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Before the Subcommittee on Select Revenue Measures, Committee on Ways and Means
U.S. House of Representatives
On the Impact of International Tax Reform on U.S. Competitiveness
June 22, 2006

Mr. Chairman and Members of the Subcommittee on Select Revenue Measures:
Witnesses before this Subcommittee today enumerate some key problems posed by our current system for America's international competitiveness. They criticize our corporate marginal tax rates as the highest in the developed world. They point out international reform must be integrated with comprehensive reform which does not punish savings and investment. They argue our extraterritorial tax system costs as much to comply with as it raises, even by the reckoning of the Joint Committee on Taxation staff.

However, none addresses the leading problem domestic producers face when competing against foreign producers: Our failure to adopt a border-adjusted destination-based consumption tax. We submit this testimony for two reasons: (1) to offer badly needed perspective on the importance of ensuring that reform adopts a border-adjusted tax system; and (2) to help untangle the underbrush of competing proposals to better explain what competitiveness should mean and how to achieve it.

Border-adjusted taxes are, quite simply, the most potent weapons foreign producers have against U.S. producers and workers. Border-adjusted taxes are consumption taxes removed on export by the producing nation and assessed upon imports as *ad valorem* taxes. At this point in time, 29 of 30 OECD countries enjoy border-adjusted tax regimes. Only one – the U.S. – refuses to adopt a border-adjusted tax system in order to continue to rely upon an origin principle, direct, world-wide income tax system that taxes returns to capital multiple times. We do so at our peril.

When two nations with border-adjusted tax regimes trade together, the effects negate themselves. Taxes one nation rebates on domestically produced exports are reimposed by the importing jurisdiction in what is effectively an economic wash. But the interaction of indirect border-adjustable systems with the U.S.'s tax system is devastating. Border-adjusted regimes effectively grant foreign producers an approximately 18-percent price advantage over U.S. produced goods, whether competing here or abroad. Our failure to respond to these incentives amounts to a self-imposed handicap which stimulates outsourcing, encourages plant relocations, lowers the wages of the American workers, harms U.S. small businesses and farmers, and decimates our production capabilities to such an extent it raises national security concerns. A recent MIT report states that the U.S. failure to recognize and confront this problem costs us more than $100 billion in exports annually. In our judgment, this is a conservative estimate.

Our unique failure to adopt a destination-based consumption tax combined with our uniquely high marginal corporate rates sends the wrong messages to American producers: "Move your plants and facilities overseas, hire foreign workers, and then market your products back to the American consumers whose tax system favors consumption over investment and savings." To retailers: "Stock foreign inventory." To consumers: "Buy foreign products." The problem is

♣ FairTax.org is the nation's largest nonpartisan, grassroots organization dedicated to replacing the current tax system. For more information visit the Web page: www.FairTax.org.

American industry and consumers are taking Congress's advice. Market forces do work. The burgeoning trade deficit, the loss of American jobs, and stagnating blue collar wages are consequences of failing to send the right message.

At a time when U.S. companies are struggling to compete against foreign manufacturers, at a time of record trade deficits and manufacturing job losses, at a time when the tax-writing committees should finally realize that they cannot legally offer domestic producers export incentives like the Foreign Sales Corporation rules without violating WTO rules, the Congress is ignoring the root problem. And today, it is ignored again. If America wants to rebuild its manufacturing base and remain competitive, it must adopt a border-adjusted tax system. And the best way to accomplish that is by enacting the most border-adjusted tax system that could be devised – the FairTax (H.R. 25).

Second, we urge Members of this Subcommittee – before reaching for any particular solution to improve "competitiveness" – to take the opportunity to better define the contours of that fuzzy concept. The true test of international competitiveness is not whether a tax system benefits multinationals which by definition know neither national boundaries nor allegiances. Rather, the true test ought to be whether or not the tax regime achieves the objective of raising the standard of living for the American people. We believe the FairTax addresses more effectively the problems raised by the witnesses than the very plans they promote, and more importantly, it offers solutions to other issues that should be more fully explicated. When examining whether various tax plans help America become more competitive, ask these questions:

