Statement

of

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Tax Cuts are Better than Central Planning

Chairman Heinrich, Vice Chairman Schweikert, and Members of the Committee: Thank you for inviting me to testify.[1]

Americans have widely benefited from the neutral, pro-growth tax policies passed in 2017. By cutting business taxes and allowing full deductions for new investments, the Tax Cuts and Jobs Act (TCJA) allowed businesses to expand domestic investment, which is still supporting higher wages and a larger economy today.

I will make three related points in my testimony.

First, the underlying US income tax system is biased against investment by double- and triple-taxing investment returns. These additional layers of tax are a particular burden on investment-intensive sectors like manufacturing. The TCJA helped alleviate some of this built-in bias through lower tax rates and full expensing.

Second, instead of expanding and making permanent the pro-growth tax policies of 2017, Congress has recently relied on industry-specific targeted subsidies to promote politically popular investments. These industrial policy strategies have a long track record of failure and come with multi-trillion-dollar opportunity costs.

Third, the Biden administration and the Organisation for Economic Co-operation and Development (OECD) are working to institutionalize industrial policy by creating a global tax cartel to raise global tax rates—primarily on American businesses—and sanction state competition for international investment using direct subsidies.

Congress should reject the Biden administration-led OECD tax cartel, repeal more than $3 trillion of targeted tax subsidies—including those in the CHIPS and Science Act (CHIPS Act) and the Inflation Reduction Act (IRA)—and permanently expand the tax cuts in the TCJA.

Pro-Growth Policy and the Tax Cuts and Jobs Act

The TCJA was a wide-ranging reform that simplified and cut taxes for Americans at every income level. The law boosted private investment, wages, and economic growth. The most economically powerful changes allowed for additional business investment by allowing full deductions for new investments (called full expensing) and cutting the federal corporate income tax from 35 percent—the highest rate in the developed world—to 21 percent, giving the US a corporate tax rate that is slightly above the average of other developed countries.

The corporate tax rate cut is permanent. Expensing is temporary.[2] Beginning in 2023, the 100 percent expensing deduction is reduced by 20 percent each year through 2026, when the bonus deduction is entirely phased out. Research expensing expired in 2022.

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[1] The views I express in this testimony are my own and should not be construed as representing any official position of the Cato Institute.

[2] The TCJA allows all businesses to fully expense asset classes with lives of 20 years or less that were put in service after September 27, 2017, and before January 1, 2023. Section 179 of the Internal Revenue Code

At the time of passage, using a diverse set of assumptions, researchers estimated that the TCJA would increase the country's capital stock and boost GDP by between 0.7 percent and 1.7 percent.[3] Almost every study agreed that the reform would produce positive changes in economic growth. Since then, various empirical investigations of the actual economic outcomes have confirmed the model's estimates.

Kyle Pomerleau and Donald Schneider find that in the years immediately after 2017, "real GDP, consumption, business investment, and payrolls grew more rapidly than expected" by pre-reform forecasts.[4] Gabriel Chodorow-Reich and coauthors report similar results. Using variations in how the 2017 tax reform impacted different corporations, they found that the tax cut "caused domestic investment of firms with the mean tax change to increase by roughly 20% relative to firms experiencing no tax change." This result is in line with some of the most optimistic projections from the time of passage. Another paper by Patrick Kennedy et al. similarly finds that the corporate tax cuts caused "increases in sales, profits, investment, employment, and payrolls."[5]

As I've estimated elsewhere, the average production and nonsupervisory worker received about $1,400 more in annualized earnings by spring 2020, measured from the pre-TCJA trend.[6] These estimates are consistent with a long academic literature of sophisticated economic analyses that almost universally finds taxes matter for investment and growth.[7]

The Tax Code's Anti-Investment Bias

The normal income tax system is biased against investment in two important ways.

First, the income tax system encourages consumption over saving by assessing multiple layers of tax on interest and investment returns. Wages are first taxed by income and payroll taxes. Individuals then choose to spend or save their after-tax income. The increased value of saved and invested income is often taxed again as interest, capital gains, dividends, and transfers at death. The corporate income tax adds another layer of tax on income earned from corporate equity investments. Taxing investment returns—as the US

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allows some small businesses—those with less than $2.7 million in annual investments—to expense up to $1,080,000 in qualified short-lived investments.

[3] Adam N. Michel, "Protecting American Families from Higher Taxes," Testimony, Committee on the Budget, United States Senate, May 17, 2023.

[4] Kyle Pomerleau and Donald Schneider, "Making the Tax Cuts and Jobs Act Permanent: Two Revenue-Neutral, Pro-Growth Options for Tax Reform," American Enterprise Institute Report, April 8, 2024.

[5] Patrick J. Kennedy, Christine L. Dobridge, Paul Landefeld, Jacob Mortenson, "The Efficiency-Equity Tradeoff of the Corporate Income Tax: Evidence from the Tax Cuts and Jobs Act," March 21, 2024.

[6] Adam N. Michel, "Protecting American Families from Higher Taxes," Testimony, Committee on the Budget, United States Senate, May 17, 2023.

