



CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Douglas Holtz-Eakin, Director

February 24, 2004

Honorable Don Nickles
Chairman
Committee on Budget
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

This letter and the attached report respond to your request of January 16 for an economic analysis of an amendment to S. 1637, the Jumpstart Our Business Strength Act. Specifically, you asked about the effects of a 2 percentage-point cut in the corporate tax rate in three contexts: in general; compared with the provisions of section 102, title II, and title III of the version of S. 1637 reported by the Finance Committee; and compared with a narrowly tailored rate cut limited to domestic manufacturing. You inquired about the impact of that cut on growth, efficiency, jobs, and the competitiveness of U.S. businesses in comparison with businesses in other developed countries.

Briefly, our analysis indicates four conclusions. First, an across-the board reduction in the corporate tax rate would improve economic efficiency in all three of the contexts specified. Second, both that cut and one targeted solely toward manufacturing would produce a relatively minor increase in long-term growth compared with the current tax regime and the provisions of S. 1637. Third, none of the alternatives considered would have any significant short-term effect on employment. And fourth, a corporate rate cut would improve the country's international economic position compared with the current tax regime, but it would have roughly the same effects as the tax cuts embodied in S. 1637 or as a rate cut targeted solely toward manufacturing.

I hope you find the attached discussion helpful. If you would like further information, we would be pleased to provide it. The staff contact is Thomas Woodward, CBO's Assistant Director for Tax Analysis, who can be reached at 226-2687.

Sincerely,

A handwritten signature in black ink that reads "Douglas Holtz-Eakin".

Douglas Holtz-Eakin
Director

cc: Honorable Kent Conrad
Ranking Member

An Economic Analysis of Alternatives to Tax Reductions in S. 1637

Introduction

In July 2001, a World Trade Organization (WTO) panel ruled that the United States' extraterritorial income exclusion (ETI) is an export subsidy that contravenes the agreements on which the WTO is based. In January 2002, that ruling was upheld by the WTO's Appellate Body. The ETI is the most recent in a series of tax laws intended to give a tax preference to U.S. exports. Both of the previous incarnations of the preference—Domestic International Sales Corporations (DISC) and Foreign Sales Corporations (FSC)—encountered similar difficulties in complying with international trade agreements.

The European Union, which brought the complaint before the WTO, threatens trade retaliation if the statute is not repealed. As a result, bills have been reported out of the House Ways and Means Committee (H.R. 2896) and the Senate Finance Committee (S. 1637) that would repeal the ETI and replace it with other provisions. Those provisions have taken different form in the two bills. Both include some reduction in the taxation of foreign profits of U.S. corporations and some tax relief directly related to income generated by qualified domestic productive activity (primarily manufacturing).

This analysis focuses on S. 1637 and on a specific alternative—an across-the-board reduction of 2 percentage points in the corporate tax rate—to be offered as an amendment to replace the provisions reducing taxes in the bill. The analysis compares that lower corporate rate to three alternatives: the approach currently embodied in S. 1637, a reduced tax rate targeted solely toward the manufacturing sector of the economy, and the existing tax system in general, including the export tax subsidy contained in the ETI.¹ The comparison looks at effects on short-term employment, long-term economic growth, efficiency, and international terms-of-trade.

Current Law and Alternatives

Under the ETI, a tax exemption is provided for 15 percent to 30 percent of a firm's "extraterritorial" income—which the law defines as income from exports

1. The revenue-raising provisions in S. 1637 finance the reductions in each of the other three alternatives, so all comparisons are budget neutral. In addition, for the purpose of comparing the current tax system to alternatives, it is assumed that the ETI tax benefit could continue without trade retaliation, so the cost of trade retaliation does not become part of the comparison.

and from foreign operations (but the latter only to the extent that it does not exceed the former). Thus, the tax benefit is a 15 percent to 30 percent reduction in the rate of tax imposed on a firm's export income and an equal amount of its foreign-source income.

The main feature of S. 1637 is a phased-out repeal of the ETI benefit.² Consequently, the focus of business tax reduction in the bill is providing businesses with a compensating tax cut that is permissible under WTO. Because a WTO-compliant export preference has proved so difficult to create, the tax benefits in the repeal legislation would affect the international position of U.S. firms in other ways.

