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MARK BLYTH: We're going to talk taxes today with John Freidman. This is Mark Blyth. Today, I'm asking the questions, rather than furtively trying to answer them.

So John, let's get started with this one. So from my understanding of tax cuts, you want a tax cut because you want to stimulate the economy. But stock markets are at an all-time high. Unemployment's low. Things seem to be going really well, despite what is over Trump. Why do we need a tax cut now?

JOHN FREIDMAN: Well, I do think this is a pretty peculiar time to have a stimulatory tax cut. I think that there is some truth behind the idea that we could rearrange the corporate tax code to get more investment. But still, I don't think there's any reason to have a tax code that is as regressive as the way they're making it. And to have a tax cut that's done in such an amateurish way is just a step backwards.

MARK BLYTH: Well, I think we're getting used to the fact that it's a bit of a *Keystone Kops* comedy for policymaking all round, from what happened with health care, et cetera.

But sticking with the whole notion of the tax cut and corporates, there's an idea out there that there's this huge pile of cash offshore and that if you just change the rate, then they're going to bring it home. Yet at the same time, people read that Apple, for example, pays no effective taxes. So how does all this play into it? Why are we giving a tax cut to people who don't pay taxes in the first place?

JOHN FREIDMAN: That's a great point. And in fact, we have this image of all this money overseas. And I think people conjure up pictures of boxes of treasure in some cave in the Caribbean. And in fact, most of this money is actually sitting in a JP Morgan account in New York City, invested in US Treasury Bills and sometimes the US stock market. That money is already here.

And I think that--

MARK BLYTH: So why do people think it's abroad? Can you explain that?

JOHN FREIDMAN: The way the US corporate tax code currently works is that you owe 35% tax on profits made anywhere in the world. But if you make those profits abroad, you only have to pay the tax when you technically bring it home, which is to say you transfer control of those resources from a foreign subsidiary to the US corporation. And so a company like Apple has approximately $250 billion worth of cash in its Irish and other international subsidiaries.

Now, if you're a company anywhere in the world, it's great to invest your money in New York City. And so the Irish subsidiary has a bank account, just like you or I could have but with a little bit more money in it, in New York City, invested in US Treasury Bills. So what this will do is yes, it will make it very tax-advantaged for the subsidiary to then move that money back to the parent.

But Apple's already got $25 billion worth of cash in its US company. They're not doing that much investment. Most likely, what'll happen is they'll just return a bunch of that money to shareholders.

And in fact, they did exactly this policy about 12 years ago. In 2005, they had what's called the "repatriation holiday" then. And analysis shows that $0.90 on the dollar just went on payouts to shareholders. Wages did not increase. Investment did not increase.

So of all parts of the reform, I think this is the least likely one in order to really generate growth.

MARK BLYTH: So one of the things that we're hearing now is that even the conservative think tanks are saying, whoa, guys. There's going to be at least half a trillion on the deficit over 10 years. And some of the estimates go way--

JOHN FREIDMAN: Probably more--

MARK BLYTH: Exactly-- on the upper bound, way past there. So how is it possible that a party that sees itself as being the guardian of fiscal rectitude, every time it gets into power, becomes fiscally incontinent? Why do they never get called on that? Is there not some kind of grounds for some moment of self-reflection here? Or am I just being naive?

JOHN FREIDMAN: My sense is that all parties are deficit hawks when they're not in power. And everyone's OK with deficit spending on what they want to spend money on.

So in this case, Republicans are more than happy to deficit-spend on corporate tax cuts. When the Democrats were in power, they would have also been happy to deficit-spend on expansions of the EATC. Or if they could have done Obamacare in a way that was deficit-spending, they might have done that, too.

MARK BLYTH: So it's a pox on both houses in that case. Is there a case for the corporate tax reform, though, for, let's say, small and medium-sized enterprises in the United States-- not your global tax dodgers, but sort of mid-sized American corporates? Will this tax cut actually do something positive for those firms?

JOHN FREIDMAN: For both small and medium-sized firms and for multinational corporations, the fact that we're going to make investment more attractive will actually increase investment. I think there's good empirical evidence-- not just stuff from the 1980s, but recent, good-quality evidence-- that provisions like investment expensing do actually increase investment.

MARK BLYTH: But we live in a world in which money's been ultra cheap for ages. And as you said, Apple's sitting on an enormous cash pile. And they don't do much investment. How much can we tweak at the margin through incentives like this?

JOHN FREIDMAN: Yeah. So I actually think the main benefit of something like expensing is not coming through making it cheaper to borrow money. It's actually giving firms money that don't have access to the credit markets.

And so for firms that find it really difficult to borrow, whether they're small or large-- but you're right. That typically attaches more to small firms than large firms-- having cash in your pocket right now because you get a tax write-off for an investment that you just made can be really helpful.

