AMERICANS for TAX REFORM
722 12th Street N.W.
Fourth Floor
Washington, D.C.
20005
T: (202)785-0266
F:(202)785-0261
www.atr.org

Testimony of Grover G. Norquist
President, Americans for Tax Reform

To: The National Commission on Fiscal Responsibility and Reform

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Chairman Bowles and Chairman Simpson:

Thank you for inviting me to testify today on Americans for Tax Reform's solutions to the nation's over-spending crisis. Americans for Tax Reform is a non-partisan, non-profit taxpayer advocacy organization committed to lower taxes and less government. We receive no government funding.

The Problem Is Not Deficits—It Is Spending

A "deficit" is merely the difference between total taxes and total spending. Just focusing on the deficit ignores whether a fiscal crisis is predominately on the tax side or the spending side. **The proper metric is not deficits—it is spending.**

100 percent of the fiscal crisis we face is due to an over-spending problem in Washington. Federal tax revenues have averaged approximately 18 percent of GDP since 1970. According to the Congressional Budget Office (CBO), tax revenues over the next decade will climb back to this historical average—even if all expiring tax relief is extended, and the AMT is indexed to inflation. Clearly, taxes are not causing the deficit—spending is.

Since 1970, spending has averaged about 21 percent of GDP (giving a structural budget deficit of 3 percent of GDP). According to CBO, federal spending will exceed this level for the entire decade, averaging 23 percent of GDP.

Don't Raise Taxes

President Obama famously said that: "No family making less than $250,000 per year will see any form of tax increase." That has not been the result thus far, as documented on ATR's "Obama Tax Hike Exemption Card." He has also said that this commission should leave all options on the table. I am urging you today to remove any further tax hikes on these families from your considerations.

To date, 173 Congressman and 33 senators have taken ATR's "Taxpayer Protection Pledge," which obliges them to rule out any income tax increase. This pledge is a necessary, but not sufficient, condition for reducing government spending. Only when tax hikes are convincingly and permanently taken off the table will politicians in Washington, DC and state capitals begin to limit spending.

I would also urge you to **reject a value-added tax (VAT),** a proposal which has been floated by prominent Obama Administration officials and allies. The average VAT rate in Europe grew from 5 percent in 1970 to 20 percent today, in concert with higher taxes on income, profits, and businesses. "VAT" is French for "big government."

One bad idea that the Commission should reject is a "public option" for tax preparation (where the IRS would compete with private sector tax preparers or even send completed returns to taxpayers). Not surprisingly, there's only one reason liberal politicians and policy wonks want to see this--tax revenue goes up. They'll tell you it's because everybody (including tax preparers) cheats. The reality is that a Bigfoot-sized government tax preparer would be just too intimidating to take on. It should be up to the IRS to challenge the assertion of the taxpayer, not the other way around. To socialize tax preparation (which would be the effect of this policy, much as a public option in health care would have destroyed private insurance over time) would reverse the dynamics of how our entire tax system works.

<u>Spending Restraint: Stop Spending So Much Money</u>

The solution to this over-spending problem is spending restraint and stronger economic growth. The best way to measure the impact of spending (and the compliance costs of regulations) is found in a study my organization conducts known as "Cost of Government Day" (COGD). This measures how long Americans have to work before they have paid for the total cost of government—spending and regulations.

Since Democrats took control of Congress in 2006, COGD has moved forward from July 10th to August 11th. During the Reagan Administration, by contrast, it fell from July 20th in 1982 to July 2nd in 1988.

Given the dual nature of the present overspending problem, leaders must pursue both long and short term solutions. Long-term spending restraint is best achieved by reforming the long-term entitlement programs and enacting meaningful budget constraints as found in Congressman Paul Ryan's (R-Wis.) "American Roadmap" plan.

In the shorter run, the RSC balanced budget plan is notable for not raising taxes or letting tax relief expire and returning discretionary spending to the FY 2008 approved level (that is, pre-bailouts).

It should be noted that spending restraint was conspicuously absent from the last two "bipartisan budget deals":

- In 1982, President Reagan and Congressional Democrats agreed on a plan that promised to cut $3 in spending for every $1 in tax hikes. All the tax hikes went through. Spending, though, grew from $808 billion in 1983 to $1.06 trillion in 1988. This is more than 2 percentage points *above* the inflation rate.