The principal tax benefit in the bill is a phased-in reduction of taxes on income attributable to qualified U.S. production—principally (but not exclusively) manufacturing. It allows a deduction from a firm's taxable income equal to 9 percent of the firm's net income from qualified domestic production multiplied by the ratio of the value added from the firm's domestic production to the total value added by the firm worldwide. Under that proposal, therefore, the tax reduction is limited to a firm's U.S. production activities. Moreover, the amount of the benefit is reduced to the degree that the firm claiming it has income arising from production activities abroad.³ Hence, a firm that has only qualified domestic-source income receives a deduction equal to 9 percent of its net income. In contrast, a firm that receives half of its income from qualified domestic production, with the other half from foreign activities, gets a deduction equal to only 2.25 percent of its net income (half of its income is qualified production, which is reduced by one-half because of its activities abroad).

The alternative of an across-the-board cut in corporate tax rates is a reduction on the highest statutory corporate marginal rate from the current level of 35 percent to 33 percent. It applies to the entire corporate sector and is phased in slowly from 2004 to 2010. The alternative of a tax cut targeted solely toward manufacturing takes the form of a separate marginal corporate tax rate for manufacturing firms. For this analysis, the specific size of that reduction is undetermined, but it is assumed to be whatever rate yields the same approximate revenue loss as the overall rate reduction and is phased in gradually over the same period. It differs from the reductions in S. 1637 in several ways: all of the revenue raised in the bill is de-

2. The second largest increase in receipts in S. 1637 (after ETI repeal) is an extension of customs user fees. Because those fees are offsetting receipts, they reduce outlays and contribute to making the bill budget neutral. The bill also includes an assortment of smaller revenue raisers—most significantly, alterations in the tax treatment of tax shelters. Those may be loosely classified into general antishelter provisions (such as codifying the economic substance doctrine), provisions addressing numerous specific shelters, and changes in tax policy that reduce opportunities to engage in the sheltering of income.

3. That feature of the bill expires in 2013.

voted purely to the rate cut for manufacturers, it is limited just to manufacturers, it takes the form of a rate cut instead of a deduction, and the benefit is not reduced in accordance with how much of a firm's income comes from activity abroad.

Tax Rates and Marginal Incentives

The Joint Committee on Taxation (JCT) estimates that the revenue-reducing provisions now in S. 1637 lower receipts by about as much as receipts are increased by the repeal of the ETI benefit and other revenue raisers in the bill. JCT also estimates that a phased-in across-the-board cut of 2 percentage points in the corporate tax rate would reduce receipts by about the same amount. For the purposes of comparison, any reduced tax rate targeted solely toward manufacturing is assumed to be comparable in terms of its revenue loss. Consequently, the alternatives are roughly comparable in terms of their revenue effects, and none of the conclusions in this analysis depend on additional assumptions about the financing of the tax reduction.

Although all of the alternatives have roughly the same revenue impact, however, they do not all reduce the marginal tax rate on corporate income by comparable magnitudes. Marginal tax rates (the tax rate on another increment of income) are the rates critical to influencing growth and efficiency. The existing ETI affects marginal tax rates. But many of the tax-shelter and other revenue-raising provisions of S. 1637 do not. Similarly, some of the provisions of S. 1637 that reduce taxes (such as the temporary reduction in the tax rate on dividends from controlled foreign corporations) do not reduce effective marginal tax rates. In contrast, both a cut in the overall corporate tax rate and a cut in the rate on manufacturing are marginal rate cuts.

A 2 percentage-point reduction in the corporate tax rate does not translate directly into a 2 percentage-point cut in the effective rate on corporate income. An important reason is that actual economic depreciation (the decline in the value of the capital used for production) is not the same as the depreciation permitted in calculating taxable income. In most cases, tax depreciation is faster and reduces the effective tax rate on income generated by corporate assets because it allows more of the cost of production to be deducted sooner, when such benefits have more value. The divergence between economic and tax depreciation, therefore, has the effect of causing a 2 percentage-point decline in the statutory marginal tax rate to be less than 2 percentage points in the case of most categories of assets (see Table 1). Most of the effective marginal tax rates on income from various categories of assets are less than the statutory rate of 35 percent. And the reduction in the rate to 33 percent in those instances is less than two percentage points.

