



Flat Tax or Fair Tax?

Daniel J Mitchell January 30, 2013

I'm currently at Hillsdale College in Michigan for a conference on taxation. The event is called "The Federal Income Tax: A Centenary Consideration," though I would have called it something like "100 Years of Misery from the IRS."

I'm glad to be here, both because Hillsdale proudly refuses to take government money (which would mean being ensnared by government rules) and also because I've heard superb speeches by scholars such as Amity Shlaes (author of *The Forgotten Man*, as well as a new book on Calvin Coolidge that is now on my must-read list) and George Gilder (author of *Wealth and Poverty*, as well as the forthcoming *Knowledge and Power*).

My modest contribution was to present "The Case for the Flat Tax," and I was matched up – at least indirectly, since there were several hours between our presentations – against former Congressman John Linder, who gave "The Case for the Fair Tax."

I was very ecumenical in my remarks. I pointed out the flat tax and sales tax (and even, at least in theory, the value-added tax) all share very attractive features.

A single (and presumably low) tax rate, thus treating taxpayers equally and minimizing the penalty on productive behavior.

No double taxation of saving and investment since every economic theory agrees that capital formation is key to long-run growth.

Elimination of all loopholes (other than mechanisms to protect the poor from tax) to promote efficiency and reduce corruption.

Dramatically downsize and neuter the IRS by replacing 72,000 pages of complexity with simple post-card sized tax forms.

For all intents and purposes the flat tax and sales tax are different sides of the same coin. The only real difference is the collection point. The flat tax takes a bite of your income as it is earned and the sales tax takes a bite of your income as it is spent.

That being said, I do have a couple of qualms about the Fair Tax and other national sales tax plans.

First, I don't trust politicians. I can envision the crowd in Washington adopting a national sales tax (or VAT) while promising to phase out the income tax over a couple of years. But I'm afraid they'll discover some "temporary" emergency reason to keep the income tax, followed by another "short-term" excuse. And when the dust settles, we'll be stuck with both an income tax and a sales tax.

As we know from the European VAT evidence, this is a recipe for even bigger government. That's a big downside risk. I explore my concerns in this video.

To be sure, there are downside risks to the flat tax. It's quite possible, after all, that we could get a flat tax and then degenerate back to something resembling the current system (though that's still better than being France!).

My second qualm is political. The Fair Tax seems to attract very passionate supporters, which is admirable, but candidates in competitive states and districts are very vulnerable to attacks when they embrace the national sales tax.

On dozens of occasions over the past 15-plus years, I've had to explain to reporters that why anti-sales tax demagoguery is wrong.

So I hope it's clear that I'm not opposed to the concept. Heck, I've testified before Congress about the benefits of a national sales tax and I've debated on C-Span about how the national sales tax is far better than the current system.

I would be delighted to have a national sales tax, but what I really want is a low-rate, non-discriminatory system that isn't biased against saving and investment.

Actually, what I want is a very small federal government, which presumably could be financed without any broad-based tax, but that's an issue for another day.

Returning to the issue of tax reform, there's no significant economic difference between the flat tax and the sales tax debate. What we're really debating is how to replace the squalid internal revenue code with something worthy of a great nation.

And if there are two paths to the same destination and one involves crossing an alligator-infested swamp and the other requires a stroll through a meadow filled with kittens and butterflies, I know which one I'm going to choose. Okay, a slight exaggeration, but I think you get my point.