

## Flat Income Tax, Fair (Sales) Tax, and The Hedgehog

The Flat Income Tax is advocated in various forms. But to simplify this comparison, we will use a single rate with a large deduction similar to that proposed by Steve Forbes. In the Forbes proposal, all taxes except the proposed flat income tax are eliminated.

The Fair Tax, advocated by Fair Tax.org is a national sales tax that completely replaces the income and other taxes. Hedgehogparty.com has posted link [http://www.fairtax.org/PDF/Forbes-Rebuttal\\_of\\_Flat\\_Tax\\_Revolution\\_2-9-06.pdf](http://www.fairtax.org/PDF/Forbes-Rebuttal_of_Flat_Tax_Revolution_2-9-06.pdf) to a rebuttal by the Fair Tax group of the Forbes book. Many of the issues between the two groups are highlighted by this exchange. You should also read the description of the Fair Tax on <http://www.FairTax.org>, and Steve Forbes book "Flat Tax Revolution."

The Hedgehog Party advocates the Flat Income Tax as part of its tax reform. On an economic basis, the Party could accept either a Flat Income Tax or Fair Tax as part of its tax reform. They both propose a broad based tax system that taxes most of the electorate at a common rate. Because of that they both go part way to connecting spending to taxation. Of course, they both purport to eliminate our current tax code.

Both plans contain what are ultimately fatal flaws.

First, they are both subject to tinkering. Powerful interests will always find a way to legislatively undo these reforms after they are passed. Taxes that were eliminated in the flat tax legislation could, bit by bit, be reintroduced. The Fair Tax could be subverted by a maize of exceptions, credits, and preferences until the tax rate was so high, the electorate would beg for an income tax on the rich. Instead of reducing tax complexity, either plan could ultimately increase it. The class warfare over taxes would go on and on.

The Hedgehog Party believes strongly that the only battle worth fighting is a Tax Amendment battle that sets new taxing rules that Congress and the Executive can't easily change. It is easier to set those rules with a Flat Income Tax amendment, though not impossible for a Fair Tax Amendment.

Second, any tax reform as dramatic as these groups propose (including the Hedgehog Party), will be difficult and time consuming to implement. The Hedgehog Party leans to the Flat Income Tax, because the institutions are in place to collect it. The Fair Tax depends on the states to collect the tax through their normal sales tax system where they exist. This process will not be as simple as it seems. State sales taxes are not uniform, and they are not collected on many things that the Fair Tax group proposes to tax. Each state has its own set of lobbyists that create exceptions, preferences and rebates to their sales taxes. Several states have no sales tax at all. In addition, there is no history of a state (or country) successfully collecting a retail sales tax at rates above 15%. The psychological impact of these rates will be a tough sell despite the probable reductions in the price of goods..

On the other side, the Fair Tax taxes the black economy. Drug traffickers will pay the same tax as church goers. Another very big Fair Tax advantage is the potential effect on trade deficits. Exempting exports from the fair tax (as our trading partners exempt their VAT taxes), will dramatically improve our competitive advantage in manufactured and other export products. Probably no changes to our existing trade agreements would be required to implement the Fair Tax.

Third, neither plan attacks deficit spending. The incentives to burden the future economy with big public debts remain intact. The Hedgehog proposes a balanced budget as part of the Tax Amendment with real teeth. There are escape clauses in dire national emergencies, but other than that, the budgets will be balanced.

This issue is important, because deficits disconnect spending from taxation. It is pretty easy to convince voters to be for a spending program if someone else pays for it at some other time.

Third, both plans raise little or no new revenue sources. The Fair Tax does tax the black economy, and they both broaden the tax base, but both reduce taxes on high incomes. Another problem is that large wealth accumulations are taxed less than they are now. Despite all the efforts of both groups, they simply will not be able to eliminate this criticism in the mind of a broad spectrum of voters.

The Hedgehog party proposes a maximum 1% asset tax on the top 10% of asset holders. Those numbers seems small, but it is a big tax directed at those that escape all other forms of taxation. Will it harm the economy? No. The incentives to produce wealth are enhanced, because the most creative and hardest working members of our society will experience lower tax rates on new wealth. When they get rich, they will pay the asset tax.

Fourth, neither plan will ever be enacted because they are unfair. I know this statement creates a firestorm of protest by advocates, but it is true. Both plans do a good job at the low end of the income curve. The poor will pay little or no tax (unlike the heavy labor taxes they pay now). Unfortunately, both plans fail at the high end of the wealth and income curve. I think it is good that these plans reduce taxes on the poor and the creative wealth builders in our economy. But at some point, this revenue will fall short without spending reform. Neither plan offers a clear path to spending reform, and because of that, the burden of tax reform will likely fall on the middle class. This is a non-starter politically.

The asset tax solves this problem. It raises new revenue that will protect the middle class from a tax increase and will likely permit a small decline in taxes. But more important, it creates a big psychological edge for passage. The average citizen thinks he is being ripped off by the system, and he is right. He/She is very angry about a super wealthy class that pays tax rates similar to a minimum wage worker. The political effect on the super wealthy is profound. They will care about spending, because it affects their taxes.

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