**Table 1: Effective Tax Rates by Asset Type,
With and Without Corporate Rate Reduction**

Asset Type	Current Law	Lower Rate	Reduction
Autos	34.0	32.1	1.9
Office/Computing Equipment	30.9	29.0	1.9
Trucks/Buses/Trailers	29.2	27.3	1.9
Aircraft	29.3	27.4	1.8
Construction Machinery	23.3	21.7	1.6
Mining/Oilfield Equipment	28.2	26.4	1.6
Service Industry Equipment	28.2	26.4	1.8
Tractors	26.6	24.8	1.8
Instruments	27.9	26.2	1.7
Other Equipment	26.6	24.9	1.7
General Industrial Equipment	25.5	23.8	1.7
Metalworking Machinery	23.4	21.9	1.5
Electric Transmission Equipment	33.1	31.1	2.0
Communications Equipment	18.8	17.5	1.3
Other Electrical Equipment	23.7	22.0	1.7
Furniture and Fixtures	22.9	21.8	1.1
Special Industrial Equipment	21.0	19.6	1.4
Agricultural Equipment	21.4	10.0	1.4
Fabricated Metal	29.1	27.4	1.7
Engines and Turbines	36.0	34.0	2.0
Ships and Boats	17.3	16.1	1.2
Railroad Equipment	17.9	16.8	1.3
Mining Structures	7.1	6.5	0.6
Other Structures	39.9	37.7	2.2
Industrial Structures	36.8	34.7	2.1
Public Utility Structures	26.7	25.2	1.5
Commercial Structures	36.0	34.0	2.0
Farm Structures	25.9	24.2	1.7

Source: Congressional Research Service.

Two other aspects of those effective tax rates are relevant to the analysis. First, the current corporate tax does not fall evenly on all assets. That is largely because tax depreciation is more generous than economic depreciation, which affects assets differentially. Second, those asset classes most associated with manufacturing—fabricated metal, special industrial equipment, metalworking machinery, instruments, general industrial equipment, and other equipment—are taxed at rates fairly close to the average, suggesting that the current tax system does not disadvantage manufacturing relative to most other sectors of the economy.

Evaluating Economic Impacts

The economic effects of tax policy may differ in the short run and over longer horizons. In the long run, an economy can be expected to fully employ its labor force and capital stock, and growth occurs as its capacity to produce grows. But in any particular interval of time, the economy may be operating under capacity, with unemployed resources, including idled equipment and jobless workers. Short-term employment gains are usually generated by raising demand: incentives for households to spend more and firms to invest more. Gains in long-term output come by boosting supply: encouraging work effort and saving to finance investment in technology, skills, and capital.

Those long-run impacts may be further broken down into efficiency and growth effects. An increase in efficiency is an increase in output that comes from using existing inputs in a better way. Efficiency raises capacity to a higher level but does not continue to increase it without additional inputs. Growth, by contrast, is a continual process associated with higher saving and investment. A higher saving rate increases the growth of capacity not only this year but each year as long as it continues.⁴

A final consideration arises because the tax policies under discussion are international in nature—that of the country's economic situation compared with the situations of other countries. As long as a nation engages in international trade, the terms of that trade measure the value of what it gets for what it gives up. The more resources it must trade away for the goods and services it gets in return, the worse off it is.

In short, multiple standards exist for evaluating the economic effects of tax policy: the short-term impact on demand (and thus employment), the long-term effects on

4. In the very long run, even a higher saving rate ceases to keep economic growth rates higher. Over time, the higher depreciation associated with the larger capital stock, and the reduction in the pay-off of further investment, weaken the growth effects of saving.

growth and efficiency, and the degree to which the policy improves the terms under which a nation trades.

Short-Term Employment Effects

Replacing the current ETI benefit (and the shelters in S. 1637) with the cuts in S. 1637, a cut targeted solely toward manufacturing, or an across-the-board reduction in the corporate tax rate would not have any significant effect—positive or negative—on demand or short-term employment. None of the alternatives dominate any of the others by that standard.

In the short run, budget policy can increase employment and output by increasing aggregate demand. In general, that is achieved either by increasing consumers' disposable income or by increasing the after-tax return that firms receive on their investment.

None of the tax policy alternatives considered here are likely to measurably increase aggregate demand or short-term employment compared with what would occur if the current tax system was left unchanged. First, none of them increase disposable income for consumers. In every case, the tax changes relate to business taxation, and in all cases, the budgetary effects are roughly budget neutral. Second, the effects of the cuts on income from capital generally exchange one set of investment incentives for another, with little net decrease in the taxation of capital income overall. The reduced tax rate on manufacturing, for example, should have much the same aggregate effect as the more general cut in the corporate tax rate. The former would be a deeper cut—but on a narrower eligible class of investments—than the latter, producing much the same net effect on demand.