[7] Adam N. Michel, "Research Shows Taxes Matter for Investment and Growth," Cato At Liberty (blog), Cato Institute, November 9, 2023.

tax code does—reduces the incentives to save by lowering the market's payment to delay consumption.[8]

Second, the normal income tax code effectively denies businesses the full value of deductions for expenditures on physical investments. Because businesses pay income taxes on their profits (revenues minus expenditures), the tax code artificially inflates taxable profits by denying full deductions and, thus, inflates the after-tax cost of additional physical investments.[9]

Expenses such as employee salaries, utilities, and rent are all deductible in the year they are incurred.[10] However, different rules have historically applied to expenditures on longer-lived capital investments, such as equipment and structures. Businesses are typically required to deduct the cost of physical investments from their revenues over multiple years, according to depreciation schedules that usually range from 3 years to 39 years.

Spreading out an investment's deductible expenditures over multiple years increases its after-tax cost because the real value of the deduction decreases each year due to inflation and the opportunity cost of passing time. A deduction delayed is a deduction (partially) denied.

For example, say, Intel builds a new semiconductor fabrication plant at a cost of $1 billion. If the new structure has to be depreciated over 39 years, Intel can only deduct roughly 1/39 (about $26 million) of what it paid to offset revenues in the first year.[11] In 39 years, the final deduction of $26 million will be worth less than $3 million to the company. The partial deduction means that Intel will have artificially high profits and thus pay a higher effective tax rate. The higher taxes will cut into its ability to make other investments in new technologies and future expansions.

The tax code divides investment types into asset classes, each with different depreciation schedules. Most business equipment falls under the 3-year, 5-year, 7-year, 10-year, 15-year, or 20-year depreciation schedule, while residential property has a 27.5-year schedule and commercial real property has a 39-year schedule. Figure 1 shows how the present value of a $1 deduction can decline quickly under longer asset lives.[12] At 3 percent inflation, a $1 investment depreciated over 5 years is worth only 92 cents to the business in present value.

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[8] Adam N. Michel "Less Government, More Savings," Testimony, Committee on Finance, United States Senate, May 21, 2024.

[9] This section draws heavily from Adam N. Michel, "Expensing and the Taxation of Capital Investment," Cato Institute Briefing Paper No. 159, June 7, 2023.

[10] From 1954 to 2022, research expenses were also fully deductible.

[11] Equipment and other related investments are subject to different schedules.

[12] Present value assumes a 3 percent real discount rate; 3-year to 20-year assets are placed in service in the first quarter of the year using 200 percent (3–10 years) or 150 percent (15 years and 20 years) declining balance general depreciation system (GDS); 27.5-year to 39-year assets are placed in service in January using GDS straight line method; and R&D is amortized over 5 years using the midyear convention.

A $1 investment in a nonresidential structure, depreciated over 39 years, has a present value of only 40 cents.

If the business could write off the full investment immediately (full expensing), it could recover the entire cost of the investment. The $1 investment would be worth $1 in write-offs.

Figure 1

Deduction values fall quickly with longer write-off times

Present value of $1 write-off when inflation is 3%
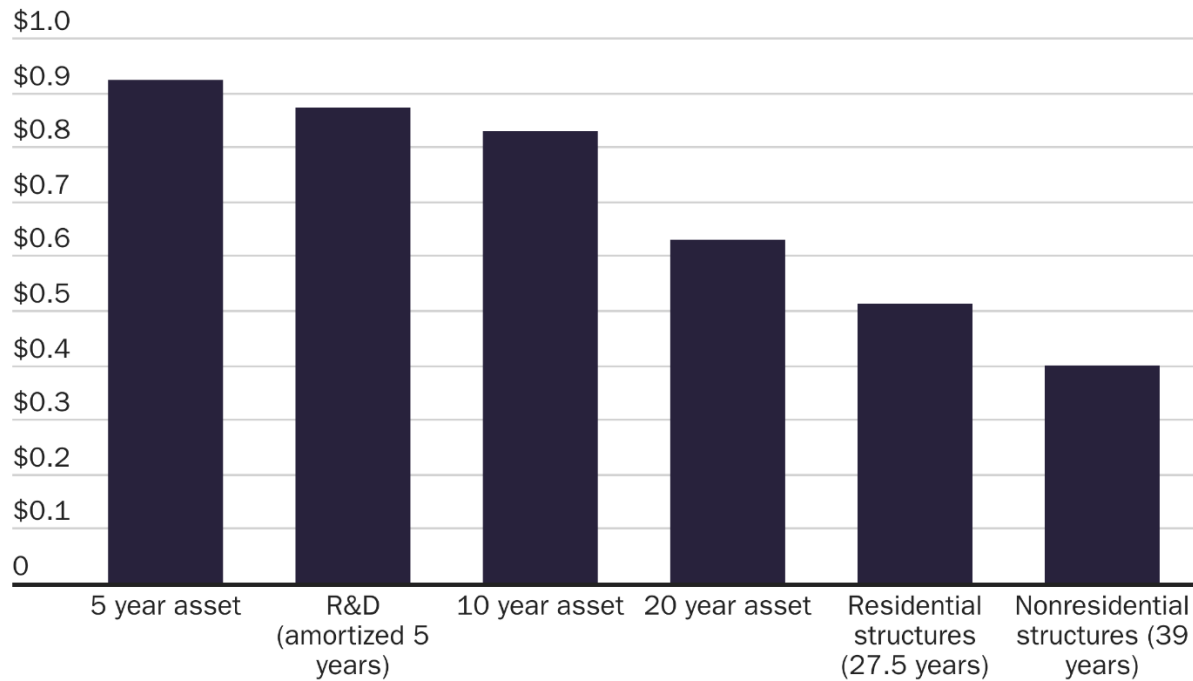
Source: author's calculations.

