TESTIMONY OF DAMON A. SILVERS

POLICY DIRECTOR AND SPECIAL COUNSEL

AMERICAN FEDERATION OF LABOR & CONGRESS OF INDUSTRIAL ORGANIZATIONS

BEFORE THE HOUSE FINANCIAL SERVICES COMMITTEE

ON THE ECONOMIC EFFECTS OF THE TAX CUTS AND JOBS ACT OF 2017

June 20, 2018

Good morning Chairman Hensarling and Ranking Member Waters and Members of the Committee.. My name is Damon Silvers, I am the Policy Director and Special Counsel of the American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO"), on whose behalf I am giving this testimony. The AFL-CIO is America's labor federation, comprising 55 member unions and 13 million union members. The AFL-CIO is grateful to be able to appear this morning to discuss the effects of The Tax Cuts and Jobs Act ("The Republican Tax Law") and the question of what financial regulatory policies would best contribute to long-term prosperity in the 21st century in light of the passage of that law.

What are the fundamental characteristics of the Republican tax law?

The Republican tax law is regressive—in the sense that it gives more benefits to wealthier Americans than to middle and lower income Americans- both in total and on a percentage of income basis. According to the Urban Institute and Brookings Institution Tax Policy Center, the top quintile of Americans will see a percentage change in after tax income that is seven times higher than the percentage change of the bottom quintile. https://www.taxpolicycenter.org/publications/effects-tax-cuts-and-jobs-act-preliminary-analysis/full Not surprisingly, the top quintile will capture 65% of the total gains from the tax cuts, while the bottom 40% will only capture 6%. And the Republican tax law is anti-labor in a very specific way according to the Urban Institute's Tax Policy Center—it shifts the tax burden from capital to labor, and rapidly accelerates the multi-decade trend shifting the federal tax burden from corporations to households. The result of the Republican tax law is it will worsen inequality of both wealth and income. As the Tax Policy Center put it, "The bill encourages more of national income to accrue to businesses and less in the form of wages." https://www.taxpolicycenter.org/publications/tax-cuts-and-jobs-act-missed-opportunity-establish-sustainable-tax-code/full

This shift in the tax burden from capital to labor is likely to further exacerbate an already cavernous racial wealth and income gap. This is because while the typical white household has an income about 60% higher than the typical African American household, the typical white household has wealth—assets—TEN TIMES—1000%-- greater than the typical African American household.
https://www.epi.org/publication/racial-inequalities-in-wages-income-and-wealth-show-that-mlks-work-remains-unfinished/

The Republican tax law is revenue negative—at the end of the day the United States government will have to borrow money to fund the tax cuts enacted by this bill—between $1.9 and $2.3 trillion in the ten year budget window according to the CBO depending on whether dynamic modeling is used.
https://www.taxpolicycenter.org/publications/effects-tax-cuts-and-jobs-act-preliminary-analysis/full. This is borrowing capacity that will not be available to meet the U.S. increasingly urgent needs for investment in infrastructure and education. This effect is compounded by the capping the deductibility of state and local taxes, which is of course the primary way the United States funds both infrastructure and education.

And the Republican tax law is a job killer in at least one sense—it results in a tax system that charges lower taxes on corporate profits earned offshore than on corporate profits earned by creating jobs here in the United States. This is the exact opposite of what President Trump said he wanted to do in the 2016 campaign. It really can't get much more simple than this—the U.S. government now taxes a corporation that creates jobs here in the U.S. 22% of the profits it makes. But if that same corporation sets up a foreign subsidiary to do the same work, and moves those jobs offshore, it will owe the U.S. government sbsolutely nothing on "normal" profits from those operations. Even if a firm is earning extraordinary profits, the effective maximum US tax rate is 13%. And it rewards those companies that stashed $2.6 trillion offshore in anticipation of just such a political bonanza with a retroactive tax rate of no more than 15.5%- -as opposed to the 35% statutory rate companies that did business in the U.S. in those years had to pay.