MARK BLYTH: So let's turn to sort of what politicians like to call "ordinary Americans." What's in this for them? Walk me through, let's say, the income distribution very simply.

If you're in the bottom third, what does this mean for you? If you're in the top third, what does it mean for you? In the middle, what does it mean for you? And is it really all about the 1%, the death tax, and a giant clawback by the plutocracy?

JOHN FREIDMAN: So I think that broadly speaking, there's on average, at least upfront, a tax cut in here for most people, although that tax cut is smallest for people at the bottom of the income distribution than at the top of the income distribution.

So just to give you a sense, if you're in the bottom quintile of the income distribution, you're going to get an average tax cut of about 0.3% of your income. So if you have income of

$10,000, you might get a tax cut of $30.

MARK BLYTH: Wow. That's not much.

JOHN FREIDMAN: That is not much money. If you are in the top quintile, you're going to get a tax cut of about 2.2% of your income. And on average, that's going to be about $6,000. And so it's not just more dollars, but a larger change in the resources you have available to those at the top.

Now, part of that is due to the estate tax. But that really only affects a few thousand families, anyway. A lot of it is how they're treating the businesses and especially so-called "pass-through businesses."

So a lot of businesses in the US, more than half of business income in the US does not get earned by a company that then pays the corporate tax rate. It gets earned by a partnership or a small corporation that's owned just by a few people. Income from that business just flows on to your income tax return.

And those corporations already pay much less tax than everybody else. So on average, it's actually a 19% rate, even lower than the new 20% corporate rate. But they've made it even more attractive to be that type of business. And so that's going to be a good thing for some of those businesses that already are out there.

It's also going to be a good thing if you're the type of person who can reorganize a lot of your income into this form. It just means it's a big tax break for lots of doctors and lawyers and things like that.

MARK BLYTH: So that's the $64,000 question. So let's assume that expensing actually helps small to medium-sized firms. And then this lower rate through the pass-through helps those firms. How much of it goes on, in your estimation, rent seeking, as opposed to positive investment?

JOHN FREIDMAN: Well, I would actually add a third category, which is just pure income shifting.

MARK BLYTH: Right. Pure income shifting.

JOHN FREIDMAN: There's going to be a lot of money lost in this tax reform because it's very difficult to police what's this type of income and what's that type of income. And my sense is because this was written so fast and in the middle of the night, there's going to be even a lot more of that than we realize now, as the clever lawyers and accountants take a swing at it.

But I think in practice, a lot of the beneficial effects from things like expensing are going to be counteracted, especially in the medium and long term, by the fact that we're having increased deficits. So how does that work? The government needs to borrow more and more money in order to cover its share of the economy, leaving less and less money available out there for private businesses, which raises the cost of investment and financing for them.

And so most estimates of the impact on growth suggest that there might be kind of a small, essentially one-time boost in the short run, maybe half a percent to a percent, over the next few years. And now, that almost fades so that we're back at the same size of economy after 10 years as when we started.

MARK BLYTH: So in other words, it's a huge ado about not very much over the long term.

JOHN FREIDMAN: I think that's right. I think that if they had wanted to write this bill in a way that was really pro-growth, they could have done it in a bunch of different ways.

Again, even setting aside the distributional impacts, they could have had a reorganization of the corporate tax code, rather than just a cut. And they could have made sure that it was paid for in a way that would really have the biggest impact on businesses.

MARK BLYTH: So one of the critiques that's going around of this entire project is that it really is just a give-back for the 0.1%. They're taking away the lion's share. Everything else is--

JOHN FREIDMAN: Let's not forget the 0.1%.

MARK BLYTH: And the 0.1%-- exactly. So break it down for me. Let's go for sort of the top 10%, the top 1%, the 0.1%. Who really wins because of this?

JOHN FREIDMAN: So I think that anyone who's going to die with an enormous estate, they are potentially saving an enormous amount of money. So just as an example, some estimates are that the president's family themselves will save upwards of a billion dollars as a result of the estate tax cut on this bill.

So if you're looking for the largest kind of personal effect of this, it's going to come through the estate tax. But of course, because there are so few families that pay the estate tax--

MARK BLYTH: Was it 5,0000 and some, 5,000 and change?

JOHN FREIDMAN: Yeah. I think it might have been 4,000 the last time I checked. That's going to fall even more.

Now, I think where the distributional effects seem to show the biggest impacts are actually in this kind of not quite top but near top, like the top 5%.

MARK BLYTH: Yeah.

JOHN FREIDMAN: So for instance, they're going to get an average of 3.5% additional income through the tax cut, worth about $11,000. That's kind of the income group that's being treated the best.

