IS THE FLAT TAX A RADICAL IDEA?

James Gwartney and James Long

Recent proposals to implement a flat rate federal income tax have revived the debate concerning the appropriate rate structure. Despite the renewed interest in this question, particularly among academicians and politicians, there is much confusion surrounding the issue of flat rate taxation. No doubt some Americans incorrectly interpret a "flat tax" as one that imposes the same liability on low- and high-income taxpayers. Of course, under a true flat rate tax only the average (and marginal) *rate* of tax is equal for all income levels; the *dollar* liability rises proportionally with income. Another myth of flat rate taxation is that it would constitute a radical departure from a federal income tax which has been in place for over 70 years. During the first 50 years of its existence, after making allowance for personal exemptions, the U.S. income tax imposed approximately the same marginal tax rate on all except the top 5 percent of income recipients. Progressive marginal rates rising throughout the income structure as income increases 10 or 15 percent are actually a relatively new phenomenon, attributable primarily to the inflationary bracket creep of the 1970s.

As an alternative formulation to the title of this paper, we would like to pose the following question: "How strong is the case for progressive income taxation?" After section I presents a brief historical overview of the income tax in the United States, section II analyzes the philosophical underpinnings of progressive taxation. Sections III and IV consider practical problems with progressive taxation that substantially reduce its ability to accomplish the objectives of its proponents. Finally, sections V and VI consider the impact of progressive taxation on tax avoidance and economic efficiency, respectively.

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James Gwartney is Professor of Economics and Policy Sciences at Florida State University, and James Long is Professor of Economics at Auburn University.

I. The Federal Income Tax: A Historical Look

When the federal income tax was established in 1913, the marginal tax rates ranged from 1 percent to 7 percent. At least one U.S. senator voted against the tax because he feared that someday rates might run as high as 14 percent, a level he considered confiscatory. With regard to the likelihood of increasing marginal rates, the senator's fears were more than realized. During World War I, the top marginal rate was eventually raised to 73 percent. Except for a brief period during the 1920s, the top marginal rate has been 50 percent or more.

Focus on the rate structure alone, however, conceals the transformations of the federal income tax. In the United States this tax has gone through three rather distinct phases. These phases can be seen in the data presented in Table 1. First, there was what might be called the "income tax is for the few" phase covering the 1913–40 period. Only a small number of Americans, the top 10 percent or so of income recipients, paid income taxes. Most were not even required to file a return. Prior to 1940, the number of returns as a percent of

TABLE 1

SELECT DATA ON THE FEDERAL PERSONAL INCOME TAX, 1913–1982

Year	Returns as a Percent of Households	AGI as a Percent of Personal Income	Range of Marginal Tax Rates	Income Tax Revenue as a Percent of Personal Income	Percent of Returns Taxed at MTR of 28 Percent or More
1913	2	16	1–7	0.2	NA
1920	30	36	4–73	1.4	0.2
1925	15	33	1.5–25	1.0	0.0
1935	15	29	4–63	1.1	0.2
1945	133	71	23–94	10.0	NA
1955	121	80	20–91	9.5	NA
1960	114	79	20–91	9.8	3.0
1965	117	80	14–70	9.2	2.7
1970	117	78	14–70	10.1	6.5
1975	115	75	14–70	9.8	12.0
1980	118	75	14–70	11.6	26.0
1982	113	72	12–50	10.8	NA

SOURCE: U.S. Bureau of Census, *Statistical History of the United States from Colonial Times to Present;* Internal Revenue Service, *Individual Income Tax Returns* (annual); Barro and Sahasakul (1983).

households reached 30 percent during only one year, 1920. Throughout most of the period, less than one-sixth of the households were required to file returns. For example, during the 1925–31 period, a married couple was not required to file unless their net income exceeded $3,500 (or gross income exceeded $5,000). Given that nominal *per capita* incomes have increased more than twelvefold since 1930, it is easy to see why so few were required to file. The $3,500 plateau would be the equivalent of approximately $42,000 given today's income structure.

In the second phase, which began with World War II and lasted into the early 1960s, the income tax resembled a quasi flat tax. The tax was generalized to the entire population. The number of returns consistently exceeded the number of households.[1] Adjusted gross income of returns jumped to approximately 80 percent of personal income, up from less than 35 percent throughout most of the pre-1940 period. However, except for the top 4 or 5 percent of earners, taxpayers confronted approximately the same marginal tax rate. While the rate structure spread to exceedingly high rates (the maximum rate was 91 percent throughout most of the period), few taxpayers earned incomes such that the high rates were applicable.

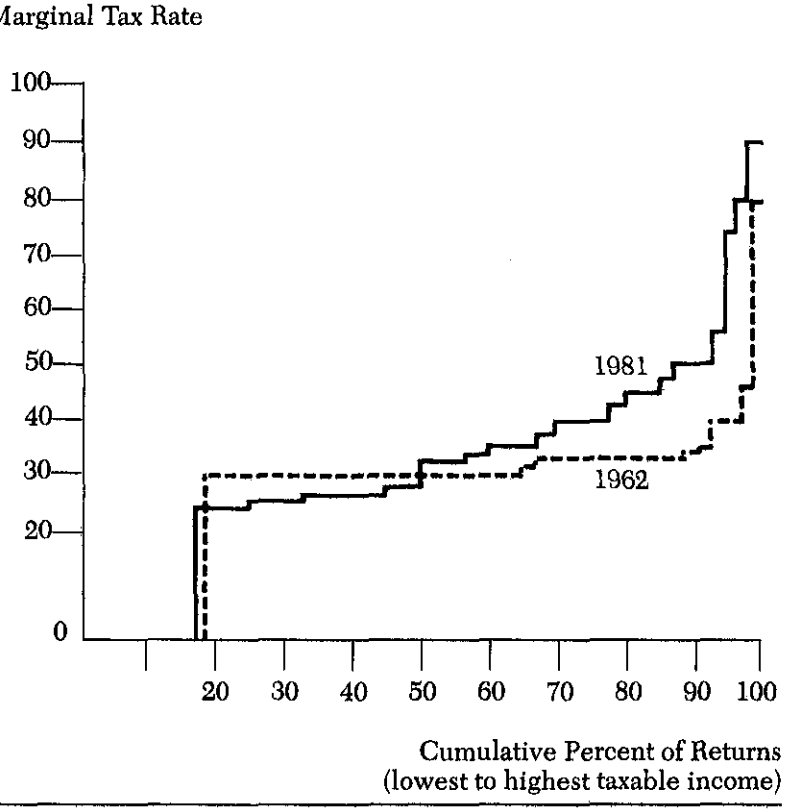
Figure 1 uses the 1962 data to illustrate the flatness of the structure during the period. Here we show the cumulative percent of returns (ranked according to income) confronting alternative marginal tax rates in 1962 and 1981. In 1962, the personal exemption amount excluded approximately one-fifth of the income recipients from tax liability. Taxpayers ranked from the 20th percentile to the 89th percentile all confronted marginal rates of 20 percent to 22 percent. For those with incomes in the 89 to 96 percentiles, the top marginal rate was 26 percent. Only the top 2 percent of taxpayers paid marginal tax rates of 30 percent or more in 1962. *Thus, as recently as the early 1960s, the structure of the income tax in the United States was essentially that of a flat tax (except for the top 3 or 4 percent of earners) with a personal exemption level which excluded the bottom one-fifth of returns from tax liability.*

Third, since the mid-1960s the structure of the income tax has changed rather dramatically. During this period for the first time, we moved to a generalized progressive income tax. With the increase in number of brackets in 1964 and the inflationary bracket creep of the 1970s, the progressivity of the rate structure increased substantially. In contrast with 1962, by 1981 taxpayers at the 75th percentile of the

[1]The excess of number of returns relative to households reflects the multifiling in many households with more than one earner.