Research Spending Plummets When Expensing for R&D Expired

The TCJA also included some changes that increased the cost of investment, which provides a cautionary lesson for policymakers. Starting in 2022, full expensing for research expenses expired, requiring the costs to be amortized over five years (15 years for non-domestic expenditures). Research expenses include related wages for the researchers and their supervisors and other attributable costs such as rent, utilities, and overhead. Five-year amortization effectively reduces the value of research deductions by about 13 percent, making research spending more costly after tax.

Figure 2 shows that the pre-COVID quarterly growth rate in real private R&D investment was 6.7 percent, and 2021 R&D spending growth remained strong. Following the loss of full expensing for R&D in the first quarter of 2022, R&D spending growth steadily declined,

averaging 2.3 percent through the first quarter of 2024—a 66 percent decline from the pre-COVID average.

The decline in R&D spending provides a stark example of how tax policy can significantly affect investment behavior. Policymakers should expect similar effects across the rest of the economy as expensing for the remaining short-lived assets continues to phase out.

Figure 2

After full expensing expired, new research spending fell by two thirds

Percent change in real private R&D investment
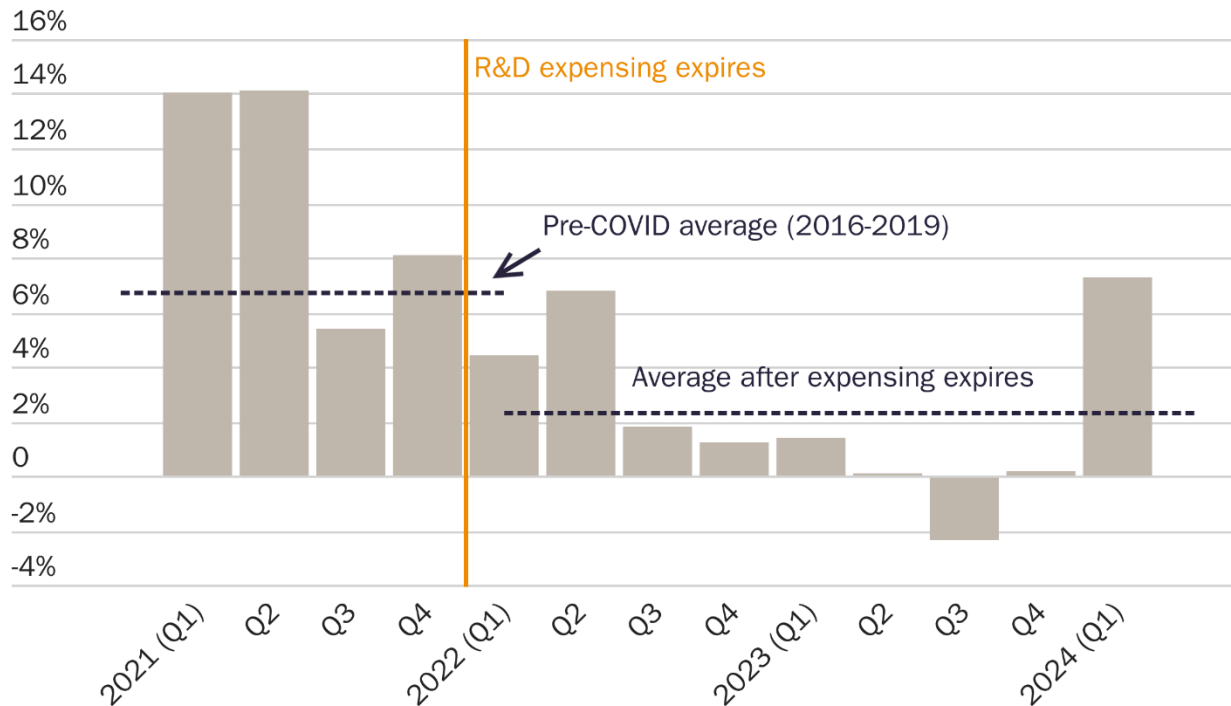
Sources: US Bureau of Economic Analysis, "Table 5.3.1. Percent Change From Preceding Period in Real Private Fixed Investment by Type," last revised, May 30, 2024; author's calculations.

Manufacturing is Disproportionately Affected

Focusing too narrowly on the manufacturing sector can distract policymakers from pursuing neutral, pro-growth policies that benefit all sectors of the economy. However, because the manufacturing sector tends to rely heavily on physical investments and research spending, the tax code creates a particular disadvantage for America's manufacturers and their employees.