MARK BLYTH: Right. So in terms of the relative shift in income--

JOHN FREIDMAN: That's right--

MARK BLYTH: They're getting the biggest payoff. Even if you go all the way out to the tail of the distribution, people are getting much more money. But it's relative to the cash pile they've already got.

JOHN FREIDMAN: That's right. The other thing to keep in mind here is that they talk about simplification. This bill is anything but, because they have so many provisions that need to disappear or fade in order to make the budgetary numbers work.

And so that just leads to an enormous amount of uncertainty over what the tax code is going to look like, over calculating your income liabilities in any given year--

MARK BLYTH: Do we even really know what the individual tax bans for income tax are going to be under this? Or is that still up for negotiation?

JOHN FREIDMAN: Well, so they state what the bans are in both the House and the Senate bills. I think they can maybe renegotiate that in the conference. But those at least are stated. Key thing that people haven't paid as much attention to, though, is that as you go through time, you need to increase, say, the rate below which you pay one tax rate and above which you pay another.

So historically, those have been increased at the rate of inflation. As the economy grows, you don't have to pay more taxes purely because of inflation. They're changing to a slower measure of growth called "chained CPI." So over time, that's really going to bite especially the middle class for eligibility for a lot of these programs.

MARK BLYTH: So this is essentially bringing back bracket creep back--

JOHN FREIDMAN: That's right--

MARK BLYTH: For the middle.

JOHN FREIDMAN: That's right.

MARK BLYTH: So you're going to give them a tax cut if you're slightly above the middle. And then over time, chained CPI is going to bring back that tax raise, in a sense.

JOHN FREIDMAN: That's correct. That's right.

MARK BLYTH: That's horribly unfair and sneaky.

JOHN FREIDMAN: This is something where I think there's good argument that this might actually be a better measure of inflation. And so maybe as a piece of tax policy, you'd want it to be this way. But if you actually cared about the distribution of this, you'd probably find some other way to counteract that effect.

So I think all of this-- if you look at the choices that have been made, you can say, well, fine. You had to cut a bunch of stuff in order to get this to fit under whatever parliamentary procedure. That's fine. But the fact that the things they cut are like the child tax credit extension instead of the corporate rate cut I think really shows priorities here.

MARK BLYTH: Yeah. And I would agree.

Let's go to the one thing that most people care about in the United States, their home. So I can make an argument that's almost progressive about not having a mortgage interest rate tax deduction unless you're below half a million, because then you're giving it to the people who basically will benefit the most relative to their income. So there's almost a progressive intent. Or am I just fantasizing?

JOHN FREIDMAN: One of the things that was really good tax policy and is honestly pretty hard politically that especially the House did was to really try to sweep out a lot of these individual deductions, which to some people are a great boon, but to most people are just a source of inefficiency.

And when everybody takes their own particular little cut, then we all end up worse off. And so the fact that they've cut the home interest deduction-- that primarily just encourages people to buy bigger homes. It doesn't encourage home ownership. And so I think that's probably headed in the right direction.

What's going to be interesting here, though, is that now after having increased the standard deduction, estimates are that fewer and fewer people are actually going to benefit from that home mortgage interest deduction, because they won't have enough deductions in order to claim it above.

So just what is that? Currently, your standard deduction is about $12,000. And unless you accrue deductions that are more than $12,000, you just take $12,000.

So if you pay $5,000 worth of mortgage interest in a year, that doesn't matter. You don't get a tax cut from that, unless you also, say, contribute $10,000 to charity to get you above that. What they've done is first, they've doubled the standard deduction, which is going to make it harder for people to get over.

And second, they've eliminated a lot of the things that you used to get to take as deductions to help you get over. So for instance, they've eliminated a lot of the state and local income deductions-- not entirely. So what that's going to mean, people estimate, is we're going to fall from something like 15%, 20% of people itemizing to more like 3% of people itemizing. And so I think in practice, most people will not benefit from the mortgage interest deduction anymore.

MARK BLYTH: But the one that they didn't actually do was the carried interest deduction for people running things like hedge funds.

JOHN FREIDMAN: Well, that's right. And it's--

MARK BLYTH: Any idea why they did that, John, why they just left that one alone?

JOHN FREIDMAN: So I think I have two ideas. One is that a lot of this income is taxed in the form of pass-through businesses. And so they're giving a big tax cut to pass-through businesses. This kind of got swept along.

But second of all, that group of folks has a very concentrated, powerful lobby group. And they came to meet with me when I was in the White House and talked about how they really wanted to keep their tax deduction. And I have to imagine the pressure that was on these folks about the political donations that would not be coming if they actually changed this.

MARK BLYTH: [SPEAKING FRENCH]

John, thank you very much for explaining to me that none of this really matters in the long term. But in the short term, it sure is ugly.

JOHN FREIDMAN: Thanks, Mark. I agree with you.

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