FIGURE 1

PROGRESSIVITY OF MARGINAL TAX RATES: 1962 VS. 1981



SOURCE: Internal Revenue Service, *Individual Income Tax Returns: 1962* and *SOI Bulletin* (Fall 1983): 44.

distribution paid a marginal tax rate twice (28 percent compared to 14 percent) their counterparts at the 25th percentile. Of course, there was a substantial increase in the number of taxpayers confronting high marginal rates. By 1980, 26 percent of taxpayers faced federal marginal rates of 28 percent or more, up from only 2.7 percent as recently as 1965 (see Table 1, column 5).

II. The Philosophical Case for Progressive Taxation

The proponents of progressive taxation generally base their case on the concepts of ability-to-pay and the diminishing marginal utility of income. They argue that persons with larger incomes have more

resources with which to pay taxes and that they tend to value marginal units of income less. Thus, collecting a disproportionally large share of tax revenues from high income taxpayers imposes the burden on those best able to afford it while minimizing the welfare cost of taxes.

Walter Blum and Harry Kalven (1953) analyze these arguments in a fascinating little book written more than three decades ago. They conclude that the philosophical case for progressive taxation is an uneasy one. The reasons for their conclusion are worth reviewing. As Blum and Kalven note, ability-to-pay is a slogan, not a substantive concept. What does it mean? How is it measured? To the extent income is a measure of ability-to-pay, one would think that after allowance for some subsistence level, a person with twice the income of another would have twice the ability-to-pay. If so, why should the former be taxed more than twice as much? Economic theory fails to provide an answer.

Suppose one wants to impose an equal tax burden on the rich and poor alike. Assuming diminishing marginal utility of income, would this equal sacrifice principle justify progressive taxation? Surprisingly, the answer is, "not necessarily." As Blum and Kalven discuss in detail, the marginal utility of money must not only decline with income, it must decline *more rapidly* than income increases in order to justify progressive taxation under an equal sacrifice theory. Since there is nothing in economic theory that implies such a rapid decline in marginal utility, the equal sacrifice principle is unable to provide ethical underpinnings for progressive taxation.

Suppose one wanted to minimize the welfare cost of taxation—to take each dollar of taxation from the recipient who valued it the least. Would this principle justify progressive taxation? Once again the case is shaky. If the marginal utility of money is inversely related to income and neither the rich nor the poor alter their income-generating behavior in response to taxation, a welfare cost minimization theory would imply a topping off of incomes until the required number of tax dollars were obtained. Persons with incomes above the topping-off income level would confront 100 percent marginal tax rates. Such confiscatory rates, however, would destroy the incentive to produce income. The welfare cost advantages of taxing only income yielding the lowest marginal utility therefore must be balanced against the utility losses due to loss of income.

In addition, the welfare cost minimization theory suffers from a still more significant deficiency, a deficiency that also applies to all theories based on the diminishing marginal utility of income. Economic theory does *not* imply that a person with more income derives less marginal utility from income than a person with less income.

The law of diminishing marginal utility applies to an individual at a point in time. It has no application across individuals. There is simply no way anyone, including a benevolent despot, can determine whether one individual derives more or less utility than another individual from an additional dollar of income (see Robbins 1935, pp. 136–43). Thus, there is no way it can be determined whether individual *A* is better able to bear the taxation burden or would lose less utility than individual *B*.

Neither can the theory be rescued, as the English economist A. C. Pigou sought to do, by assuming that individuals have a similar capacity to enjoy income. The preferences of individuals differ with regard to the television programs they enjoy, social activities they choose, and a thousand other matters. Why should preferences not also vary with regard to work-leisure, time preferences, and other factors that influence income? In fact, work effort data indicate they do. Persons who earn higher incomes work longer hours, move more often in order to upgrade their salaries, spend more time and money developing and maintaining their skills, and labor under additional pressure (as measured by such things as the incidence of ulcers and nervous disorders). These actions suggest that, even at the margin, many persons with high incomes place a high evaluation on income and the things it can buy.

There is also reason to believe that factors such as family background, age, and source of income influence the marginal utility of income, *independent of the income level.* An offspring of a poor family is likely to derive considerably more utility from $25,000 of income than would be derived by the son of a millionaire. A youthful family just starting out in life may place a considerably higher valuation on additional income than a retiree with the same amount of income. The process which generates the income is also likely to make a difference. The personal utility derived from income earned in the marketplace is likely to differ from "income" received from inheritance or transfer payments, for example.

Progressive taxation cannot be justified by broadly accepted ethical principles of taxation. In the final analysis, the foundation of progressive taxation is simply a preference for economic equality. As Henry C. Simons (1938), an advocate of progressive taxation, put it: "The case for drastic progression in taxation must be rested on the case against inequality—on the ethical or aesthetic judgment that the prevailing distribution of wealth and income reveals a degree (and/or kind) of inequality which is distinctly evil or unlovely" (pp. 18–19).

The strength of the case for progressive taxation must rise or fall, therefore, on the basis of its effectiveness as an egalitarian weapon. Before we investigate this topic, one final philosophical point must be made. One cannot help but be struck by the lack of respect for individual claims implicit in the welfare maximization and allocation of burden arguments for progressive taxation. The emphasis is entirely on end results. The analysis proceeds as if all income belongs to the government, which in its wisdom, often finds it advantageous to permit those with higher incomes to keep some of their additional earnings since failure to do so would drastically reduce the size of the economic pie. But in doing so the social welfare maximizers and benevolent despots alike are motivated by pragmatic realism, not recognition of valid claims belonging to individuals who acquired income via voluntary exchange without the use of violence, theft, or fraud. The process by which income is acquired matters not at all in this world. Clearly, this view is a long way from the Lockian concept of government on which Western civilization was founded.