This is a giant reward to move jobs outside of the United States. It's not complicated. It's not a mistake. It's an intentional giveaway of your and my tax dollars to people who chose to kill U.S. jobs.

How does it play out in a real American community? For twenty years Harley Davidson manufactured motorcycles in Kansas City, MO. Two weeks after the Republican tax bill passed, Harley Davidson announced it was closing the plant, laying off 800 workers. The company said it was moving production to York, PA, where it added 400 workers. Net U.S. job loss—400 jobs. But meanwhile Harley Davidson is building a plant in Thailand to meet growing foreign demand—a plant on whose profits as a result of the Republican tax bill Harley Davidson will pay no U.S. taxes. http://thehill.com/homenews/news/387120-harley-davidson-to-open-plant-in-thailand-after-closing-one-in-kansas-city

The advocates of the Republican tax bill argued that if we worsened economic inequality, shifted the tax burden away from big corporations and onto families, and borrowed money to do these things, the result, in classic 'trickle down theory" would be an avalanche of business investment that would lead to more job creation and rising wages as businesses reinvested the tax cuts and put cash that had been sitting on the shelf to work with the lure of higher profits. President Trump promised that his corporate tax cuts would give the typical American household a $4,000 pay raise, lead corporations to "shower their workers with bonuses," produce "massive investments" and stop corporations from outsourcing jobs and shifting profits offshore.

Of course it has only been six months since the Republican tax law passed, but the Committee's charge was for us witnesses to examine whether there has turned out to be any truth to those predictions. And so far there is a clear answer. The predictions with which this Act was sold to this Congress have turned out to have been wrong so far.

America's big companies are not reinvesting the money they are saving in taxes. They are paying that money out in the form of stock buybacks and dividends. In many cases they are paying out more than the tax cuts they received from this bill.

The broad based coalition Americans for Tax Fairness compiled a comprehensive data base of employer behavior in the aftermath of the Republican tax law's passage. They found that just 67 companies out of the Fortune 500 gave ANY wage increase or bonus to their employees as a result of the tax bill. Out of the Fortune 1000, only 9% have announced any wage increase or bonus tied to the Republican tax law. Out of all U.S. employers ATF could identify only 402 companies that gave any bonus or pay increase. Out of the relative handful of companies that did give some money to their workers, most were either in the form of one time bonuses or in the form of pay raises for new hires.

By contrast, 317 public companies have announced stock buyback programs since the tax bill was passed, totaling over $484 billion paid out. This is more than 68 times the $7 billion estimated amount that the ATF could identify corporations were giving workers in pay raises and bonuses. And this number keeps growing. S&P Dow Jones now estimates by the end of 2018 U.S. public companies will pay out over $1 trillion in stock buybacks. https://www.reuters.com/article/us-usa-stocks-buyback/sp-500-companies-return-1-trillion-to-shareholders-in-tax-cut-surge-idUSKCN1IQ33F This is close to the entire value of the corporate tax cuts in the bill over the ten year budget window. Goldman Sachs estimates stock buybacks and dividends in 2018 among S&P 500 companies will grow at twice the rate of capital expenditures and will exceed capital expenditures in total. And corporate cash paid out in stock buybacks and dividends will not be reinvested in an economic sense unless the stockholders choose to reinvest, not in secondary markets, but in actual investment in an economic sense—new productive physical or intellectual assets. Not surprisingly, Goldman Sachs analysts warn companies that do stock buybacks are likely to underperform the market in the long run. http://money.cnn.com/2018/04/26/investing/stock-buybacks-goldman-sachs/index.html

The results can be seen in the inconclusive direction of aggregate measures of new capital investment since the passage of the Act. For example, the Federal Reserve's tracking of new orders of non-defense related capital goods shows investment levels flat since the end of last summer at levels below that of the period from 2010-2015. In a national survey of companies by the Federal Reserve Bank of Atlanta, 75% of the respondents said the tax cut law made "no material change" to their capital investment plans in 2018 and 73% said the same thing for 2019.