Long-Term Growth

All of the alternatives have roughly the same effect on the rate of long-term growth. But the across-the-board corporate rate cut and the cut focused purely on manufacturing would result in slightly more growth than the current tax regime or the cuts in S. 1637.

In the long run, economic growth depends on the growth of capacity. That capacity is partly determined by the size of the nation's capital stock, which grows by the amount of investment (net of depreciation) that takes place each year. The incentive to invest, because it depends on the after-tax return that investors expect to receive, is influenced by taxes. In general, a heavier rate of taxation on income from capital is likely to result in slower growth of the economy (assuming that government borrowing and other things do not change).

Virtually all of the taxes involved in these alternatives are imposed on income from capital, and all are expected to raise approximately the same amount of reve-

nue. However, that does not mean they have equivalent effects on the incentive to invest. That incentive depends on marginal tax rates—the rates that will help determine the return an investor gets from an additional increment of investment.

In the case of the across-the-board cut in the corporate tax rate, the full 2 percentage points represent a reduction in the marginal tax rate on corporate income and thus an increase in the return on corporate capital (all other things being equal). In the alternative proposals, the tax preferences for exports, qualified domestic production, and manufacturing also decrease the marginal tax rate and increase the return on capital. But they do so for the returns on only a subset of investments. Nonetheless, those preferences raise the return on investment overall and attract investment.

As a result, the principal difference among the alternative proposals in terms of long-term growth is the extent to which some of them involve tax breaks that do not affect new investment. The current-law sheltering activities that would be eliminated along with the ETI benefit probably have little marginal effect. And the temporary reduction in the tax rate on dividends from controlled foreign corporations in S. 1637 has no marginal effect. Therefore, both current law and S. 1637 would have slightly smaller effects on investment than would the across-the-board corporate rate cut or the manufacturing rate cut. In both cases, however, the differences are small.

Efficiency

In terms of economic efficiency, the proposed across-the-board 2 percentage-point rate cut is superior to the other three alternatives considered here. It would not have the distortions associated with favoring exports, domestic production, or manufacturing. In addition, it would lessen all of the distortions associated with the corporate income tax.

Economic efficiency requires that resources be channeled to their most valuable uses. Tax policy influences efficiency by altering the incentives to direct resources to various activities. In the case of taxation of capital, taxes can cause a divergence between the after-tax return on investment (the return that matters to the investor and that determines how he or she directs its use) and the before-tax return (the return that measures the income that the investment generates, and hence the value of the investment to society).⁵ That divergence typically makes the economy less efficient than it could be, and reducing the divergence usually increases

5. That statement ignores the possibilities of “externalities,” which cause the before-tax return to differ from the social value of the investment because the investor does not capture or incur all of the benefits or costs of the investment.

the output that an economy can produce with a given set of inputs, as well as the value of that output to people in the economy.

In the absence of taxation, relative returns on investments in different sectors provide both the information and the incentive to move investment among uses in the economy for which it is most productive. If returns in the manufacturing sector or among the firms and industries that are heavily engaged in exporting, for example, are higher than in other sectors, investment will occur in those places, expanding output there. The outcome is a gain in total efficiency, as the output generated by the capital added to those industries exceeds the output lost from removing the capital from elsewhere. As activity in the expanding sectors increases, and as it decreases in other sectors, returns will tend to equilibrate. As a result, capital will be allocated so that there can be no gain from shifting it from one sector to another.

If taxes are imposed on one sector and not another, however, resources will be directed to the tax-favored industries. The results will be a contraction in the activity of those industries that are not favored and an expansion of the activity of those that are. Those results will occur until the after-tax returns are equilibrated among industries. But after-tax returns can only be equilibrated if before-tax returns (the ones that represent the actual productivity of the investment) are unequal. In turn, unequal before-tax returns mean that the allocation of capital is inefficient; output can be increased by shifting investment from the low-return to high-return industries.

Consequently, the efficiency effects of tax policy can generally be assessed by reference to how unevenly tax rates fall on different endeavors. The current corporate tax system creates a number of distortions that cause after-tax returns to deviate from before-tax returns. The corporate income tax increases the tax on capital income, thereby distorting the choice between accumulating capital and spending (the effect discussed in the previous section on economic growth). It also distorts the choice between organizing in corporate or noncorporate form and the choice between debt and equity financing.

