

Testimony

Of Congressman John Linder (GA-7)

Before The Joint Economic Committee

On Rethinking the Tax Code

November 5, 2003

Mr. Chairman, thank you very much for giving me a chance to testify before the Joint Economic Committee this morning on the need for fundamental tax reform generally, and H.R. 25, the FairTax, my fundamental tax reform proposal specifically. I appreciate having the chance to share with the Committee my thoughts on this pressing issue.

In debating any fundamental tax reform proposal, I believe that the Congress should judge any such bill by the following key principles:

1. Fair: It must protect the poor and treat everyone else the same. No exemptions - no exclusions - no advantages.
2. Simple: It must be easy to understand for all Americans - no matter one's education, occupation, or station in life.
3. Voluntary: It must not be coercive or intrusive.
4. Transparent: We should all know what the government costs. There must be no "hidden" taxes.
5. Border-Neutral: Our exports must be unburdened by any tax component in the price system, while imports carry the same tax burden at retail as our domestic competition.
6. Industry-Neutral: It must be neutral between businesses and industries.
7. Strengthens Social Security: Fundamental reform must address the long-term solvency of Social Security.
8. Manageable Transition Costs: It must not be costly or difficult to implement.

My FairTax proposal, which eliminates all income and payroll taxes and replaces them with a national retail sales tax, meets these criteria. The FairTax is a compelling proposal that would benefit the U.S. economy, businesses across the nation, and all American taxpayers.

The FairTax plan is fair. It contains a monthly rebate of the sales tax for every household, which would totally rebate the tax consequences of spending up to the poverty line. This rebate mechanism ensures that every household can buy necessities taxfree, and it totally untaxes the poor. All Americans receive equal, fair treatment. If Bill and Melinda Gates want to move to a farm and grow their own groceries and live off the rebate, what do we care? We'll borrow his money and create jobs.

The FairTax plan is simple. It totally eliminates the more than 10,000 pages of complexities in the current income tax code once and for all, and replaces them with a simple uniform sales tax.

The FairTax plan is a voluntary tax system. Every citizen becomes a voluntary taxpayer, paying as much as they choose, when they choose, by how they choose to spend.

The FairTax plan creates transparency within the tax code. It eliminates the hidden tax component from the prices of goods.

According to a Harvard study, the current tax component in our price system averages 22 percent, meaning that the least well off among us lose 22 percent of their purchasing power.

Any system that burdens business with any payroll tax, income tax, or compliance costs embeds that cost in our price system. By abolishing the IRS and abolishing the income paradigm in favor of a consumption paradigm we let the market drive the tax component out of the price system.

Moreover, knowing how much we pay in federal taxes on every purchase we make would make all Americans more aware of the cost of government. The next time someone wants to raise taxes, they will not be able to sell such a bad idea with the old argument that it only applies to the "wealthiest amongst us." The rationale for any future tax increase must necessarily be so compelling that my mother would be willing to pay it.

The FairTax plan is border-neutral. Under a national sales tax, imported goods and domestically produced goods would receive the same U.S. tax treatment at the checkout counter. Moreover, our exports would go abroad unburdened by any tax component in the price system.

The FairTax plan is industry-neutral. There is not a good reason that our neighbor who builds a bookstore, hires our kids, votes in our elections and supports our community should be placed at a seven percent disadvantage against Amazon.com. Governors have a keen interest in this due to the loss of hundreds millions of dollars in revenue to Internet and catalogue sales. A national retail sales tax would collect these revenues, and in doing so help the states.

Nor is there a good reason why I, as a dentist, didn't have to collect a sales tax in Georgia while my neighbor, the retailer, did.

The first principle of government tax policy ought to be neutrality.

The FairTax plan would also strengthen Social Security's long-term future. The arguments about partial private investments saving Social Security seem to miss an important point - we will increase the number of retirees in the next 30 years by 100 percent and increase the number of workers supporting them by 15 percent.

That system will only survive by dramatically reducing benefits, increasing taxes, or increasing the number paying into it, or some combination of both.

Under the FairTax, Social Security benefits would be paid out of the general sales tax revenues. The sales tax would be collected from roughly 285 million Americans and 51

million visitors to our shores. Revenues to Social Security and Medicare would double, as we expect the size of the economy to double, in 13 to 14 years under the proposal.

The FairTax plan has manageable transition costs. The only transition rule we envision is to allow retailers to use inventory on hand on December 31 as a credit against collecting taxes on sales in the new year, on the principle that things should be taxed only once and goods produced before the transition would already have the current tax embedded in them.

According to the U.S. Census Bureau, at any given time, U.S. businesses have about \$1.1 trillion in inventory on hand at any given time. Not collecting taxes on that inventory would cost the treasury about \$300 billion. Compare that to any estimates of transition costs just trying to bring some private investment into Social Security alone. According to the Social Security Administration, the 75-year unfunded liability in Social Security is nearly \$5 trillion. Remember this proposal fixes Social Security in 13 to 14 years.

Beyond the above arguments, what will the new paradigm do in our present economy? Passing the FairTax does several things that will directly affect the U.S. economy:

1. We currently spend anywhere between \$250-500 billion a year on compliance with the tax code. Most of that is spent by corporate America and high-income investors. The savings that accompany a simpler tax system will go to bottom lines and investment for job creation.

2. Corporate America spends additional billions calculating the tax implications of business decisions. The savings generated by the FairTax will go to the bottom line.

3. Eliminating the income tax will bring long-term interest rates down to municipal bond rates, ultimately reducing interest rates by 30 percent. That is good for corporate profits and the market.

4. What do you think will happen to the stock market if all the world's investors could invest in our markets with no tax consequences?

5. Having no complicated depreciation schedules, no Alternative Minimum Tax, no credits and deductions to confuse investors, and no tax or compliance costs forces a whole new look at corporate accounting. Only three numbers have meaning: earnings, expenses and dividends.

This will make it much easier for shareholders and investors to evaluate and monitor all publicly-owned companies.

6. Deficits spook the market. Instead of declining Federal revenues because an income-based tax system depends on ever growing incomes, the Federal government would collect higher revenues under the FairTax, as revenues would track consumption. A study from 1945 to 1995 shows that the consumption economy is a far more predictable revenue base than the income economy, which has much higher amplitudes of volatility.

7. The FairTax would bring a 26 percent increase in exports in the first year as well as a 76 percent increase in capital investment. Capital investment increases lead to increases in productivity and then increases in real wages.

How does the FairTax compare to other fundamental tax reform ideas? The FairTax is decidedly simpler and fairer than flat tax proposals.

The U.S. instituted a flat tax in 1913. Since then, it has been amended over and over, resulting in the very plan you are working to correct today. In 1986, we eliminated many itemized deductions and drastically lowered tax rates to only two levels. We have amended the code over 6,000 times since then.

I know that you recognize the need for a more fundamental change - we have walked the flat tax path before, to no avail, and it simply does not make sense to implement the same mistake again.

Some other sales tax proposals leave in place the payroll tax - the largest hidden tax component in the prices of our goods and services. The FairTax would completely eliminate these hidden taxes, allowing competition to bring prices down an average of 20-30 percent and increasing the transparency of the tax system.

The FairTax has the following other benefits:

*** Because of the tax component incorporated into prices under the current income tax code, we are already paying the equivalent of the FairTax!**

*** The FairTax eliminates payroll taxes, which are the most regressive of existing taxes.**

*** The FairTax is a tax on accumulated wealth. However, the holders of accumulated wealth are already paying it. It's just hidden.**

In closing, thank you for the opportunity to testify. I'll be more than happy to answer any questions the Committee members may have.