III. Does Income Measure Economic Status?

If progressive taxation is going to promote economic equality, annual income must be a reasonably accurate indicator of economic status. If it is not, the high tax rates intended for the well-off will be levied on other taxpayers who are not so well off. Perhaps surprising to some, annual income is often a misleading indicator of economic well-being. There are four major reasons why this is the case.

1. *Annual income differences partially reflect life-cycle factors rather than real differences in economic status.* Over our lifetimes, most of us go through three phases. First, there is a "skill-development" phase during which we spend a substantial amount of our time and energy acquiring knowledge and developing skills. By way of comparison with our expected future income, current annual income is low during the skill-development phase. Next there is the prime-earning years. Emphasis shifts from skill development to utilization. During this phase, which generally covers ages 30 through the mid–50s, annual income tends to overstate our economic well-being, making us look richer than we really are. Finally, there is the retirement phase, characterized by less work and more leisure. Even households that are quite well-off tend to experience low annual incomes during the retirement phase.

Annual income data illustrate the importance of these life-cycle factors. In 1981 the mean family income of households headed by a person in the prime-age 45 to 54 grouping was $30,090, comparing

to $15,073 for families headed by a 15 to 24 year old and $14,246 for families headed by a person 65 years and over (U.S. Department of Commerce, 1981a, Table 10). Thus, annual income was approximately twice as great for prime working-age families as was true for their counterparts during the skill development and retirement phases of the life-cycle.

During the skill development and retirement phases, families with average incomes (for their age grouping) appear to be poor. Thus, the bottom quintile of income recipients is heavily populated by households headed by persons experiencing this phase of the life-cycle. For example, in 1981 households headed by a person either under age 25 or over age 64 years comprised only 17.8 percent of total households, but they accounted for 61.1 percent of the bottom quintile of low-income households.

In contrast, prime-age persons with only an average income (for their age grouping) appear among the high-income earners. For example, an average income for a household headed by a person age 45 to 54 years would place it among the top 25 percent of income recipients when all age groupings are considered. Unsurprisingly, prime-age households dominate the upper income brackets. The 35 to 64 age groupings, meanwhile, accounted for less than half of the total households but comprised nearly three-fourths (73.8 percent) of the top quintile of income recipients.

Given the variation of income attributable to life-cycle factors, annual income is not a very good indicator of economic status. Annual income data make it appear that people are not well-off when, in fact, they are merely acquiring skills or enjoying retirement. Simultaneously, other people are made to appear quite well-off during their prime earning years when, in fact, they are not nearly so well off as their annual income implies.

2. *Higher annual incomes partially reflect locational cost-of-living differences rather than real differences in income.* In 1980, the cost of purchasing the typical bundle of goods and services consumed by a family of four was 29 percent more in New York City than in Dallas, and 28 percent more in Boston than in Atlanta (U.S. Department of Commerce, 1981b, Table 786). While these differences are sizable, cost-of-living differences between most large, densely populated urban areas and small-to-median size towns (and rural areas) are generally even greater.

Of course, if prices are *on average* 30 percent higher in one area than another, 30 percent more income will not buy more goods and services. Thus, a household with $39,000 of income in New York City is no better off than an identical family with an income of $30,000

in Dallas. But our progressive federal tax structure treats the New York family as if it were better off. Federal taxes take a larger share of the New York family's income, leaving it with less real income than the lower taxed Dallas family.

Like prime-age earners, persons living in large urban areas with a high cost-of-living are overrepresented among high-income (and highly taxed) earners. In 1981, only 43.6 percent of households were located in urban areas with a population of one million or more. But these large urban areas supplied 51.3 percent of the income recipients in the top quintile. The high money income of households in large urban areas at least partially reflects cost-of-living factors rather than real income differences. Nonetheless, a progressive tax structure imposes higher rates on the larger nominal incomes, even when they are merely reflections of cost-of-living differences.

3. *Annual income is often a misleading indicator of economic status because it fails to account for differences in work effort and availability of nonmarket time.* Like market goods, nonmarket time contributes to our well-being. As modern microeconomic theory emphasizes, the *full-income* of a household is a reflection of utility generating commodities produced with a combination of market goods and nonmarket time (Becker 1965; Becker and Michael 1976). Many commodities such as watching television, playing games, reading books, jogging, and hiking are quite time intensive—that is, they require relatively more nonmarket time than market goods.[2] Nonmarket time may also be used to produce goods (food, clothing, laundry service, etc.) that would otherwise have to be purchased with market income. Despite the importance of nonmarket time to our standard of living, tax legislation is structured as though market income (and goods) were the sole source of economic well-being. Families that sacrifice nonmarket time in order to gain money income are doubly penalized by progressive taxation. They not only have less nonmarket time because of their greater work effort, but in addition progressive taxation takes a *larger percentage* of the market income derived from their work effort.

In many cases, the major distinction between high and middle (and middle and low) income families is the quantity and intensity of work force participation. In recent years, the top fifth of family income recipients have contributed more than 30 percent of the total weeks

[2]Since the opportunity cost of time is directly related to one's wage rate, time-intensive commodities are more expensive for high-wage than low-wage earners. This higher "price" of time-intensive goods such as vacations, hunting, fishing, and television watching serves to reduce the *full income* differences between high- and low-money income recipients.

worked compared to only 8 percent for the bottom quintile. Among high income husband-wife families in 1981, more than three-fifths (61.7 percent) of the wives worked outside the home compared to 42.3 percent of the wives in middle income families, and only 17.8 percent of the wives of low income families. The differences in full-time participation of working wives were even greater. Full-time working wives characterize 46.1 percent of the high income families compared to 27.3 percent of the middle income families, and only 9.2 percent of the low income families. Therefore, the wife was five times more likely to work full-time in high income families than in low income families.[3]

While data are unavailable on the intensity of work effort, economic theory indicates that acceptance of additional responsibility and job pressure, a more hectic work pace, and less desirable working conditions will be associated with higher incomes. The market income of individuals accepting positions requiring intense work effort will overstate their full income. Income statistics will make it appear that workaholics are better off than leisure lovers with the same full income. Under a progressive system, the former will be penalized relative to the latter, independent of full income.

4. *Since the number of family members tends to increase with income, annual income differences exaggerate differences in living standards.* In 1981, the average size of high income (top 20 percent) households was 3.4 members, compared to 1.9 members for low income families. While only 12.1 percent of the low income households had four or more members in 1981, 43.5 percent of the high income households fall into that category. A larger family must feed more mouths, clothe more bodies, and provide more shelter. Thus, a larger family with more income may not be better off than a smaller family with less income. The personal exemption and different rates for separate filing categories built into our tax structure make some allowance for this factor. However, they are unlikely to compensate

[3]One might suspect that these rather dramatic differences reflect the age composition of the households. However, this is not the case. *Within age groupings,* the incidence of working wives is still far greater among high income than low income households. The incidence of working wives for prime-age (35 to 54 years) families is given below:

Husband-Wife Families with Household Head Age 35 to 54 Years	Annual Income 1981		
	Bottom 20 percent	Middle 20 percent	Top 20 percent
Percent with:			
Wife employed	29.9	47.6	66.9
Wife employed full-time	17.1	30.3	48.6

fully for the expenses associated with an additional family member. As a result, progressive taxation will often tax families with *less per capita* income (and a lower standard of living) at *higher rates* than smaller families with a high economic status.

