



A FairTaxSM White Paper

The FairTax and economic growth

Virtually all economists agree that the following will promote economic growth:

- Replacing the income tax with a consumption tax
- Replacing a graduated rate system with a flat marginal tax rate system
- Lower marginal rates and a broader tax base

The Fair Tax Act (a national retail sales tax) does all three.

Here are some applied research results of economists who analyzed the likely impact on the U.S. economy of moving from the current federal income tax system to a broad-based consumption tax, such as the national retail sales tax plan called for by HR 25, the FairTax.

In a study of the specifics of the FairTax plan, Kotlikoff and Jokisch find that the capital stock will be 13 percent higher under the FairTax system than under the current system by 2010, and 41.4 percent higher by 2030, and that long-run interest rates would be 150 basis points lower than under the current system. Their study states that, “the shift to the FairTax raises marginal labor productivity and real wages, over the course of the century, by 18.9 percent and long-run output by 10.6 percent. . . . These macroeconomic gains have important microeconomic welfare implications. In the long run, low-income households experience a 26.7 percent welfare gain, middle-income households experience a 10.9 percent welfare gain, and high-income households experience a 4.7 percent welfare gain. This is a very progressive long-run outcome.”¹

Another new study of the FairTax plan by Arduin, Laffer & Moore Econometrics finds that investment will be 33 percent higher in the first year and 41 percent higher by the tenth year than under the current tax system. The effect of an increased rate of productivity growth and the reduced efficiency costs yields GDP up to 24.4 percent greater than under the current system by the tenth year. Consumption, fueled by 1.7 percent higher real disposable income in the first year which increases to 11.8 percent higher by the tenth year, is higher by 2.4 percent in the first year and 11.7 percent by the tenth year.²

¹ Kotlikoff, Laurence J. and Sabine Jokisch, “Simulating the Dynamic Macroeconomic and Microeconomic Effects of the FairTax,” National Bureau of Economic Research, Working Paper No. 11858, December, 2005.

² Arduin, Laffer & Moore Econometrics, “A Macroeconomic Analysis of the FairTax Proposal, Americans For Fair Taxation Research Monograph, December, 2005.



The FairTax and economic growth

Alan Auerbach of the University of California at Berkeley found that long-run GDP per capita would be 9.7 percent higher under a national sales tax.³

Michael Boskin, former chairman of the Council of Economic Advisers has stated that the long-term gain to GDP from a consumption-based tax reform would be about 10 percent.⁴

Dale Jorgenson, Ph.D., former chairman of the Economics Department at Harvard University, estimated a near-term 9 to 13 percent increase in the Gross Domestic Product (GDP).⁵

Laurence Kotlikoff, Ph.D., chairman of the economics department at Boston University, estimated a 7 to 14 percent increase in GDP.⁶ In a separate study, his model predicts “significant macroeconomic and welfare improvements from implementing the proposed tax reform [national sales tax to replace federal income/payroll tax system]. In the long run, the reform raises the economy’s capital stock by 42 percent, its labor supply by 4 percent, its output by 12 percent, and its real wage by 8 percent.”⁷

Gary and Aldona Robbins, Fiscal Associates, show that replacing the current tax system with a flat rate system that taxes capital and labor income equally – such as the FairTax – would increase the GDP by 36.3 percent and increase private output by 48.4 percent over the long run.⁸

Finally, a 1997 Joint Committee on Taxation report summarized results from nine different economic models, all finding that a change to a flat rate consumption tax would increase investment and boost economic growth.⁹

The above studies do not take into account the following additional economic benefits from replacing the current tax system with the FairTax:

1. Decline in interest rates
2. Freeing up of capital spent on tax compliance
3. Productivity gains from massively reduced compliance costs.¹⁰

³ Auerbach, Alan, “Tax Reform, Capital Allocation, Efficiency, and Growth,” in *Economic Effects of Fundamental Tax Reform*, Henry J. Aaron and William G. Gale, eds., Washington, D.C.: Brookings Institution Press, 1996, p. 58.

