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THE FLATTER THE BETTER?

I WILL NOT be satisfied with anything less than the total abolition of the income tax. Indeed, after years of careful study of the science of public finance, and lengthy consultations with eminent practitioners of the dismal science, I have come to the conclusion that there is but one source of revenue ideally suited to the federal government. This single tax would cover all the necessary and legitimate functions of a central government, would be simple to administer, and would have built-in self-limiting features.

The tax is a toll on the roads entering the District of Columbia, with the rate at whatever the traffic would bear, so long as people were allowed to leave town at no charge.

Unfortunately, my intuition is that a

RON PAUL is a Republican representative from Texas.

Abolishing the income tax altogether is what we ought to do—but the more politically expedient flat-rate tax proposal could give us relief from bracket creep, crazy IRS rulings, and an economy turned inside out by attempts to wring advantages out of the current tax system.

majority of my esteemed colleagues are not yet ready for this sort of comprehensive tax reform. Therefore, without doubting the compelling arguments for full abolition of the income tax, I support a more modest reform, the flat-rate income tax.

I recognize, of course, that the flat-

rate tax would still be coercive, and would still have a redistributive effect, lessening, not eliminating, these and other injustices of the present system. Nevertheless, the flat-rate tax would be far more equitable, simple, and efficient than the unbelievable mess we have now. In addition, a flat-rate tax would spread the burden of paying for government more evenly, foreclosing once and for all the illusion that the burden can be placed on the shoulders of the rich. By shifting the tax burden toward the political center, *any* flat-rate tax would increase pressures for *less* government taxing and spending. This would

surely be one of the most salubrious effects of a flat-rate tax.

Admittedly, many of those who favor the flat-rate tax have impure motives. Some hope that it can be used to squeeze more revenue from the hapless taxpayers. For example, one congressman has proposed a flat tax of 15

by Ron Paul



A flat-rate tax would make it possible to tear out thousands of pages of IRS rules and file income taxes on a postcard.

percent on all income over \$8000 (the exemption amount for a family of four), with no deductions, exclusions, or credits, except for a deduction for donations to churches. His bill is supported by supply-side economist Paul Craig Roberts, who has estimated that it would *increase* tax revenues by \$45 billion in 1983. I cannot help but wonder whether a similar motive underlies recent pronouncements from the Reagan administration about the “immorality” of progressive taxation, and the advantages of proportional (flat-rate) taxation.

Indeed, the flat-rate tax is the *ultimate* supply-side reform: The tax brackets would be completely eliminated, as would the escalating disincentives that deter people from saving, investing, and otherwise trying to hit the jackpot. Paul Craig Roberts glimpses nirvana in the “flat-tax” world of the future:

Imagine a world free of bracket creep, tax indexing, high interest rates, capital shortages, marriage penalties, and penalties for success. Imagine the end of the underground economy and the improvements in economic efficiency that would result from the elimination of the numerous distortions in the tax code. Not least of all, imagine being able to quickly and easily prepare your own income tax form.

It certainly gives you a warm feeling inside, doesn't it? Well, it might, until you consider that the supply-siders are perfectly comfortable with the idea of a big, strong, and inexorably growing federal government. For many supply-siders the point of cutting taxes is not to enhance freedom and reduce government resources, but to increase government revenues so that government can go on spending more and more year after year. Any concern for individual freedom among supply-siders seems, at times, purely incidental.

I do not support the flat-rate tax as a

method of raising total taxes. However, the case for the flat-rate doesn't need that foundation. My bill, H.R. 6352, for example, would *reduce* government revenues. It would impose a 10 percent tax on all individual income over \$10,000, and would wipe out all deductions, exemptions, and credits. Linking elimination of both progressive tax rates and “loopholes” together in a single bill makes sense because it is the outrageously high progressive rates that justify the tax shelters in the first place. Also, eliminating the deductions, thereby “widening the tax base,” allows a very low, flat rate, which may be the only way to pry all the special interests away from their pet tax breaks.



HERE ARE SEVERAL important arguments in support of the flat-rate tax. The most obvious advantage is simplicity: With the progressive rates and all the “loopholes” gone, we could tear out thousands of pages of IRS regulations and get rid of short forms and long forms, and the headaches and uncertainty. Income taxes could be filed on a postcard.