Due to the depreciation system, the tax code has a built-in bias against the longest-lived capital investments. Allowing a business to recoup only 40 percent of its expenditures on nonresidential structures (Figure 1) makes building new plants and fabs more costly than they would be under a neutral tax code. In the UK, the Adam Smith Institute has noted that

a similar system creates a "Factory Tax" that largely falls on investment-heavy sectors, such as manufacturing.[13] Full expensing for structures or a "neutral cost-recovery system" (which allows businesses to index their write-offs for inflation and time) would eliminate the US factory tax and allow all sectors of the economy to invest without the distortion of the current write-off system.

Individual income tax rates are also important for manufacturers and other small or family-owned businesses. Over 90 percent of businesses in the United States pass their income through from the entity level to the owners, where it is taxed as personal income at individual income tax rates. [14] These pass-through businesses (S corporations, partnerships, LLCs, cooperatives) account for about two-thirds of all manufacturing businesses and employ a third of the manufacturing workforce. In 2026, when the TCJA expires, income tax rates will increase automatically. After the tax increase, manufacturers in the top income tax bracket will face tax rates above 50 percent in 15 states (accounting for state and local taxes).[15]

The Tax Code's $3 trillion of Industrial Policy Subsidies

The tax code is littered with credits and deductions intended to support specific industries, technologies, and business types. These targeted preferences will provide $209 billion in federal support in 2025. The subsidies are in addition to the tens of billions of dollars in direct expenditures and government-subsidized loans.

Table 1 includes a selection of the largest and most targeted tax subsidies intended to manipulate a business's location, timing, legal form, or inputs. The table includes each provision's cost in 2025 and the ten-year cost under current law, as reported by the Treasury Department. However, over time, many provisions phase down and expire, which understates their fiscal cost because Congress tends to extend expiring tax provisions. To approximate the true cost of these provisions, Table 1 also includes the annual cost at each provision's peak cost (usually before it begins to phase out). The annual peak cost of $356 billion implies a ten-year cost of more than $3.5 trillion for targeted industrial policy in the tax code.

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[13] Sam Dumitriu and Pedro Serodio, "Abolishing The Factory Tax: How to Boost Investment and Level Up Britain," The Adam Smith Institute, February 19, 2020.
[14] Scott Greenberg and Nicole Kaeding, "Reforming the Pass-Through Deduction," Tax Foundation Fiscal Fact No. 593, June 2018.
[15] Adam N. Michel, "Top Tax Rates Are Already on Wrong Side of Laffer Curve in at Least Ten States," Cato At Liberty (Blog), Cato Institute, April 24, 2024.

Table 1
Industrial policy tax subsidies could be as high as $3.5 trillion over 10 years

	2025	Peak year	2024-2033
Pass-through deduction	$65.2	$65.2	$154.0
Research and development credit	$31.9	$48.3	$388.7
Clean vehicles and refueling credits	$26.3	$35.9	$182.1
Energy investment credit	$19.9	$29.1	$156.6
Low-income housing credit	$14.4	$17.9	$174.8
Energy production credit	$9.9	$49.8	$290.2
Advanced manufacturing production credit	$9.8	$36.4	$222.6
Residential energy efficiency credits	$7.9	$11.0	$64.2
Clean fuel credits	$7.8	$7.8	$27.5
Advanced manufacturing investment credit	$5.8	$6.2	$39.8
Credit union income exemption	$3.1	$4.2	$35.8
Orphan drug research credit	$2.2	$5.3	$33.5
Other energy provisions	$2.0	$2.0	$9.9
Clean hydrogen production credit	$1.5	$20.0	$75.0
Carbon oxide sequestration credit	$0.9	$14.2	$61.8
Historic structures credit	$0.7	$0.9	$7.3
Nuclear power production credits	$0.2	$1.9	$5.6
Railroad track maintenance credit	$0.1	$0.1	$0.3
Total	**$209.3**	**$356.0**	**$1,929.8**

Source: author's caclulations; US Treasury, Office of Tax Analysis, Estimates of Total Income Tax Expenditures, March 11, 2024.

New Semiconductor and Energy Subsidies

Recent legislation—the CHIPS Act and the IRA—make up about half of the cost of the programs in Table 1. These two pieces of legislation represent an unprecedented expansion of government subsidies to support investment in politically popular technologies.