- *Do the plans create a better environment for domestic companies to produce in the U.S. and to hire American workers rather than to produce abroad and hire foreign workers?* Only under the FairTax would domestic corporations enjoy a zero rate of tax for producing in the U.S.
- *Do the plans make the U.S. a better environment from which to export?* Only under the FairTax would exports be fully exempted from taxation.
- *Do the plans tax foreign produced goods and U.S. produced goods alike in the U.S. market?* Only under the FairTax's inherently border-adjusted scheme would foreign goods be taxed exactly the same as domestically produced goods consumed in the U.S.
- *Do the plans encourage foreign establishment of plants and operations in the U.S. more than abroad?* Only under the FairTax would foreign business enjoy a zero U.S. tax on earnings. A territorial income tax system, in contrast, would probably drive job-generating plants and facilities overseas so that only the shell corporation remains headquartered here.
- *How well do the plans encourage tax competition (i.e., do they encourage global rates on savings and investment to fall or do they encourage a race to the top)?* Only under the FairTax would foreign nations have such a clear choice: Reduce your taxes or lose investment to America. This would have a pronounced positive impact on world economic growth.
- *How well do the plans reduce the costs of compliance with the international tax system?* Only the FairTax eliminates the complexity of the foreign tax credit scheme, the personal foreign holding company rules, intercompany transfer pricing rules, Subpart F, income sourcing and expense allocation rules, and a host of other complex international tax rules that create high compliance costs today. It does so by eliminating any business-to-business taxation and by taxing only consumption in the U.S.
- *Will the plans afford an easy transition from the current system to the alternative?* Moving to a territorial income tax will raise many transition issues, including how to treat pre-enactment dividends and how to treat excess foreign tax credits.
- *Will the plans allow businesses to make decisions entirely on economic grounds rather than for tax planning reasons?* Only the FairTax would completely remove taxes from decision making

by being vertically and horizontally equitable.

- *Will the plan be sustainable or merely a temporary fix that will eventually devolve into the current morass?* The FairTax is the only plan that can be guaranteed not to devolve into the current morass by repeal of the 16th Amendment.
- *Will the interaction of the tax plan with foreign tax systems be favorable?* Only the FairTax eliminates fully the need to coordinate juridical taxation because source income is not taxed.

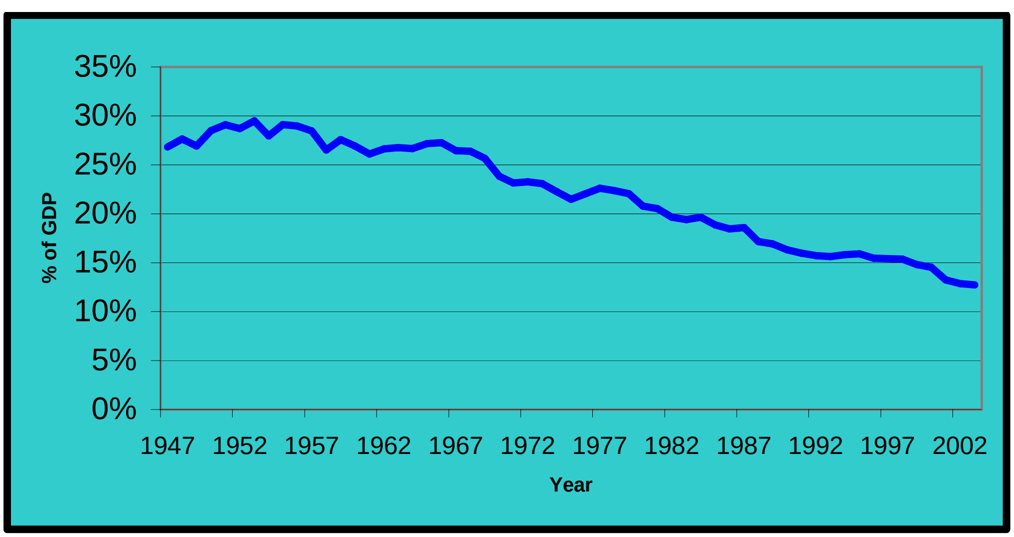
These questions properly frame the debate over whether or not a plan is good for America.

Mr. Chairman, as the nation's largest tax reform organization, we compliment this Subcommittee for focusing on the problem faced by U.S. producers. American producers struggle to compete in a global market where capital, technology, management, and increasingly labor are free to move to any venue offering the best opportunities for profit. However, American producers and the workers whose jobs depend on them are beyond mere rhetoric. They do not see increased outsourcing as a healthy correction in the economy, or a normal casualty of destructive capitalism like the obsolescence of the buggy whip manufacturers caused by automakers. They do not see America's manufacturing decline as a statistical abstraction relevant only to those nostalgic about America's industrial past. They do not see our tax system as repairable. Rather, they see destruction of America's manufacturing base as a harbinger of hardship ahead for future generations of Americans. This Subcommittee has a duty to understand how the tax laws they helped construct contribute to this problem, and what can be done to fix it.

