WHO PAYS THE CORPORATE TAX IN AN OPEN ECONOMY?

KEYNOTE SPEAKER:
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MR. : Our speaker is Lawrence Summers. Larry is the Charles W. Elliott university professor at Harvard University. He was the 27th president of Harvard University, where he served from 2001 to 2006. He was the United States secretary of the Treasury from 1999 to 2001. Previously, he served in the Treasury as undersecretary and deputy secretary. Prior to that, he was chief economist and vice president to the World Bank. Prior to that, Larry was a professor first at MIT and then at Harvard. He received the John Bates Clark medal of the American Economic Association, the National Science Foundation’s Allen T. Waterman award. He is a member of the National Academy of Sciences and for – and as a distinguished contributor to the literature on corporate taxation, which is the subject of today’s conference, in addition to all of his public service and engagement in public affairs.

It’s my pleasure to introduce Larry in part because he’s the one who introduced me to many of these issues and turnabout is fair play. We wanted someone who was extremely knowledgeable and contributed to the research in this area, who has served the government and been heavily involved in U.S. policy in this area for some time and who has thoughtful, measured, judicious views on this and other subjects. (Laughter.) And so, naturally, we were hoping that we would be able to have Larry Summers as our speaker, and we do. Thank you, Larry. (Applause.)

LAWRENCE SUMMERS: Jim, thank you very much. It’s good to be back and to see so many friends from within the tax community, people who I have studied with, people who I have worked with, people with whom I have agreed over the years, people with whom I have disagreed over the years. I think, in the fullness of it all, if I think about all of the public policy communities and all of the public policy issues, and I think about the ratio of the quality of people who work on the issue to the quality of the outcome in public policy – (laughter) – I think there is no area where that ratio is greater. (Laughter.)

Tax policy has been the province of extremely thoughtful policy experts, attorneys, economists who work with enormous dedication, skill, and analytic capacity, and who have a deep commitment to serve the public interest. And yet, I think our collective satisfaction with the outcome, in terms of the tax policy that we have, is less than entirely complete. It’s probably an interesting paradox of democracy, but I mean it primarily as a compliment to those who are here today and to the kind of endeavor that this effort of Brookings and the Urban Institute represent.

When Jim invited me to speak here, I protested heavily that there was nothing that I had to say that was new in both senses of the word new, that there were perhaps some things that I knew, K-N-E-W, but they were surely not N-E-W as well, that this had not been a major area of my thinking in recent years and I wasn’t sure how successful it had been an area of my thinking ever. And Jim said, well, you surely don’t mean to say that there’s a question on which you have nothing to say – (laughter) – or no opinion. And I
had to acknowledge that that was a claim that I was not prepared to rise to making. (Laughter.) And in that way, he did get me to come.

I want to try to take a big picture on this subject and to offer a kind of big picture perspective about what it seems to me that you all ought to be heavily concerning yourselves with. I do this in the knowledge that some of you are in ways I don’t understand concerned with the things that I am going to stress, but also with the sense that it represents a smaller part of our collective concern with improving taxation than I believe it should.

Take the biggest picture. What will people say about the global economy and economic issues in this quarter century when people write economic history books 100 or 200 years from now? They might basically say that it was all shaped by the SARS epidemic of 2010 or the major terrorist outbreak or the nuclear proliferation of 2014. But if that’s true, probably nothing we’re going to discuss here is going to prove to be hugely historically important. So I’m going to proceed on the premise that that won’t be what it will be about.

We can’t know what the outline will exactly be, but I think we can suspect that it will have these elements. We’ll have an element of making the point that they called it the industrial revolution in 1800, the 1800s, because for the first time in human history, living standards started to rise because of economic processes at a rate where they as much as doubled within a single human lifespan. And yet, in societies where 40 percent of human lives, living standards are now rising at a rate where they double in a decade – think about it, 7 percent a year. With a human lifespan of 70 years, that means they are rising by 100 fold within a single human lifespan.

They will talk about the unprecedented degree of global integration in production and patterns of consumption that led to the international mobility of far more kinds of economic activity than had previously been the case. Perhaps they will even talk about a revolution in international trade, which has traditionally been conceptualized as trade in goods and perhaps trade in services towards a mode where it can be more deeply conceptualized as trade in tasks as integrated international organizations produce goods and services with a portion of the value added in many different jurisdictions.

