Romney Should be Even More Aggressive on Tax

By: John C. Goodman **August 11, 2012**

Did you know that personal income taxes equal about 10% of personal income? Think about that. In principle, we could collect all the income tax revenue the government is collecting today for a tax rate no higher than the biblical tithe.

Of course that would mean no deductions (including deductions for charitable giving and mortgage interest, as well as the standard deduction), no credits (including credits for wind mills and solar power panels) and no loopholes (including tax free interest on municipal bonds). But isn't that a tradeoff worth considering?

Economists are almost unanimous about the economic benefits of such a change. An enormous amount of economic activity is nothing more than a response to tens of thousands of provisions in the tax code. Just imagine how much more productive and efficient our economy would be if we all made decisions based on economic advantages rather than tax advantages.

Mitt Romney is taking a step in this direction. Under the **Romney plan** , the corporate tax rate would fall from 35% to 25%. Individual rates would fall by 20% across the board. A family in the 10% bracket would pay 8% instead. A family in the 35% bracket would pay only 28%. Plus, families who earn less than $200,000 would pay no taxes on capital income (dividends, interest and capital gains). Romney would pay for these changes by eliminating unspecified deductions and loopholes.

Since the political season is also a silly season, this plan has been fodder for more TV commercials than serious analysis. The Obama campaign, relying on a **report** from the left-leaning Tax Policy Center, claims that the Romney would raise taxes on the middle class in order to cut taxes for rich people (like him!). A *Wall Street Journal* **editorial** this week rightly responds that the Romney plan would be good for almost everybody.

One **study** in particular projects that the Romney tax plan would raise GDP by 5.4 percentage points and create 6.8 million new jobs. Still, I think we can do better than that.

Let's begin with the 10% flat tax and consider some adjustments we might want to make. If we want to replace the corporate income tax as part of reform, our rate would have to rise to 11%. Then consider the whole consumption/investment question. Loyal readers will remember my argument that when people save and invest they are benefitting the rest of us. When they consume, they are benefitting themselves. That's why it makes sense to only tax that part of people's income that they consume. If we do that, our flat tax begins to look almost identical to a national sales tax. The rate, however, has to rise to 14%.

Then there is the whole question of whether this type of reform unduly benefits the wealthy at the expense of low and moderate income families. To deal with this objection, some flat tax advocates (Dick Armey, Steve Forbes, etc.) include a generous standard deduction for everyone. Advocates of a national sales tax include a generous rebate for everyone. Sometime back, my colleague Larry Kotlikoff and I decided that this approach gives away too much money to people who don't need it (e.g., Warren Buffett) while leaving important social goals unmet.

As an alternative, we proposed to rebate tax dollars to the bottom third of taxpayers to solve other social problems. For example, instead of people automatically getting the 14% rebate, we would require them to show that they have health insurance and a retirement pension as a condition. Specifically, to get one-half the rebate (7%), low-income families would have to produce proof of health insurance. This would encourage millions of people who qualify to enroll in Medicaid or in their employer's health plan. Barring that, families could apply the tax rebate to health insurance they purchase on their own. We propose making the other half (7%) contingent on proof of a pension, an IRA, a 401(k) or some other savings account.

So instead of national health insurance and more government spending on the elderly, we would use our flat-tax proposal to urge people to solve these problems on their own.

Then there is the problem of the payroll tax. Although it is usually ignored in discussions of tax reform, the Social Security payroll tax is itself a flat tax!

The 12.4% payroll tax (split between employer and employee) currently applies to income up to $110,100. We don't think it's fair that a $50,000-a-year autoworker has to pay payroll taxes on all his income while a million-dollar-a-year auto executive does not, however. So under our proposal all wages would face the same income and payroll tax rate and that would be a rate of about 26%. With more economic activity in response, let’s put that at about 25%. So one fourth of your income would go to the federal government. But you would pay taxes on your income only once. After that all savings would accumulate tax free.

We call our proposal a **"progressive flat tax."** The reason: it allows us to have a lower flat-tax rate and produces results that should appeal to conservatives as well as liberals. The left objects to most consumption tax proposals because they are not progressive. Low- and middle-income people would pay a greater share of what they earn than rich people. What we are proposing is more progressive than the Forbes flat tax. It's also more progressive than the current system. Using economic modeling, Kotlikoff and I found that under our flat tax the rich would bear more of the burden than they currently do.

Many in Congress agree on the need for change. The oft-repeated objection is that tax reform benefits high-income taxpayers at the expense of low-income taxpayers. That objection need not apply.