I. America's Manufacturing Base is at Critically Low Mass.

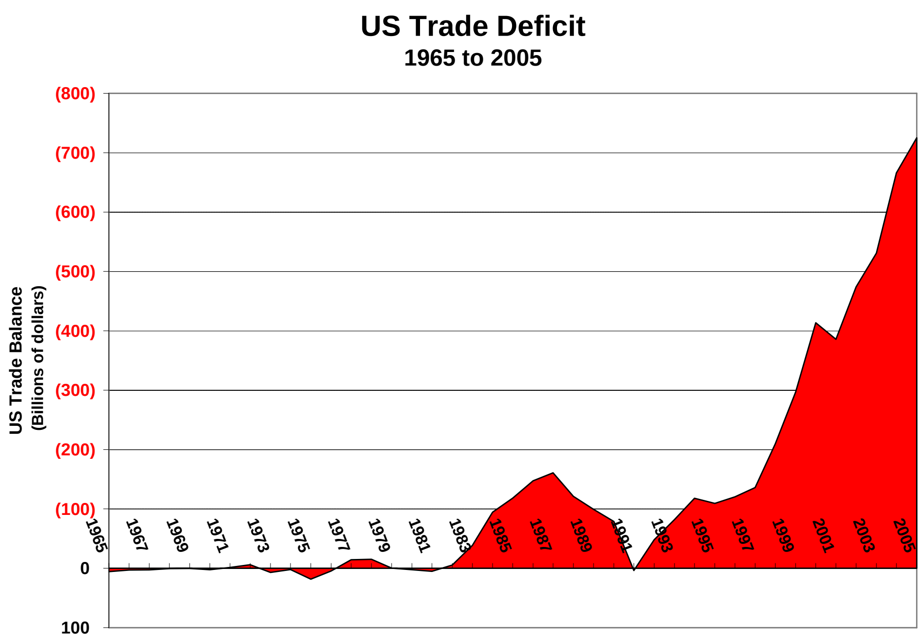
For many decades, American manufacturing has been the nutrient of national prosperity and security; raising the standard of living for working Americans, fulfilling dreams of immigrants, enabling sustainable national security, building communities, and launching America on the global stage as a world leader. American industry has long been distinguished for its productivity and sustained innovation. The health of the U.S., the well-being of its citizenry, and our very survival are undeniably and inextricably bound to the health, well-being, and survival of the American manufacturer. Without strong manufacturing, America's strength cannot endure.

But U.S. manufacturing is rapidly eroding in the face of foreign competition. This erosion is visible in the dwindling contribution of manufacturing as a share of the U.S. economy.



Until recent years, U.S. companies employed Americans to produce most of the goods that Americans consumed, employment supported sales, and sales supported employment. Today, manufacturing represents half of what its share of Gross Domestic Product (GDP) was in the 1950s. With each passing year, manufacturing has become an ever-decreasing part of the overall economy. Consider that the value of all goods manufactured in the U.S. was roughly 30 percent of the value of all goods and services in the economy in 1953, 25 percent in 1970, 20 percent in 1982, and it fell below 15 percent in 2001. The share of the U.S. labor force working in the manufacturing sector fell over the same period from over 26 percent to about 10 percent.

When manufacturing moves overseas, it takes the practical engineering know-how with it. Manufacturing has declined so severely in many communities that basic industrial skills and the small business suppliers and support industries are disappearing. Even the industrial base necessary to maintain a technological edge in military hardware and the ability to ramp up in the case of war is starting to vanish. The National Association of Manufacturers has warned, "…the country may be dropping below critical mass in manufacturing."



The bad news does not stop there. The U.S. runs a sizable negative trade balance in goods with every principal nation and region in almost every category of goods; so large an imbalance that the U.S. trade deficit exceeded $700 billion in 2005, around 6 percent of GDP. Even the agricultural trade surplus is gone. In what is a demonstrably unsustainable pattern, we produce only two-thirds of the goods we consume.[1] And the relentless growth of the trade deficit has converted the U.S., once the world's largest creditor, into the world's largest debtor, enabling foreigners to own an estimated $3.7 trillion in U.S. assets (an amount on scale with the total privately owned portion of the U.S. federal debt).