The CHIPS and Science Act was a significant shift in US industrial strategy, focusing on bolstering domestic semiconductor manufacturing to reduce dependency on foreign suppliers and stimulate innovation. The CHIPS Act combines direct subsidies, tax incentives, and research grants, which the Congressional Budget Office estimates will cost $79 billion over ten years, including about $50 billion in direct funding and $24 billion in new tax credits. If Congress appropriates the remaining funds in future years, as planned, the cost of the legislation could increase to almost $280 billion.[16]

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[16] Congressional Budget Office, "Estimated Budgetary Effects of Division C of H.R. 4346, as Amended by the Senate and as Posted by the Senate Committee on Commerce, Science, & Transportation on July 20, 2022," CBO Cost Estimate, July 21, 2022

The Inflation Reduction Act (IRA) also marked a significant shift in US energy policy—to one that pairs costly and complicated regulatory requirements with open-ended tax subsidies to manipulate consumer and producer incentives toward politically popular energy sources. Since its passage, the estimated cost of the IRA's new and expanded energy tax credits has increased dramatically. Congressional scorekeepers initially estimated the tax provisions would cost $271 billion over ten years.[17] Due to higher projected uptake, the cost of the IRA tax credits is likely to be more than $907 billion over ten years, three times larger than initially projected.[18] These estimates bring the entire cost of the green energy spending in the IRA to about $1.1 trillion over ten years and possibly more than $3 trillion over a longer time horizon.[19]

Industrial Policy Comes With Trillion Dollar Opportunity Costs

Industrial policy spending, in the tax code or elsewhere, has large opportunity costs. Open-ended tax credits have a multi-decade track record of failing to meet their stated goals, creating billion-dollar cottage industries for fraud and manipulation, and representing lost opportunities for more effective policies, such as full expensing.

Track record of failures. The tax code has included subsidies for wind and solar energy technologies for more than four decades since the Section 48 investment tax credit was created in the Energy Tax Act of 1978.[20] Instead of being temporary support for nascent industries—as originally intended[21]—the federal energy subsidies have created government-dependent industries that are more responsive to public money than consumer demand. The Biden administration has sold many of the newest energy subsidies in the IRA as phasing out by 2035, but Energy Information Administration data suggests tax dollars could flow to these industries well after 2050.[22]

Many credits also do not stand up to simple cost-benefit analysis. A Tax Foundation report summarizes the failures of targeted tax policies intended to reduce carbon emissions, concluding they have "proven ineffective, or at the very least inefficient…. The tax credit for

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[17] Committee for a Responsible Federal Budget, "IRA Energy Provisions Cost Could Double With New Emissions Rule," CRFB Blog, February 13, 2024.

[18] Adam N. Michel, "Energy Tax Subsidies Could Top $1.8 Trillion," Cato At Liberty (Blog), Cato Institute, March 26, 2024.

[19] Travis Fisher, "The Inflation Reduction Act's Energy Subsidies Are More Expensive Than You Think," Cato At Liberty (Blog), Cato Institute, September 5, 2023.

[20] Salvatore Lazzari, "Energy Tax Policy: History and Current Issues," Congressional Research Service RL33578, last revised October 30, 2008.

[21] In 2003, Senator Chuck Grassley, an original author of the 1992 wind energy production tax credit said, "I'd say we're going to have to do it for at least another five years, maybe for 10 years. Sometime we're going to reach that point where it's competitive (with other forms of energy). I think the argument for any tax credit is to make the new source of energy economically competitive." Brendan O'Bryhim, "Wind Energy Rides Roller Coaster Year," Electrical Wholesaling, April 1, 2003.

[22] Travis Fisher, "New IRS Guidance Makes the Inflation Reduction Act's Energy Subsidies Harder to Eliminate," Cato At Liberty (Blog), Cato Institute, May 31, 2024; Travis Fisher, "The Inflation Reduction Act's Energy Subsidies Are More Expensive Than You Think," Cato At Liberty (Blog), Cato Institute, September 5, 2023.

ethanol in motor fuel, as one example, effectively spent $1,000 to reduce carbon emissions by one ton, magnitudes more than the societal cost of one ton of emissions."[23]

Less targeted tax credits, such as those for R&D, also come with high administrative and economic efficiency costs that undermine the traditional academic case for such subsidies.[24] When compared to other policies—such as a lower corporate tax rate or full expensing—government subsidies for R&D are likely a less efficient means of encouraging private research spending and innovation.[25]

Fraud and Manipulation. Because they are often open-ended subsidies and claimed on tax returns without prior validation, tax credits have a long track record of inducing fraud, corruption, and unintended legal manipulation.

In the case of biofuel tax credits, the Treasury Inspector General for Tax Administration (TIGTA) has found widespread misuse of the credits that have led to "one of the largest fraud schemes in US history." The TIGTA report concludes that "with the passage of additional and expanded clean energy tax credits in the IRA, there is even greater incentive to take advantage of biofuel tax credits and make fraudulent claims for biofuel that does not exist or does not qualify for the biofuel tax credits."[26]

The biofuel tax credits are only one small microsome of the problems that follow in the wake of overly generous, targeted federal tax subsidies. For example, the fiscal cost of the Employee Retention Tax Credit (a pandemic-era payroll tax credit) increased from $77 billion to as much as $550 billion due to a combination of lax rules and outright fraud.[27] Other tax programs, such as the Low-Income Housing Tax Credit—a lucrative subsidy awarded in a discretionary manner—has been the center of numerous corruption scandals. The credit is also ineffective at inducing additional low-income housing.[28]

Better Policies Forgone. In 2017, expensing was not made permanent due to its fiscal cost. Making full expensing permanent and extending similar treatment to structures would lower revenue by about $600 billion over ten years. This is a fraction of the cost of the

[23] Erica York, Alex Muresianu, and Alex Durante, "Taxes, Tariffs, and Industrial Policy: How the U.S. Tax Code Fails Manufacturing," Tax Foundation Fiscal Fact No. 788, March 2022; Gilbert E. Metcalf, "Using Tax Expenditures to Achieve Energy Policy Goals," *American Economic Review*, vol. 98, no. 2, May 2008.

