

ORAL REMARKS
Before the Joint Economic Committee Hearing
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“Could Tax Reform Boost Business Investment and Job Creation?”
November 17, 2011

Dear Mr. Chairman and Members of the Committee:

There’s an old adage ... ‘if we could manage to line up all the economists end-to-end on Pennsylvania Avenue, they still would not reach a conclusion.’ True perhaps ... but they should sing with the harmony of chorus girls when asked about the principles that inform an optimal tax system.

Economists ought to tell you an optimal tax regime imposes minimum costs for maximum voluntary compliance.

But that’s not what we do. We waste \$431 billion in compliance costs only to endure a tax gap equally as large and growing.¹ That is the dollar value of *all* finished goods and services in Virginia and 41 other states; resources unavailable for payroll, plant or equipment. The IRS embroils Americans in 72 thousand lawsuits: 7 of 10 involving small firms to enforce a system that confused two former Ways and Means Chairs and a Secretary of the Treasury.

Economists say an optimal system applies low marginal rates on a base neutral towards savings and investment.

But that’s not what we do. Our corporations pay a national statutory marginal rate of 35 percent, which masks the fact that the return on capital is taxed repeatedly. These rates impose efficiency costs of as much as \$728 billion [based on our 2010 GDP of \$14.6 trillion]. Marginal rates work. After all, that explains why the 9,833 sections of gibberish we call our tax Code, have been cobbled together by the finest lobbyists America can produce, not our nation’s finest economists.

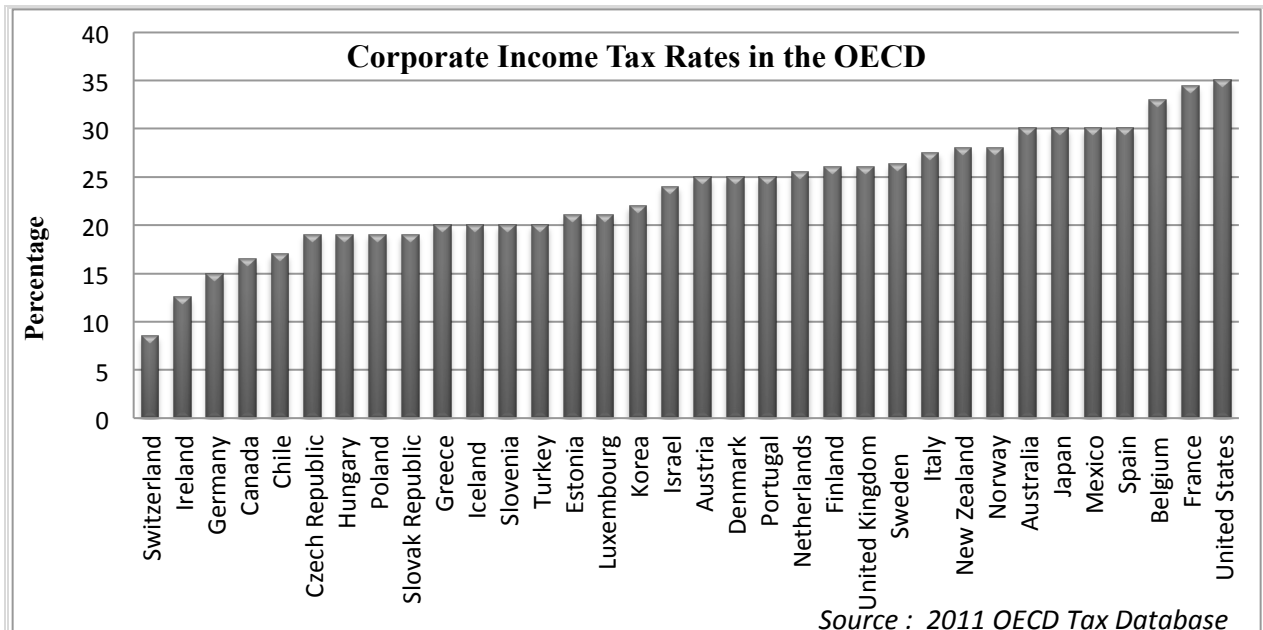
Economists tell you an optimal system wouldn’t favor imports over exports or discourage earnings repatriation.

But that is not what we do. The U.S. is alone:

- in applying its punishing rates -- highest in the OECD and 50 percent higher than the average OECD rate of 23 percent -- to domestic and foreign earnings alike (as shown in Figures 1 and 2 below).
- And in refusing to adopt a border-adjustable consumption tax (as shown in Figure 3 below).