They will talk about the unprecedented rise of global finance in this period and the paradox of very large capital flows from the developing world to the industrial world, even as the developing world grows much more rapidly than the industrial world.

They will talk about how all of these technology, technological changes combined with the consequences of this international integration led to very substantial changes in the income distribution, with those in a position to get access to technology who never had it before seeing those remarkable increases in living standards, those with the capacity to lever these changes in the world reaping fortunes on an unprecedented scale, but the very large number of people who were already fortunate in having access to cutting-edge technology, but who lacked the capacity to lever the opportunity that China
and India represent feeling disenfranchised and seeing their share of the economic pie declining, creating an anxious middle.

These will, I suspect, be major themes of the economic developments that shaped this era. And it seems to me that, in thinking about tax policy, these forces are of profound importance. There are many different takes on globalization; there are many different takes on the Washington consensus. Increasingly, there’s a — you know, now, people are talking about the Beijing consensus as an alternative to the Washington consensus and there’s a great deal that can be debated and probably every point in idea space is occupied by some economist or other.

But I think there would be a quite widespread consensus that continued, properly managed global integration is a positive thing and that a failure to maintain global integration would carry with it enormous political and economic risks. And I think there would be a quite widespread consensus that if the momentum of global integration is going to be maintained with all of the benefits that it can bring, that there will need to be a great deal of attention in the months and the years ahead to making sure that it works not just in aggregate, but for a sufficiently broad coalition of citizens and countries, that it is able to command political support.

And yet, if one thinks, and here I focus particularly on the distributional issue, there is a major paradox. On the one hand, globalization is — and the forces that are driving it — are bringing with them very large increases in inequality. To just offer a number to illustrate the point, there are plenty of ways in which one could criticize or do the calculation differently, imagine that the income distribution in the United States were the same today as it was in 1979. The result would be somewhere in the neighborhood of $600 billion more for those in the bottom 80 percent of the income distribution, or about $7,000 per family, and something, some comparable figure less for those in the top 1 percent of the income distribution, or some $600,000 per family. Those are not present value figures; those are annual figures.

Or, to put it differently, if the income distribution had remained constant over the last 30 years and the standards and the growth rate of aggregate incomes had been the same, the incomes of the bottom 80 percent of the population would have risen about 15 percent more rapidly, which is very large relative to the amount by which they actually rose. And so, in a sense which has not been true historically, in this era of rapid productivity growth, the distributional questions are central to income growth of the middle class.

Distribution questions are critical. Distributional questions are central to our considerations of tax policy. And yet, here is the central tax paradox of globalization. On the one hand, it increases inequality and therefore raises the need for the warrant for redistribution. On the other hand, it increases all of the relevant elasticities from the point of view of any one country. Capital can move more easily. Tax production activities can migrate more effectively. More sophisticated financial accounting and
More sophisticated financial accounting and instruments enables the movement of income without the movement of economic activity. Indeed, in the era of private jets, individuals can occupy residences without hardly being there to much greater extent than was once the case.

And so, we confront on the one hand widening inequality, which optimal tax theory tells us, means that we should have more redistributive taxation, and on the other hand, far higher elasticities of supply on every dimension, which tells us that it is much more costly to engage in redistributive taxation. The great – part of the reason why tax debates have become more vexing in many ways is that the people who say there’s a much greater need for progressivity than there used to be are right. And the people who say that more progressivity comes at much greater cost in terms of competitiveness than it used to and that structures that we once could afford without too much competitive difficulty we can no longer afford, are also asserting a valid proposition. This all is the practical way to think about it.

A different way of approaching the same issues, just to show you that I still got a little bit of the old fastball – (laughter) – is to think about the question of tax incidence in a one-good global model in which capital is mobile and labor is not. Imagine a single, small jurisdiction that imposes a tax on capital income. A moment’s reflection will reveal that after-tax returns have to equalize around the world, and so, that jurisdiction will eject capital to the point where the after-tax return is lower. Productivity will, as a consequence, be reduced, and so, the tax will be borne entirely by labor, and appear regressive.