[1] This, of course, means that the U.S. is running a large capital surplus. But this capital is not being used to fund new investment. Business fixed investment is stable at 15 percent of GDP. Instead, the U.S. is selling its assets – and its economic future – to foreign investors to fund current consumption.

High paying jobs are being destroyed. The effect of this decline is not a numerical abstraction. It can be felt in the shrinking share of U.S. income earned by blue-collar workers. The decimation of our domestic producer base results in job losses for America's middle class, lost opportunities for the young, suffering for the poor, and a widening wealth gap. This decline corresponds with the outsourcing of jobs and production overseas, and an increase in the number of manufacturing start-ups basing their operations on foreign soil.

It means we must work harder for less. Indeed, the U.S., which led the world in adopting the 40-hour work week in the 20th century, enters the 21st century with a generally adopted 80-hour family work week simply to keep pace with costs. Today, it is becoming increasingly difficult for blue-collar families to achieve a middle-class standard of living.

II. The Central Problem Ignored: Failure to Adopt a Border-Adjusted Tax System

The U.S. manufacturing decline and the ascendancy of foreign competition have been due in large part to the failure of the U.S. to adopt a border-adjusted tax base.

We subsidize foreign producers and punish our exports. The U.S. should not target a particular trade deficit level, subsidize its exporters or impose tariffs on imports. By doing so, we would interfere with mutually beneficial transnational economic exchanges to the disadvantage of both countries' economies. That is the very purpose for seeking to achieve the objectives of capital export and import neutrality, which some witnesses believe are mutually unobtainable.[2] By the same token, however, the U.S. government should not accord a huge advantage to foreign companies competing in the U.S. market or impose a huge disadvantage on American producers and workers selling their goods and services in the U.S. and foreign markets – as we now do as a matter of policy.

We harm the competitiveness of domestic producers and workers. The U.S. tax system imposes heavy income and payroll taxes on U.S. workers and domestic producers whether their products are sold here or abroad. As noted, U.S. corporate taxes are the highest in the industrialized world, with a top corporate rate about nine percentage points higher than the OECD average.[3] At the same time, the U.S. tax system imposes no corresponding tax burden on foreign goods sold in the U.S. market. Moreover, foreign VATs, which are a major component of the total revenue raised elsewhere, are rebated when 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.

Advantage for Foreign Producers

Origin	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 taxes and foreign VAT
Foreign production	Pays no U.S. income or payroll tax and no foreign VAT	Pays foreign VAT

[2] Capital export neutrality is achieved when a taxpayer's choice to invest here or abroad is not effected by taxation. Capital important neutrality is achieved when all firms doing business in a market are taxed at the same rate. While conventional wisdom is that all forms of neutrality cannot coexist, these mutual goals are obtainable with the FairTax.

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

As the table above illustrates, 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 VAT is forgiven. Thus, among the 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 both in U.S. markets and in foreign markets. Our failure to counteract these border-adjusted taxes explicitly encourages consumption of foreign, rather than American, goods. And it converts many of our nation's retailers into what are effectively tax-free trade zones for foreign produced goods.

Birth of the anomaly. The U.S. has adopted this self-flagellating policy partly because of our laudable commitment to free enterprise and rejection of mercantilism and colonialism. At least since World War II, American business and political leaders have viewed free trade as the basis for international peace and prosperity. As the dominant economic and military power, the U.S. led the movement to dismantle trade barriers and supported international trade liberalization (GATT and WTO), economic cooperation (OECD), and customs unions (such as the European Union and NAFTA). According to the OECD, its members have reduced their average tariff rates from 40 percent at the end of World War II to 4 percent today. The U.S.'s average import duty on goods is currently 1.7 percent. As tariffs declined, however, a trend emerged in Europe toward border-adjusted taxation in the form of VATs. These taxes were levied principally on manufactured goods. The alleged purpose was to "level the playing field" by offsetting the expense of government welfare through taxation of spending on consumption.

The scope of the problem. Today, the European Union has an average standard VAT of 19 percent, while the average OECD standard VAT is 17.7 percent. During the 1990s, Mexico and Canada increased composite rates to 15 percent from 10 percent and 7 percent, respectively. China adopted a 17-percent VAT in 1994. As foreign governments increased the VAT, they also reduced effective corporate income taxes. Meanwhile, high U.S. corporate tax rates today, coupled with U.S. taxation of the foreign income of corporations based in the U.S., caused the flight of corporations' headquarters to countries that exempt taxation of overseas income. In effect, the U.S. tax system is distorting the international marketplace and literally driving plants and good jobs out of this country at a devastating and unsustainable pace. There are, after all, only so many assets we can sell to foreigners before the entire financial system enters into a severe crisis.