Some examples can be given to illustrate the above points and, therefore, to answer the question of whether income is a good measure of economic status. One way to approach this question is to ask yourself, "Is a family with an annual income of $40,000 better-off than one with a $20,000 annual income?" Reflection on the issue indicates that it is highly complex. For example, suppose the high-income family lives in a high cost-of-living area such as New York or Chicago. They have three children, both husband and wife are employed, and their commute time to and from work is one hour each way. Transportation, suitable clothing, and child care services are major items in their family budget. Given the time spent working and commuting, the family has little nonmarket (leisure) time.

In contrast, suppose the $20,000 per year family lives in a small town or rural area where the cost-of-living is low. The husband's commute time to work is measured in minutes, not hours. The wife does not work outside of the home and the family has only one child. Given the work and commute time of this family, they have considerably more nonmarket (nonwork) time. It is not at all obvious that the high income family will even be able to purchase more market goods for household consumption. Given its smaller family size and greater leisure time, the standard-of-living of the low income family is almost certainly higher than the family with twice as large an income.

Consider another example. Suppose the $40,000 income represented the joint earnings of a typical middle-aged working couple striving to pay the mortgage, keep the kids in school, and save for their college education. On the other hand, suppose the $20,000 represents the interest and pension income of a childless, retired couple who own a comfortable home. Again, once one accounts for differing circumstances including family responsibilities and availability of nonmarket time, the family with the lower money income almost surely lives more comfortably than the high income family.

These examples are not atypical. As Table 2 summarizes, high income families are more likely to confront circumstances that reduce their overall standard-of-living. By way of comparison with low income households, high money income households are more likely to be characterized by prime-age workers, residence in a high cost-of-living area, larger family size, working wives, less nonmarket time, and a greater investment in human capital. Given these characteris-

TABLE 2

SELECTED HOUSEHOLD CHARACTERISTICS FOR LOW, MIDDLE, AND HIGH INCOME HOUSEHOLDS IN 1981

Characteristic	Annual Income 1981[a]		
	Bottom 20 Percent	Middle 20 Percent	Top 20 Percent
Percent of Households			
Age: 35–64	31.5	45.9	80.0
15–24	9.7	8.5	1.6
65 and over	45.6	15.4	7.9
Percent of Households Located in Metropolitan Area of 1,000,000 or more	35.9	36.3	51.3
Average Size of Household (No. of Persons)	1.9	2.7	3.4
Average Number of Earners	0.5	1.4	2.2
Percent of Husband-Wife Families with a Working Wife:			
Employed	17.8	42.3	61.7
Employed Full-time	9.2	27.3	46.1
Mean Years of Schooling	10.7	12.5	14.4

[a]The annual income of the three brackets is: less than $8,024 (bottom 20 percent), $15,000–$23,000 (middle 20 percent), and above $34,300 (top 20 percent).

SOURCE: U.S. Department of Commerce, *Money Income of Households, Families, and Persons in the United States: 1981*, Tables 5, 11, 12, and 23.

tics, it is clear that annual income often overstates their economic well-being. Annual income often categorizes families as rich (and therefore prime candidates for heavy taxation) when closer inspection reveals that they are less well-off than many others who are taxed less heavily. Similarly, annual income will often place families among those to be moderately taxed, even though they are less well-off than others with an annual income that qualifies them for various types of income transfers.

IV. Market Adjustments and Eroding the Redistributive Effects of Progressive Taxation

Even if income could be measured in such a manner that progressive taxation would impose larger statutory tax burdens on those with larger real lifetime incomes, its redistributive power would tend to

be thwarted by adjustments in the quantity and allocation of factor supplies, particularly labor. In the traditional analysis of the economic incidence of an income tax, changes in the relative supplies of labor and capital determine the distributional impact of the tax. If labor and capital inputs are unresponsive to taxation, the distributional impact is identical to the rate structure. Under such circumstances, progressive taxation tends to equalize after-tax income.

However, when tax rates exert a differential impact on the supply of labor relative to capital, the egalitarian impact of progressive taxation becomes less certain. If the progressive tax rates reduced labor supply relative to capital, wage rates would rise relative to returns to capital. Since low income recipients tend to derive more of their income from labor, the distribution of before-tax incomes would become more equal. But the opposite outcome is also a possibility. If progressive rates reduce the supply of capital relative to labor, returns to capital will rise relative to wage rates. Under these circumstances, the inequality of pre-tax income will increase. Thus, the ability of progressive taxation to promote income equality is dependent on the relative sizes of labor and capital supply elasticities.

Unfortunately, empirical evidence on factor supply is highly controversial and there is no consensus on how large an impact income taxes have on work effort and saving. According to Boskin (1978), taxation of the income from capital has substantially reduced saving in the United States. A recent study by Hausman (1981) concludes that the current progressive income tax has significantly reduced labor supply and, in the case of husbands, that the largest tax response arose in the case of high-skill persons earning high wages. If these findings are correct, if high marginal tax rates have reduced capital formation and retarded the supply of high-skill labor, then progressive taxation has almost certainly worsened inequality by increasing the market returns to capital and high-skill labor relative to the wage of low-skill labor.

However, even if *aggregate* labor supply is unaffected by progressive income taxation, market wage rates will adjust in a manner that will tend to erode the redistributive effects of progressive taxation. Earnings differences do not just happen—they are not like lottery tickets drawn from an urn. Rather, they reflect the choices of buyers and sellers in the marketplace. In the long-run, high wages reflect compensation for necessary human capital investments and less attractive job attributes. Work opportunities requiring costly education, training, and skill-building experience will be unable to attract workers unless they offer earnings sufficient to compensate suppliers for their sacrifices. Similarly, positions requiring intense work effort,

long and inconvenient hours, frequent locational moves and/or out-of-town travel, unstable employment patterns, residence in less desirable areas, substantial employee risk, and/or other less desirable attributes find it necessary to compensate suppliers for these less attractive job characteristics. In the absence of taxes, a set of wage differentials emerge which reflect these conditions.

The introduction of progressive taxation compresses after-tax wage differentials by reducing the supplier's rate of return on human capital investment and his compensation for less desirable job attributes. Individuals also will adjust their choices to the new incentive structure.[4] Fewer individuals will undertake costly human capital investments and fewer will accept the less desirable job attributes at the lower after-tax earnings levels that are no longer sufficient to compensate them for their sacrifices. The supply of labor to highly taxed categories will decline causing wage rates to rise until the after-tax net returns in these areas are once again normal (equal to what can be earned on similar investments). In occupational categories (primarily low wage occupations) taxed less heavily via a progressive system, just the opposite will occur. More people will enter such occupations, depressing wage rates until eventually normal returns are restored in the low-tax occupations. As the result of supply shifts induced by progressive taxation, a different set of pre-tax wage differentials will emerge.[5] This reallocation of labor and human capital investment will increase the pre-tax inequality of the earnings distribution and, at least partially, offset the intended egalitarian effects of progressive taxation.

