

NATIONAL REVIEW

Flat-Tax Plans: All Are Good, None Are Perfect

Any flat tax is a great improvement over our current system, so conservatives shouldn't quibble over details.

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Here's a no-good-deed-goes unpunished story.

Rand Paul has proposed a \$2 trillion tax cut over years — arguably the biggest tax reduction in American history. He wants to shave tax rates down to 14.5 percent, the lowest rate since the income tax was introduced a century ago. Ted Cruz has proposed a tax cut nearly as large; his rate is 16 percent. This compares with tax rates that are as high as 42 percent under the current tax code.

Both plans would eliminate the corporate income tax AND the payroll tax. They would also eliminate almost all loopholes in the tax system.

The Tax Foundation estimates that the plans would add about 12 percent to GDP within a decade, which amounts to an extra \$2.5 trillion over that period — like adding another California to the economy.

This could be the biggest takedown of our \$4 trillion colossal government and Washington, D.C.'s micro-control of the economy in decades. K Street's million-dollar lobbyists would be all but shut down.

If you're a free-marketeer, it sounds like a dream come true, right?

So why are the libertarians at the Cato Institute and other purists on the right attacking the lowest flat-rate tax out there? Dan Mitchell and Chris Edwards, economists at Cato, say the plan will grow government because it is a European-style hidden value-added tax (VAT). “The left's dream is a value-added tax on the middle class,” says Mitchell, “so why are advocates of small government helping to advance that awful levy?”

I and others have made the case against a VAT for many years. VATs in Europe have financed the European cradle-to-grave welfare states, with spending zooming to as much as 50 percent of GDP, versus closer to 35 percent in the U.S. VATs have tended to start low and then go higher and higher.

Which brings me back to the Rand Paul and Ted Cruz plans. Both have their origins in a book that Arthur Laffer and I wrote, *Return to Prosperity*. In it we endorse what we call the “Complete Flat Tax.” Under that plan, wages and salaries are taxed at a low flat rate, while on the business side, companies are taxed at a flat rate on their revenues minus their cost of production.

It is a consumption-based tax, and most economists would agree that it uses the proper base for taxing business output. Senators Paul and Cruz call it a net-business-income tax.

Cato calls it a VAT.

Here’s how it is different from a VAT. First, Europe’s VAT expanded governments because it was an add-on to the existing income- and payroll-tax system. That is what financed the Euro-welfare-state time bomb.

By contrast, the Rand Paul and the Ted Cruz plans — let me shout this again — **ELIMINATE** the payroll tax and corporate taxes — entirely. The corporate tax is the worst tax ever. It is costly, it is riddled with loopholes that make some companies pay a lot and some pay almost nothing, and it destroys American jobs. The complete flat tax creates millions of jobs.

Skeptics say that the flat business tax is hidden from consumers, and taxes should be visible. That’s true. But the current corporate tax is invisible, and so is the payroll tax — especially the half paid by businesses. With electronic paychecks, most workers don’t ever see what FICA takes from their check. So this is no less transparent than what we have now. Perhaps we need to find ways to make the tax more visible to consumers, as Senator Cruz is proposing.

Opponents also say that the business tax is such a big revenue generator that politicians will start increasing rates by a point or two at a time to raise a vault of dollars to fund more government programs. Sure, but the same danger arises under every flat-tax plan. There is no way to prevent the rate from being raised later.

At least the Rand Paul plan requires the votes of 60 percent of Congress to raise taxes later. Cato has long been an admirer of a Steve Forbes/Dick Armey flat tax, which also replaces the corporate tax with a form of VAT. (I worked for Dick Armey back in the mid-1990s and had a hand in that tax-reform plan, too. It’s a very good tax plan — we are comparing a Ferrari with a Porsche here.) The only major difference is that the Paul and Cruz plans require businesses to pay the tax on worker payrolls, while the Forbes/Armey plan retains the current payroll-tax structure.

There are two advantages to taxing employee costs at the business level. First, since all wages are taxed under the complete flat tax, there is no cap, as under the current FICA tax. This means that the effective tax rate on wages and salaries is flat, whereas under the Forbes/Armey plan, a worker who earns \$100,000 pays a higher marginal tax rate than a worker who earns a million dollars. So the distributional impact across income groups is more evenly — and I would argue, fairly — distributed under the complete flat tax.

Second, and this is crucial: The Paul and Cruz plans tax imports at the low rate and don't tax exports. So for manufacturing workers and Trump voters, this plan is a big jobs producer here at home. Our current tax system perversely taxes what we produce, but not what we import. That's dumb policy and even worse politics. Republicans can win middle-class union voters by persuading them that the complete flat tax is a GATT-legal tariff on all goods and services imported into the United States, and no tax on what they produce for export — just as a national sales tax accomplishes the same thing. That's huge for Trump voters.

Then there is the argument by some folks at American Enterprise Institute, and National Review's Ramesh Ponnuru, that the Paul and Cruz plans will cause inflation. Really? A \$2 trillion tax cut will be inflationary? That's what the Left warned about the Reagan tax cuts. Instead we had the biggest cut in inflation ever. The flat tax increases production of goods and services, which reduces inflation. Duh.

There are probably about a dozen different ways to craft a flat tax, everything from the 9-9-9 plan devised by Herman Cain to the national sales tax to the Paul and Cruz plans. They are variations on the same theme, and conservatives should be for whichever one of them is politically most salable and can pass. A circular firing squad on the right by those who only want their plan is counterproductive.

The “my way or the highway” mentality benefits only the Left — and the politicians, accountants, lawyers, lobbyists, and redistributionists who want to strangle tax reform altogether.