⁴ Boskin, Michael, “A Framework for the Tax Reform Debate,” testimony before the House Ways and Means Committee, June 6, 1995.

⁵ Jorgenson, Dale W., “The Economic Impact of the National Retail Sales Tax,” November, 1996.

⁶ Kotlikoff, Laurence J., “The Economic Impact of Replacing Federal Income Taxes with A Sales Tax,” Cato Institute Policy Analysis No. 193, April 15, 1993.

⁷ Kotlikoff, Laurence J., “Replacing the U.S. Federal Tax System with a Retail Sales Tax – Macroeconomic and Distributional Impacts,” Report to Americans For Fair Taxation, December, 1996.

⁸ Robbins, Gary and Aldona, “Looking Back to Move Forward: What Tax Policy Costs Americans and the Economy,” Institute for Policy Innovation, Policy Report No. 127, September 1, 1994.

⁹ Joint Committee on Taxation, “Tax Modeling Project and 1997 Tax Symposium Papers,” JCS-21-97, November 20, 1997. Symposium participants: Alan J. Auerbach, Charles L. Ballard, Michael J. Boskin, Roger E. Brinner, Eric Engen, William Gale, Jane G. Gravelle, Dale W. Jorgenson, Laurence J. Kotlikoff, Joel L. Prakken, David Reifschneider, Robert D. Reischauer, Aldona Robbins, Gary Robbins, Diane Lim Rogers, Harvey S. Rosen, Joel Slemrod, Kent Smetters, Jan Walliser, Peter J. Wilcoxon, John G. Wilkins.



The FairTax and economic growth

Interest rates are projected to fall by 25 percent (the difference between current interest rates for taxable and non-taxable bonds).

Capital that is now unproductively spent on the cost of complying with the current complex tax system is freed up by the FairTax and available for investment. According to a detailed study by the Tax Foundation, in 2005 individuals, businesses, and non-profits spent an estimated 6.0 billion hours complying with the federal income tax code at an estimated cost of over \$265.1 billion. This amounts to imposing a 22-cent tax compliance surcharge for every dollar the income tax system collects. The Tax Foundation projects compliance costs to reach \$482.7 billion by 2015. Under the FairTax, the number of tax filers decreases by at least 75 percent and, according to Tax Foundation estimates, compliance costs are reduced by 90 percent.

What is the FairTax Plan?

The FairTax Plan is a comprehensive proposal that replaces all federal income and payroll based taxes with an integrated approach including a progressive national retail sales tax, a prebate to ensure no American pays federal taxes on spending up to the poverty level, dollar-for-dollar federal revenue replacement, and, through companion legislation, the repeal of the 16th Amendment. This nonpartisan legislation (HR 25/S 1025) abolishes all federal personal and corporate income taxes, gift, estate, capital gains, alternative minimum, Social Security, Medicare, and self-employment taxes and replaces them with one simple, visible, federal retail sales tax – administered primarily by existing state sales tax authorities. The IRS is disbanded and defunded. The FairTax taxes us only on what we choose to spend on new goods or services, not on what we earn. The FairTax is a fair, efficient, transparent, and intelligent solution to the frustration and inequity of our current tax system.

What is Americans For Fair Taxation (FairTax.org)?

FairTax.org is a nonprofit, nonpartisan, grassroots organization solely dedicated to replacing the current tax system. The organization has hundreds of thousands of members and volunteers nationwide. Its plan supports sound economic research, education of citizens and community leaders, and grassroots mobilization efforts. For more information visit the Web page: www.FairTax.org or call 1-800-FAIRTAX.

KEW/km 4-18-06

(AFFT Documents\Papers on a specific subject\The FairTax and economic growth)

¹⁰ Burton, David R. and Dan R. Mastromarco, “Emancipating America From the Income Tax: How a National Sales Tax Would Work,” Cato Policy Analysis No. 272, April 15, 1997.