amendments are limited and time for debate is limited.

Romina Boccia:

You have a supercharged legislative vehicle. You don't need to bring democrats on board, necessarily, or if you have a few defections on the republican side, you don't need that many democrats and you could potentially work out a good compromise. One of the limitations of reconciliation is that it requires that whatever changes you're making to the tax code be deficit neutral outside of whatever budget window is chosen, which traditionally has been ten years.

Romina Boccia:

Could be 20 years, could be 30, Congress can choose whatever budget window it wants to but they will have to offset any tax cuts with spending cuts in order to fit through that procedural rule. Now they can easily do that if they just put a limit on overall spending, and then they can work out exactly where those cuts should happen. We really need to have a discussion over our spending trends because spending is growing at an unsustainable rate and it's taxes that are funding this spending.

Romina Boccia:

We can't really cut taxes sustainably and for the long run if we don't get control of spending because that's the hunger, that's the appetite for more taxes in the future. I think investors know this, too: they worry about what taxes will look like in the future if spending continues growing on this unsustainable pace.

Adam Michel:

We laughed a little when we talked about cutting spending, but just by way of illustration, it's not that difficult. When we talk about spending to the future, there's always an assumption that we're increasing spending year after year. There's an assumed five percent year over year increase in spending in the federal budget baseline that we were talking about. Just reducing that growth rate and spending to about two percent each year could allow us to have a three trillion dollar tax cut over ten years and balance the budget at the end of that ten-year window.

Romina Boccia:

Can you repeat that?

Adam Michel:

It's really not-

Bill Walton:

Say that again, I want to make sure I heard that.

Adam Michel:

We assume the government is going to grow five percent each year. When we talk about cutting spending, we're always talking about cutting the growth rate in spending, not actual, absolute spending. Cutting that growth rate to two percent a year, so we're just keeping up with inflation, we're keeping the government we have, we can balance the budget at the end of ten years and provide a three trillion dollar tax cut over ten years.

Bill Walton:

Wow, well, you two are young enough to have a big stake in this game. How do others in your generation feel about this? Do they know that this avalanche is out there, we're at 20 trillion now. If this goes on for another ten years, we're going to be at 30 trillion more.

Romina Boccia:

I occasionally have an opportunity to go to campuses and then we also have very talented young leaders at the Heritage Foundation internship program, the young leaders programs, and have a chance to talk to these folks. Also, from my own experience, it is very scary because these high spending and debt rates, eventually they will come back to haunt us and we're already seeing this in the form of lower economic growth.

Romina Boccia:

The academic research shows that when industrialized countries spend and borrow beyond the size of their economy, it drags down growth in a significant way. The difficulty is people can't really pinpoint it, they don't know that the debt is one of the reasons that growth is down, so we try to explain that. Young people, if you ask them, especially millennials, they support, for example, opting out of Social Security because they don't believe that programs like Social Security and Medicare are going to be there for them, based on how expensive those programs have already become.

Romina Boccia:

What we're looking at if we don't get control of our spending problem, I come from Germany, it would mean likely a new tax, for example, a value-added tax down the road. What that would mean is much less money in peoples' pockets, much less discretionary income.

Bill Walton:

A value-added tax is like a national sales tax, so in addition to income tax, we'd be paying taxes on what we buy?

Romina Boccia:

That's right. In Germany, that is actually 19 percent. Everything you buy, the government levies a 19 percent tax on top. Everything's about 20 percent more expensive and you're also paying income taxes that are much higher than what's true in the United States right now.

Bill Walton:

Let's walk back to where we got into this. How do we do this? What are the steps? You two spend a lot of time on Capital Hill, you've spent a lot of time in committees, you're advising people. The fall of 2017, is there any political appetite to tackle this?

Adam Michel:

On the tax reform side, that's a big piece of getting the economy growing again and that can help with a lot of these problems that we've been talking about. There is political appetite and using these budget tools that Romina was talking about, we need to keep up pressure that we do tax reform in a sustainable way and then we make sure that it is long-lasting, that down the road in several years we keep coming back to this spending issue.

Bill Walton:

The election math is interesting. 2018's coming up, people want to get reelected. Of the 33 seats that are up for reelection in 2018, 25 of them are held by democrats, many of them in states that were carried by President Trump. It would seem there ought to be some way to get some bipartisan consensus to do something that would do some good. Thoughts?

Romina Boccia:

I think there's a real risk there, too, because the democrats tend to vote as a block. There's a chance that some of them will peel off to support the president in the tax reform effort.

Bill Walton:

Yeah.

Romina Boccia:

I do worry that it might come at a steep price, which means that the tax reform package won't be as good as it could be because the democrats are still practicing politics of envy, the idea that rich aren't paying their fair share and they want to get at that, this is the kind of win they want to get for their base. Another risk is that we might look at a tax reform package that includes a short-term revenue boost through something called repatriation, bringing these profits that are held overseas back to the United States.

Bill Walton:

It's about two trillion?

Romina Boccia:

Two or three trillion, I believe.