A reduction in the corporate tax rate reduces the corporate/noncorporate distortion and the debt/equity distortion. Tables 2 and 3 provide estimates of the effective tax rates associated with each of those distortions from the combined individual and corporate tax rate on investment, as well as the impact on those tax rates of an across-the-board 2 percentage-point reduction in the corporate tax. (The rates assume the extension of the lower individual tax rates in EGTRRA and the dividend

tax relief in JGTRRA).⁶ Because the corporate tax rate does not apply to noncorporate income, the reduction in the rate has no effect on the effective tax rate on noncorporate businesses. The difference in treatment of the two shown in Table 2 is narrowed by the full amount of the reduction in effective corporate taxes. In Table 3, a similar calculation is made for the financing choice. In that case, the effect of the cut is even greater, because the cut reduces the effective tax rate on equity financing while raising it for debt financing (interest costs are deductible from taxable corporate income), significantly narrowing the disparity in taxation.

Table 2. Weighted Effective Total Tax Rates on the Corporate and Noncorporate Sectors

	Current Law	Lower Rates	Reduction
Corporate	28.5	27.1	1.4
Noncorporate	16.4	16.4	0

Source: Congressional Research Service.

Table 3: Weighted Effective Average Tax Rates on Debt Versus Equity, for Corporate and Individual Taxes

Asset Type	Current Law	Rate Cut	Change
Debt	-6.8	-4.8	2.0
Equity	36.2	34.4	-1.8

Source: Congressional Research Service.

All of the alternatives—the current ETI benefit, the cuts in S. 1637, and a rate reduction targeted solely toward the manufacturing sector—reduce the effective corporate tax rate relative to what it would be in the absence of those tax breaks, although the extent is impossible to quantify. But the efficiency gain from an across-the-board corporate tax rate reduction is greater than the gain from a cut (even a revenue-neutral one) that is concentrated in a narrow part of the corporate sector. In addition, because part of the distortion is between corporate and noncorporate forms of organization, and because the manufacturing sector is overwhelmingly corporate, the reductions concentrated on manufacturing would offer less in the way of efficiency gains than would reductions that reach industries where both corporate and significant noncorporate activity occur. Hence, the across-the-board

6. This analysis assumes that some of the investment is financed on the margin by pension funds and other tax-deferred or tax-exempt sources of funding.

2 percentage-point corporate tax cut would yield greater efficiency gains than the alternatives.

In addition to those effects resulting from the corporate income tax, two other distortions are relevant to the analysis. The first is that through various features of the tax code, different business endeavors are effectively taxed at different rates, creating the inefficiency that results from more economic activity in the tax-favored sectors (and less in the tax-penalized sectors). That results both from the variation in the differential between economic and tax depreciation among various asset categories and from preferences given in other forms to particular industries. The second relevant distortion is that opportunities to minimize taxes through changes in business conduct cause more resources to be used for compliance and enforcement that could otherwise be devoted to production.

The across-the-board rate reduction also compares favorably with the alternatives in terms of those distortions, for a number of reasons. First, as shown in Table 1, an across-the-board reduction in corporate rates reduces the disparities in effective tax rates among assets.

Second, the alternatives to an across-the-board rate reduction, by focusing their benefits on narrow segments of corporate activity, create additional distortions. Each favors economic activity in specific forms. The ETI distorts activity by favoring firms that export. The cuts in S. 1637 largely favor production activity in the United States. A preference aimed at manufacturing would be similarly distorting relative to an overall rate cut. In contrast, the across-the-board cut in the corporate tax rate generates no new distortions of that kind.

Third, targeted reductions typically increase the complexity of the tax code and therefore increase compliance and enforcement costs. That is especially true of the reductions focused on manufacturing. A rate cut limited to manufacturing would create incentives to redefine various activities as manufacturing—requiring federal resources to determine what would qualify, firms' resources to find ways to maximize the income that could meet the letter of such rules, and additional federal resources to monitor and adjudicate firms' efforts.

The efficiency gains associated with an across-the-board corporate rate cut of 2 percentage points are potentially significant. The inefficiency generated by the corporate income tax is large relative to the revenue it raises, and even small changes in the corporate tax rate can reduce that inefficiency substantially. Using the differentials from the tax rates in Tables 2 and 3, it is possible to make a rough estimate of the efficiency gain from a 2 percentage-point cut in the corporate tax rate based on earlier studies of the inefficiency arising from the corporate tax. At current levels of output, that efficiency gain is about \$4 billion to \$7 billion a year.

