Impact of the FairTax on Wages

Under the FairTax, what you make will be what you keep. Income and payroll taxes will no longer be withheld from employees' paychecks. The self-employed will no longer be subject to income and self-employment taxes.

The FairTax will have a pronounced positive impact on the after-tax real wages of the American people. Real wages will increase because:

- Higher investment levels will increase the productivity of employees;
- The economy will grow more rapidly, increasing the demand for workers and improving job opportunities;
- The economy will become more productive because we will waste fewer resources on needless paperwork related to complying with an overly complex tax system;
- American-based businesses will be more competitive in the international marketplace because of the improved tax climate and lower compliance costs;
- American-foreign and domestically produced goods will be taxed equally, instead of foreign-produced goods enjoying a tax advantage as under current law.

The income of some people will increase because they will find working more attractive in the absence of income and payroll taxes, and they may choose to work more or at a second job. Others may choose to work less because they are making more money per hour worked, and it is easier for them to meet their personal financial goals. In either case, people will be better off.

The most important cause of higher real wages is a higher level of capital investment per worker. A worker or farmer is more productive if he has more machinery and equipment to work with, particularly new equipment that incorporates the latest technological innovations. Higher productivity leads to higher real wages. It is impossible, on a sustained basis, for an employer to pay workers higher wages than their productivity justifies because employers that did so would go out of business. Higher investment levels per hour worked explain as much as 97 percent of the increase in inflation-adjusted wages since 1948, as can be seen in Figure 1.[1]

Virtually all economic models project a much healthier economy if a federal sales tax replaces the current tax system. These models typically project that the economy will be 10 to 14 percent larger in 10 years.[2] A dynamic, growing economy will provide more and better paying jobs. Employers will need more and better-trained workers.

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[1] "The Truth About 'Falling Wages," Gary and Aldona Robbins, p. 5, Institute for Policy Innovation, 3rd Quarter, 1995.

[2] See, "The Economic Impact of Fundamental Tax Reform," Dale W. Jorgenson, Testimony before the House Ways and Means Committee, June 6, 1995; "Looking Back to Move Forward: What Tax Policy Cost Americans and the Economy," Gary Robbins and Aldona Robbins, September, 1994, Policy Report Number 127, Institute for Policy Innovation; "The Economic Impact of Taxing Consumption," Laurence J. Kotlikoff, April 15, 1993, Cato Institute Policy Analysis. Also see "The National Sales Tax: Moving Beyond the Idea," Tax Notes, March 21, 1996, David R. Burton and Dan R. Mastromarco.