And if housing investment is included the picture turns distinctly more negative, which should be hardly surprising given the disincentives built into the Republican tax law around housing and in particular around housing for the working poor in the form of both the weakened value of the Low Income Housing Tax Program. At the same time as the Republican tax law disfavors housing generally, it appears to have potential tax incentives for gentrification built into the Opportunity Zones provisions of the Republican tax law.

The consequences of these underlying trends is that the Republican tax bill appears to so far have had no impact at all on job creation. Job creation in the U.S. economy continues its slow decline from its peak levels in 2015.

But the most telling failure so far is in wages. Wages have been flat in real terms in aggregate across the economy since the passage of the Republican tax bill. And if you break out wages by segments of the labor market, you see that in the last year average hourly wages for four out of five workers in the private sector have *gone down* after inflation—and that it is only the high performance of the top of the labor market that is holding the aggregate numbers even.. [The Washington Post]

This is the picture across the labor market at the aggregate level. But it is a picture shaped by the behavior of America's largest employers—companies that issued press releases in the immediate aftermath of the passage of the Republican tax law that did not withstand detailed scrutiny very well.

A number of unions have asked major employers who supported the Republican tax bill about President Trump's promise of a $4,000 raise if the Republican tax bill passed. A typical experience was the Communications Workers of America's dialogue with AT&T. AT&T booked an immediate $20 billion tax related profit as a result of the passage of the Republican tax bill. AT&T's executives had promised each billion of gains would yield 7,000 new jobs. Instead in the days following the actual passage of the Republican tax bill AT&T laid off 1,500 workers. With respect to wages, CWA members asked AT&T where their $4,000 raise was, and in response AT&T offered a $1,000 one-time bonus. AT&T's wages remained unchanged.

But the most single telling example of what the Republican tax bill is really about is Walmart, America's largest private employer. Walmart disclosed it expected to receive a $2.2 billion tax cut for 2018. At year-end 2017, Walmart paid a one-time bonus of $400 million to its employees, which it financed by laying off simultaneously over 10,000 employees. Walmart also announced it was raising its starting pay from $9 to $11 an hour, which it estimated would cost $300 million a year.

How does it all add up over ten years—more than $22 billion in tax breaks for Walmart—half of which roughly goes to the wealthiest family in the world. Cost savings from layoffs of as much as another $5 billion a year, half of which flows to the Walton family. Wage increases and bonuses of less than 10% of that total. So the Walton family, which could fit into this room, gets roughly $13 billion in debt financed tax breaks courtesy of Congress. The 1 million U.S. employees of Walmart get $3 billion.

Except of course that maybe the employees would have gotten the raises anyway. Harry Holzer of the Brookings Institute looked at it all and said Walmart probably would have had to give the raises anyway because of the improving labor market since 2012 and rising statutory minimum wages in key Walmart markets.

And this point is critical in any evaluation of the tax bill. The U.S. economy and labor market have improved significantly since 2012 as the Federal Reserve's insistence on taking its full employment mandate seriously finally overcame the fiscal headwinds created by the sequester and other forms of austerity since 2010. The cumulative impact resulted in a modest upward spiral of tighter labor markets leading to greater consumer confidence and rising business investment. Any attempt to assess the impact of the tax bill has to begin by taking these trends as the baseline.

The Republican Tax Law and Financial Regulation

Like other large corporations, America's largest banks have benefited handsomely from the Republican tax law. The big six banks that control more than 70% of the nation's bank holding company assets are projected by the Wall Street Journal and the Institute for Taxation and Economic Policy to receive $14 billion in tax breaks in 2018 alone. This is 7 times what Walmart will receive. But these numbers are dwarfed by the $23 billion in stock buybanks and dividend payouts already announced by the six biggest banks.

This is not surprising because key features of the Republican tax law are designed to benefit the nation's largest banks in ways that community banks cannot benefit. For example, these six banks are global institutions, with income streams that will benefit from the dramatic reductions in tax rates for offshore incomes.