Now, do the calculation on a global basis; it’s slightly more complicated to see because if you think about the first order effects, you’d say, well the first thing to say is the rate of return won’t change at all, since this small jurisdiction ejecting capital won’t change the world capital stock at all, so that the rate of return to capital won’t change. But then if you think about it for a second, the only reason the rate of return to capital isn’t changing is because the supply of capital that is – into which the jurisdiction’s capital is being ejected, is infinitely large relative to the jurisdiction.

And so, if you want to measure the change in global capital income, you’re in a sense multiplying a zero delta times an infinite stock. And so, without doing a little bit of mathematics, you can’t work out the answer, but doing a little bit of mathematics, as has been done many times now, you can work out the answer. And the answer is that, on a global basis, that tax imposed on capital locally is 100 percent borne by capital globally. So, from a national perspective, it’s entirely regressive in the sense of being borne by labor; in a global perspective, there are offsetting costs to local labor, gains to foreign labor, with 100 percent of the cost being borne by capital globally.
What does all of this suggest? It seems to me that it suggests that if we are going to be able to engage in the kind of redistribution and the kind of universal benefiting from the economic efficiency that comes from globalization, it is imperative that we find ways to achieve much greater cooperation in taxation than we have to date. It is an emergent theme in – probably more than emergent right now – in trade discussions that you have to have trade plus, and so great emphasis has been spent on trade and labor standards and trade and environmental standards.

Both of these agendas have their merits and strong arguments can be constructed regarding both of them. The environmental issues involve a somewhat different set of considerations. It is not clear how great in terms of actual impact the labor standards issues are, given that the nature of the goods we produce and the nature of the goods our low wage trading partners produce, are sufficiently divergent. What has received much less attention, I would suggest in order of magnitude less attention at least, is questions having to do with harmonization and cooperation with taxation, in their relationship to the international trading system.

Now, taxes are an area of what I once called Larry’s law of international trade negotiation, which is that everyone is strongly in favor of harmonization, international trade dialogue, and referral to the WTO of any area that they know nothing about, and is passionately opposed to any role for international trade negotiation with respect to any issue they understand. Joe, I think, was present at the Treasury, I don’t remember if it was before or after you go to the Treasury, Joe, that Les Samuels stood alone against 185 trade negotiators in Geneva. Was that under you? Was that with your guidance?

Q:  (Off mike.)

MR. SUMMERS:  Let’s do that – (chuckles) – they were all there, but the U.S. position was, you know, you guys may want to harmonize some tax rules. They said, not to hear of it, we’re happy to have a meeting with our tax guys. You know, if you want us to have a little OECD tax meeting, we’re happy to have an OECD tax meeting, but we are not discussing tax issues with trade negotiators. It will not happen. And you know, the question arose, I remember a discussion with various finance ministry colleagues and the question arose whether our respective tax officials were on our countries’ teams or whether they were on the international tax team – (chuckles) – determined to maintain jurisdiction.

I jest, and I don’t have –

Q:  We’re on the record, by the way – (chuckles).

MR. SUMMERS:  I jest, but I don’t jest – I’ve been there before – (laughter).

But I don’t jest entirely, whether the WTO is the right forum, whether an international tax organization is the right forum, whether greater voluntary cooperation through consultation with officials without extensive involvement of politicians is the
right forum, I don’t pretend to have a confident answer. But it seems to me that there is a hierarchy of issues on which much more could be done to achieve international cooperation and that the benefits of that international cooperation would go far beyond the technical tax virtues.

Seems to me at the lowest and least controversial level, these questions surrounding bank secrecy, cooperation in enforcement, preventing the hiding of income, where my understanding is that a fair amount has happened over the last seven or eight years, probably more due to 9/11 and the parallel concerns with money laundering than due to a true tax imperative, but where my impression is there has been real progress but still a considerable distance to go.

A second broad set of issues, where my impression is that the forces of legal avoidance through technological progress in financial scheming have run ahead of the aggregate enforcement effort is with respect to questions of the location of income and deductions across jurisdictions. Here, there have been a variety of improvements in regulation and enforcement, but they have to contend with the fact that the movement towards a trade in tasks-based international economy has greatly increased the scope for transfer pricing issues, and financial innovation has greatly increase the scope for locating deductions in one place and income in other places.

