Summary of House Ways and Means Committee Hearing on Tax Reform June 8, 2005

On June 8, 2005, the House Ways and Means Committee held the first in a series of hearings on tax reform and received testimony from Alan Auerbach (University of California at Berkeley), William Beach (the Heritage Foundation), Leonard Burman (the Urban Institute), Glen Hubbard (Columbia University), and Joel Slemrod (University of Michigan). The questions and reaction of the members of the Committee, detailed in the bottom portion of this summary, were the most noteworthy part of the hearing.

In his opening statement, Chairman Thomas (R-CA) explained that the Committee is beginning its hearing process before release of the report from the President's Advisory Panel on Federal Tax Reform and the Treasury Secretary's subsequent recommendations because he believes the Committee members should begin analyzing criteria they may want to use in evaluating the recommendations of the Panel and the Secretary. He added that the Ways and Means Committee needs "to lay the groundwork and provide some degree of uniformity of comparison between approaches as we examine suggested changes in the tax code." He also noted that there are three recurring priorities that are raised by nearly everyone discussing tax reform. These are simplicity, fairness, and economic growth. At the request of the Chairman, the witnesses discussed the principle objectives of tax reform focusing on these three priorities. The testimony is summarized below and copies of the written statements are available on the committee's web site at http://waysandmeans.house.gov/hearings.asp?formmode=detail&hearing=417.

Testimony

Alan Auerbach discussed the role that tax reform can and cannot play in promoting economic growth and international competitiveness and offered seven guidelines for design and evaluation of fundamental tax reform plans. These include avoiding narrowly targeted tax provisions, avoiding windfalls for existing assets, carefully considering the transition design, and considering tax reform in the overall context of broader fiscal reform.

William Beach said the Committee needs to establish guiding principles to evaluate the fairness of reform proposals. Among other things, he believes lawmakers should consider whether policy change facilitates individual economic, social, and personal choices. He also noted that distributional analysis can be an effective tool for determining whether policy changes meet certain fairness tests. There are, however, issues that need to be addressed with respect to performance of distributional analyses. For example, income often is the measure used in distributional tables, but income can be defined many ways. Congress will need to reach an agreement on what constitutes income for these purposes. Dr. Beach said that tax policy changes also could be measured by their effect on consumption.

Leonard Burman described how the current income tax system affects low and middle-income taxpayers and the potential effects of tax reform on these individuals. He made six specific points in his statement: (1) the current system is highly progressive, despite its flaws, (2) the current system provides income support for low-income households, (3) tax reform could reduce the tax burdens of low- and middle-income households, (4) some of the fundamental reform proposals under discussion could shift the tax burden from wealthy to the middle-income, (5) the claimed economic benefits from these fundamental reforms are speculative at best, and (6) systemic tax reform offers an opportunity to bring the fiscal system back into balance.

Glenn Hubbard said that the current tax system discourages risk taking and entrepreneurship and suggested that the benchmark for tax reform should be that income is taxed only once. Calling business tax reform the major priority in the overall reform debate, Dr. Hubbard urged the Committee to focus on the prospects for improving economic growth as it evaluates options for tax reform.

Joel Slemrod discussed the amount of time and money spent complying with the current income tax system, and said that tax simplification deserves serious consideration. However, while he argued that the potential benefit from tax simplification is substantial, Dr. Slemrod pointed out that moving to a simpler system would require tradeoffs. Some of the complexity costs arise because of the high standards for fairness in the tax code. Other costs occur because the tax system is used for purposes other than raising revenue. Dealing with tax complexity, he said, requires addressing the most fundamental questions about the relationship between government and the people it serves - how activist should be government be, how intrusive should it be, and when should it settle for rough justice.

Members Comments and Questions

In his opening statement, Ranking Minority Member Rangel (D-NY) said that tax reform must be addressed on a bipartisan basis and said that members need to reach an agreement about which deductions and credits are worth keeping. He questioned the Chairman's style of leadership -- which he suggested prevents the Committee from acting in a bipartisan way -- and asked Chairman Thomas whether he intends to combine tax reform and Social Security reform proposals into one package.

Chairman Thomas did not respond to the question, but noted that he has sent letters to all members of the Ways and Means Committee asking for their input. He reiterated that the purpose of the hearing is to give members the opportunity to learn about the various tax reform issues and have a dialogue before receiving Treasury's recommendations.