[24] Tax credits are different from deductions. Martin A. Sullivan, "Putting the Research Tax Credit to the Test," *Tax Notes*, March 17, 2014; Jeffrey Miron and Jacob Winter, "Governments Should Not Fund Research," *Cato at Liberty* (blog), Cato Institute, July 31, 2023.

[25] Jason J. Fichtner and Adam N. Michel, "Can a Research and Development Tax Credit Be Properly Designed for Economic Efficiency?," *Mercatus Research*, Mercatus Center, George Mason University, July 14, 2015; Maxwell Tabarrock "Tax Cuts and Innovation," Maximum Progress (Blog), May 29, 2024.

[26] Treasury Inspector General for Tax Administration, "Additional Actions Need to Be Taken to Identify and Address Noncompliant Biofuel Tax Credit Claims," U.S. Department of the Treasury Inspector General for Tax Administration Report 2024-300-021, April 24, 2024; and Adam N. Michel, "A Case Study in Tax Credit Fraud and Manipulation, Biofuel Edition," Cato At Liberty (Blog) Cato Institute, May 2, 2024.

[27] Adam N. Michel, "Employee Retention Credit Shows Folly of Tax Code Subsidies," Cato At Liberty (blog) Cato Institute, October 12, 2023.

[28] Chris Edwards and Vanessa Brown Calder, "Low- Income Housing Tax Credit: Costly, Complex, and Corruption- Prone," Cato Institute Tax and Budget Bulletin No. 79, November 13, 2017.

existing $3 trillion tax subsidy regime. Expensing also avoids the capital misallocation, cronyism, and other costs that too often result from targeted subsidies.

In 2023, Scott Lincicome and I made a similar point, comparing the uncertain costs of the three big subsidy bills—the Infrastructure Investment and Jobs Act (2021), the CHIPS Act, and the IRA—to full expensing. We concluded that "even the most aggressive, pro-growth expensing package would still be dwarfed by the amounts that Congress has just spent on industrial policy." (Figure 3)

The opportunity costs are even larger because, at best, the targeted subsidies will just reallocate existing resources to less efficient political priorities. Whereas pro-growth tax cuts expand the pool of total private investment and put private investors—not politicians—in charge of determining where new investments should be made.

Even when state subsidies result in successful projects, it does not mean that those resources would not have been better spent elsewhere. For example, a lower tax rate for all companies could result in additional R&D and successful new projects at 100 companies instead of only the innovations from the one firm that received a government subsidy. Government subsidies also distort private investment by attracting scarce resources to government-subsidized activities at the expense of other investment opportunities.