A third set of issues which, I have to confess, have been explained to me on numerous occasions by Joe Gutentag and others. And each time I think I understand and it is the case that I could give an accurate summary for an hour and a half after receiving the explanation – (chuckles) – but insight soon escapes, go to questions of worldwide versus national taxation, domicile residence, the location of tax, location of taxpayers and how that affects – and the location of their assets and how that affects their taxation. It was in that context that Les Samuels memorably coined the phrase economic Benedict Arnolds, referring to those who renounced citizenship in order to avoid the payment of taxes. The most abusive such cases are currently covered by U.S. law, but there is a great deal more scope for addressing these issues, particularly in a world where the – where more and more people are marrying spouses who are not of – who do not share their citizenship, and more and more children are being born with multiple citizenships, creating great capacity for avoiding the taxes that one might suppose would be collected.

A fourth area for investigation is the whole question – and these are obviously moving up in terms of how radical they are relative to current conventions – is the whole question of tax competition and tax harmonization. It is the case that in a world of competitive jurisdiction, taxes on multiple factors – mobile factors will tend to be driven down relative to taxes on immobile factors, if those who are fortunate are in possession of mobile factors and those who are unfortunate or less fortunate are in possession of immobile factors, that will have important distributional implications, and that would be true even if all of the other issues that I have referred to or addressed. There is some movement on this direction within the European Union. In the late years of the Clinton administration, there were some initial discussions of tax competition within the OECD,
though my impression is the idea that those would go to a fundamental tax structure, rather than to questions of tax avoidance, would have been seen as quite a radical one.

And finally, of a piece with the rest of this but somewhat different, is the whole question of the taxation of financial products and the development of financial instruments, that to put it politely, blur traditional tax distinctions between capital gains and ordinary income, between a cruel and realization.

I continue to be stunned by – as one who straddles several different policy communities, by the fact that one can go to any number of meetings where the issue of systemic risk in the global financial system is discussed, where it is a shared consensus that ultimately this goes back to excessive leverage and to the consequences of excessive leverage, that the ways in which excessive leverage interacts with optionality and a variety of other features of securities are considering, in great and nuanced detail, and that the possibility that the government is subsidizing all of this activity to the tune of billions of dollars in subsidy towards what at least these financial experts see as negative externality-generating activity in the form of taking on of leverage, is neither mentioned nor considered and yet, for issues of global financial stability, is of profound importance. Here, too, it seems to me that there is no possibility of progress without substantial international cooperation.

And so, I will have served my purpose today, just to summarize, if I have induced you to think about three things. One, the global economy, in its essence, is really quite different than the global economy that existed when most of us were introduced to the subjects we’re discussing today. Two, that those changes create a central paradox for the tax system of an increased demand for redistribution at the same time that redistribution becomes much more difficult. And third, that the only way through is a substantial increase in international cooperation so as to enable more progressive taxation, and that there is a great deal that could be done in that sphere and that while, as my initial remark about the quality of the people and the quality of the policy suggests, there are limits to the collective influence of the community we represent. Those limits are far greater than zero, that working to promote this kind of international cooperation seems to me an important agenda for all of us.

Thank you very much.

(Applause.)

Q: (Off mike.)

MR. SUMMERS: I don’t know. I don’t know, and the reason I don’t know – the question was, would I favor getting rid of the deductability of interest from the corporate tax. And I’ve never really been able – I sort of know it’s a big problem, and since I’m not a policymaker anymore, I don’t have to have judgments as to what I favor on every question. What bothers me in this is that the guy who’s running some business and is sitting around, thinking about whether he should issue preferred stock, or whether he
should issue a junk bond, from the point of view of that guy, the interest is an alternative. The junk bond’s a different kind of financing, and why shouldn’t there be some neutrality between the different kinds of financing.

On the other hand, from the point of view of the guy who runs a hardware store, who’s financing his inventory with a 30-day bank loan, that interest feels a lot more like a cost, kind of like his wages, and it seems really very unnatural for him not to be able to deduct it because it really does feel like a cost of his doing business. And how you either cover the second case, or draw lines that distinguish the two cases in a meaningful way, is not something that I’ve figured out the answer to.