Counterarguments are usually self-serving. Some economists mistakenly argue that if America adopted a border-adjusted tax system, *any* relative price change would be eliminated by an offsetting appreciation in the dollar. This argument is normally advanced by supporters of tax plans that aren't or can't be made border adjustable. If the FairTax were implemented, for example, they hypothesize that the price change would be offset by a 23-percent immediate appreciation in the dollar. They contend such appreciation would be caused by a reduction in U.S. demand for foreign currency to acquire (the now more expensive) foreign goods and an increase in foreign demand for U.S. currency to acquire (the now less expensive) U.S. goods.

Their arguments are specious. The fallacy is that the demand for U.S. dollars is not limited to the traded-goods market. Nearly $90 trillion in U.S. assets owned by households and non-financial businesses are denominated in dollars. Financial institutions trade trillions of dollars in securities and currency each day based on expectations and guesses. Furthermore, the non-traded goods and services sector is much larger than the traded-goods sector and is also denominated in dollars.[4]

Prominent economists have recently begun to publicly disagree with their colleagues on the mitigating effects of exchange rates. A recent study by Professor Jerry Hausman of M.I.T. found that:

- Existing disparities in treatment of corporate income taxes and VATs for purposes of border adjustment lead to extremely large economic distortions.
- U.S. exporters bear both domestic income taxes and foreign VATs when selling abroad.
- Foreign exporters in countries relying largely on VATs typically receive a full rebate of such taxes upon export to the U.S., and are not subject to U.S. corporate taxes.
- This situation creates a very significant tax and cost disadvantage for U.S. producers in international trade with significant impact on investment decisions – leading to the location of major manufacturing and other production facilities in countries that benefit from current rules on the border adjustment of taxes.
- The economic implications for the U.S. are very large.
- Elimination of the current disparity in WTO rules (by eliminating border adjustment for either direct or indirect taxes) would increase U.S. exports by 14 to 15 percent, or approximately $100 billion based upon 2004 import levels.
- Eliminating such economic distortions should be a high priority.

In sum, Professor Hausman agrees with FairTax.org that adjustments in exchange rates are not likely to counteract the relative price advantage of foreign produced goods.

III. How to Confront Border-Adjustable Tax Regimes

There are two ways tax writers could defend U.S. industry against global border-adjusted taxes: (1) encourage our trade representatives and trading partners to allow income taxes to be border adjusted, or (2) adopt a destination-based consumption tax. In order for our trading partners to allow border-adjusted *income* taxes (direct taxes), they would need to eliminate the admittedly artificial distinction between direct taxes (income taxes) and indirect taxes (consumption taxes) alluded to earlier. Because GATT/WTO rules treat border tax adjustment of "direct taxes" as a prohibited export subsidy, border-adjusted taxes are permissible only in the case of indirect taxing regimes and then only insofar as the amount remitted doesn't exceed the amount of indirect tax "levied in respect of the production." That rule was written so the U.S. income tax would not pass muster as a border-adjustable tax, and as a direct tax it does not. Professors Hall and Rabushka's flat tax proposal would also probably fail to satisfy that rule.

Were it politically expedient to eliminate the indirect/direct distinction in the Doha Round of WTO negotiations, such an action would warm the collective aortae of K Street lobbyists. They could immediately work to bring back FSCs, ETIs, DISCs, interest-charge DISCs, and other export subsidy vehicles which from time to time have been lobbied, enacted, and then quickly

[4] If these economists are right and there is no increase in the competitiveness of U.S. goods because of a 23-percent increase in the price of the dollar (more or less precisely) relative to foreign currency, then that means the FairTax will have succeeded in increasing the wealth of the American people by something on the order of $20 trillion (23 percent of $90 trillion) relative to the rest of the world, an instantaneous increase nearly equal to the value of all the goods and services produced in the U.S. over two years. Although that would be reason enough to enact the FairTax, it is impossible for the traded-goods sector to dominate the currency movements, since the dollar-asset markets are perhaps 100 times as large as the annual traded-goods market (net basis). See B. 100 and B. 102, Flow of Funds Accounts, U.S. of America, Fourth Quarter 2004, Federal Reserve System, for statistical information on asset markets.