Figure 3

Industrial subsidies are more expensive (and less effective) than neutral, pro-growth tax reform
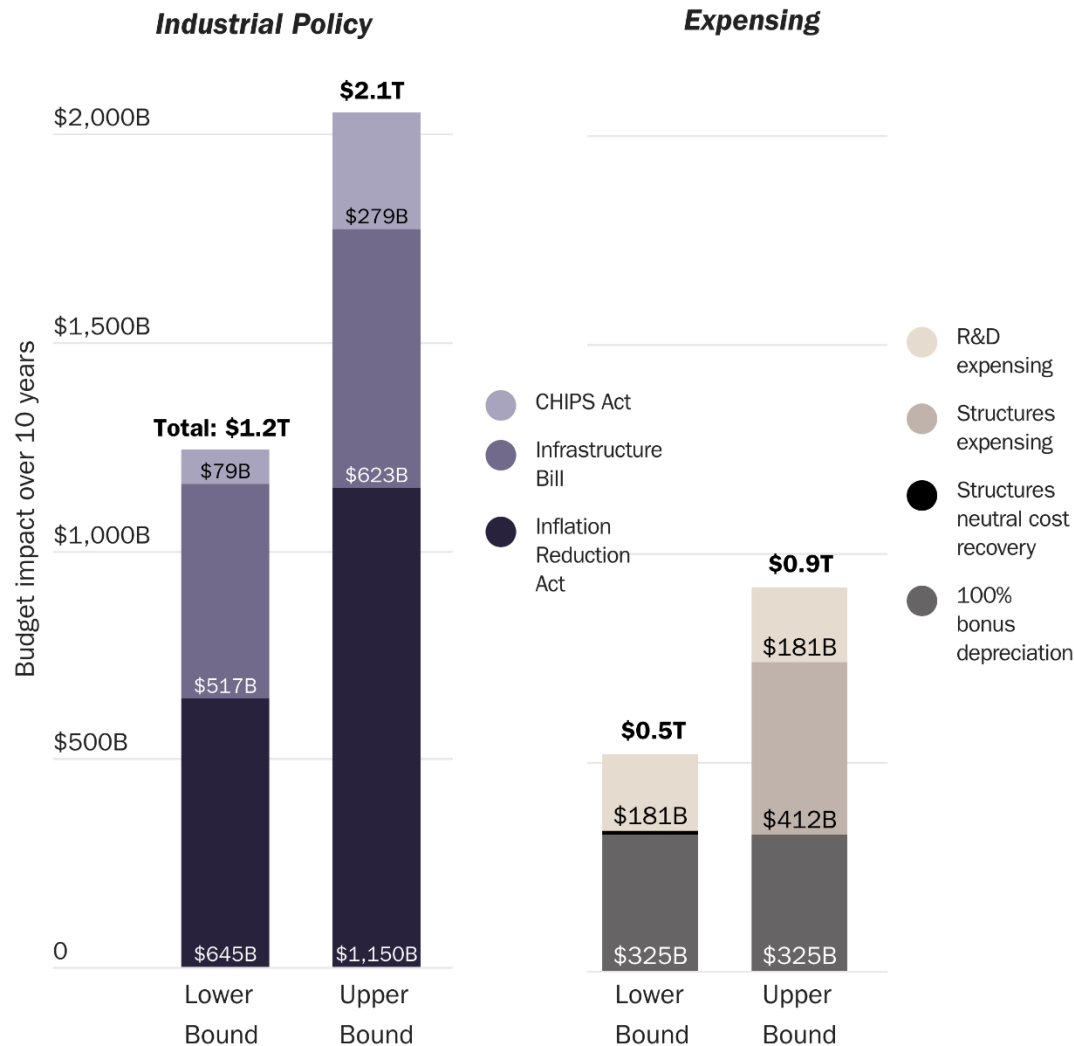
Sources: Congressional Budget Office, Joint Committee on Taxation, Goldman Sachs, Tax Foundation, CRFB.
Note: Industrial policy spending estimates include direct outlays, grants, and tax credits. The estimates reflect industrial policy spending exclusive of other associated revenue raisers and non-industrial policy outlays.

Biden Administration's Zero-Sum International Subsidy Wars

Treasury Secretary Janet Yellen recently described China's state subsidies for solar energy, electric vehicles, batteries, and other emerging technologies as distorting global prices, noting that it "hurts American firms and workers, as well as firms and workers around the world."[29] She left out that the United States is doing the same thing—pouring massive

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[29] Fatima Hussein, "Yellen Says China's Rapid Buildout of its Green Energy Industry 'Distorts Global Prices'," Associated Press World News, last updated March 27, 2024.

government subsidies into strategic industries and manipulating global markets to everyone's detriment.

Making matters worse, the Biden administration has led the development of the OECD's project to create a global tax system that will institutionalize the US and China-led move toward industrial policy.

Pillar Two of the OECD global tax framework includes a global minimum corporate tax rate of 15 percent, enforced by a system of extraterritorial taxes. The OECD tax cartel has numerous economic and political costs that make it a bad deal for American workers and businesses, which I've outlined in detail elsewhere.[30] For the purposes of this discussion, I will focus on how the Pillar Two rules incentivize and institutionalize industrial policy.

By focusing narrowly on tax rate competition (setting a 15 percent tax rate floor), the OECD rules push international fiscal policy competition to the more inefficient form of targeted subsidies. The minimum tax does this by treating refundable tax credits (cash payments through the tax code) and direct state subsidies as income instead of reductions in taxes paid.[31]

The OECD's minimum tax will not reduce governments' incentive to attract new business; it will simply shift the margin on which this competition takes place. The US has ensured the transition to competition with direct subsidies by simultaneously creating trillions of dollars of open-ended subsidies through the CHIPS Act and the IRA.

Unlike lower tax rates, which expand total global investment, dueling state subsidies for specific companies are a net negative; they cost fiscal resources to both countries and create few new investments. When the subsidies are funded by higher general taxes—as they are in the case of the OECD proposal—they will depress overall levels of investment and still not bring in any additional fiscal resources.

Some countries have already begun reforming their fiscal systems in response to the OECD's proposal and the US subsidies. A few examples include:

- South Korea expanded domestic subsidies by $19 billion for companies like Samsung and SK Hynix through the K-Chips Act in response to the US CHIPS Act and resulting pressure from domestic manufacturers.[32]

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[30] For more see, Adam N. Michel, "Bold International Tax Reforms to Counteract the OECD Global Tax," Cato Policy Analysis No. 968, February 13, 2024; Adam N. Michel, "It's Time to Defund the OECD," Cato At Liberty (Blog), Cato Institute, May 9, 2024.

[31] Adam N. Michel, "OECD Rules Risk Fueling Competition for State Subsidies," GIS Reports Online, December 12, 2023.

[32] Alex Kim, "CHIP on the Shoulder," The Wilson Center Asia Dispatches: A blog of the Indo-Pacific Program, October 10, 2023; Kimberley Kao, "South Korea Unveils $19 Billion Package for Chip Industry," Wall Street Journal, May 23, 2024.