That gain would not appear entirely as an increase in output, however. Consumers and investors would receive some of the increase in forms (such as improvements the risk composition of portfolios) that are not measured in gross domestic product. Moreover, because the cut would be phased in, and because the efficiency increase would result partly from shifts in assets between sectors that would take time to accomplish, the full gain would not be realized for a number of years.⁷

A complete comparison of the alternatives to repealing the ETI benefit requires similar estimates to be made for the other options under discussion in order to fully quantify the efficiency gain associated with the rate cut compared with ETI repeal, the cuts in S. 1637, or a rate cut targeted solely toward manufacturing. Each of those alternatives also reduces the corporate tax wedge from what it would be without the preferences. As explained above, the gains associated with those approaches would be less—probably substantially less—than the gains associated with a broad-based cut. Moreover, those approaches would simultaneously introduce other distortions that would fully offset the more limited gains. Consequently, the efficiency superiority of the 2 percentage-point cut could be as large as the \$4 billion to \$7 billion gain estimated above.

International Terms of Trade

The across-the-board corporate rate cut would be more beneficial than the current tax regime with respect to its effects on the terms of trade. In comparison to the other two alternatives, it would be roughly comparable.

The ETI and the tax benefits for exports that preceded it were all attempts to create a more favorable position for the United States in international trade. Similarly, various aspects of the replacement provisions in S. 1637 are directed at influencing the competitive position of U.S. firms with respect to foreign competition. Hence, the final standard by which the alternative tax proposals may be assessed is how they affect the international position of the U.S. economy.

The international economic position of a country cannot be assessed in the same way as a firm or industry. A firm or industry may be thought of as being more competitive internationally if it can sell its output and maintain market share in competition with its counterparts from abroad. But for a nation to export its output, it must also import. One is the exchange for the other. Consequently, a nation as a whole cannot be said to be more or less competitive in this same sense. If some sectors of the economy are more successful in exporting, it generally means

7. That estimate is also based on the so-called old view of dividends. A “new view” or “trapped equity” model would substantially reduce the potential for gain, since the main conclusion of such a model is that the corporate tax produces few distortions in the marginal incentives to invest.

that other sectors are becoming less successful in competing with imports. One implies the other.

As a result, the way to assess a nation's international economic position is by reference to the terms on which that exchange of imports for exports occurs. The less a nation must give up in the form of exports for the imports it gets, the better off it is. In the extreme, consider a situation in which nothing is given up for imports. If other nations gave Americans their resources and products at no charge, the United States would be economically better off than it would be if it paid for them.

Taxes and a variety of other policies can influence the terms of international trade. Of the alternatives considered here, the ETI produces the worst U.S. terms of trade. It provides a subsidy to exports that manifests itself partly in the reduction of the cost of exports to foreign consumers. As a result, a greater amount of U.S. resources is given up in exchange for the imports the United States gets in return. The amount of the tax preference that is lost to foreign consumers depends on how much can be captured by domestic producers instead. But in the long run, in a competitive environment such as the United States, domestic producers are not likely to keep any of that tax preference. The loss to the United States, therefore should be approximately the size of the subsidy: \$5 billion to \$6 billion a year.

The other alternatives are little different from one another in their terms-of-trade effects. Replacing the ETI benefit with an across-the-board cut in the corporate tax rate would have the most salutary effect. But the cuts in S. 1637 and a break purely for manufacturing—though having some minute effects on the terms of trade relative to the rate cut—would still be superior to the ETI by nearly the same magnitude.

Conclusion

Repealing the ETI should generate a gain to the United States about equal to the revenue loss associated with that exclusion: in the range of \$5 billion to \$6 billion a year. That gain will manifest itself as an improvement in the United States' international economic position, as the nation gives up less in resources to acquire goods and services from abroad. The gain will accrue regardless of whether the revenue-raising provisions in S. 1637 are offset with the current set of tax preferences in that bill, with a tax rate cut targeted solely toward manufacturing, or with an across-the-board cut of 2 percentage points in the corporate tax rate.

The gain to the economy, however, would be further increased if the across-the-board corporate rate cut was enacted instead of the other two alternatives. Although that choice would be unlikely to affect either short-term employment or

long-term growth to a significant degree one way or the other, the broad-based corporate tax rate cut would result in a greater efficiency gain. That gain relative to those of the alternatives cannot be completely quantified, but it is likely to be in the same size range as the gain from repealing the ETI.