Many economists are fond of calculating the Gini coefficient before and after taxes, measuring the redistributive effects of progressive taxation to the third decimal point. Our analysis indicates that such comparisons are seriously flawed because they are based on the

[4]A principle economists refer to as "the rate of return equalization theorem" underlies the adjustment process. Once allowance is made for factors such as risk, nonpecuniary benefits, and taxes, market forces will tend to equalize the rate of return across investments in human and physical capital. Investment opportunity A cannot permanently yield a lower net return than alternative B because the lower net return in A will induce individuals (and investment funds) to shift to B, thereby depressing the return in B and increasing the return in A. The process will continue until, at the margin, the rates of return are equal. As long as individuals are free to make decisions about how to use their time, energy, and resources, they will reallocate resources so as to equalize marginal rates of return across alternative opportunities.

[5]See Wagner (1983, pp. 187–201) for an excellent, technical treatment of the distributional effects of progressive taxation. Also see Holcombe (1981). For evidence of labor supply shifts between wage and salary work and self-employment, see Long (1982).

assumption that the pre-tax distribution of income is invariant to taxation. Economic theory indicates this is not the case. However, since we cannot directly observe what the distribution of pre-tax income would have been in the absence of progressive taxation, the importance of the market adjustment is difficult to ascertain. Nevertheless, recent empirical work by Morgan Reynolds and Eugene Smolensky (1977) does shed some light on the topic. Examining income distribution data for the 1950–70 period, Reynolds and Smolensky found that the degree of inequality in after-tax and transfer income in the United States was roughly the same in 1970 as in 1950. The relative size of government approximately doubled between these two periods. Direct income transfers and social welfare expenditure increased even more rapidly. More and more people were pushed into high tax brackets in order to finance the expansion in government expenditures. Yet, despite this vast expansion in redistributive activities, the degree of after-tax inequality was roughly the same. As a result of their study, Reynolds and Smolensky question the ability of government to redistribute income: "It appears to be a common view that, even in a predominantly market economy, the distribution of income, however defined, is subject to government modification. We are not convinced that the conventional wisdom is correct" (1977, p. 96).

The recent work of Joseph Pechman and Mark Mazur (1984) on the after-tax income share of the top 15 percent of income recipients also indicates there has been little change in the after-tax distribution of income during the last three decades. Pechman and Mazur use tax return data to calculate the share of before- and after-tax income of the top 15 percent of recipients during the 1952–81 period. As Table 3 shows, prior to adjustment for taxes and transfers, the income share of the top 15 percent of earners rose from 33 percent to 38 percent of the total. Given the tax rate increases over this period, this pattern is consistent with the market adjustments outlined above. However, both cash and noncash transfers rose sharply during the period. Once adjustment is made for transfer income, the data indicate that there was little change in the after-tax and transfer income share of the top 15 percent of earners between 1952 and 1981. Thus, despite a substantial increase in the progressivity of the income tax (see Table 1 and Figure 1) and a tripling of transfer payments as a percent of personal income, the share of after-tax income going to top earners was altered little. Given market adjustments to taxes and transfers, this is precisely what one would expect.

TABLE 3

INCOME SHARE OF TOP 15 PERCENT OF TAX UNITS

Year	Share of Nontransfer Income Received by Top 15 Percent: Before-Tax	Share of Nontransfer Income Received by Top 15 Percent: After-Tax	Cash Transfers as a Percent of Personal Income	Share of Top 15 Percent: After-Tax and Cash Transfers[a]	Noncash Transfers as a Percent of Personal Income	Share of Top 15 Percent: After-Tax and Cash Plus Noncash Transfers[a]
1952	33	30	4.8	28.6	0	28.6
1963	35	33	7.7	30.6	1.0	30.4
1981	38	35	13.9	30.7	4.1	29.7

[a]The calculations assume that all of the cash and noncash transfer benefits were allocated to households in the bottom 85 percent of the distribution.

SOURCE: The first two columns are from Pechman and Mazur (1984, Tables I and III). Data on cash and noncash transfers are from the Council of Economic Advisors (1984) and the U.S. Department of Commerce (1984).

V. Progressive Taxation, Tax Avoidance, and Effective Tax Rates

The "productivity" of progressive taxation as an input in tax-transfer policies to promote greater equality is further limited by the impact of high marginal tax rates on the taxable income base. There is substantial evidence to suggest that increases in federal tax rates resulting from inflation and an unindexed progressive income tax have contributed to the growth of nontaxed fringe benefits as a share of employee compensation (Long and Scott 1982; Woodbury 1983). Charles Clotfelter (1983a, 1983b) has shown that higher tax rates stimulate both tax evasion and tax avoidance, the latter resulting from the greater incentive of business proprietors to purchase deductible inputs that provide personal utility, such as travel and entertainment. Other types of consumption that are tax deductible (for example, housing expenses and charitable giving) have also been estimated to be responsive to changes in tax rates. Since increases in fringe benefits, tax evasion, and deductions reduce the tax base, the current progressive tax structure may generate a lower level of revenue to finance redistributive transfers than might otherwise be collected.

Of all the forms of tax avoidance, there is some suspicion that "tax shelters" are the most serious (Barro and Sahasakul 1983). The most widely used tax avoidance techniques generate accounting losses while moving income into lower tax categories (for example, taking capital gain income or deferring income to the retirement phase of one's lifetime). As Table 4 shows, accounting losses have increased substantially as more and more taxpayers confronted high marginal rates during the 1966–81 period. In 1981, 3.3 percent of the joint returns showed net losses from partnerships, up from less than 1 percent in 1966. The number of joint returns with losses from business and professional practice rose to 5.2 percent in 1981, up from 1.9 percent in 1966. The percent of returns with losses from rents, farming, and small business corporations were also sharply higher during the 1966–81 period. As a percent of adjusted gross income (AGI), the dollar losses from the five sources shown in Table 4 were three times greater in 1981 than 1966. While aggregate statistics such as these are consistent with the hypothesis that rising tax rates erode the tax base, they lack the precision necessary to estimate the impact of high marginal tax rates on tax revenue.