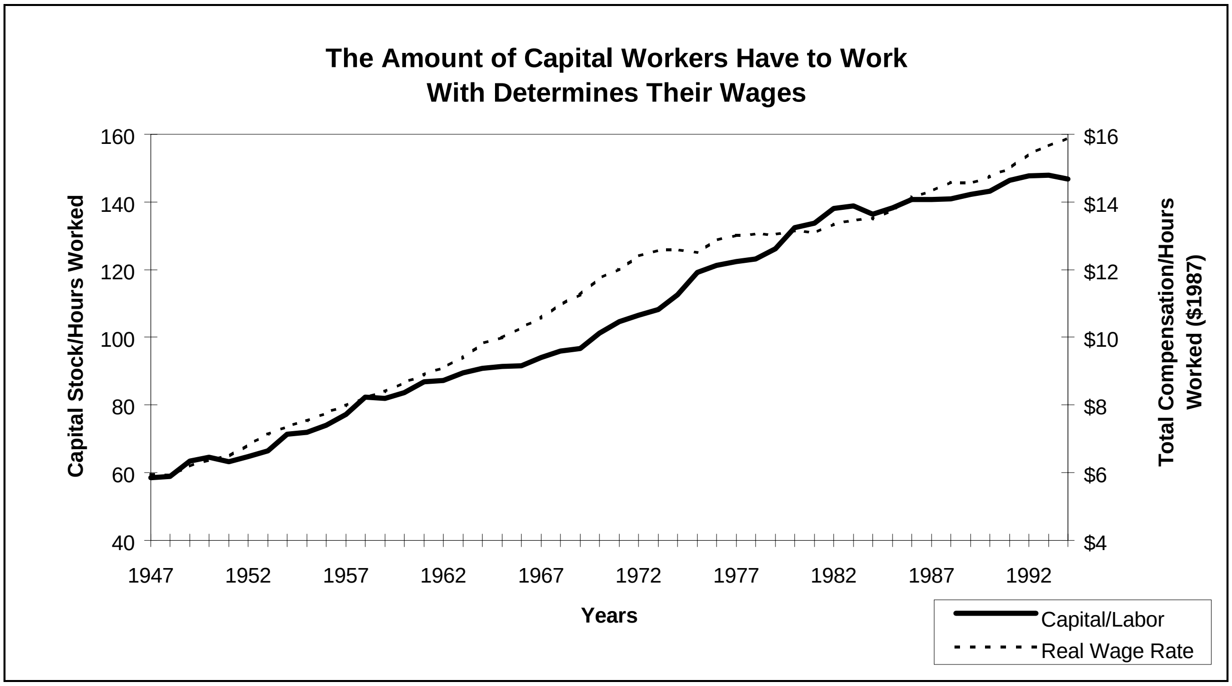

Figure 1: This figure shows the positive correlation between real wage rates and capital investment per hours worked, from 1947 to 1992. During this time period, the amount of capital per hour worked increased steadily and these increases led to increases in real wage rates over the same time period.

Today we spend $225 billion per year -- nearly $1,000 for every American – complying with the present tax system.[3] We spend much more money complying with the tax system than we do building every automobile and airplane built in the country.[4] Under a federal sales tax, well over three-quarters of these resources could be redirected toward more useful pursuits,[5] and the productivity and competitiveness of our industries will increase.

Under a federal sales tax, businesses would be able to compete much more effectively in the international marketplace than under our present tax system. If U.S. firms are more competitive, they will need to

[3] Compliance Costs of Alternative Tax Systems, Arthur P. Hall, Ph.D, Senior Economist, The Tax Foundation, House Ways and Means Committee Testimony, March, 1996.

[4] An IRS commissioned study (Development of Methodology for Estimating Taxpayer Paperwork Burden, IRS, June 1988) by Arthur D. Little, Inc. estimated in 1983 total compliance hours at 5.4 billion hours per year. Since then, the economy and the population has gotten larger and the tax law much more complex. Accordingly, the number of hours lost to our tax system is undoubtedly larger today. James L. Payne, author of Costly Returns (ICS Press, 1993) in testimony before the Committee on Ways and Means, House of Representatives, “Replacing the Federal Income Tax,” Hearings of June 6, 7 and 8, 1995, Serial 104-28, p. 183-187, estimated that we spent 10.2 billion hours in 1995. Assuming a 40 hour work week and further assuming a burden equal to that of 1983, 5.4 billion hours translates into 2.7 million man-years (Payne’s work implies 5.1 million man-years in 1995) for tax compliance compared to 850 thousand persons employed in automobile manufacturing and 550 thousand employed in aircraft manufacturing. See also, Statistical Abstract of the United States, 1995, Table no. 1246, p. 753, manufacturing value added, automobiles $80.5 billion (92) and $49.3 billion (92) aircraft compared to estimated compliance costs of $225 billion.

[5] Hall op. cit.

employ more workers. As the demand for U.S. workers rises, employment and wages will increase. Because compliance costs and the overall tax burden would be lower, firms manufacturing in the United States would be better able to compete than today. Firms could sell their product at a lower price and still achieve the same rate of return for their investors.

Under a federal sales tax, foreign-produced goods would pay the same tax as U.S. manufactured goods. Under the current tax system, imported goods bear no income or payroll tax on the value added abroad. Similarly, U.S. goods exported abroad contain embedded income and payroll taxes that must be included in the price of the good, reducing the competitiveness of U.S. firms.