Testimony by the Honorable Jim McDermott
Before the Joint Economic Committee
For a hearing titled, "Re-Thinking the Tax Code"
November 5, 2003

Thank you, Chairman Bennett, and, Ranking Member Stark, for this opportunity to testify. I'm happy that the Joint Economic Committee is holding a hearing about the tax code.

I wish, however, that a congressional committee would hold a hearing about how the deficit is affecting our nation's economy. I kind of believe that we ought to be paying much more attention to the deficit, and how it affects our economy, by increasing interest rates, reducing saving, and inflating the value of the U.S. dollar, which makes American products less competitive overseas.

Next year's deficit may top $500 billion and there is not an organization or a government agency in Washington that knows when we will return to a balanced budget. It is as if the Bush Administration and the Congress is suffering from an "Inattention to Deficit Disorder."

President Bush inherited a government that took in about 20 percent of GDP in revenues, and it spent a little less than that. He inherited a budget surplus that could have been used to shore up Social Security for the baby boomers and pay off the deficits that piled up during the Reagan-Bush era.

We have quite a different picture today. Mostly due to three rounds of tax cuts, in fiscal year 2003, revenues dropped to 16.6 percent of GDP, while our deficit exploded. Revenues now are at the lowest level since 1959, which was near the end of the Eisenhower Administration, before Medicare, Medicaid and number of other federal programs.

I want to be sure everyone knows that taxes in America are not high. U.S. tax revenue as a percentage of GDP is among the lowest in the developed world. Only two OECD members have lower taxes than the United States.

I understand that today's hearing is about re-thinking the tax code, to explore the merits of consumption taxes and flat taxes.

The Ways and Means Committee held a host of hearings about this same issue in the mid 1990s, under Chairman Archer. At one point during the hearings in 1995, the Chairman said he was convinced the tax code needed to go to a flat tax. He even said that he was going to introduce legislation to do it. But after all of the hearings and the rhetoric, he never even introduced a bill.

Today, income taxes as a share of GDP are at their lowest level since 1941. But payroll taxes, which take its heaviest bite from lower income workers, rose to its biggest share of federal revenue ever. This is unfortunate because it means that our system of taxation has become more regressive over the past few years. In other words, poor people are bearing more of the tax burden today than they have in an awful long time.

Mr. Chairman, you can do two things with money: you can save it, or you can spend it. Rich people have more to save than poor people. If all that we do is impose taxes when people spend money, then poor people are going to spend a larger share of their paycheck on taxes than rich people are. A system based on consumption taxes hardly seems fair to me.

Legislation has been introduced in the past to convert our tax regime to one that relies solely on consumption taxes. Representative Linder has introduced legislation to abolish the IRS and force the federal government to rely on a national sales tax. This proposal would involve an extraordinarily regressive shift of the tax burden from the affluent to everyone else. It would be a boon to the wealthy elite.

His proposal would tax all purchases of goods and services in our economy, including food, health care, home rents, and new home purchases. The Joint Committee on Taxation did an analysis of HR 2525, the bill Mr. Linder introduced in the 106th Congress. The study indicated that in order for the bill to be revenue neutral over 10 years, the estimated national sales tax rate would be between 36 and 57 percent.

In other words, the price of blood transfusions, prescription drugs, and a pair of sneakers would increase between 37- and 57-percent. I don't know how this is fair. I don't know how I could sell the proposal the baby boomers of this country that are about to live on a fixed income.

There have been several flat tax proposals floated.

The former House Majority Leader, Dick Armey, was a staunch proponent of the flat tax. Mr. Armey introduced a bill to create a flat tax consisting of a permanent 17-percent rate. The Department of the Treasury estimated that his bill would cost $138 billion each year. Treasury also indicated that in order for a flat tax proposal to be revenue neutral, the rate would need to be closer to 21-percent. At this rate, taxes would double for America's working poor, while they would be cut in half for millionaires.

Every time someone talks about a flat tax, my question to them is what about pensions, health care, home ownership and charitable giving?

The Health insurance Association of America states that one of the consequences of a flat tax bill is likely to be a rapid increase in the number of people without private health insurance coverage. One economist estimated that there would be 8 million more people without health insurance if a flat tax proposal were enacted.

James Poterba, an economist at MIT, estimated that eliminating the current law tax benefits for purchasing homes could result in a 17-percent decline in the value of the U.S. housing market.

And what about payroll taxes? A flat tax proposal may eliminate the deduction that employers pay for their share of payroll taxes, amounting to a massive tax increase on businesses of all sizes.

Furthermore, isn't it a bit naïve to think that the pressures that we currently have to change the tax code for public policy reasons would go away with a new tax regime? I think it highly unlikely that our tax code would not become just as complex, over time, as it is today.

I believe that we must stress a few important things when it comes to thinking about the way our government raises revenue.

First, and most fundamentally, I believe that our tax system must be fair. A 20-percent tax to someone making $20,000 a year is much different than a 20-percent tax to someone making $200,000 a year, no matter how you look at it.

Second, our tax system must bring in enough revenue to pay for government expenditures.

Third, our Internal Revenue Code should try and provide as much efficiency in our economy as possible.

Lastly, we should try and reduce the complexity of the Code by doing things such as reforming the Alternative Minimum Tax, which is increasingly creeping into the pocketbooks of middle-income families.

Thank you.