- In 1990, President Bush and Congressional Democrats agreed on a plan that promised to cut $2 in spending for every $1 in tax hikes. All the tax hikes went through (including a hike in the top income tax rate). Spending, though, grew from $1.25 trillion in 1990 to $1.52 trillion in 1995. This is also faster than the growth of inflation.

There is a long list of states and countries where a "tax hike solution" has been tried and has failed: Greece, Portugal, Italy, Venezuela, Argentina, Zimbabwe, Japan in the 1990s, California (under both Gray Davis and Arnold Schwarzenegger), New York, New Jersey—the list goes on and on.

Economic Growth: The Only Way to Raise Tax Revenues Over Time

Long term economic growth is the only way to raise tax revenue over time.

CBO projects that every 0.1 percentage point increase in real economic growth over the next decade would increase federal tax revenues by $247 billion. Therefore, 1 percentage point of higher growth should increase tax revenues by $2.5 trillion over the same decade. **This is $2.5 trillion of higher tax revenue from growth, not higher taxes.** Moreover, these numbers come from the outdated static tax scoring methods used by the CBO rather than dynamic scoring, which better predicts the benefits of tax rate cuts.

How realistic is a pro-growth "boost" of this level? Some examples to cite which bring this home are relatively-recent reductions in tax rates. Over the past half-century, real economic growth has averaged 3 percent annually. Yet:

- In 1978, the capital gains tax rate was cut from 39 to 28 percent. Over the next two years, real economic growth averaged 4.4 percent

- When President Reagan's reduction in the top rate from 70 to 50 percent and his reduction in the capital gains rate from 28 to 20 percent was fully phased-in by 1983, economic growth averaged 5.3 percent over the next three years. The Dow Jones Industrial Average more than doubled from 1983 to 1987.

- When President Clinton and the Republican Congress cut the capital gains tax from 28 to 20 percent in 1997, economic growth averaged 4.6 percent over the next three years. The Dow grew by more than 50 percent from the time of the tax cut to the year 2000.

- When the capital gains and dividends tax rate was cut from 20 percent (38.6 percent in the case of dividends) to 15 percent in 2003, economic growth averaged 3.1 percent from 2004-2007 (after a sluggish 1.8 percent average in the three years prior). The Dow grew by approximately 75 percent over this era.

Take decisive action to pursue long-<u>term growth.</u> <u>Uncertainty about future government actions when there is a consensus that government action may lead to a less desirable economic climate cripples growth and speculation. To prevent this slowdown, lawmakers must plot a long-term solution that lends itself to growth rather than working piecemeal year-by-year.</u>

<u>Ideas to Reduce Spending</u>

1. **Resurrect the "Byrd Committee."** One good idea for spending restraint is to restore a committee that once existed, the Joint Committee on Reduction of Nonessential Federal Expenditures (known in the post-War years as the "Byrd Committee"). First proposed in 1941, the committee was a bipartisan, joint committee with subpoena powers that focused only on making rescissions in federal spending. Its proposals enacted over $38 billion (in 2010 dollars) in savings. The fatal flaw in many other "fiscal commissions" is this lack of narrow focus – only when tax hikes are taken off the table are meaningful spending cuts made. Any recommendations from a committee modeled on the Byrd Committee should be privileged and require an up-or-down vote on the floor. To give an idea of the sort of spending that this committee might curb, the federal government made at least $98 billion in improper payments in 2009, Medicare spends $47 billion (12.4 percent of its budget) annually improperly or fraudulently, and Congress recently spent $2.4 billion on 10 new jets that the Pentagon claims it does not need and will not use. With regards to duplicate programs, the Government Accountability Office reports hundreds of wastefully duplicated programs in areas as wide ranging as economic development, serving the disabled, helping at-risk youth, early childhood development, funding international education, and providing safe water. Indeed, according to the Bush administration OMB's PART program reviews, 22 percent of all federal programs, costing a total of $123 billion per year, fail to show any positive impact on their target populations.

2. **Give the public five days to read bills before a floor vote.** Congress should enact a five-day waiting period before passing any new or amended legislation. This "cooling-off" time might have prevented $350 billion in President Bush's TARP, $350 billion in President Obama's TARP, over $500 billion in the so-called "stimulus" bill, $183 billion more in discretionary spending in FY 2010, and $794 billion in healthcare "reform."