The blood, sweat, and tears, and the time and the expense, caused by the complexity of the current law, is a very real part of the total tax burden. Indeed, Peter Brimelow has reported in *Barron's* that nearly half of the taxpayers were driven to pay for professional help with their taxes in 1977, and estimates the direct costs of complying with IRS regulations at around \$60 billion. This, of course, doesn't include the billions that the IRS spends to track down and punish tax evaders. The flat-rate tax would greatly reduce this extra tax burden.

A flat-rate tax would also improve economic efficiency. Progressively

higher rates distort incentives to work, save, and invest, and thus discourage, especially as one moves up into higher tax brackets, the very activities that make a people prosperous. Why work overtime or make long-shot investments, when you know that most of the extra income will simply be confiscated? Ironically, by discouraging effort in this way, the progressive income tax shelters old wealth and makes it more difficult for the middle class and poor to acquire new wealth.

Incentives are not only thwarted by excessive rates, but also *skewed* by deductions. Home ownership is good, but so is industrial investment, especially when one's trade competitors are operating with plant and equipment a generation or so more advanced than one's own. But when the government channels credit into homes, it inevitably hurts industrial investment. Only the market—not politicians—responds efficiently to the relative costs and benefits of different investments.

The progressive income tax, being a government instrument for manipulating individual behavior, is not just economically inefficient, but also restrictive of our liberty. The flat-rate tax would end this obnoxious form of government intrusion.

Yet another advantage of the flat-rate tax would be its liberating effect on economic activity that now goes on underground. The size of the “underground economy”—basically the amount of income not reported to the government—was estimated at upwards of \$400 billion in 1981, about 14 percent of the GNP, by Peter Gutmann of Baruch College. Even if you view the resulting revenue losses of more than \$100 billion to the treasury as a *good* thing, it is still unfortunate that so much productive activity is forced into hiding. A low flat-rate tax would re-

BUT WILL IT REDUCE TAXES ?

Jimmy Carter rightly called our tax system “a disgrace to the human race,” and we should spare no effort to make it more simple, fair, and economically efficient, while limiting the invasive powers of the IRS. But would a flat-rate income tax really do this? If not, we should concentrate on the most important objective—reducing the burden of taxation.

Reducing taxes is important because the average American today has almost half his income seized by various governments: It is difficult to call our society free when government confiscates almost half of everything we earn. Even medieval serfs had to give up only one-fourth of their income to their lords.

Besides restricting our freedom, high taxes depress and distort our economy. They deprive businesses and individuals of investment capital and incentive. Taxes discourage workers from working by reducing the real reward for work, and they substitute the demand preferences of politicians and bureaucrats for those of consumers and taxpayers.

Would the flat-rate tax reduce taxes? The only answer we can give is, maybe: It depends on the rate and the particular plan. For example, Senator Dan Quayle (R-Ind.) supports a plan under which, he proudly tells us, “total [federal] revenues would have been nearly \$30 billion more than will be collected under the present tax laws.” Surely the government taking another \$30 billion out of the private economy is no way to increase fairness and economic efficiency.

Of course, a flat-rate tax with a high enough personal exemption and/or a

low enough rate could result in a net tax cut, but that goal doesn't seem uppermost in the minds of its advocates. Even if the total in taxes collected were not increased, a flat-rate tax has little to offer those who want to reduce the government's role.

For instance, a flat-rate tax would be simpler than our present system, assuming, of course, that Congress would actually pass a simple tax bill eliminating all the exemptions, deductions, credits, and exclusions in the current law. But would it be more fair than our present system? All taxes are unfair, taking money from people who have earned it and giving it to people who have not. Is a mugger who takes the same amount of money from everyone passing his corner “fairer” than one who takes different amounts from different victims? Our goal should be to minimize coercion rather than to spread it around.

A flat-rate tax probably would be more economically efficient, that is, would cause fewer distortions in the economy, than the current system, since high marginal rates discourage additional effort, and the various credits and deductions channel resources into areas favored by the government rather than the taxpayers. But simply lowering rates across the board and expanding credits and deductions would reduce this “inefficiency.” And let us not be misled into thinking that a flat-rate tax is efficient per se. All taxes discourage work and investment, and all taxes distort the economy; the overall level of taxation—the net deprivation of society by government—has more effect on the economy than the specific form of that deprivation.

