



A Kinder, Gentler Flat Tax

How to reform our tax system--and satisfy both the left and the right.

by John C. Goodman

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Steve Forbes has done a commendable job spelling out why America's tax system must be simplified. Scrap the mind-numbingly complex, loophole-filled, savings-averse code, advises the editor-in-chief of this magazine, in favor of one elegant, clear rate. A flat tax is what America needs.

That all sounds good to me. But I think we can do even better. Under Steve Forbes' plan the flat rate would be 17%. All families would get generous personal exemptions, so that a family of four would not pay taxes until its income exceeded \$46,000. To encourage growth, the Forbes plan exempts income that is saved and invested. Which means that the Forbes plan is really a consumption tax. It taxes people based on what they take out of the system, not on what they put in.

I would offer Americans an even lower flat tax rate--14% as opposed to 17%--and at the same time do more to help low-income people. Boston University economist Laurence Kotlikoff and I have put together a plan that works in the following way.

First we'd get rid of the across-the-board \$9,000-per-person exemption in the Forbes plan. Why should billionaires like Bill Gates get an exemption? Forbes is giving too much money away to rich people. We'd save that exemption money and give it instead, in the form of a rebate, to the bottom third of earners, those who bring home roughly less than \$25,000 for a family of four.

Second, Forbes ignores the 12.4% Social Security payroll tax (split between employer and employee). Currently, income over \$90,000 a year is not subject to the tax. 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. Under our proposal all wages would face the same income and payroll tax rates.

There is just no way Forbes' plan would ever fly in Congress. Politicians are not going to adopt a system that taxes the wages of the rich at a lower rate than the wages of blue-collar workers. Under our proposal all wages would face the same income and payroll tax rates. And these rates would be paid only once. After that all savings would accumulate tax free.

Our plan allows us to have a lower flat-tax rate and produces results that should appeal to conservatives as well as liberals. What conservatives most want is an uncomplicated system that taxes income only once (when it is earned) at one low rate. Liberals are more concerned about progressivity. They want the rich to bear more of a burden than the poor.

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.

We would also use the rebate of 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.

President Bush wants to reshape our tax system. 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.