3. **Put every federal transaction and contract online in real time.** Every federal transaction, contract, and grant should be available online in real time. A spending transparency portal is an important tool that can be used to cut waste, locate inefficiencies and empower the people whose money is being spent, the taxpayers, as fiscal watchdogs. This was debuted successfully by Governor Rick Perry of Texas. Missouri, Kansas, and Oklahoma also have good transparency initiatives.

4. **Term limit appropriators.** Those serving on the Appropriations Committee should be limited to no more than six (6) years on that committee, as is already the case with members of the Budget Committee.

5. **Sitting Congressmen and Senators should not be able to name buildings or other monuments to themselves, and none should be named for them while they are still living.** This encourages Congressmen and Senators to direct pork/earmark projects with more energy, and other Members feel peer pressure to support the projects (with an eye toward their eventual "legacy" vote later on).

6. **Block grant education funding and welfare to the states.** All remaining welfare programs—Medicaid, food stamps, etc.—should be block-granted to the states, the same way that AFDC was in 1996. The cost growth of the block grant should be something less than current law's cost trajectory. Likewise, the block granting of education funding allows for each state to pursue its own solution and experiment, much as Canadian provinces did when education was federalized. As the Cato Institute has reported, this experimentation led to innovation, including school vouchers and charter schools, and Canadian students generally outperform their U.S. peers in reading, math, and science.

7. **Freeze the salary and benefit levels of federal employees.** Scholars at the American Enterprise Institute and the Heritage Foundation have estimated that federal employees earn $14,000 more than their private sector counterparts in salary and benefits (even when controlling for factors such as education level, age, etc.). The pay and benefits disparity is 30 to 40 percent. In the aggregate, bringing federal employee compensation in line with the private sector would save $47 billion per year. Government salary and benefits should be frozen until the private sector has a chance to catch up. The new government in the United Kingdom recently announced a two year pay freeze for the highest-earning 72 percent of government employees. Moreover, taxpayers presently match federal employees' pension contributions 14 to 1 as reported by Third Way, exemplifying the massive chasm between public sector and private sector benefit packages. To make matters worse, government employees owe over $3 billion in unpaid taxes from 2008.

8. **Require all eligible federal employees to compete for their job with a private sector bidder.** According to the Office of Management and Budget, some 850,000 federal employees (one-third of all federal employees) have jobs that are commercial in nature, and could be performed by a private contractor. The Heritage Foundation estimates that the mere act of competing all these jobs would save taxpayers $27 billion annually. The act of competing forces government employees to become more lean and efficient, so even a low success rate by contractors has big savings for taxpayers. To make maters worse, the present lack of competition actively hurts small businesses as well; every White House Conference on Small Business has identified unfair government competition as one of the leading concerns for small business owners. Moreover, as reported by the Business Coalition for Fair Competition, Congress and the White House continue to enact policies that exacerbate this crowding-out of commercial activities by government.

9. **Only hire one new federal employee for every two that retire from government employment.** Over time, the federal workforce can be reduced simply by not filling half the job slots which come up because of retirement. The positions not filled can be consolidated or privatized. According to our research, the career savings for each federal slot not filled would range from just under $5 million (low-cost employees) to just under

$14 million (high-cost employees), with an average savings of $7 million per employee. If attrition was used to shed just 10 percent of the current federal workforce, it would save taxpayers nearly $2 trillion over the next forty years.

10. **Repeal the Davis-Bacon Act.** Other policies that inflate spending include the Davis-Bacon Act, a Depression-era wage subsidy law that artificially inflates the cost of federal construction contracts by mandating workers are paid no less than local prevailing wages. However, there is a high frequency of errors in data the Wage and Hour Division (WHD) of the Department of Labor (DOL) uses to calculate rates; the survey WHD conducts is self-reported and therefore the results could be biased; a wide gap in time between surveys, long times needed to complete and publish surveys – consequently wage determinations are outdated. The Beacon Hill Institute found that, on average, the WHD inflates wages by 22 percent, increases construction costs by 9.91 percent and raised construction costs by $9 billion in 2009. Repealing the Act could save $9.5 billion over 2002-2011 and decrease mandatory spending by $255 million in the same period. By enacting this cost savings, government could do more with less in terms of infrastructure construction and maitenance.