During the question period, Chairman Thomas said that there was very little discussion about fairness, simplicity, and economic growth during debate of the 1986 tax reform bill, and asked if tools are available today to address these issues. At a later point in the hearing, the Chairman asked the witnesses if tax incentives based on income, such as those for pensions, need to be addressed separately if the country moves from an income tax system to a consumption tax system.

Congressman Rangel asked for the witness' help in determining which current law benefits and deductions are worth keeping and which have no economic benefit. He then listed a series of current incentives (mortgage deduction, charitable contributions, and the R&D credit) and asked the witnesses to rank them.

Congresswoman Nancy Johnson (R-CT) told the witnesses that she is troubled by economists' general disregard of the positive benefits derived from tax incentives. She specifically talked about the positive societal effects of the low-income housing credits. Noting that there are many reasons why it is more expensive to build low-income housing than regular housing, she said that primary way such housing is being provided is through the tax code. She also argued that tax incentives are less expensive to administer and reach more people than government programs, and told the witnesses that they needed better information to convince her that tax incentives don't serve a powerful purpose. Dr. Slemrod disagreed with her comments about low-income housing and said that he believes there are more efficient ways to provide such housing. Mrs. Johnson responded by suggesting they discuss the issue at a later date.

Congressman Sander Levin (D-MI) discussed the June 5th New York Times article, which said that the tax burden is shifting away from people at the highest income levels. Congressman Pomeroy (D-ND) also mentioned this article. In addition, Congressman Pomeroy asked the witnesses to rank three issues (national debt, trade deficits, and the structure of the tax system) according to their effect on the economy. None of the witnesses were willing to rank them, and Dr. Auerbach said that complementary solutions were needed for all three.

Congressman Wally Herger (R-CA) expressed opposition to a VAT because it is hidden from the taxpayer and therefore, he believes, easily increased.

Congressman Ben Cardin (D-MD) said that progressivity is the most important issue to him and asked how progressivity could be maintained if the income tax is abolished. Dr. Burman said that some progressivity could be factored into a consumption tax but he believes that it would be more complicated and cause more compliance issues than the current system. He also believes it would be very difficult to make a consumption tax as progressive as the current system. Congressman Cardin responded that some have suggested exempting a certain amount of income under a consumption tax and asked if that would address the progressivity issue. Dr. Auerbach said that the real challenge is dealing with progressivity at the top. He said that it is easy to address progressivity for low-income, but it would be extremely difficult to ensure that the top 1% continues at the same tax burden level as under current law.

Congressman Jim McCrery (R-LA) discussed the issue of fairness and asked how one might factor economic growth into the fairness equation. Arguing that a system that encourages more growth is more fair that one that inhibits growth, he asked whether we shouldn't factor that into our discussion.

Congressman Dave Camp (R-MI) asked how much emphasis should be placed on simplification, and Dr. Slemrod responded that simplification should be considered as one way to make the system fairer.

Congressman John Lewis (D-GA), Congressman John Larson (D-CT), and Congressman Richard Neal (D-MA) asked questions about the AMT.

Congressman Phil English (R-PA) asked how moving to a border adjustable tax system would affect the trade deficit, but none of the witnesses thought that it would have any effect per se on trade competitiveness.

Congressman Paul Ryan (R-WI) asked about the transition costs of moving from an income tax system to another system, and Dr. Hubbard replied that transition costs associated with a flat tax would be modest.

Congressman John Linder (R-GA) asked about the compliance costs associated with the current tax system, which he believes are higher than those cited by Dr. Slemrod.

Congressman Lloyd Doggett (D-TX) asked the panelists' opinion about Social Security personal accounts and also asked whether any recently-enacted tax cuts should be repealed.

Noting that the current tax code includes 16 separate savings vehicles, Rahm Emanuel (D-IL) said that the code could be simplified by combining these provisions. He suggested that if wholesale reform could not be accomplished, the Committee could simplify the code by addressing the following four issues: savings and retirement vehicles, higher education, charitable deductions, and mortgage interest.

At the end of the hearing, Chairman Thomas said that a seminar based on aspects of the issues discussed at today's hearing will be held for members of the Ways and Means Committee in the future and said that some of the witnesses will be asked to participate. He did not indicate when the seminar would occur nor did he indicate when additional hearings would be scheduled.