Budget Committee Testimony

The Honorable Nick Lampson

Consumption Tax and Flat Tax

October 6, 2004

Thank you, Mr. Chairman, for holding this hearing and allowing me to give testimony today. I feel there are dangers inherent in the proposed National Retail Sales Tax. Over the years, I have been contacted by many supporters of a National Retail Sales Tax, and I am glad that we finally have an opportunity to discuss the proposal seriously.

I am deeply concerned about potential problems with this proposal, worried that it will hurt home builders and automobile manufacturers, state government and small business, and most importantly seniors and the middle class. I am also concerned that this supposedly simple proposed tax structure would be incredibly complex in its implementation, the cost of which has been understated.

Under the current National Retail Sales Tax proposal, 30 additional dollars in taxes would be levied against every 100 dollars in goods and services. That means Southeast Texans would pay 130 dollars for 100 dollars in groceries. Where I come from that is a 30% sales tax—*not* the 23% many supporters claim.

Even this outrageously high projected rate is too low. Many economists estimate a true estimate between 50 and 60%. Even Harvard economist Ken Jorgenson, cited by many sales tax defenders as confirming a 30% tax rate or 23% tax inclusive, indicated that the rate would need to be 40% or 28.5% tax inclusive.

Former Republican leader Dick Armey discussed the many failures of a National Retail Sales Tax in a 1995 Policy Review article. He cites a 1993 report by the

Organization for Economic Cooperation and Development (OECD) arguing that while several countries have tried, almost no industrialized country has managed to sustain a National Retail Sales Tax above 12%.

A high tax rate assessed at the cash register would increase demand for black market goods. Consumers receive large price savings for engaging in what some consider low risk and minor criminal behavior. To prevent this we could assess the tax not at the cash register, but instead have each firm pass the tax on to consumers by charging it to their distributors. European nations have done this through a Value Added Tax (VAT). Unfortunately, administering a VAT requires government oversight and careful tracking by companies, creating additional work to our business community and a new, large, governmental bureaucracy.

The National Retail Sales Tax is supposed to favor small businesses, but this proposal would not. In states that use a sales tax, like my home state of Texas, it is estimated that between 20 and 40% of all sales tax revenue comes from small businesses. Small businesses are not supposed to be impacted by state sales tax, yet if employees head over to Office Depot periodically to pick up supplies, that small business would pay an additional 30% tax on those items, unless it keeps all their receipts and asks the government for a refund. This amounts to a heavy tax levied against businesses. It's reasonable to assume that a similar 20% to 40% of the total revenue raised by a National Sales Tax would come from the same small business community.

The impact of this proposal on automobile dealers and home builders is also alarming. The National Sales Tax only taxes new goods. That means that an $85,000 new home in my hometown of Beaumont would now be a $110,500 home, while an equivalent older home would still cost $85,000. This is a strong disincentive for people considering the purchase of a new home or a car. As a homeowner, this might be good for me because my home's value would go up, but what is the impact on new home sale rates our Administration sees as signs of recovery?

In fact many people would turn away from new consumer durables like cars and home appliances, instead opting to maintain older items or to purchase the older, used versions of the same items. Antique dealers and repair shops may benefit heavily from this, but our nation's automakers, dealers, and major retailers would suffer greatly.

Under this proposal, it is estimated that the Texas state government would now owe the U.S. government over 20 billion dollars. The only way to make up that money would be either to increase an already high sales tax— further driving up home, health, food, and energy costs— or to increase property taxes by around 82%. This does not even include the money Texas would now spend enforcing the federal government's new tax laws. This added cost would fall most heavily upon Americans whose paycheck is largely spent on housing. Rental rates would increase, and between losing their mortgage tax exemption and the increase in property tax rates, lower and middle income homeowners may be unable to pay for their current housing.

I've read the arguments about how Texas' state government already pays taxes to the U.S. Government. Any reputable economist would acknowledge that employees of the state government are the ones who pay in the form of their income and payroll taxes. Unless the Texas state government offsets its new tax burden by cutting state employees wages, it would have to increase its property taxes.

The biggest question is not how this proposal impacts big or small businesses or state governments, but *How does this proposal affect average Americans*?

Seniors in my district would be crushed under this proposal. Currently they pay little or no income tax, spending from their savings and pensions. The most horrifying tax increase will be upon them. Seniors will surely be surprised to see the price of all their goods increase by 30% and appalled as the cost of medication and health care likewise increase. Many seniors currently find it hard to balance their budgets. This policy would make that task impossible.

Even with a reasonable exemption, this policy would amount to a tax increase on the poorest Americans. The refundable earned income tax credit under current law actually provides income subsidies to the poorest Americans. This essentially gives them a negative tax rate, meaning the government pays them more than they pay in taxes. Current provisions in this bill aim to give these Americans a *zero percent* tax rate, ignoring secondary effects from increased rental rates. Even with this optimistic assumption, it still amounts to a tax increase.

The richest Americans would benefit from this policy. If someone has the means to own two Ferraris, he or she likely has the ability to put a lot of money into investments or the bank. All of *that* money would go untaxed in a National Retail Sales Tax scheme. Some people estimate that their tax rates would drop to as low as 5%, while many less well off Americans would experience rates much closer to 30%.

Even if one grants generous assumptions about how well poorer Americans would do under this proposal, one must ask where the tax burden falls if the rich go untaxed *and* the poor go untaxed. We talk a lot in this body about helping the middle class, but it is very clear that this proposal means bad news for the middle class. Ultimately, the consequences of a National Sales Tax are burdens that come to rest on the shoulders of America’s working families. I hope the members of this committee will agree we must not be the ones to put them there. Thank you.