Q: (Off mike.)

MR. SUMMERS: Well, I guess you have to start by – you have to start with some sort of broad theory of when cooperation’s appropriate and when cooperation isn’t. If you believe that I represent the government of one country and you represent the government of another country, and in both countries we desire to pursue – we were elected to pursue the public interest, and we in fact are pursuing the public interest. Then, if we agree on our policies in ways that we find both to be beneficial, then presumably, the public interest will have been enhanced.

If you have the view that government is a malign leviathan that is simply seeking to steal resources from its citizens, then it’s indeed true that the more you can pit government against government, the more you’ll make it unable for them to do that. But that seems to me to be a rather dark view of democratic governance, and if you believe in democratic governance, then it seems to me that allowing mutually beneficial cooperation between different governments is fine. Or, to put the point a different way, the reason why economists oppose cartels is that we think they’re good for the producers, but we think that they are bad for the consumers.

If you envision cooperative tax policy, or cooperation with respect to global warming, or cooperation with respect to renouncing nuclear proliferation, you don’t have the same kind of distinction between the producers and the consumers that is in the normal cartel case. But I think you’re right in the terms of your question, that if you have Art Laffer’s (ph) view of the state, that you best serve your nation by assuring that its government is as small as possible, then you probably should not be sympathetic to the agenda that I’ve just advocated. (Laughter.)

Yeah.

Q: (Off mike) – dark view of government, let me ask you about this international tax cooperation. Back in the 1970s, the European Commission proposed to harmonize corporate rates that would range between 45 and 55 percent. They didn’t succeed; tax competition drove down the corporate rate. Then, they proposed in ’92 to harmonize the corporate rate with a floor of 30 percent. That didn’t succeed; the rates continued to
come down. And now, the average rate in the European Union is something around 25 percent.

And if you believe there’s any efficiency cost to having high corporate tax rates and high – you know, also the same would apply to personal income tax rates, and not to mention the fact that death taxes and wealth taxes have come down because of competition, I mean, isn’t there something to the notion that having governments compete with each other will reduce some of the most punitive aspects of the tax system?

MR. SUMMERS: I think you and I are coming from very different places, my friend. (Laughter.) You and I are coming from very different places.

You know something? If European taxation – if European economic performance had been bad in the ’60s, and good in the last decade, you would be certain that the reason was that they had cut the corporate tax rate and that they had cut the capital gains tax rate, and that they had cut a variety of taxes. And in fact, it should give you some pause that the European economies have never been seen as more sclerotic than over the last decade, and they’ve never had more of the kind of tax cuts that you favor than over the last decade.

Now, I don’t – I’ll make you a deal: I’ll stop making simplistic, demagogic comparisons like that – (laughter) – when those who are on your side of the argument stop saying that we had some kind of economic miracle because of the 1981 tax cuts, and so forth. So I just think that there’s no evidence to suggest that the kind of broad-gauged view that we’ve had these way-high tax rates that have done this enormous damage, that the premise of your argument is right.

And I would add that, to whatever very limited extent it’s true, it is true because of the failure of cooperation. That is, insofar as Ireland has benefited, and Ireland surely has benefited by becoming a tax haven, there are two interpretations of that fact. And when I tell you that Ireland is the, I believe, the largest or the second-largest – has the largest or the second-largest level of foreign profits of U.S. corporations of any nation in the world: Japan, China, Ireland, number one or number two. Just as you think about this, just consider that fact. Does the Irish renaissance, insofar as it is related to lower taxation, reflect the fact that really, it’s a great natural experiment and there’s more incentive to do stuff in Ireland; or, does it reflect the fact that, by doing this, as in the example I gave, Ireland’s benefit have come almost entirely at the expense of other countries, as people have moved to locate income there and to a lesser extent, to locate production there because of their reductions in tax rates.

So, I would say to you first, the evidence on the broad correlation you suggest isn’t there; second, insofar as it’s there, it’s because the countries that do that are imposing substantial negative externalities on other countries.