Consequently, it seems likely that the Republican tax bill will add to the levels of concentration in America's banking system. This trend will likely be compounded by the changes Congress recently made in the Dodd-Frank Act by passing the Crapo bill that made it easier for the big banks to take risks in the derivatives markets. These risks are magnified by recent announcements by bank regulators that they intend try to weaken critical regulatory aspects of the Dodd-Frank Act's Volcker Rule that also limited banks' ability to put bank capital at risk in derivatives markets.

The overall direction of Congress' recent actions have been to benefit the banks that caused the financial crisis, to encourage them to grow at the expense of other, smaller financial institutions, and to remove key constraints to risky behavior of the kind that caused the 2008 crash.

In the wake of these actions Congress should go in a different direction entirely. Rather than seek to repeat the policy mistakes that led to the financial and economic disaster of 2008, Congress should consider following through on the promise of reform by enacting a 21st century version of the Glass-Steagall Act, the New Deal era legislation that separated commercial banking from investment banking. Our real need as an economy is a financial system that is a stable source of credit to the real economy. Measures such as the Republican tax law and the Crapo bill point in the opposite direction by once again encouraging bank assets to be invested in speculative secondary markets rather than in real economic investment.

Changes to the Tax Bill to Promote Jobs and Growth

The AFL-CIO believes the Republican tax law will in the long run be destructive to jobs and growth, partly because it increases pre-tax inequality, which negatively affects aggregate demand, partly because will have the effect of starving public investment, and partly because it incentivizes both offshoring and the draining of investment capital from America's large businesses. We believe that ultimately these negative effects of the Republican tax law will dominate any growth effects from its regressive fiscal expansionism.

The AFL-CIO urges Congress to make significant structural change to the Republican tax law. Specifically, we would urge Congress to begin by amending the Republican tax law to,

1) Eliminate all the incentives for outsourcing jobs and profits built into the Republican tax bill by equalizing the effective corporate tax rate for offshore earnings and onshore earnings as provided for in the No Tax Breaks for Outsourcing Act of 2018 sponsored by Representative Doggett and Senator Whitehouse;

2) Equalize the tax rate between labor and capital through a combination of a financial transaction tax, increases to the capital gains rate, and imposing Social Security and Medicare taxes on capital gains.

3) End the gigantic loopholes the Republican tax law opens up for tax avoidance through pass through business structures, which both threatens massive revenue loss and treats income from similar business activities radically differently depending on what legal form those activities take

4) Restore the deductability of state and local income taxes, or alternatively offer comparable direct federal support to critical state and local government activities in the areas of education, infrastructure and health care.

Conclusion

The economic and financial crisis revealed the United States to be a country whose economy was structurally vulnerable as a result of decades of rising inequality and a financial sector that was dominating rather than serving the real economy. It also revealed a tax system rife with transparent unfairness—offshore earnings subject to deferred tax while Main Street earnings paid full freight, heavy taxes levied on working people when they bought and sold homes and cars while hedge funds transacted freely with their capital assets. There was a bipartisan consensus at the time of the 2016 elections that Congress should take action to see to it that the wealthy and big corporations paid their fair share of taxes. Finally, the economic crisis and the destructive policies of fiscal austerity that followed exacerbated decades of neglect of our nation's physical infrastructure and our nation's educational systems—to the point where earlier this year teachers in Oklahoma were striking to demand the restoration of the 5 day work week.

In this context, thoughtful tax policy should have aimed at addressing economic inequality, restoring the public's faith in the fairness of the tax system, and funding the public investment we need to be competitive globally, attract investment, and drive productivity.

Instead the Republican tax law went the opposite direction. It starves the public sector of revenue, redistributes the tax burden toward working people and away from the 1%, and encourages the further growth of too big to fail banks. Not surprisingly the Republican tax law's legacy so far for working people is broken promises and more wage stagnation. And now, not surprisingly, we face attacks on health care, Social Security, Medicare, Medicaid and education funding. Meanwhile big corporations and their executives are laughing all the way to the bank, where they find the bankers are laughing too.