Now What's Going On?

CORPORATE TAX REFORM

At long last, there are some GOP lawmakers on the House Ways and Means Committee that are working on a draft proposal that would shift the United States corporate tax system to what is being dubbed the "***territorial***" tax system. American companies have long been disadvantaged because to be American is in reality to be an economic slave. Americans owe taxes simply for being born American. The only country that also adopted the same policy is Japan. Everyone else takes the position that you owe taxes because you are using the services provided by the government. America has always adopted the policy that if you are born in Kenya by at least one American parent, you owe taxes in the USA even if you never come here. The American companies have been forced offshore just to be competitive in the international arena. To put it bluntly – ***THEY OWN YOUR ASS!*** The proposals are too long in the coming, but basically would only tax profits made within American borders. If this proposal goes through, it has the potential to actually shift the job flow from leaving the USA to an inflow. It is being touted as an encouragement for American corporates to bring back their money to the USA where supporters argue that this would encourage money to be invested domestically. I testified on this issue before Congress more than a decade ago before the House Ways & Means Committee on July 18th, 1996 (see attached).

The Democrats of course will be screaming about how this will lower taxation for the super-rich corporations. All they care about is getting a ***pound of flesh*** without any regard for what their policies may produce. Our problem is **NOT** that someone didn't pay their "**fair share**" of taxes. The issue is regardless of how much government collects in taxes, it is **NEVER** enough. They will always spend more than what they have and then blame someone else for the deficit. This is like your teenage child using a credit card you gave them, and they blow beyond the limit blaming you that there is a limit.

We desperately **NEED** a conference in Washington on **Monetary Reform** where ideas can be presented and it is open to the public. We do not need a committee investigating something asking canned questions. We **NEED** a brand new conference open to the public giving a forum in which ideas are presented. This would be a first step in the right direction. Who on Capitol Hill will sponsor this type of event? Do we wait for the patient to die? Or perhaps we start listening to ideas now? Europe is imploding. We can continue to ignore all the problems and hope they will go away when the lights come back on. We elect people to do a job. Not hide under the covers afraid to even use a flashlight!

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July 18, 1996
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Mr. Chairman, members of the committee. I would like to thank you for inviting me here today to offer what information PEI has gathered from our experience in dealing with the multinational corporate and institutional sector of the global economy. As a brief background, PEI maintains offices in the US, Tokyo, Hong Kong, Sydney and London. We currently provide corporate and institutional advice under contract on global assets exceeding US$2.5 trillion, an amount equal to about half of the US national debt.

In our capacity as an advisor serving the international community in real live decision making rather than theory, PEI may be uniquely qualified in providing insight as to how and why both investment and business capital flows are affected by a nation's domestic policy objectives.

It has been our experience, that there are five key factors that provide the core stimulus behind capital flows internationally.

1) Foreign Exchange
2) Taxation
3) Labor Costs
4) Inflation & Interest Rates
5) Security (geopolitical & financial)

Foreign Exchange fluctuations have become the number one cause of corporate losses. The percentage movement in the exchange value of currencies has become as high as 40% over a two year period. Exchange losses have impacted every sector of business in every nation to the point that the very way multinationals operate today is dramatically shifting from that of only 10 years ago. Multinationals have been forced to change pricing policy as well as the location of manufacture in an effort to reduce extreme financial risks for their shareholders. Deals such as Rockefeller Center, MCA etc. resulted in significant losses to the Japanese investors more so by the 40% depreciation of the dollar than the actual decline in value of the underlying assets. Japan Airlines was forced to lay-off 25% of its work force last year due to the fact that their cost base was Japanese yen while their revenue was largely foreign currency denominated. In Germany, Mercedes has been forced to restructure their pricing policy as of July 1st, 1996 due to foreign exchange. Instead of pricing the product in DMarks around the world, which has cost them market share, product will now be priced in local currency thereby transferring the currency risk back to Germany.

These are but a few examples of how the more recent extreme fluctuations in the exchange value of currencies has impacted business and investment decisions on a global scale. While it may be politically preferable to manipulate currency values in an attempt to impact trade flows, in reality trade accounts for less than 10% of the total world capital flow movement. Our warnings delivered in a letter to Congress and the White House back in 1985 cautioned against such intentional currency manipulation as enacted in the G5 September Plaza Accord. The net result of attempts to influence trade through currency manipulation led to the 1987 Stock Market Panic. PEI's research was requested by the Brady Commission and we would like to think that we had some impact upon its findings since two of our clients were on the Commission itself. Mr. Brady later stated that he believed that currency fluctuations had played a role in the Panic of 1987. Offered here is a graphic illustration of the net capital flow movement for that period. The upper portion of the graph plots trade and the lower portion capital movement which included stocks, bonds and real estate investment. What is important to note is that ever since 1987, the fluctuations in net capital movement have become more than 10 times as volatile when compared to the p re-1987 era.