Many have enthusiastically noted the flat-rate tax's “liberating effect” on economic activities that now occur “underground.” But bringing eco-

nomie activity within the reach of the tax system is liberating only in the sense that people may feel lower tax rates are a lesser burden than the inconvenience of going underground, where people must get along without such conveniences as checking accounts, legal contract enforcement, and advertising. Even then, they are no more liberated than is, say, a draft evader who decides that a brief jail term is preferable to permanent exile. And if more IRS resources are freed up to harass the underground economy, those people will be worse off.

Indeed, the powers of the IRS might be increased under a flat-rate tax. Much IRS power is now channeled into enforcing the various complexities of the law, but even with a flat rate the IRS would have to ascertain that taxpayers are reporting their entire income (a term that is more complex than it sounds). Moreover, if the IRS spends less time on esoterica in the tax code, and they still have the same number of IRS agents, they will spend more time on enforcing the simpler requirements for everyone.

Perhaps the biggest problem with the flat-rate proposal is that it is a red herring, diverting us from the real goal of reducing taxes. It offers the *prospect* of some appealing reforms—simplicity, efficiency, maybe even lower rates—but if we end up with the Quayle proposal, or a similar plan, the appearance of reform will have led to *higher* net taxes.

The basic issue comes down to this: If we really think that Congress and the special interests that cluster around it will implement a simpler, fairer, more-efficient, *lower* tax, then we should support the flat-rate proposal. But if we doubt that, we should not let our efforts be diverted from the main goal, fighting for tax *reduction*. ■

by David Boaz

DAVID BOAZ is vice president for public policy affairs of the Cato Institute, a Washington-based policy research foundation.



The wealthy and the poor now pay much higher percentages of their income in taxes than do those with moderate incomes.

duce the oppressiveness of the tax code, bringing economic activity above-ground if the people found the tax burden on them sufficiently lessened.

The flat-rate tax would also help us curb the inordinate powers of the IRS. People are justified in using the law to shelter as much of their income as possible from the rapacious maw of the taxman, but the statutes are so vague, the deductions, credits, and loopholes so complex, and the powers of the IRS so unbridled, that few individuals can conduct their affairs without trepidation.

Indeed, taxpayers are presumed guilty until proven innocent in IRS tax courts, and the IRS has often acted as a Gestapo, uncontrolled by the legal safeguards we all normally take for granted. It makes absolutely no difference that many IRS prosecutions result from the bad advice of the agency itself; in 1978, House subcommittee staffers found that IRS taxpayer-assistance offices provided wrong answers one-fourth of the time! No wonder one internal IRS memorandum asserted that "agents should be able to discover errors in 99.9 percent of all returns if they want."

The simplicity of the flat-rate tax would change all this. We could fire thousands of IRS agents, and this alone might be reason enough to go flat out for the flat-rate tax.

Finally, the flat-rate tax is more fair: Everyone would pay the same percentage of their income. The wealthy would, of course, still pay more, but they would pay at the same *rate* as everyone else. It is true that the flat-rate tax would still be coercive and redistributive. But every tax is coercive, and any tax not scaled precisely (somehow) to the value of benefits derived from the government will be redistributive.



SHOULD EMPHASIZE that, despite occasional spectacular cases of tax avoidance, the federal income tax is progressive—

the rich pay not only more of their income to Uncle Sam, but also pay a higher percentage of their income, than do those with lower incomes. Despite the preoccupation of liberals and the media with sensationalizing the tax "loopholes" of the wealthy, the biggest such tax breaks are solidly middle-class. The largest is the exclusion for employee pension-plan contributions and earnings, closely followed by the deductibility of mortgage interest on homes. Thus people at the lower end of the income scale are able to shelter a much higher portion of their income from taxes than are the wealthy. Those making less than \$5000 per year shelter a third of their income from taxes, while those making more than \$50,000 a year shelter less than a fifth. In fact, the Tax Foundation reports that the tax burden of the average taxpayer rose 75 percent from 1975 to 1980, and 87 percent for those in the top 10 percent income bracket. By 1980 more than half of the individual income tax bill was shouldered by these 9 million top-income taxpayers.

