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# The Flaky Flat Tax

As a portent of the 1996 election, the "flat tax" is the political equivalent of pulp fiction. It's an escapist evasion of the real choices about the size and the role of government that Americans face. We already have a president who promises to protect all popular programs, promoting the illusion that benefits will never be curbed or modified. Now come the Republicans, who until recently have been fairly candid about budget choices, peddling the illusion that a flat tax will ignite a burst of economic growth that will wash our hardest choices away. It won't.

The flat tax resurrects the worst excesses of the 1980s' "supply side" economics. It takes sensible ideas (lower tax rates, simplification) and vastly exaggerates their potential for good. All the flat-tax plans suffer from two general defects. The first is that they are a huge distraction, requiring that we abolish the current income-tax system. No political system can handle more than a few big issues at a time, and ours is already overburdened by balancing the budget. Such an additional undertaking would be justified only if the economic benefits were immense. And that's the second problem: They aren't.

Jack Kemp, the former congressman who chaired the self-styled "national commission" that endorsed a flat tax, says that its adoption would double the rate of economic growth. No way. The U.S. economy is now growing at about 2.5 percent a year; by Kemp's math, we'd jump to 5 percent. Well, the economy has never grown that fast for a sustained period in peacetime. Since 1870, growth has averaged 3.3 percent, reports economist Edward Wolff of New York University. Between 1950 and 1973—the so-called golden age of postwar prosperity—growth averaged 3.9 percent.

It's not that taxes don't matter or that the current tax system couldn't be improved. But the performance of the $7 trillion economy depends on too many things (technology, management, workers, inflation, etc.) to be moved predictably by a single shift in government policies. We simply don't know enough to raise the annual growth rate to, say, even 4 percent. (That's another figure that Kemp carelessly brandishes.) Nor would the benefits of a new tax system eliminate the political choices posed by the budget debate.

Even if, optimistically, Clinton and the Republicans agree to balance the budget by 2002, the issue won't be settled. Under the various budget plans, about half the required spending cuts would have to be made by future Congresses. And even if these cuts occur, Congress hasn't faced the broader issues raised by the retirement of baby boomers in the next century. If nothing happens, spending for the elderly will explode, as will budget deficits or taxes. Should retirement ages be raised? Should Social Security or Medicare benefits be limited for the affluent? Clinton has never wanted to engage this sort of debate or even acknowledge the pressures for change. The Republicans had been edging toward these larger questions, but in the face of the budget stalemate and their decline in the polls, they seem to be moving to their own politics of denial, as symbolized by the flat tax.

How will it unleash higher growth? To advocates, the main answer is simple: by ending alleged overtaxation of saving and investment. If savings are taxed less, people will save more. Productive investment will rise and so will economic growth. History isn't kind to this theory. If taxes depress saving, then saving should have been higher when taxes were lower. It wasn't. In 1929, federal taxes were less than 4 percent of gross domestic product and the savings rate was about 15 percent. Since the 1950s, the savings rate has been slightly higher (17 percent of GDP) even though federal taxes were much higher (17 to 19 percent of GDP).

Economist Barry Bosworth of the Brookings Institution says that one reason saving doesn't necessarily respond to higher after-tax returns is that much of it is targeted to, say, retirement or college tuition. If savings are taxed less, people and companies may save less. But even if we could raise savings, the payoff in economic growth would be modest. Bosworth figures an extra $70 billion of annual investment might raise the rate of economic growth by 0.1 or 0.2 percent. The reason is that there's already more than $11 trillion worth of business investment (machinery, computers, buildings) in place. How fast the economy grows depends heavily on how efficiently that's used.

It's true that today's income tax is riddled with preferences (a.k.a. loopholes). But the largest serve mass constituencies and are popular: the mortgage-interest rate deduction (28 million taxpayers), the charitable deduction (31 million taxpayers) and the exclusion of company health insurance from taxes (two-thirds of the under-65 population). Replacing the income tax could disrupt much of the economy, and if transition rules were adopted, the new system might initially be more complex. "You've got to run parallel tax systems," says economist Joel Slemrod of the University of Michigan. Indeed, the practical difficulties deterred Kemp's commission from endorsing any single plan.

What's more desirable is an improvement of the present system. The 1986 tax reform did a lot. It lowered the top statutory rate to 28 percent and broadened the tax base. But subsequently, Congress raised the top rate to 39.6 percent in 1993. High rates invite tax evasion and the creation of new preferences. We still could reverse this trend and cut the top rate to 30 percent without altering progressivity. That could be done by ending some preferences and converting others into tax credits, which most benefit people with lower incomes. (Progressive taxes mean tax rates rise with income; in 1996, the richest fifth of Americans will pay an estimated 61 percent of federal taxes.)

Such reform would reduce the distortions inspired by high tax rates—discouraging work, inspiring tax avoidance—without huge disruptions. But it lacks the rhetorical appeal of a flat tax, even if that appeal is mostly deceptive. There is no substitute for settling the basic issues of what government should do and how big it should be: questions that will ultimately determine the size of the tax burden. The flat tax avoids that; it's flaky.