Adam Michel:

It's different, but it's there.

Romina Boccia:

There may be some talk of bundling that with a spending package, potentially infrastructure spending and that sort of thing-

Bill Walton:

Spending goes up.

Romina Boccia:

Yes. That's exactly the opposite of what we should be doing. I worry about that.

Adam Michel:

If we do tax that money that's brought back, that's currently locked overseas, it should be used for lowering tax rates across the board. We shouldn't be using it to invest in new infrastructure. The true infrastructure stimulus that we need is expensing and lower tax rates. That's the true way to get sustainable investment in America, is through tax reform.

Bill Walton:

There are market-based ways to promote infrastructure spending.

Romina Boccia:

That's right.

Bill Walton:

Not just through a government program./

Adam Michel:

Exactly.

Bill Walton:

Yeah.

Romina Boccia:

Right.

Bill Walton:

Well, you two are brilliant on this. I'm really happy you're here today and I highly recommend everybody taking a look at the federal budget in pictures, which you can find, again, at the FederalBudgetInPictures.com. We're going to have some of your writings featured on our website. You've been talking taxes, budget and then all these words that I'm really going to have to learn better. Reconciliation and tax extenders, you can learn a lot about that from those sites and those articles. Any final words?

Romina Boccia:

Thank you, Bill, for having us and I'm really excited to be working with you and many other Americans around the country to make tax reform happen. I think we're going to need everybody's help because lawmakers are reluctant to do the right thing, so they need to hear from their constituents to make sure that they do that.

Bill Walton:

Okay. Adam?

Adam Michel:

Yeah, same note. Tax reform is about economic growth, it's about raising wages, increasing investment in America and that's where the focus should remain. Tax reform is about cutting taxes and reforming the structure of the tax code and that can benefit all Americans. I'm excited that we had the opportunity to talk about it today and hopefully we'll see some movement in the next couple of months.

Bill Walton:

You're going to be back, we're going to be talking about it some more so let's get some things done. All right, thanks guys, this was great. Good to have you here.

Adam Michel:

Thank you.

Speaker 1:

Wonderful.

Bill Walton:

You guys were great.

Speaker 1:

Fantastic show.

Romina Boccia:

Thank you, you were great, too, Bill.

Bill Walton:

You say that to all the girls. We had a real conversation.

Romina Boccia:

Yeah.

Bill Walton:

We only covered two percent of what we could've covered.

Romina Boccia:

There's not that much time.

Adam Michel:

A lot of different facets.

Bill Walton:

The millennials, I don't want to start pounding on millennials, but boy, do people have the stake in getting involved.

Romina Boccia:

I know but they don't really vote, they're not involved in the political process. It's always been an issue across generations.

Adam Michel:

It's also the morphous and just the size of these things are so big it's hard to grasp what it all means. Putting a face on it is difficult, when you talk about 20 trillion dollars. What does that even mean to the average person?

Romina Boccia:

Right.

Adam Michel:

We're having trouble getting people just excited about tax reform at the grassroots level that it seems like it's just the excitement about these issues is just not there.

Bill Walton:

I think you guys made a pretty good tie, though, about why this matters to ordinary people. That's really-

Romina Boccia:

We try.

Marie:

You did a good job, I'll tell you. I learned a lot.

Romina Boccia:

Thank you, Marie. That's good to hear.

Bill Walton:

Yeah, I think that's why ... this is the reason I want to do this. I just don't think people understand this arcane stuff, like when you say-

Adam Michel:

I know.

Bill Walton:

Putting the budget through reconciliation, people stop listening. Oh well.

Romina Boccia:

Maybe that's why they use these terms, or the mandatory spending. I guess we can't cut it, it's mandatory. That's why I call it autopilot.

Bill Walton:

Yeah.

Romina Boccia:

We just need to put a pilot back in the cockpit.

Bill Walton:

All right, well, you guys are great.

Romina Boccia:

Well, thank you Bill.

Adam Michel:

Yeah, thank you for inviting us.

Bill Walton:

We'll do this again.

Adam Michel:

Yeah, definitely.

Bill Walton:

Do this again. There's a lot of topics to cover here.

Adam Michel:

Maybe we can talk about the success of tax reform after we get it through.

Romina Boccia:

Hopefully, that would be wonderful.

Bill Walton:

Well, I'm going to talk with Rob. We're also doing an audio version of this, so there may be something where we get something timely that we just get on Skype and do something audio. This is a bigger production-

Romina Boccia:

Production, yeah.

Bill Walton:

Pulled together. Audio, we just start talking.

Adam Michel:

Yeah.

Bill Walton:

All right.

Romina Boccia:

Well, good luck with the BBC today.

Bill Walton:

Yeah, thanks.

Romina Boccia:

Blow them away.

Bill Walton:

Yeah.

Speaker 1:

Great job, guys.

Romina Boccia:

Thank you so much for having us in your lovely home.

Bill Walton:

Well, you're going to be back. This is studio north.

Adam Michel:

Yeah, right.