11. **Reform farm subsidies along the lines of the 1996 "Freedom to Farm" Act.** Farm subsidies distort the market by inducing farmers to overproduce, which further perpetuates the cycle of taxpayers subsidizing the small, well-off group of farm owners. According to the Cato Institute, the largest 10 percent of recipients receive almost 72 percent of all farm subsidy outlays. Moreover, this wasteful injection of government into the economy distorts international trade and reduces competition. When New Zealand, an economy significantly based on agriculture, boldly repealed its farm subsidies in 1984, it met initial resistance, but farm output, productivity, and profitability have soared since.

12. **Leave defense cuts on the table.** As with all other federal departments, the Department of Defense contains waste. Likewise, US military spending in constant dollars presently exceeds Cold War levels, and there remains room to pare the budget, especially since a Government Accountability Office audit of 95 Pentagon weapons systems showed combined cost overruns of $295 billion.

13. **Stop using "emergency" spending loopholes to get around budget rules.** A recent paper by Veronique de Rugy of the Mercatus Center demonstrates the various ways in which lawmakers hide spending, the most pernicious and expensive being labeling spending as "emergency," and therefore spending off-budget or avoiding budgetary rules.

    Both parties have used this technique to spend abusively. President Bush used it for most of the war supplemental in Iraq and Afghanistan, and Congressional Research Service data obtained by the office of Senator Tom Coburn (R-Okla.) finds that emergency spending has increased deficits by almost $1 trillion since the 111th Congress was seated in January 2009 as reported by the Cato Institute.

    In determining what constitutes emergency spending, Keith Hennessey, a former economic advisor to George W. Bush, offers a pragmatic political definition: "it's whatever you can get away with labeling as an emergency."

However, the Office of Management and Budget created a test with a fairly high bar by in 1991. According to Hennessey, *all five* of these conditions had to be met:

1. Necessary; (essential or vital, not merely useful or beneficial)
2. Sudden; (coming into being quickly, not building up over time)
3. Urgent; (requiring immediate action)
4. Unforeseen; and
5. Not permanent.

To restore fiscal responsibility and accountability, Congress needs to adhere to this standard, both to reduce spending and to account for spending that exists better.

14. **Freeze discretionary spending at 2007 levels**. Freezing federal spending at the FY 2008 amounts would return the federal government to pre-bailout and "stimulus" spending levels. Such a spending reduction would bring the budget into balance by 2013 and cut the national debt nearly in half by 2010, even assuming that Congress extends the 2001 and 2003 tax cuts and indexes the Alternative Minimum Tax for inflation. In contrast to the President's current promise to "freeze" spending at FY 2011 levels, this would ensure the recent spending bonanza is not enshrined in the nation's fiscal outlook in perpetuity.

<u>Ideas to Increase Federal Revenues by Increasing Economic Growth</u>

1. **Increase legal immigration.** Legal immigration needs to be higher in order to provide the economy with enough labor as the Baby Boomers retire. High-skilled visas, for example, should rise from too few today to 1 million.

2. **Enact worldwide free trade.** Free trade is an important component to long-run economic growth. Tariffs are taxes on international commerce. To enact free trade is to cut taxes on that commerce. More trade globally means more prosperity for everyone—consumers and producers. The "Doha Round" should be passed. End Big Labor's chokehold on our trade policy by ratifying all outstanding free trade agreements (Panama, Columbia, South Korea, etc.)

3. **Replace tax "depreciation" with full business expensing.** Businesses should be allowed to immediately-expense all capital purchases, rather than have to subject them to "depreciation" deductions. This would spur productivity and help ratchet up economic growth.

4. **Cut marginal tax rates.** It is vital to economic growth to cut marginal tax rates on individuals and businesses. In particular, the corporate income tax (the highest in the developed world at 35 percent) should be no higher than Europe's 25 percent average. The capital gains and dividends tax should be eliminated. The top individual marginal income tax rate (where two-thirds of small business profit taxes are paid) should be reduced from 43.4 percent (after next year's expiration of the 2001 tax relief and

Obamacare's new 3.8 percent Medicare tax) to 25 percent. This will ensure that the economy will grow faster –and CBO has said that faster economic growth of even one percentage point would lead to $2.5 trillion in new tax revenue.