- Intel received 10 billion euros from Germany and $3.2 billion from Israel to stay in the respective countries following the passage of the CHIPS Act.[33]

- Germany pledged new state funding for battery manufacturer Northvolt after they threatened to exclusively open new projects in the US unless the EU matched the subsidies they are eligible for under the IRA.[34]

- Vietnam is considering ways to directly compensate Samsung and other foreign companies for the higher taxes the firms will be forced to pay under the new 15 percent minimum rate.[35]

- Bermuda—which previously did not have a corporate income tax—will introduce a 15 percent corporate income tax in 2025 and use the revenue to provide new types of incentives.[36]

- Singapore acknowledged that the new minimum tax revenue would be spent on other incentives, stating, "given the significant spending required to stay competitive, at this point, I do not expect the new moves to generate net revenue gains for Singapore on a sustained basis."[37]

- The EU's new STEP initiative and Temporary Crisis Framework shift the bloc's economic policy toward fiscal subsidy regimes, which is embodied in the Green Deal Industrial Plan (GDIP), a direct response to the IRA.[38]

Policy Recommendations

Ensuring permanently low and economically neutral taxes is the most important way the tax code can support manufacturing and the rest of the American economy. Permanent policy is important so that investors and workers have the certainty they need to plan for the future.

Congress will need to cut spending to keep taxes from rising over time. Over the long run, spending is the true tax rate. So, if Congress wants to keep the United States a relatively low-tax country (compared to most of the developed world), spending will need to come

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[33] Steven Scheer, "Israel Grants Intel $3.2 Billion for New $25 Billion Chip Plant," Reuters News, December 26, 2023; Friederike Heine, Supantha Mukherjee and Andreas Rinke, "Intel Spends $33 Billion in Germany in Landmark Expansion," Reuters News, June 19, 2023.

[34] Guy Chazan and Richard Milne, "Northvolt to Build German Battery Factory After Berlin Pledges State Aid," Financial Times, May 12, 2023.

[35] Francesco Guarascio and Khanh Vu, "Exclusive: Vietnam Eyes Multi-Million-Dollar Handouts to Samsung, Others to Offset Global Tax," Reuters Asia Pacific, May 30, 2023; Martin A. Sullivan, "Vietnam Pillar 2 Revenue to Be Funneled Into New FDI Incentives," *Tax Notes*, May 28, 2024.

[36] Sean Bray and Cecilia Perez Weigel, "How Bermuda's New Corporate Income Tax Could Negatively Impact Some OECD Member States," Tax Foundation Blog, August 29, 2023; Martin A. Sullivan, "Gain and Little Pain From New Bermuda Corporate Tax," Tax Notes Today International, April 22, 2024.

[37] Martin Sullivan (@M_SullivanTax), "Will Pillar 2 raise a lot of revenue?" X Post, April 8, 2024.

[38] European Commission "The Green Deal Industrial Plan: Putting Europe's Net Zero Industry in the Lead," The European Commission Strategy and Policy, February 1, 2023.

down to meet revenues. If Congress decides that current spending levels and projected spending increases are appropriate, taxes will eventually need to increase on Americans at every income level to cover the costs of projected spending levels. Every other large modern welfare state funds its higher government spending with high taxes on a broad swath of the population because there is not enough money at the top of the income distribution to fund current spending patterns.[39]

Specific tax reforms should include:

- **Permanently extend the TCJA and continue to lower taxes on work and investment**. The most important policy is permanent full expensing for all investments. Congress should expand expensing to longer-lived structures by allowing the same immediate deduction or implementing a "neutral cost-recovery system," which provides a similar economic benefit as expensing by allowing businesses to index their write-offs for inflation and time.

- **Repeal the IRA and CHIPS Act**. Congress should repeal all distortionary subsidies in the tax code, including those in the IRA and CHIPS Act. The higher revenue from repealing tax credits should be used to lower business tax rates.

- **Defund the OECD.** One important way Congress can stop the OECD global tax process is by explicitly rejecting the OECD framework and moving to withdraw from OECD membership if it continues to advocate for higher taxes on American businesses.[40] Withdrawal from the OECD should be paired with a prohibition on any US funding for the OECD in future budgets.[41] Congress could further undermine the OECD tax cartel by lowering the US corporate income tax rate to 12 percent—the lowest rate in the OECD—and making America the most attractive place to do business in the world.[42]

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[39] Adam N. Michel, "Biden's Math of Just Taxing the Rich Doesn't Add Up," Cato at Liberty (blog), Cato Institute, March 22, 2023.

[40] To withdraw from the OECD, Congress must instruct the president to immediately notify the depository government (the government of France, where the OECD is based) under Article 17 of the Convention on the Organisation for Economic Co-operation and Development that the United States will terminate the application of the Convention and the Convention's protocols.

[41] Adam N. Michel, "It's Time to Defund the OECD," Cato at Liberty (Blog), Cato Institute, May 9, 2024

[42] Adam N. Michel, "Bold International Tax Reforms to Counteract the OECD Global Tax," Cato Policy Analysis No. 968, February 13, 2024.