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Figure 1



Thirty-three of 34 OECD countries impose an average border-adjustable VAT of 18.5 percent. It's as if Congress is urging global producers: Invest in overseas plants and facilities, hire foreign workers, then market your products back to the American consumer who is punished for saving and rewarded for consumption. Don't take my word for it; the World Bank awards us the 124th worst nation status for "total tax cost," behind the Russian Federation.²

Figure 2
2010 Corporate Tax Rates, U.S. vs. OECD Countries

Rate	United States	OECD Average	U.S. Rank
National Statutory Rate	35.0%	23.4%	34 th out of 34
Statutory Combined Rate	39.2%	25.1%	33 rd out of 34
Effective Rate	29.0%	20.5%	33 rd out of 34

The U.S. tax system imposes heavy income and payroll taxes on U.S. workers and businesses producing goods in the U.S. whether those goods are sold in the U.S. market or abroad. Recall U.S. corporate taxes are the about nine percentage points higher than the OECD average.³ The

² The World Bank, *Paying Taxes in 2011: The Global Picture*, Table 4. According to World Bank rankings, the U.S.' relative ranking on the "total tax cost" imposed on businesses has gone from bad to worse, falling from 118th in 2010 to 124th in 2011. The total tax cost expressed as a percent of before-tax profits is 46.8%.

³ Edwards, Chris, "The U.S. Corporate Tax and the Global Economy," Cato Institute, September 2003.

U.S., however, imposes no corresponding tax burden on foreign goods sold in the U.S. market. Moreover, foreign VATs -- a major component of the revenue raised in most developed countries -- are rebated if foreign goods are exported to the U.S. market. This creates a large and artificial relative price advantage for foreign goods, in both the U.S. market and abroad.

Figure 3 below illustrates this point. American producers pay two sets of taxes when selling into foreign markets. Conversely, in U.S. markets, foreign goods bear no U.S. tax and the foreign value added tax is forgiven. Thus, a most manifest unfairness in the U.S. tax system is that it places U.S. producers – including businesses and workers in manufacturing, agriculture, mining, and forestry – at a large competitive disadvantage relative to their foreign competitors here and abroad. Our failure to counteract these border-adjusted taxes explicitly encourages consumption of foreign goods. And it converts many of our nation’s retailers into tax free trade zones for foreign produced goods.

Figure 3
Current System Advantage for Foreign Producers

	Sold in U.S. Market	Sold in Foreign Markets
U.S. production	Pays U.S. income and payroll taxes.	Pays U.S. income and payroll tax & foreign VATs.
Foreign production	Pays no U.S. income or payroll tax and no foreign VAT.	Pays foreign value-added tax.

Mr. Chairman, the FairTax (HR 25 / S 122) – which replaces income and payroll taxes with a single-stage consumption tax – addresses these infirmities. It eliminates an estimated 90% of the compliance costs, relieving individuals and non-retail businesses from filing returns or paying taxes. It would impose the lowest marginal rates on the broadest base of any plan that doesn’t tax the same income twice. Laurence Kotlikoff estimates the FairTax increases capital stock over the century by 96 percent (44 percent by 2030), increasing real wages by 17 percent over that same period rather than a decline of 8 percent.⁴ Economic growth increases consumption and investment. Think of it as a world where all income is sheltered in both a Roth and regular IRA, where pre-tax earnings can be invested in business and where the profits grow tax free.

It would transform the U.S. from one of the least, to the most tax-favored jurisdictions for business, meeting the challenge of border-adjustable regimes by:

- Exempting foreign consumption of U.S. goods from taxation.
- While imposing the FairTax on foreign goods consumed here just as we do on domestic goods.

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A zero marginal rate on productive income is better than a territorial income tax, because it issues competitor nations an ultimatum: Reduce your tax rate on savings and investment or lose that investment to America. And that sparks global tax competition.

By not taxing the fruits of our labor until consumed, the FairTax gives taxpayers control over their tax obligation, which in turn lubricates upward mobility. And it proves we needn't trade economic growth for equity. The poor are literally untaxed. And no households pay taxes on what they determine to be essential spending up to the poverty level.

Mr. Chairman, the so-called Super Committee will soon report to great fanfare. But this only guarantees the imprint of the 112th Congress will be etched forever in the annals of America's history; it tells us nothing about what will be written there. Will it reflect sound economic reasoning or a bad political compromise only to avoid a perception of dysfunctionality?

Americans for Fair Taxation, perhaps the largest tax reform movement assembled; ask you carry to the Super Committee a message: how we raise revenue dictates our long-term fiscal health every bit as much as how we spend it. The \$267 billion in additional revenues the FairTax would have raised had it been enacted last year shows tax reform is fiscal reform.⁵ They ask you to lend them your compass to guide that tax reform.

They ask you to demand transparency in revenue forecasting that incorporates macroeconomic impacts. Why insist on static estimates knowing tax increases or cuts are not created equal? And why allow the Joint Committee on Taxation to hide their math under the inscrutable cover of secrecy that rivals the CIA?

Americans have always believed Congress, during times of crisis, will set aside partisan differences to do what was right for the Nation. Renew in them their confidence in this institution. Show them that their faith in the character of America has not been misplaced. Consider the FairTax on its merits.

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