I offer this information because it tends to help illustrate the importance that domestic policy objectives have in the new global economy. The second most important factor influencing net capital flow movement is none other than taxation. However, taxation is more than a pure income tax. Taxation contributions imposed on business based upon social objectives for labor are of greater importance than the mere superficial level of corporate income tax rates alone.

It is wrong to assume that manufacturing jobs flow to merely the lowest possible labor cost. If this were true, then all manufacture should be conducted in Mexico, South East Asia or better still - Africa. In our capacity as a corporate advisor helping to make such strategic decisions as to where companies should or should not locate, there are 5 primary considerations that go into the final decision process.

1) Rule of Law
2) Labor Skill availability
3) Taxation Contributions Required on Labor
4) Corporate Tax Rate
5) Regulation

We have clients who have turned down what appeared to be lucrative business ventures in 3rd world nations as well as Russia or China based upon the lack of a Rule of Law that is required to secure the capital at risk. Without a solid Rule of Law, business cannot operate. Such ventures that do develop in those parts of the world depend upon government guarantees from their native country of origin in an effort to underwrite the political risk at hand.

While it is obvious that labor costs are closely associated with labor skills, what is largely overlooked are the social taxation and regulations associated with a work force. We found Asian companies who wished to open manufacturing plants within the EC made their decision based upon the level of skills available and then secondly choose the lower total cost of labor. For example, the UK attracted more than 40% of all foreign investment into Europe due to the fact that it had a skilled labor force but its cost was much less compared to that of Germany or France. This cost factor was determined not by mere wages, but included the social taxation that companies were required by law to provide. On that score, the labor costs in the UK were 40% less than Germany.

When a company did NOT require a major work force but instead merely needed a legal entity within the EC, then the primary deciding factor became the corporate tax rate. While the UK corporate tax rate was 19% less than Germany, they were still more than twice that of nations such as Spain and Ireland. Therefore, corporate headquarters or low skilled labor requirements tended to gravitate to the lowest possible corporate rate within the EC. This is illustrated by the impressive Irish economic growth rates of 9% compared to European economic growth rates of 2.5%. We have found that there is a correlation between high unemployment and high total taxation and regulation costs across Europe today.

Of course, regulation was a major factor as well. This we can see within our own US borders as well. Southern States are activity competing for Northern corporations and jobs. If we look at those states where regulation is the least intrusive and taxation is the most favorable, you will find the highest number of corporate relocations and new foreign business ventures within the United States.

Domestic Taxation policy must take into consideration our new global economy. We must be sensitive to being competitive not merely on labor costs, but also on the total taxation and regulation costs if we hope to avoid the dismal European example with its chronic unemployment in excess of 10% year after year. We must also keep in mind that taxation itself is largely influenced by philosophical decisions made by governments without considering the true total economic impact. For this reason, taxation has been a major factor in altering world capital flows as well as economic growth levels. When the US corporate tax rate hit nearly 70% during 1968-1969, virtually every American company began shifting manufacture offshore. Today, over 65% of the US trade deficit is made up of US companies importing their own goods manufactured somewhere else. In fact, if we allocate world trade according to the flag a company flies instead of the last port of assembly, you will find that the US has a net trade surplus in excess of $150 billion.

Much of the economic turmoil in Japan today is being caused by excessively high tax rates. In fact, 3 of the first section listed companies on the Tokyo Stock Exchange have renounced their Japanese heritage and moved to Hong Kong due to a 15% tax rate compared to nearly 70% in Japan. Our economy contracted from the 1960s for 12 years. Japan appears to be facing the very same long-term trend. After 6 years, the Japanese economy remains in the throes of a near depression and taxes have still not been reduced. Despite the fact that interest rates have fallen in Japan to 0.25%, there remains no interest in borrowing for domestic economic expansion.

The method of taxation through domestic social objectives is also a key factor in shifting global capital flows. For example, the US is one of the very few nations that seek to tax their citizens and corporations on worldwide income. Most British Commonwealth nations tax worldwide income if earned in a tax free zone. Therefore, if the US were to totally eliminate the corporate income tax, we would run the risk of corporate earnings in the US being considered as income from a tax free zone.

Furthermore, US tax code classifies income made overseas as if any overseas income is derived solely to avoid domestic taxation. The 50% and/or control rule for US companies as the sole criteria for taxation penalizes US enterprises forcing many into join ventures simply to avoid double taxation in the US. We also discriminate against American companies trying to enter foreign markets by passing the tax burden directly to personal income even if such earnings are not distributed. Our tax code assumes that any offshore entity is merely trying to avoid taxes without testing whether or not an actual business is being developed as compared to an offshore account for investment purposes.

