

The Honorable Mark Steven Kirk  
U.S. House of Representatives  
Washington, DC 20515

Re: The FairTax Plan (Letter confirmation # 1056414)

Dear Congressman Kirk:

I received your November 2<sup>nd</sup> response to my letter in support of the FairTax. First, let me acknowledge your call for comprehensive tax reform. The current system is indeed broken beyond fixing. Second, in your response you stated concerns that prevent you from supporting the FairTax at this time. This follow-up letter is intended to address each of your concerns.

**The FairTax improves progressivity of the federal tax system.** In your letter you stated that the FairTax may unintentionally shift the tax burden from one group of taxpayers to another. Most recently, noted public finance economist, Laurence Kotlikoff of Boston University, has completed comprehensive research on the distributional aspects of the FairTax. His research demonstrates that the FairTax lowers marginal tax rates on work and saving, cuts remaining average lifetime tax rates, and enhances overall progressivity. This occurs because the reduction in these tax rates is proportionately much greater at the low end of the earnings distribution than at the high end. Consider a middle-aged couple with two children earning \$20,000 per year compared to that same couple earning \$500,000 per year. In switching to the FairTax, the low-income couple's remaining average lifetime tax rate is only 1.5 percent versus 11.0 percent under the current system. The high-income couple's rate is 20.5 percent versus 35.6 percent under the current system. The low-income couple gets an 86 percent cut in its average remaining lifetime tax rate, whereas the high-income couple gets a 42 percent cut. That same couple earning \$70,000 would see their tax rate drop from 21.3 percent to 11.6 percent, a decline of 46 percent.<sup>1</sup>

**The FairTax dramatically improves the U.S. economy.** In your letter you stated that the FairTax's impact on the domestic economy, as well as America's global competitiveness, has not been fully assessed. Virtually all economists agree that replacing the income tax system with a consumption tax system will benefit the U.S. economy because of economic growth from a reduction in marginal rates and elimination of the multiple taxation of returns to capital. Since the FairTax base is the broadest

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<sup>1</sup> Average remaining lifetime tax rates are based on the total tax payments, net of Social Security benefits, that the household will pay in its remaining years of life. They measure the household's future tax burden under the FairTax compared to what the household would have to pay if the current tax system remains in place. See Table 5 in Kotlikoff, Laurence J. and David Rapson, "Comparing Average and Marginal Tax Rates under the FairTax and the Current System of Federal Taxation," NBER Working Paper No. 12533, Revised October 2006. Available at <http://people.bu.edu/kotlikoff/Comparing%20Average%20and%20Marginal%20Tax%20Rates%2010-17-06.pdf>.

consumption base and taxes income only once, recent economic research shows that the economy fares much better under the FairTax than under current law. Specifically, the economy as measured by GDP is 2.4 percent higher in the first year and 11.3 percent higher by the tenth year than it would otherwise be. Consumption increases by 2.4 percent more in the first year than it would if the current system were to remain in place. The increase in consumption is fueled by the 1.7 percent increase in disposable (after tax) personal income that accompanies the rise in incomes from capital and labor once the FairTax is enacted. By the tenth year, consumption increases by 11.7 percent over what it would be if the current tax system remained in place, and disposable income will be up by 11.8 percent.

Following the implementation of the FairTax plan, the higher take-home wage provides an immediate incentive for people to work more. During the first year, this will lead to total employment growth of 3.5 percent in excess of the baseline scenario, which continues to grow through year ten such that total employment is 9.0 percent above what it would have been under the baseline scenario. The impact on total labor income is even more pronounced, increasing due to both an increase in after-tax wages and an increase in the number of people working. Total labor income will rise 27.4 percent in the first year. By year ten, labor income will be over 41 percent higher than what it would have been under the baseline scenario. (See results summary table below.)<sup>2</sup>

<b>Cumulative growth over current system</b>	<b><u>Year 1</u></b>	<b><u>Year 2</u></b>	<b><u>Year 3</u></b>	<b><u>Year 4</u></b>	<b><u>Year 5</u></b>	<b><u>Year 10</u></b>
Gross domestic product	2.4%	5.2%	7.0%	8.2%	9.0%	11.3%
Employment	3.5%	5.7%	7.0%	7.7%	8.2%	9.0%
Domestic investment	33.0%	35.4%	36.9%	38.0%	38.8%	41.2%
Income from employment (wages)	27.4%	31.8%	34.5%	36.4%	37.7%	41.2%
Consumption	2.4%	4.1%	5.8%	7.1%	8.1%	11.7%
Disposable personal income (adjusted for changes in the price level)	1.7%	4.5%	6.4%	7.7%	8.7%	11.8%

*Units scaled 2004 GDP = 1.00. Capital and labor set to equal constant shares of 0.3 and 0.7, respectively.*

There is no research to support the claim that an income tax actually increases the well-being of the American people relative to a consumption tax, and no economist makes that claim. As a result, the onus should be shifted to those who support the income tax to defend how they can continue to do so. Support for the income tax is the policy equivalent of supporting lower wages, greater poverty, and a decrease in lifetime living standards for the American people.

**The FairTax also improves the international competitiveness of American producers.** Today, we have a tax system that remarkably subsidizes foreign produced goods, assisting Korea, Japan, Germany, and others in competing against the American worker. How do we do so? The Congress's failure to remove the tax on exports (as do

<sup>2</sup> Arduin, Laffer & Moore Econometrics, "A Macroeconomic Analysis of the FairTax Proposal," Americans For Fair Taxation Research Monograph, July 2006.

the other 29 OECD nations) simply grants foreign producers a large and artificial relative price advantage (estimated to be over 18 percent) for foreign-made goods, whether those goods are sold in the U.S. market or foreign markets.<sup>3</sup> 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.<sup>4</sup> The result is that the U.S.'s principal export these days appears to be manufacturing jobs, and we are exporting this valuable resource at a devastating and unsustainable pace. The FairTax remedies this by taxing foreign-produced goods as U.S.-produced goods are taxed and by exempting exports fully from taxation, thereby restoring a level playing field for U.S. and foreign-produced goods.

I hope that this response alleviates your concerns. If it does not, FairTax.org stands ready to brief you or your staff and to provide the results of this research in detail. The nonpartisan FairTax is likely the most researched tax reform plan being considered, and the attention it is getting in the policy arena is justified.

Congressman Kirk: The product Congress produces is public policy, and it is Congress's responsibility to ensure the American people have a tax structure worthy of the 21<sup>st</sup> century. I urge you again to support the one tax plan against which all others are measured.

Sincerely,

Kurt Thoss

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<sup>3</sup> Hartman, David A., "The Case for Border-Adjusted Taxation in the United States," *Tax Notes International*, September 27, 2004, p. 1183.

<sup>4</sup> Hausman, Jerry, "An Economic Analysis of WTO Rules on Border Adjustability of Taxes," Massachusetts Institute of Technology, May 2006. Available at <http://www.standupforsteel.org/hausman.html>.