Seeking to estimate this relationship more precisely, we obtained detailed data on income, losses, and deductible expenditures from the *1979 Individual Tax Model File* of the Internal Revenue Service. Tax avoidance was defined as the sum of (a) gross losses from

TABLE 4

NET INCOME LOSSES FROM TAX AVOIDANCE
(SELECTED YEARS)

	1966	1973	1979	1981
Number of Joint Returns (In millions)	40.2	43.6	44.9	46.7
Form of Tax Avoidance	Percentage of Joint Returns Showing a Net Income Loss			
Rents	4.5	4.8	5.9	6.8
Business and Professional Practice	1.9	3.0	3.9	5.2
Farming	2.2	2.4	2.6	3.1
Partnerships	0.8	1.5	2.1	3.3
Small Business Corporations	0.2	0.3	0.5	0.7
	Net Losses as a Percentage of Adjusted Gross Income			
Rents	0.39	0.44	0.75	1.12
Business and Professional Practice	0.45	0.53	0.73	1.01
Farming	0.47	0.58	0.75	1.16
Partnerships	0.31	0.78	0.96	1.77
Small Business Corporations	0.12	0.17	0.24	0.35
Total	1.74	2.50	3.44	5.40

SOURCE: Internal Revenue Service, *Statistics of Income: Individual Tax Returns* (annual).

partnerships, small business corporations, and estates or trusts plus net losses from rents, royalties, business, farming, and other sources plus (b) deductions for all itemized deductions except state and local income taxes paid and the sum of adjustments to income (that is, payments into an individual retirement account [IRA] and other expenses included in Line 30, Form 1040). This measure of tax avoidance was regressed on the combined federal-state marginal income tax rate the taxpayer would confront in the absence of tax avoidance.[6]

State marginal tax rates range from zero in states without an income tax to maximum rates in the teens in several other states.[7] In addition,

[6]A more detailed description of the model and variables is provided in Long and Gwartney (1985).

[7]Florida, Nevada, North Dakota, Texas, Washington, and Wyoming did not levy a state

the federal income tax rate in 1979 varied with the source of income. A 50 percent statutory rate applied to personal service income (essentially, labor earnings) while marginal rates on other (capital) income ranged up to 70 percent. As a result, the combined federal-state tax rate could vary substantially among taxpayers with the same gross income, personal exemptions, and other characteristics. This variation in marginal tax rates allowed us to estimate the independent effect of higher tax rates on tax avoidance.

Our regression model took the form:

$$\text{tax avoidance} = f(\text{MTR, GI, PE, AGE 65, INCAVG})$$

where:

MTR	is the combined marginal federal and state income tax rate the taxpayer would confront in the absence of deductible expenditures and deductions for losses,
GI	is the gross income of the tax return,
PE	is the number of personal exemptions,
AGE 65	is a dummy variable indicating the taxpayer is age 65 or over, and
INCAVG	is a dummy variable indicating taxpayers using the income averaging method to calculate their tax liability.

Since we expected tax avoidance to vary as marginal tax rates (and gross income) increase, the model was estimated for joint returns in seven different income groupings.[8]

Table 5 summarizes the relevant findings. For gross incomes of less than $40,000 and combined marginal tax rates of 36 percent or less, the impact of tax rates on avoidance was negligible. However, for gross incomes above $40,000, higher rates exerted a substantial positive impact on tax avoidance. For the $40,000–$60,000 grouping, tax avoidance increased by $162 for each one unit increase in marginal tax rates, independent of the impact of gross income, age, personal exemptions, and income averaging. For the $60,000–$95,000 grouping, a unit increase in MTR was associated with $715 of additional tax avoidance. The parallel estimates of additional tax avoid-

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income tax in 1979. In contrast, California, Delaware, Hawaii, Iowa, Minnesota, Montana, New York, and Wisconsin all levied maximum rates of 11 percent or more.

[8]The income ranges were chosen with the objectives of maintaining sufficient sample sizes and encompassing at least two federal tax brackets in order to allow maximum possible variation in the marginal tax rate measure. However, utilizing different income ranges does not alter the basic nature of our findings. The IRS data base provides sampling weights equal to the inverse of the sampling rate for each observation. This weight was applied to each observation in our analysis. When the data base is a stratified sample, failure to utilize weighted regression analysis can substantially alter the results.

TABLE 5

ESTIMATED IMPACT OF MARGINAL TAX RATES ON TAX AVOIDANCE FOR VARIOUS INCOME CLASSES—JOINT RETURNS 1979

Pre-Avoidance Gross Income Class ($ thousands)	Mean Pre-Avoidance Combined Federal-State Marginal Tax Rate	Dollar Change in Tax Avoidance Associated with a Unit Increase in Marginal Tax Rate	Estimated Tax Base Elasticity
0–20	21.1	−26	.03
20–40	36.4	−10	.02
40–60	49.4	162	−.17
60–95	57.3	715	−.56
95–140	61.7	2,847	−1.56
140–200	64.4	5,148	−2.02
200+	66.4	7,979	−1.78

SOURCE: Derived from Internal Revenue Service, *1979 Individual Tax Model File and 1979 State Tax Model File.*

ance for other groupings were $2,847 for $95,000–$140,000; $5,148 for $140,000–$200,000; and $7,979 for the over $200,000 cell.

Since an increase in tax avoidance shrinks the tax base, our tax avoidance estimates can easily be converted to tax rate elasticities. The tax rate elasticity coefficient is equal to the percentage change in taxable income divided by the percentage change in the marginal tax rate. If the negative percentage change in the tax base (pre-avoidance "taxable" income in our case) is less than the percentage change in the tax rate, the elasticity coefficient will be less than one. Under these circumstances, higher (lower) marginal tax rates would lead to an expansion (contraction) in tax revenues. In contrast, when a change in the tax rate leads to an even larger change in the tax base, the tax rate elasticity coefficient will be greater than one. When this is the case, higher (lower) tax rates would lead to a reduction (increase) in tax revenues. Tax rate elasticity coefficients in excess of unity indicate that taxpayers in the grouping are on the backward bending portion of their Laffer curve.

Table 5 (column 3) presents the estimated tax rate elasticity coefficients for each of the income groupings. For incomes above $60,000 (and combined federal and state marginal tax rates above 49 percent), the estimated tax elasticities are quite large. The 0.56 estimate for the $60,000–$95,000 grouping implies that 10 percent higher mar-

ginal rates shrink the tax base by 5.6 percent. For the three highest income groupings, the tax elasticity estimates exceed unity, indicating that lower rates generate more revenue in this range.

The rate variations in our model reflect a federal-state tax structure, the pattern of which has been in place for some time. Taxpayers have had time to adjust fully their tax avoidance strategy. In this sense, our estimates are long-run rather than short-run. Thus, our elasticities may overestimate the sensitivity of the tax base for the first year or two after a change in tax rates.

Since our methodology does not capture the effect of rising marginal tax rates on labor supply, tax evasion, employee fringe benefits, and other avoidance strategies which influence reported income, our estimates should be viewed as a lower bound. Nonetheless, they imply that combined federal-state marginal rates in the 50 percent and above range promote substantial amounts of tax avoidance activities. Given that many states levy income taxes with double-digit marginal rates, these estimates suggest that policymakers should seriously consider the appropriateness of *federal* marginal rates above the 35 to 40 percent range, particularly if the deductibility of state and local taxes is eliminated.