found violative of the WTO (and before that GATT). But negotiating away the indirect/direct distinction is not a sensible long-term policy response because convincing the WTO's 139 Member countries to abandon the indirect/direct distinction – no matter how baseless that distinction – would take phenomenal diplomatic acumen. If we can't change our own system into one that stimulates economic growth, if this Subcommittee itself cannot appreciate the importance of granting foreign producers unchallenged subsidies to compete unfairly against domestic producers, if the Europeans were willing to sue for a relatively minor export incentive worth about $4 billion annually (the FSCs/ETIs), it may be naive to assume our negotiators could convince the Chinese, Japanese, Canadians, Mexicans, Koreans, Indians, and Europeans that they should abandon their unique bargaining leverage attributable to their border-adjusted taxes. After all, these nations adopted border-adjusted tax systems with the sole purpose of granting themselves a unilateral trade advantage *against the U.S.*

Assuming *arguendo* such diplomacy were miraculously successful, eliminating the indirect/direct distinction would solve only a fraction of the economic problem, and then only for exporters. If the indirect/direct distinction were fully eliminated, an export subsidy would only allow exporters to defer or exempt a portion of their *income tax,* even though payroll taxes constitute abut 36 percent of the gross collections by type of tax. And lest we forget about our record trade deficits, this does nothing to level the playing field on imports which continue to compete against domestic producers unfairly on our own soil.

Finally, such a victory would be but one step in a process. The Ways and Means Committee is unlikely to have the appetite to pay for another major FSC provision given the current level of deficit spending.

The best alternative is to enact a destination-principle tax system (also known as a border-adjusted tax system). U.S. manufacturers can compete effectively as the most productive and innovative workers in the world, but the U.S. must first remove this large and unjustified inequity against U.S. domestic producers. The removal of this tax advantage is nothing more than the promotion of neutrality, not the enactment of a special advantage. Replacing current U.S. income taxation with comparable border-adjusted taxation would tax all goods consumed in the U.S. alike, whether the goods are produced in the U.S. or abroad. We need to eliminate those aspects of the U.S. tax system that artificially place U.S. production at a competitive disadvantage compared to foreign production.

And the best border-adjusted plan is the FairTax. The November 2005 Report of the President's Advisory Panel on Federal Tax Reform recommends a border-adjusted tax system,[5] but fails to honestly conclude none of its proposals would pass muster under the WTO/GATT rules. In fact, of the five candidates for true tax reform, only three are or could be made border-adjustable. These are: The FairTax (the most comprehensive, single-stage consumption tax), a business transfer tax (BTT) or a credit-invoice method value-added tax (which is called a Goods and Services Tax in Canada and Australia). Each is a *destination principle* consumption tax.

Of these plans, only the FairTax is hard wired to make the entire system border adjusted. The FairTax would transform the entire U.S. tax system into a border-adjusted tax by:

- repealing *all* upstream federal taxes now embedded in the product price of U.S. goods

[5] See "Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System," Report of the President's Advisory Panel on Federal Tax Reform, November 2005, pp. 171-172 and 283.

and eliminating any business-to-business taxes, including payroll taxes,
- completely exempting exports from taxation, and
- imposing the FairTax on foreign goods entering our shores for final consumption.

Only the FairTax can claim that under its regime, foreign manufactured goods and U.S. manufactured goods would bear the same tax burden when the goods are sold at retail. Only the FairTax can make the claim that U.S. businesses selling goods or services in foreign markets are fully relieved of federal tax (including payroll taxes).[6] Only the FairTax addresses this preeminent issue ignored by the Subcommittee today.

IV. Other Criteria for Reform

We can safely predict the issue of border adjustability will not be raised today because none of the plans the witnesses espouse can be made border adjusted. Instead, the witnesses are expected to support the combination of an origin-based territorial tax system and a reduction of marginal rates as the cornerstone of their competitiveness proposals. In touching upon the hundreds of pages of complexity that constitute our international tax system, from the income sourcing and expense allocation rules, to the foreign tax credit limitations, to CFCs, to Subpart F, to personal holding company rules, to the various "baskets" of income which have made tax lawyers basket cases, the witnesses recommend simplification.

If extraterritoriality, rates, and simplicity were the only factors the Subcommittee reviews to evaluate how various plans improve America's competitiveness, the FairTax would still be superior to every policy option presented.

