Insight

Why Corporate Tax Reform is a Must

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President Obama embarked on a nationwide tour to declare his intent to “win the future” for American workers. He should embrace corporate tax reform as the lynchpin of that agenda – and devote the unwavering leadership and attention necessary to see it through – so that American companies attract the capital they need to “win the future” in a global economy.

Ninety-five percent of the world’s population lives outsides the United States. As the world gets smaller and our markets get more interlinked, the ability of US companies to compete globally will become an ever more important factor in US job creation and living standards. US companies – and their employees – must be able to thrive on that global stage, or risk withering away here at home.

Across sectors ranging from technology, to energy to professional services, US companies have risen to that challenge, and are leading their competition in markets around the globe. They succeed because they have world-beating innovation, productive employees, and the most efficient processes for bringing these new innovative products and services to market. And that global leadership creates jobs back home in the United States.

But the ability to compete is threatened by our outdated US corporate tax system. Written 25 years ago, the corporate tax code simply doesn’t work in today’s integrated global economy where it’s easier than ever before to run a successful global business from anywhere. More and more, our corporate tax code is an obstacle to the competitiveness of US companies and their ability to create American jobs.

The US has the second highest corporate tax rate among developed countries (members of the OECD). Only Japan, with its decades-long economic doldrums, has a higher corporate tax rate. And making matters worse, the US is the only industrialized nation that taxes the income US corporations earn in foreign markets – companies based in other OECD countries only pay taxes to the nation where the income is earned. So if a US-based company and a Germany-based company are both selling widgets in a third country with a low tax rate, the German company pays just the taxes owed there, while the US-based company pays both the third country taxes and then pays additional tax at home.

To stay competitive in the biggest growth markets in the world, US companies have to not just match the quality and value of their foreign-based competitors. They have to overcome the extra burden of the higher taxes they face at home.

Some argue that the corporate tax rate isn't what matters – that all the exemptions and deductions in the code make it less burdensome. But complexity doesn't solve the problem, even if it lets some companies lower their tax bill. This Swiss cheese of a tax code creates jobs for tax lawyers and accountants, as corporations look to improve the bottom line by using the tax code more effectively, rather than by creating the new products markets demand. That's no recipe for continued US economic leadership in the world.

Why does the corporate tax rate matter? Because capital goes where it is treated best. Countries around the world have recognized that, and have lowered their corporate tax rates to attract global investment. If a foreign corporation is likely to earn a higher return on capital, that's where investment dollars will flow – without regard to national borders. The impact is greatest on industries that are relatively large producers or users of capital goods – that means manufacturers. And less investment flowing to US companies can undermine the pace of innovation – the very creativity that today keeps US companies ahead of their global competition.

As investment flows to foreign companies, American workers can't pick up and follow the capital. We need to make sure US companies are attracting that capital, which drives both the creation of new American jobs and the productivity increases that raise American workers' wages.

President Obama's bipartisan National Commission on Fiscal Responsibility, led by Erskine Bowles and Alan Simpson, recognized that US job creation and prosperity are one key part of preventing a future debt crisis in the US. And they recommended an overhaul of the US corporate tax code because "without reform, it is likely that U.S. competitiveness will continue to suffer. The results of inaction are undesirable: the loss of American jobs, the movement of business operations overseas, reduced investment by foreign businesses in the U.S., reduced innovation and creation of intellectual property in the U.S., the sale of U.S. companies to foreign multinationals, and a general erosion of the corporate tax base."

That doesn't have to be our future, if the President will step up and lead a real effort to make America the best place in the world to invest.