Mike.
Q: So, Larry, the OECD’s effort at attacking what it called harmful tax competition didn’t work very well, and the European countries have failed to reach any kind of harmonization with the exception of value-added tax rates, but on direct taxes they’ve completely failed, in the face of decisions by the European court of justice that have constrained each of them, that it would have given them incentives to do this.

So, the question I have is that if the kind of international cooperation you envision is not forthcoming, at least not in the medium term, what alternatives for U.S. policy do you have in mind to address the conundrum you started with?

MR. SUMMERS: I wish I had – if I had a great and compelling answer to that question, I probably would have chosen to share it – (laughter) – with all of you on this occasion. (Laughter.)

It seems to me that, for the last – it’s kind of fun to be out of government, and not speaking for an institution and stuff. It seems to me that, for the last eight years, last seven years, the United States has been about as unconstructive as it’s possible to be on these issues, both because the general approach it has taken in the world has been such as to undermine any instinct anyone might have to cooperate with us on these issues, and because our approach on these particular issues has been motivated by the perspective alternative to mine, that you’ve heard in the last two questions, to see this kind of cooperation as some kind of plot of the communist internationale to gang up on all of the capital. So, until there’s an attempt that is rational and prudent to encourage international cooperation with consideration of some possible cession of bits of our sovereignty, detailed sovereignty in this area, by the United States, I’m not entirely prepared to give up on the possibility of international cooperation.

I have a feeling that – and, you know, Milton Friedman wrote a famous essay about the role of – I don’t think this was his phrase, but it was basically about the role of people like you, Mike, policy intellectuals, in which he basically said that what they did was they provided a kind of inventory of stuff, that they never just drove the world where somebody like said, oh, okay, now I’ve just gotten briefed by somebody who understands this so we’re going to have a different policy. But instead, they provided an inventory of ideas. And then, when the right political moment came, those ideas rose to the top, which they couldn’t have done if they hadn’t been provided earlier.

He cited as the classic example work by economists making the case for the volunteer army, which probably never would have been decisive in overcoming the draft if there hadn’t been a little squabble in Southeast Asia in the late 1960s. But when the political winds changed, we were in a position to have a very different policy. You can think of more examples.

I would argue that in a different sense, thinking of the work in his tradition, the Brookings-Urban Institute project is carrying on that all of that work of Stan Surrey (sp) and Joe Peckman and many others was kind of there when the constellation of forces that
brought you the 1986 Tax Reform Act appeared on the scene. And so, I don’t think there is a good alternative solution to international cooperation.

That said, if my experiences at the Treasury are any guide, If I invited Joe Gutentag and Eric Toter and yourself and a variety of other people in this room to a meeting and said, suppose there were no issues about Congress and we wanted to do effective domestic policy that responded to these imperatives, what would your agenda be, I would be quite confident of their ability to produce an agenda that would increase U.S. economic efficiency, would increase global economic efficiency, would increase aggregate progressivity, and would raise in the tens of billions of dollars by going after these citizenship questions, by going after these transfer pricing and location of income questions by using the issues of deductions and credits under U.S. tax law to stimulate, to encourage more constructive behavior on the part of others by putting in place proper economic substance doctrines with respect to innovative financial instruments. I think you could put together an agenda that would be sort of the Washington version, or the policy analysts’ version of Pareto optimal – more money, more efficiency, and more fairness. Yeah.

Q: So how do you convince the emerging economies of China and India that harmonization, whether it’s in the area of global warming or taxing capital, is in their interests? Why won’t they just accuse the developed world of pulling up the ladder? And can we really have effective harmonization without those economies?

MR. SUMMERS: Well, I’m not sure the two issues are in parallel. I think it’s very hard with respect to global warming, because to an important extent, if you are sitting there, you might think about it like they do. We’ve got 50 million children who go to bed hungry every night. That’s kind of – and electrifying the rural areas where several hundred million of our citizens live that don’t have electricity is sort of a higher priority than anything about 60 years from now. That’s not a self-evidently irrational perspective for them to have. And so, my guess is that success in that front is going to involve some combination of slower transition paths and greater bribes than is currently contemplated in much of the political debate.