Begin by reviewing the three principal objectives sought to be achieved by territoriality.[7] First, those that support territoriality argue that if an American company can enjoy low taxes and still be headquartered here, they are less likely to move their headquarters elsewhere. (Although they would certainly move their production.) Second, international tax laws are complex and often gamed, and companies spend billions complying with rules that yield little revenue. Third, by allowing U.S. production to move where the taxes are lowest we will force the U.S. to lower our own corporate tax rates. In other words, we will force the U.S. into tax competition. Advocates of a territorial taxing regime make some valid points. Add to the arguments the fact that the U.S. historically fell into an extraterritorial tax system, not by choice, but by default.

But before taking such a path, however, the Subcommittee should consider a past tax policy debate that offers valuable prologue on the merits of this course of action.

Forty and one-half decades ago, during President John F. Kennedy's campaign, the same question arose in an almost identical context: Should the U.S. tax the foreign earned profits of U.S. multinationals (should U.S. companies doing business overseas escape U.S. taxes)? Quite predictably, the debate pitted management (who liked to keep white-collar jobs here at a U.S. headquarters) against unions (who argued it would also be a good idea to keep U.S. blue-collar

[6] The problem with other consumption tax plans – apart from the fact that they can quickly develop into income taxes – is that they only make non-payroll taxes border adjustable. For example, the BTT, which allows for complete expensing of business inputs, could be made border adjustable by not allowing a deduction for foreign business inputs and exempting export sales. The Flat Tax is not border adjusted.

[7] Although today the U.S. taxes its citizens and residents on income no matter where is earned, under a territorial system the U.S. would exercise taxing jurisdiction only when income is earned in the U.S. Such a regime for example, would allow a U.S. multinational to escape U.S. corporate taxes on their foreign earnings.

jobs in the U.S.). It pitted Democrats against Republicans. Economist against economist. And the unions argued, quite understandably, that if American companies are able to take advantage of tax sparing (as some witnesses doubtless praise) they will establish themselves overseas to the detriment of the U.S. workforce. So 45 years later what does this mean for the territoriality debate? It is really a debate over legitimizing corporate inversions in fact. Companies can remain in the U.S. in name only, but the jobs will flock to nations that dole out the tax holidays.

Tax writers may choose to stroll unwittingly into that political minefield, but history has shown that debate to be bloody and intractable. And more importantly, that course of action does not simplify the system. Determining whether or not activity takes place within or without the U.S., applying income sourcing and expense allocation rules, and figuring out how to treat older earnings that will be repatriated will equal or exceed the complexity posed by the arcane rules of current law because the stakes will not be merely deferral, but exoneration from tax. The witnesses no doubt will underestimate these effects or the necessary transition rules, but they are very, very significant because they retain almost all the cost drivers so despised by current law.

There is a better answer that accomplishes all these objectives – impose a zero rate of tax on productive activity with the FairTax. Only under the FairTax would the U.S. become the most attractive jurisdiction within which to invest. A zero rate of tax would give foreign jurisdictions two choices: Reduce their tax rate on savings and investment (which will stimulate global economic reform and growth) or lose investment to America. Companies now American in name only would repatriate investment and jobs back to our shores.

Conclusion

As this Subcommittee holds its hearings, it misses the chance to discuss the issue of border adjustability and the chance to better elucidate those factors that bear upon the concept of competitiveness. As U.S. negotiators work to level the playing field in the Doha round of trade talks in the coming months, we urge this Subcommittee to focus a second competitiveness hearing solely on the issue of border-tax adjustments. And it might wish to take a step back and ask itself to establish the criteria on which reform should be based.

Beyond any other plan, the FairTax solves the problem the Subcommittee ignored by converting the entire U.S. tax base into a border-adjusted system. Through WTO legal means, the FairTax exempts exports from taxation, while taxing imports the same as U.S. produced goods for the first time. And it solves the problems the Subcommittee should be considering. It is the simplest plan that could be devised, without the intercompany (and intracompany) transfer pricing problems present in an origin-principle income or consumption tax. It reduces U.S. corporate rates to zero, ensuring the U.S. is the most competitive environment in which to produce and from which to export. And it would stimulate economic growth by broadening the tax base and reducing marginal rates well beyond any other proposal and do so in a way that does not tax the poor, punish savings and investment or tax income more than once.

Mr. Chairman: None of that would please K Street, but it will please Main Street.