Lower marginal rates work. They worked in the 1920s when President Coolidge cut rates until President Hoover raised taxes and helped create the Great Depression. They worked in the 1960s when President Kennedy cut rates until Presidents Johnson and Nixon raised taxes to pay for Vietnam abroad and spending at home. They worked in the 1980s when President Reagan cut rates until President George H.W. Bush raised taxes and ended the Reagan boom. They worked in the 2000s when a GOP Congress cut rates in 2001 and 2003 on individuals, businesses, capital gains and dividends until the Democrats took over Congress in 2007 under the promise to let them go up.

5. **Make all expiring tax cuts permanent.** Given the positive effects of lower tax rates on growth, economic efficiency, and tax revenues, tax cuts should not be set to sunset when crafting legislative proposals, and those that are scheduled to expire should be made permanent.

6. **Move from worldwide to territorial taxation of overseas income.** The United States is one of the last countries to tax its citizens and businesses on a "worldwide" basis. This opens up U.S. taxpayers to potential double taxation on overseas earnings. This has led to a complex system of deferrals, deductions, and credits to mitigate this reality. Congress should conform our tax regime to the way the rest of the world taxes international-source income: we should only tax that income earned in the territory of the United States. Back in 2005, Congress allowed companies to repatriate overseas income with very minor double taxation effects for one year. The result was the repatriation of $318 billion of deferred overseas earnings, resulting in a windfall in corporate taxes of $18 billion. Another round of low-tax or even tax-free repatriation would be a good idea for both economic growth and increasing tax revenue without raising taxes.

7. **Congress should stay home.** Another simple way to give markets confidence is for Congress to simply not be in session. According to the "Congressional Effect Fund" (a mutual fund which invests in the broad stock market when Congress is out of session, and divests when it meets), the stock market averaged annual growth of 0.94% on the days when Congress was in session from 1965 through 2009. On days when Congress is out of session, however, average annual growth was 16.04%.

8. **Don't import Europe's labor laws.** It doesn't help prospects for fiscal restraint or economic growth when Congress tries to import Europe's labor laws. Senator Judd Gregg (R-N.H.) has introduced S. 1611, the "Public Safety Employer-Employee Cooperation Act of 2009," which gives collective bargaining rights to "first responder" employees. This drives up the cost to taxpayers at the state and local level, empowers unions to lobby for tax dollars and unsustainable pensions, and generally contributes to higher spending at all levels.

9. **Inventory and sell all non-essential government assets.** The federal government owns approximately 650 million acres of land, almost one-third of the area of the US, yet it has no current, accurate inventory of its real property according to the Business

Coalition for Fair Competition. Moreover, the Bureau of Land Management has identified approximately 3.3 million acres of land deemed suitable for sale to non-federal entities, yet it has not sold that land. By the estimates of the Heritage Foundation, Washington spends $25 billion annually maintaining unused or vacant federal properties. Unless there is a direct national security or other compelling reason to retain these assets, they should be inventoried and sold. This would provide a one-time boost to government revenue without raising taxes. In addition, the privatized assets should help increase profits for their purchasers, who will in turn pay higher taxes on these profits.

10. **The Federal Communications Commission (FCC) should halt its misnamed "Net Neutrality" proceeding** to regulate broadband Internet under Title II of the Communications Act of 1934. As information technology and telecom investments account for a massive 47.3 percent of all non-structure capital investments in the United States, studies have found that the FCC's proposed regulations could decrease GDP by between $62 and $80 billion over the next five years. This could eliminate as many as 500,000 to 700,000 jobs. It could also raise the price of consumer bills by as much as $55 per month, shrinking demand and curtailing additional broadband expansion and adoption. This will needlessly result in lower tax revenue.

Long-term spending reforms and short-term spending discipline working in concert with pro-growth economic policy is the only recipe for prosperity and responsible government.

Finally, this commission should release its findings no later than thirty (30) days prior to the election this fall so that candidates running for office can declare whether they support lower taxes and less spending (as the American people do), or whether they support higher taxes and bigger government (as the Washington spenders do).

Thank you for allowing me to testify today.