Now, most other taxes, such as social security and sales taxes, have a "regressive incidence," which means, in plain English, that the percentage people pay declines as they become wealthier. Thus, when you take all taxes together, you get a very surprising result: People at either end of the income scale, the very wealthy *and* the very poor, both pay much higher percentages of their income in all taxes than do people with moderate incomes. Some people have attempted to justify steep progressivity in the income tax as compensation for all these

other regressive taxes. This is the sort of logic that only an IRS agent could love. The other oppressive taxes should be reduced, not the income tax raised.

Traditionally, people have also attempted to justify progressively increasing tax rates through the utilitarian "equal-sacrifice doctrine." According to this doctrine, taking a dollar from a man with an income of \$10,000 will hurt him more than taking a dollar from the man with \$100,000. To equalize the sacrifice—the *pain*—you must take more from the man with the larger income. Because the rich person can "afford" to pay more, the doctrine requires you to tax him progressively rather than proportionately, taking a higher percentage of the wealthier man's earnings.

At least the equal-sacrifice doctrine recognizes the coercive and hurtful nature of taxation. But beyond this, it is utter hooey.

There is no principle to guide the selection of the rate at which you tax the wealthier man. There is nothing to limit that rate or to prevent the system from being arbitrary and vindictive. In fact, the progressive income tax, conceived and sold to the electorate as a modest measure, has become just such an arbitrary and vindictive tool. When graduated taxes were introduced in Britain in 1910 and America in 1913, the top rates were 8¼ percent and 7 percent respectively. Within a scant thirty years, the top rate had risen to a staggering 97½ percent in Britain and 94 percent in America. Federal spending has risen from \$735 million in 1914, the year after the income tax was introduced, to \$770 billion in the 1983 budget, a better than 100,000 percent increase.

Moreover, when you look at real people, it is, of course, ridiculous to argue that a dollar is *always* worth less

The flat-rate tax would eliminate the temptation for a majority to impose a heavier tax burden on a minority.

to the guy with a higher income. This utilitarian doctrine simply gives a pseudo-scientific gloss to the prejudices, intuitions, and pure envy of a political majority.

Even if this utilitarian justification for the progressive tax had any moral force, it should mandate the highest taxes on the individuals who care the least about money, to equalize everyone's "pain level." Thus there ought to be a special surtax on Buddhist monks and a special rebate for the Midases and Scrooges of the world. If the greedy are generally wealthier than those indifferent to money, then a regressive tax really equalizes "pain."

BUT ALL THIS utility analysis is sheer claptrap and is totally divorced from what should be most important: A man has a *right* to keep his income. Since the strength of that right does not diminish as his income increases, a flat-rate tax is clearly morally superior to a progressive one.

Thus, eliminating the progressivity of the federal income tax would be a significant accomplishment. Friedrich A. Hayek accurately called the progressive tax "not only the chief source of irresponsibility of democratic action but [also] the crucial issue on which the whole character of future society will depend." William Pitt saw any experiment with graduated tax rates as "a presumptuous attempt to derange the order of society, which would terminate . . . in the overthrow of civilized life." Marx and Engels also saw the importance of "a heavy progressive or graduated income tax . . . [which would] wrest, by degrees, all capital from the bourgeoisie, to centralize all instruments of production in the hands of the state . . . as a means of entirely revolutionizing the

means of production." The flat-rate tax would end this progressive wresting of capital away from the productive, and would finally banish the immoral notion that the successful owe ever larger portions of their lives to the government.

As I argued at the outset, the flat-rate tax has many advantages. But perhaps the greatest advantage of any flat-rate tax is eliminating the temptation for a political majority to impose a discriminatory tax burden on a minority. Politicians would have a harder

time selling spending programs, and, in effect, buying votes, when the cost of paying for government is spread more evenly over the electorate. A flat rate would promote *political* efficiency as well as economic efficiency.