In addition, our prejudice against capital gains versus short-term income within our tax code provides an incentive to manufacture and develop domestic products offshore. The US is one of the few nations who's tax system punishes long-term investment while rewarding short-term speculation. Again, the capital gains taxation has exported more American jobs not because of the mere rate, but due to the fact that losses have been treated differently from short-term income while disallowing the impact of inflation indexing. Consequently, while virtually every electronic produce from VCRs, CDs and assorted appliances were designed and patented in the US, their final development and manufacture have been more fairly treated by nations such as Japan. This uncompetitive social philosophy inherent with American tax code has been one of the major causes of forcing US companies offshore into joint ventures than even the net level of income tax itself.

While many will argue that corporations pay little in income tax, what is grossly ignored is the taxation of labor that is a huge direct cost to business. If we look at our own revenue statistics, you will findthat the taxation contributions to the payroll tax paid by corporations is substantial - generally twice the level of corporate income taxes.
We must also take into consideration the net cost of taxation upon the nation as a whole. While it is true that the national debt doubled under Ronald Reagan moving from $1 to $2 trillion, this alone does not mean that lower taxes or Reaganomics failed. Under Bush and Clinton, the national debt has now more than doubled from $2 to $5 trillion despite raising taxes.

We must honestly review the economic facts of the past 16 years in order to understand our future. Since Ronald Reagan, we have actually had a balanced budget from the perspective of revenue v. spending. At 8% compounded, you double your money in a bank in about 8 years. The interest expenditures during the Reagan period were equal to nearly $1 trillion. Today, we actually collect about $100 billion more in revenue than Congress actually spends on programs. This is being absorbed by our interest expenditures. In fact, since 1950, the total interest expenditures paid now equal 68% of the total outstanding national debt. We are indeed becoming a banana republic.

At times, up to 40% of our national debt has been held by offshore investors who pay no income tax in the US. This means that domestic spending from Congress is no longer stimulating our domestic economy. If fact, an analysis of capital flows reveals that the Japanese earned more from the US on their investment income in the past 16 years than -they did on trade.

By taxing interest income, we penalize Americans and overpay foreign investors exporting more capital than would otherwise take place. If we eliminate the income tax on government bonds, we could reduce the interest rate to the actual net return after taxation. This alone could result in an instantaneous balanced budget since we currently collect more in revenue than we spend on programs.

Capital is rushing around the globe today much in the same manner as it did going into the Great Depression. Herbert Hoover wrote in his Memoirs that "capital acted like a loose cannon on the deck in the middle of a torrent." In 1985, the largest futures mutual fund was $100. Today, $1 billion funds are a dime a dozen. Everyone is investing somewhere else to avoid local taxation. It is now estimated that over $2 trillion sits offshore, untaxed and unregulated emanating from all nations. If we eliminate the personal income tax, then America itself will become the international magnet for this vast pool of capital. Our interest rates would decline as it always does whenever excess capital emerges. This single step alone, combined with creating a tax free government bond structure, could spark untold economic growth and help to actually begin reducing our national debt rather than waiting for everything to go bust beyond the year 2000.

If the purpose of this Committee is to fairly reflect upon how our tax code can be used to attract jobs and stimulate economic growth rather than employ gimmicks such as currency manipulation, special one-off tax deals or deny the damage that Marxism has created in the postwar world, then it is clear from our " experience that there can be several important conclusions.

1) End the discrimination against long-term investment by at least allowing capital gains to be indexed to inflation retroactively.

2) Promote honest reform of the Social Security System whereas contributions made should be privately managed as is the case in many other nations. The Postal Savings System in Japan actually has on deposit in real funds nearly $10 trillion which is then managed by the private sector under the watchful eye of government. This will help reduce the cost of labor in the US, create jobs through increased savings, and result in lower payroll tax contributions for business over the long-term.

3) Eliminate the taxation on government bonds.

4) Eliminate the personal income tax and replace it with a national sales tax of 10%.

5) Reduce the corporate tax rate to 15% matching Hong Kong. Allow interest paid to be deducted as a part of the cost of doing business.

Mr. Chairman, members of the Committee:

This is a brief overview of our experience in dealing around the world on a first-hand observation basis. We strongly believe that the replacement of the current income tax system on individuals with a national sales tax in combination with a corporate tax rate of 15% will prove not merely to be revenue neutral, but also a major economic stimulus that will help our domestic economy grow while forcing major economic change around the world restoring the beacon of hope and liberty by our example.