With respect to international cooperation and taxation, it’s not a set of issues in which I’ve engaged in dialogue with them to a substantial extent. But it would seem to me that in both those countries, both of which have seen a very substantial increase in their number of citizens who grace the Forbes Global 400 in the last several years, I can’t imagine that the concept that institutional innovation should make it more possible to tax those citizens without driving them offshore would be a concept that would be uncongenial to those governments. And so, my guess is, if you can find ways to make it effective that would very much be the case.

And at least the – while I’m not an expert on the Chinese and Indian situations – I remember that for many years, the American right lack of enthusiasm for any kind of financial reporting by U.S. financial institutions on capital income analogous to the kind that happens to every worker on their W-2, that that resistance was a source of very
considerable bitterness to those in other countries who felt that their ability to tax their own citizens in the way they wish would be enhanced if that kind of information was provided.

Yes, Gene?

Q: I’m wondering if you might comment further on this issue of inequality income and globalization. I think, and perhaps you are sympathetic to this theory – I think there is some notion, at least historical theory, that when income inequality becomes too great, it can actually discourage economic growth, in part because you may be concentrating decision making more among a fewer number of people, and in part because, at least if you look at the great expansion in the ’20s or even the ’50s and ’60s, there’s a sense that these goods and services we provide have such great economies of scale, it’s almost we need the income to be spread around enough that people can buy the extra drug or the extra entertainment piece that at the margin cost almost nothing. So in some sense, you need some greater quality of income, just to be able to buy these goods and services, greater quality of income.

But working against that, it seems to me, is the fact that maybe in a global world, you don’t need to do it within your own country anymore. So maybe we don’t need to worry so much about great equality of income in the U.S. to promote income growth if we can sell these goods and services abroad. So I wonder, A, if there’s something to this theory, that if there’s not this tension between globalization and whether greater inequality of income at some point actually discourages economic growth?

MR. SUMMERS: It’s an interesting set of questions. I’m sort of relieved to hear a thought interjected into the conversation that comes from the left of any of the thoughts that I was putting forward. I think it’s a plausible idea that excessive inequality might just – because of what it means for economies of scale or concentration of decisionmaking – slow economic growth. But no part of my argument hinged on believing that that was true. And I think on balance, my reading of the evidence would suggest that there wasn’t a lot of strong evidence that those were high-order or important effects.

So I thought of inequality as not being undesirable because it interfered with economic growth, but as being undesirable because I thought there’s diminishing marginal utility of income. And so, if you cause people with less to have more and people with more to have less, you’re increasing total utility. I thought it corresponded with most citizens’ idea of what would constitute a more just society. And I thought there was a fair amount of experience that with more equality, it was easier to carry on rational international policies that supported growth in global income and resisted the kind of protectionism that frankly was often a prelude to war. And so it was really from those perspectives that I was led to emphasize the progressivity element more than from the perspective that we really needed to have more equal income just so we could have more rapid economic growth.
MR.     : We’ll take one more.

Q: Would more reliance on consumption taxes make it easier or more difficult to solve the paradox you pointed out?

MR. SUMMERS: I’ve asked myself that question. And I’m not sure I know the answer to it. It may be that since you consume at home and you can measure your consumption at home that it would be helpful. On the other hand, it depends rather critically on whether – when you’re thinking about progressivity, you’re thinking about consumption, because that reflects people’s lifetime income and that reflects what they’re actually eating, or whether you have a sense that a broader kind of capacity to pay, which has to do with income and wealth, is appropriate.

And I think I’m still relatively clear on all the theorems about equivalences and such. But there’s something about me that when you say consumption taxation, you hear it one way. And when you say taxation, but not of people’s profits or interest or capital income, it sort of feels rather different in terms of its distributional implications and progressivity. And to some extent, that reflects a failure of the intellect to fully appreciate the equivalences. But I think to some extent, it may reflect the failure of the model to fully capture all the institutional realities. And so, for those reasons, I would worry about the consumption tax alternative.

But again, I’ve got much more confidence that I’m right in the problem I’m posing and the importance I’m attaching to it than I am to any particular solution that I’m raising.

MR.     : Please join me in thanking Larry. (Applause.) We’re adjourned.

(END)