The empirical results presented above suggest that upper-income taxpayers are successful in using tax avoidance to reduce their effective tax rate, that is, their tax liability as a proportion of their pre-avoidance income. Thus, with tax avoidance the statutory progressivity is more apparent than real, at least in its ability to generate tax revenue from high income taxpayers. Of course, the high statutory rates and the tax avoidance that they induce may impose other types of costs (for example, exposure to additional risk, time and record-keeping costs, and payments to tax advisors), but these costs do not raise revenue for the taxing authorities.

The redistributive effectiveness of the progressive income tax can be gauged by comparing the effective and statutory rates across income groupings. Table 6 makes this comparison for the joint returns of the *1979 Individual Tax Model Sample*. The mean effective rate is the taxpayer's actual average tax liability divided by gross income. The hypothetical statutory tax rate was derived by calculating the tax due on a joint return claiming two dependents and deductions equal to 22 percent (the approximate average of itemized deductions as a percent of AGI) of their gross income.

The results indicate that the average effective and statutory rates were approximately equal for gross incomes of less than $40,000. However, as we anticipated from our analysis of tax avoidance, effective and statutory tax rates diverge as gross income rises above $40,000.

TABLE 6

EFFECTIVE AND STATUTORY TAX RATES FOR VARIOUS INCOME LEVELS—JOINT RETURNS 1979

Gross Income ($ thousands)	Effective Average Tax Rate	Statutory Average Tax Rate
5	0.0	0.0
10	3.4	3.7
15	6.9	8.3
25	11.8	11.8
40	15.2	16.1
60	18.2	21.5
80	21.6	25.8
100	23.0	29.1
150	24.3	34.7
350	26.8	45.0
500	25.0	47.9
1,000	22.9	51.5

SOURCE: Derived from Internal Revenue Service, *1979 Individual Tax Model File and 1979 State Tax Model File*, and author's calculations. See text for details.

The statutory average tax rate increases steadily from 29 percent at $100,000 to 51 percent at $1,000,000, as it approaches its limit of 70 percent (in 1979). In contrast, the effective average tax rate increases little for incomes above $60,000. In fact, the effective average rate is virtually identical for taxpayers making both $100,000 and $1,000,000 in 1979.

This comparison underscores the difference between the intended and actual impacts of taxation when decision makers are sensitive to the rate of taxation. The actual redistributive impact of progressive taxation is reduced substantially when taxpayers respond to high statutory rates by increasing their tax-avoidance activities. Effectively the impact of the progressive rates on the distribution of the tax burden is not much different than what one would expect from a quasi flat rate structure with a much lower maximum statutory rate. When this problem is added to the previously discussed imprecision of annual income as a measure of economic status and the adjustment of markets to differential tax rates, it is clear that the egalitarian effect of progressive taxation is small.

VI. Progressive Taxation and Economic Inefficiency

While economic analysis indicates that the redistributive effects of progressive taxation are minimal, the inefficiency side-effects of

the tax can be significant. As Adam Smith pointed out long ago, private and social interests harmonize when decision makers bear the full costs and reap the full benefits of their activities. However, problems arise when this is not the case. When individuals are unable to capture fully the benefits, they have less incentive to undertake productive activity—to help others in exchange for income. Thus, they engage in fewer wealth-creating activities. Similarly, when the costs of an action are, at least partially, foisted onto nonconsenting parties, individuals may undertake actions which they value more than their personal costs, *but less than the total costs of the action,* including the costs imposed on secondary parties. Such actions destroy, rather than create, wealth.

This is precisely the set of problems raised by taxation, particularly high marginal tax rates. When marginal rates are high, individuals have less incentive to make the sacrifices—to bear the risks, make the human capital investments, accept demanding jobs, and engage in activities that generate taxable income. Lawyers, doctors, and other high income professionals spend more time on the golf course and consulting with their accountants and less time serving their clients. Similarly, secondary workers decide that their job is not worth the hassle when they get to keep only a fraction of every dollar they earn. The harmony between private and social interests breaks down. Positive-sum activities are forsaken and wealth creation is retarded.

Simultaneously, high marginal tax rates encourage individuals to increase their expenditures on items that reduce their taxable income. Valuable resources are expended purchasing business and personal deductible items since, with high marginal tax rates, a sizable portion of the cost of such items is foisted onto others. Similarly, high marginal rates encourage investors to undertake projects that generate accounting losses while moving ordinary income into the future and transforming it into capital gains income. Higher rate of return projects generating taxable income will be forsaken in favor of tax shelter investments. The process wastes valuable resources and reduces the size of the economic pie.

Progressive taxation distorts the incentive to employ resources in their most productive or highly valued uses. The loss of real income associated with tax-induced changes in taxpayer behavior is real and thought to be quite large, but it is not reported in any budget. Therefore, why should policymakers care about (or consider) the excess burden of progressive taxation? The answer, of course, is that optimal policy requires all costs—direct and hidden—to be considered in

determining whether government programs yield benefits large enough to justify their costs.

VII. Conclusion

Progressive taxation is a sacred cow. It is also one of those ideas that looks much better at first glance than it does when you delve into it. The philosophical case for it rests with egalitarianism, not some widely accepted tax equity principle. However, in practice, progressive taxation is not very egalitarian. Taxable annual income is a poor measure of economic status. Thus, the high rates are often levied on the wrong people—on dual-earner families rather than families with substantial nonmarket time, on the working poor during their prime years rather than the well-off retiree, and on the not-so-rich and temporarily well-off rather than the permanently well-off. To the extent high taxes do fall on those with high real incomes, predictably in the long-run, market adjustments will erode much of the intended egalitarian impact. A progressive tax may be able to reduce the rate of return (and after-tax earnings) from decisions that were made yesterday, but in a free society it will be difficult to seize the returns from *tomorrow's* investments, including labor supply choices. Predictably, decision makers will adjust in a manner designed to reduce the success rate of future fleecings. Their adjustments will lead to less supply and higher *pre-tax* returns and earnings for activities that are hit hardest by high tax rates. After markets have adjusted, the redistributive effects will be substantially more limited than static income statistics imply.

Finally, while the process does little to promote economic equality, we pay a dear price. Negative-sum games are encouraged and positive-sum activities are discouraged. A central principle of a free society that people are *entitled* to what they earn—what they acquire without the use of violence, theft, or fraud—is seriously tarnished. Our experience with a quasi-flat tax has been positive. The two decades following World War II were characterized by across-the-board economic progress.

Viewed from these angles, the case for progressive taxation is flimsy, at best. The case for high marginal tax rates, say combined federal-state rates in excess of 50 percent, is nonexistent. Perhaps the time has come to quit worshiping a sacred cow.

