

Virtues of a Consumption Tax

Testimony Before the Texas Senate Finance Committee—March 15, 2006

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The only two things that are certain in this world are death and taxes. This fact, however, does not mean we have to like either of them.

Because government is inevitable, and even desirable at some level, there must be taxes. That is not to say that taxes are good. All taxes are bad, but some are less bad than others. For that reason there are some good things to say about Texas' tax system even as we admit there is room for improvement.

✦ The biggest strength Texas has compared to other states is that it does not have an income tax.

- Income taxing states have suffered an out-migration of population in recent decades.
- Income taxing states suffer from a larger tax burden and less productive economies with lower job growth as a consequence.

✦ Another big strength is that Texas depends on a consumption tax which has several virtues.

- Simplicity—generally low compliance costs
- Does not favor big business over small business by putting a premium on the skill of CPAs and tax attorneys
- Transparency—people know the true cost of government
- Horizontal equity—those similarly situated pay the same (partly due to simplicity)

➤ Does not directly discourage work effort, job creation, or investment

➤ Is less likely to “pyramid” (build on itself and distort economic decisions)

➤ Does not depend on the structure of the economy or major industries to fund government

✦ Texas' sales tax has kept up well with our economy

➤ From 1991 to 2003, sales tax revenue increased an average of 5% per year, more than the 4.5% combined inflation and population growth.

➤ This includes 2002 and 2003 during which sales tax declined. Only these two years and 1992, another recession year, did sales tax fail to grow 4.5% or more.

➤ In fact, Texas non-federal spending has grown 6.5% per year, two percentage points more than inflation and population.

➤ In the 1980s, the revenue problem was not with sales tax, but with oil-related taxes.

✦ A consumption tax should only tax final goods and services, preventing the tax from determining economic decisions.

➤ For this reason many exemptions/exclusions in the current sales tax make sense.

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- Machinery, intercorporate sales of service, business-related electricity use, and materials, among others are business-to-business transactions that should be exempted.
- Other exemptions and exclusions make much less sense.
- Residential electricity use, newspapers, coin-operated services, car wash services, magazine subscriptions, and a host of other services are all final goods and services and should be included.
- ✪ It is actually possible to lower the sales tax rate if the sales tax were broadened to the final goods and services it makes economic sense to broaden to.
- ✪ The biggest argument against the sales tax is its regressivity.
- ✪ The Comptroller's incidence study shows each of the taxes analyzed to be regressive, including the franchise tax—a business tax—which actually shows MORE regressivity than the sales tax.
- ✪ The only tax that will not appear to be regressive is a progressive income tax.
- ✪ *But* there is no guarantee that a supposedly progressive income tax does not have regressive effects.
- ✪ The federal luxury tax was supposed to tax the rich by taxing their planes, yachts and furs, but it only succeeded in putting people who worked in the plane, yacht, and fur industries out of work.
- ✪ The result of the “progressive” luxury tax was actually regressive.
- ✪ Supposedly progressive taxes like an income tax or a business tax can have regressive effects by negatively affecting investment. They directly tax work and job creation.

Proper tax policy should have only one goal: Do the least possible harm to the economy—to citizens. This is best accomplished with taxes that transparently tax citizens so that they can know what government is costing them, with taxes that do the least to distort economic decisions, and with taxes that do not directly tax investment and job creation or work effort. A consumption tax on final goods and services—for the most part, Texas' sales tax—meets all of these criteria.

Texas should move more toward consumption taxes and away from distorting taxes like the franchise tax. This would be a great boon to our economy, and encourage the job creation always needed by those at the lowest end of our income scale.

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