Oral Testimony of Scott Hodge
Before the Senate Budget Committee
March 9, 2010

Mr. Chairman, members of the Committee, I am Scott Hodge, president of the Tax Foundation. Thank you for the opportunity to speak to you today regarding the distributional and economic issues surrounding tax expenditures in the federal budget.

Founded in 1937, the Tax Foundation is the nation's oldest non-partisan, non-profit organization dedicated to promoting economically sound tax policy at all levels of government.

We are guided by the immutable principles of economically sound tax policy – taxes should be neutral to economic decision making, they should be simple, transparent, stable, and they should promote economic growth.

In other words, the ideal tax system should do only one thing – raise a sufficient amount of revenues to fund government activities with the least amount of harm to the economy.

By all accounts, the U.S. tax system is far from that ideal.

Over the past two decades, lawmakers have increasingly asked the tax code to direct all manner of social and economic objectives, such as encouraging people to -- buy hybrid vehicles, turn corn into gasoline, save more for retirement, purchase health insurance, buy a home, replace the home's windows, adopt children, put them in daycare, take care of Grandma, buy bonds, spend more on research, purchase school supplies, go to college, invest in historic buildings, and the list goes on.

In too many respects, the IRS has become a substitute for every other cabinet agency – from Energy and Education to HHS and HUD.

And, thanks to the generosity of credits and deductions in the code a record 52 million, or 36 percent of all filers – pay no income taxes and are off the tax rolls. In other words, they have no “skin in the game.”

Indeed, many of these people now look to the IRS as a source of income thanks to the more than $100 billion in refundable tax credits paid out to people who have no income tax liability.

The OECD reports that the U.S. has THE most progressive income tax system of any industrialized country. Indeed, the top 1 percent of U.S. taxpayers now pays a greater share of the income tax burden than the bottom 90 percent combined.

But the entire federal fiscal system is progressive, not just the tax side.

Tax Foundation economists have estimated that the majority of American families now receive more in government spending than they pay in taxes.

Overall, federal tax and spending policies combined to redistribute more than $824 billion from the top 40 percent of families to the bottom 60 percent.

Sadly, many companies and industries are now looking to the IRS as a source of income too.

In a recent case, one-third of the profits of a major appliance company were attributable to energy production credits. I doubt that when members of Congress intended the program to be for appliance companies what the EITC is for poor people – an income subsidy.

Today, the biggest financial crises facing working families and the economy are health care, housing, and state and local government finances. Ironically, these are the areas in which government and the tax code is already the most involved.

The cure for what ails these industries is to be weaned off the tax code, not given more subsidies through such things as the First Time Homebuyer's Credit, Premium Assistance credits, or more tax free bonds.

The tax preference for employer-provided health insurance has undermined in health care, the market forces that deliver quality goods at low prices for everything from bread to computers. The recent health care reform legislation will make this problem worse, not better.

Housing suffers a similar problem because of the plethora of tax and spending subsidies intended to promote home ownership. One study determined that the MID is "an ineffective policy to promote homeownership and improve social welfare."

It should be no surprise that state and local debt has soared from $1.5 trillion in 2000 to $2.4 trillion because local governments can pass some of that cost off to the federal government. Rising local taxes are why millions of urban families find themselves trapped by the AMT.

Washington can actually do more for the American people by doing less. The solution lies in fundamental tax reform – which means lowering tax rates while eliminating many of the preferences in the code.

A good starting point could be the Zero plan authored by Erskine Bowles and Alan Simpson, co-chairmen of President Obama's National Commission on Fiscal Responsibility and Reform. While certainly not perfect, the plan did demonstrate that Americans could enjoy much lower tax rates – and the government could raise the same amount of revenue – if most if not all tax expenditures were eliminated.

That said, with trillion dollar deficits as far as the eye can see, it is tempting to look at “closing loopholes” as a honeypot for deficit reduction.

I believe that this would be a mistake. The primary goal of fundamental tax reform should not be raising more money for government, it should be to improve the nation’s long-term economic growth and lift the living standards of every American.

Economists at the OECD have determined that high corporate and personal income tax rates are the most harmful taxes for long-term economic growth. Unfortunately, the U.S. has one of the highest, least competitive corporate income taxes among industrialized nations and a very progressive personal income tax system.

Fundamental tax reform can restore the nation’s competitiveness and put us on a growth path for the future. Not only will this improve living standards in America, but it will improve the nation’s fiscal health. That is a win-win for everyone.

Thank you very much. I would welcome any questions you may have.