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ARE POLITICIANS INTERESTED IN HONEST TAX REFORM?

Dwight R. Lee

The paper by Professors Gwartney and Long (1985) is motivated by the view that our federal income tax structures can no longer be defended against any reasonable criteria. Our tax system is impossibly complicated, it fails all but the most ad hoc notions of fairness, and it grossly distorts economic decisions. That tax reform is a worthy objective is beyond serious challenge. Furthermore, the deficiencies in the current tax system are so obvious that little sophistication is required to suggest genuine improvements. Indeed, it does not seem particularly rash to assert that any intelligent eighth-grade student could formulate a tax system which, on the basis of simplicity, efficiency, and commonly accepted norms of fairness, would dominate our current tax system.

This is not to say that but little sophistication is required to fathom fully the problems arising from the way income is taxed by the federal government or to arrive at alternatives which satisfy all of the subtle requirements of economic efficiency. The Gwartney-Long paper is testimony to the sophistication required both to diagnose the ills afflicting the present system of income taxation and to prescribe detailed reforms for moderating these ills. Gwartney and Long see the major ills with the current federal income tax in the high marginal tax rates which an increasing percentage of taxpayers have been subjected to in recent years. Not only do these high marginal rates motivate blatantly inefficient decisions, but they fail to allocate the tax burden as intended, and they also fail to generate significant revenue.

I have little complaint with the Gwartney-Long diagnosis. However, their paper prompts the consideration of questions that go

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The author is Professor of Economics at the University of Georgia where he holds the Ramsey Chair of Private Enterprise.

beyond the typical concerns over the efficiency and fairness of the current tax system relative to alternatives. Although criticism of the existing tax structures and flat rate tax proposals have been around for a long time, and have no doubt had some political influence, the swell of academic interest in tax reform is explained by the fact that genuine tax reform has finally been put on the political agenda in a serious way. Why this recent interest in real tax reform on the part of politicians?

It has long been known that economic efficiency could be improved, with no sacrifice in fairness, by shifting from a steeply progressive income tax structure to a flat rate, or modified flat rate, structure. Have politicians suddenly lost their immunity to the charms of general economic efficiency? This is doubtful. Benefits that are spread widely, as are those provided by general economic efficiency, have never excited politicians as acutely as have those which are concentrated on small but politically organized groups. And there are no reasons for believing things have changed. The sudden political interest in flat rate tax proposals cannot be explained in a way that really satisfies unless we begin from the premise that politicians, like other mortals, seldom see the public interest so clearly as when it corresponds with their private interests.

A convenient place to begin an explanation of the political interest in the flat rate tax is with the observation of Gwartney and Long that not all that long ago we, in effect, had a flat rate tax structure in the United States. The tax structure was decidedly progressive on paper, but close to 90 percent of those who paid federal income taxes in 1962 faced marginal tax rates from 20 to 22 percent. This situation presented a tempting opportunity to politicians. By increasing the effective progressivity of the tax structure politicians could increase tax revenue by supposedly shifting the burden to the wealthy, a shift that always sounds appealing to the majority. Finding that the best way to get rid of temptation is by yielding to it, politicians increased dramatically, through the use of inflation induced bracket creep, the real progressivity of the income tax during the 1960s and 1970s. But yielding to one temptation invariably brings to the fore new temptations. As the tax structure became more progressive, political merchandise in the form of tax breaks and loopholes became more valuable. With those facing high marginal tax rates willing to pay more for tax relief, politicians faced another temptation which broke through their facade of resistance and the federal income tax became entangled with loopholes.

Selling loopholes can be a profitable business for politicians, but it is not a business that remains profitable indefinitely. As more and

more loopholes are sold, three things happen, all of which are unfortunate from the politician's perspective. First, most of the politically organized interest groups will have eventually purchased the tax loopholes and shelters pertinent to their businesses, and politicians will find the inventory of tax breaks running low. Second, the average taxpayer will soon begin suspecting that the tax system, no matter how progressive it may appear on paper, is placing most of the tax burden on the middle class, not on the rich. Finally, the tax system will become a less potent source of revenue than would one with more moderate rates but less permeated with loopholes. As Gwartney and Long point out convincingly, there has been an erosion in the ability of our income tax system to raise and redistribute income.

We have reached the point where most of the political advantage has been squeezed out of the progressive income tax. It is not surprising that politicians, just as anxious to capture wealth from the private sector as ever, have suddenly shown genuine interest in moving toward a flat rate tax. Talk of revenue neutrality notwithstanding, eliminating the escape hatches in the existing tax system appeals to the revenue enhancing instincts of our political representatives, even if it means sacrificing high, but impotent, tax rates. The broad gains in economic efficiency that can be generated by lower marginal tax rates, if realized, will be a by-product of narrowly motivated political concerns, and a *temporary* by-product at that.

There is no reason to believe that tax reform which reduces marginal rates will be permanent reform. Only the most trusting of political motivations can fail to recognize that a low rate tax structure with few loopholes will present politicians with a tremendous temptation. How long before "crucial" revenue requirements "justify" a "temporary" increase in the rates? How long before the political advantage of "making the rich pay their fair share" leads to more progressivity creeping back into the tax structure? And once rising tax rates increase the profit politicians can realize from merchandizing tax breaks, who can seriously believe that the tax system will not soon look much like the one we currently have?

This is not an argument against tax reform. After all, nothing lasts forever and it is clearly better to experience the efficiencies of lower and flatter taxes for a few years than never to experience them at all. But the perspective taken here does support an advantage the Hall-Rabushka proposal has over the other tax reform proposals, an advantage that seems to have gone unnoticed. One of the distinguishing features of the Hall-Rabushka proposal is that it is a true flat rate tax; everyone who pays positive taxes faces the same marginal tax rate. The efficiency advantage of a uniform marginal tax rate is obvious,

and is indeed the ideal toward which all of the modified flat rate tax proposals move; political considerations are the obstacle that prevents these proposals from being true flat rate tax proposals. But it is also political considerations, particularly those suggested by the above discussion, which, quite apart from strict economic considerations, make a uniform flat tax superior to the modified version.

Simply put, reform that results in a single tax bracket will be a more enduring reform than one that results in multiple brackets. With a genuine flat tax any move to insert progressivity back into the system by increasing the rate within certain income ranges will constitute a clear violation of the reform. Therefore, such creeping progressivity is more likely to be attempted if the reformed tax system contains multiple tax brackets at the outset. Also, with it more difficult to add tax brackets, it will be more difficult for politicians to take advantage of the reformed tax environment (one with few legitimate ways to avoid taxes) by raising tax rates. The only way to raise tax rates with a true flat rate tax is to raise the tax rates on all taxpayers, a move that will meet with more political resistance than will tax increases on selected income groups.

Tax reform which produces an honest flat rate income tax will not only be better reform, it will also be longer lasting reform.

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