The flat-rate income tax should be supported not just for the sake of simplicity, fairness, and economic efficiency, but also because it would clip the wings of demagogues and strengthen the drive for a smaller federal government. And this, after all, should be our ultimate goal. ■



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BOOKS

Tomorrow, Capitalism: The Economics of Economic Freedom, by Henri Lepage. Open Court, 254 pp., \$14.95.

Enter the new economists

ISRAEL KIRZNER

FROM ALMOST EVERY point of view this book must be described as brilliant and exciting. It is the English-language version of a French work, published in 1978, that has enjoyed remarkable popularity in Europe and been translated into six languages. Its author is described in Professor James Buchanan's foreword as having appeared, in 1976, as an "intense young journalist." But there can be few other journalists, young or old, and of whatever degree of intensity, that could write so lucid and readable an account of contemporary developments in American economic research, and link these rather abstract developments so provocatively with burning social and public-policy issues being fought over at the ideological barricades.

What Henri Lepage has done in nine chapters is to survey the contributions to current economics of a range of scholars whom he dubs the "new economists" (most of them are associated in one way or another either with the University of Chicago or with the Virginia Polytechnic Institute) and to argue persuasively that these contributions provide, at last, the intellectual and scientific ammunition needed to defend a philosophical commitment to the free-market economy. In the course of his survey Lepage examines the historical roots of capitalism and its key institutions, as set forth by writers such as Douglass North, R. M.

Hartwell, and others. He considers the works of the property-rights theorists such as Coase, Alchian, and Demsetz. Lepage further explores the prolific research done by the school of Public Choice economists, led by James Buchanan and Gordon Tullock, in applying the tools of economics to understanding the incentives operating on persons, like government officials, who are confronted by nonmarket choices. In a separate chapter Lepage reports on work done by writers from a variety of different schools on the economics of regulation and on the standard policies of the typical modern welfare state. The author devotes considerable attention to what he terms the "Gary Becker Revolution," focusing particularly on the theory of human capital as applied to a wide range of phenomena that had, in the past, been traditionally the domain of other disciplines such as sociology, rather than of economics. Finally, the ninth chapter probes the monetarism of Milton Friedman and his followers, and its implications, at the level of macroeconomics, for the "death of Keynes."

In this rapid but thorough and competent survey, there are few aspects of the works of these various schools that are not brought within reach of the general reader. Lepage's capacity to sponge up ideas, digest them, and reorganize them in systematic and popular form is quite extraordinary. He reports on the work of scores of writers, and his bibliography runs close to 200 highly significant items. Were this book to be no more than a popular introduction to these important contemporary fields of economic research, it would have earned an honorable place indeed in the rather sparse an-

nals of "economics for the intelligent layman."

BUT THE VOLUME OFFERS far more than a remarkable layman's-version of somewhat esoteric work at the frontiers of economics. It promises its readers that this body of thought will be shown to provide, for the first time, the definitive scientific case for no less unpopular a social system than capitalism itself: "Recent advances in economic theory . . . now give us the means of showing that belief in economic and social freedom is not founded on a simple act of faith in an ungraspable 'invisible hand' but is supported by a rigorous analytical and scientific approach." It is doubtless this aspect of the book that is responsible for the unusual interest the book has aroused. And it is this aspect that I shall be scrutinizing in what follows.

How powerful a case does Lepage present? Will honest critics of capitalism who read this book be convinced that their time-honored arguments against it have indeed been pulverized by the cogency of its pro-laissez-faire logic? Should veteran defenders of the free market indeed feel heartened by the message of this book: that, at long last, their staunch faith has been rewarded, that the validity of what they have, up until now, merely believed or asserted, has finally been incontrovertibly demonstrated?

The case for capitalism presented by Lepage rests primarily on his conclusion that the "new economists" he reports on in this book have, for the first time, provided "empirical corroborations of the *Homo oeconomicus* paradigm . . . that serves as a basis for all economic analysis." It is this that Lepage sees as holding "cataclysmic implications for the future of the philosophy of economic freedom." This philosophy, Lepage asserts, is based on the "economic view" of human behavior, seeing man "simply as a rational being who makes coherent decisions as a function of the problems of choice imposed on him by the scarcity of resources." It is appar-

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