

# IMPRIMIS

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## The Moral Case for the Flat Tax

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**S**teve Forbes is the president and chief executive officer of *Forbes* Inc. and editor-in-chief of *Forbes* magazine, which, with a paid circulation of approximately 750,000, is the world's largest business journal.

Also chairman of Forbes Newspapers, Inc., Mr. Forbes has served on the boards of numerous civic, business and educational organizations, including the Ronald Reagan Presidential Foundation and the Foundation for Student Communication. From 1985 to mid-1993, he also chaired the Board for International Broadcasting, which oversees Radio Free Europe and Radio Liberty. In 1995-1996, his bid for the



Republican presidential nomination on a pro-growth, pro-opportunity platform was one of the top news stories of the year and brought his now-famous "flat tax" proposal to the forefront of the national debate. ▲

*Steve Forbes argues in this issue of Imprimis that America's economic and spiritual revival are linked. These remarks are based in part on his presentation during Hillsdale College's Shavano Institute for National Leadership seminar, "The Future of American Business," in Chicago last May. This seminar was sponsored by the Edward Lowe Foundation, a nonprofit organization dedicated to free enterprise education.*

Capitalism works better than any of us can conceive. It is also the only truly *moral* system of exchange. It encourages individuals to devote their energies and impulses freely to peaceful pursuits, to the satisfaction of others' wants and needs, and to constructive action for the welfare of all. The basis of capitalism is not greed. You don't see misers creating Wal-Marts and Microsofts.

Think about it for a moment. Capitalism is truly miraculous. What other system enables us to cooperate with millions of other ordinary people—whom we will never meet but to whom we will gladly provide goods and services—in an incredible, complex web of commercial transactions? And what other system perpetuates itself, working every day, year in, year out, with no single hand guiding it?

Capitalism is a moral system if only because it is based on *trust*. When we turn on a light, we assume there will be electricity. When we drive into a service station, we assume there will be fuel. When we walk into a restaurant, we assume there will be food. If we were to

make a list of all the basic things that capitalism provides—things that we take for granted—it would fill an encyclopedia.

Three years have passed since I wrote those words in a September 1993 issue of Hillsdale College's speech digest, *Imprimis*, called "Three Cheers for Capitalism." I still firmly believe in them, but the vast majority of liberals—and, sadly, many conservatives—persist in viewing capitalism as merely an economic system, forgetting, as Warren Brookes

wrote in *The Economy in Mind* (1982), that economics is a metaphysical rather than a mathematical science, "in which intangible spiritual values and attitudes are at least as important as physical assets and morals more fundamental than the money supply." He concluded that "a national economy, like an individual business or a specific product, is the sum of the spiritual and mental qualities of its people, and its output of value will be only as strong as the values of society."

Flat tax advocates like myself are often criticized for focusing too much on "dollars and cents" issues instead of on moral issues. But as the philosopher and essayist Ralph Waldo Emerson said 150 years ago: "A dollar is not value, but representative of value, and, at last, of moral value." More recently, scholars like former education secretary Bill Bennett and Nobel Prize winning economist Milton Friedman have pointed out that every time you take a dollar out of one person's pocket and put it into another's, you are making a moral decision.

## The High Price of Taxes

Taxes are not simply a means of raising revenue; they are also a price. The taxes on our income, capital gains, and corporate profits are the price we pay for the privilege of working, the price we pay for being productive, and the price we pay for being innovative and successful. If the price we pay becomes too high, we get less of these things. If the price we pay is lowered, we get more of them.

So taxes are a barrier to progress, and they punish rather than reward success.

The Kemp-Roth bill of 1981 and the tax reform bill of 1986 reduced individual income tax rates to levels we hadn't seen in more than half a century, and they helped create an unrivaled period of prosperity. Yet today, many of our policy-makers ignore or deny the positive benefits of those tax cuts. They also fail to realize that it is people, not policies, who make an economy run.

Remember, says investor and philanthropist Theodore J. Forstmann, "No government has ever borne the cost

of anything. Taxes cost *people*. Tax cuts do not cost *government*." Families with children are hardest hit by high taxes. According to the Family Research Council, a family of four at the median income in 1948 paid 2 percent of its income in taxes; in 1994 the figure was 25 percent. That is why families feel they are on a treadmill and the treadmill is winning.

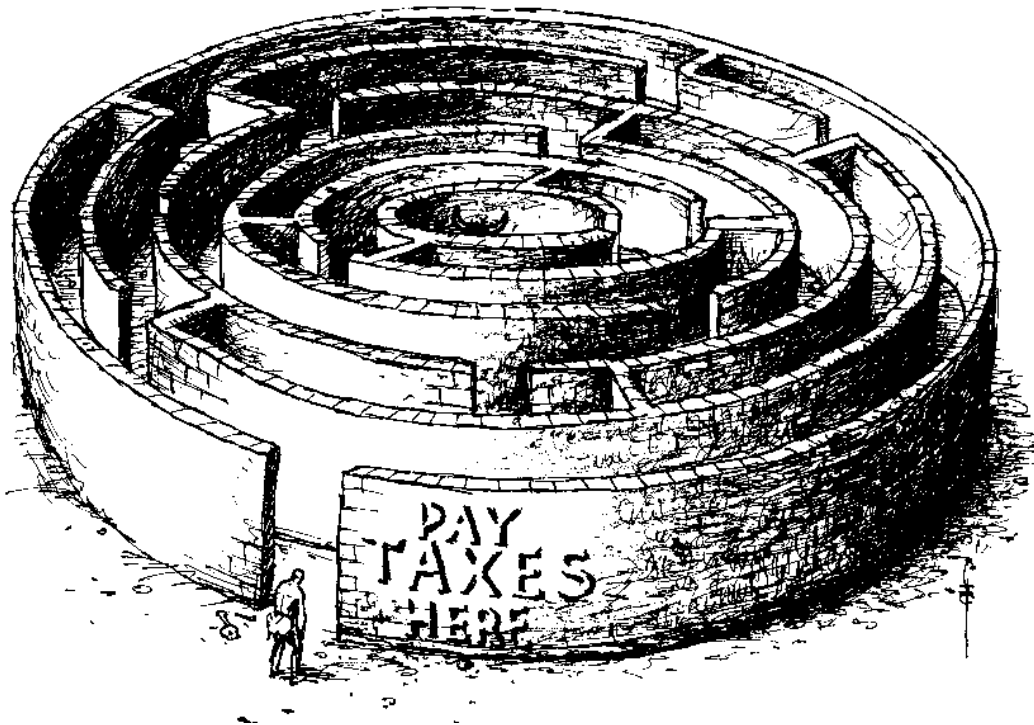
If we want to do something to help families in this country, I can't think of a better option than the flat tax. True, the across-the-board tax cuts proposed by Republican and even some Democratic leaders are an important step in the right direction and will do enormous good, but we should not stop there. We should scrap the existing tax code. Just think about what a monstrosity this code is. The Gettysburg Address runs about 200 words. The Declaration of Independence runs about 1,300 words. The Holy Bible runs about 773,000 words. But our federal income tax code runs about seven million words and is growing longer every year.

## How Taxes Corrupt

### *Political Corruption*

Today's tax code is incomprehensible, even to tax collectors, and it is the principal source of corruption in our nation's capital. Politicians have been trading favors and loopholes for political contributions and support for so long that they have come to think that this is acceptable, even virtuous, behavior. And there are now almost 13,000 registered lobbyists and special interest groups who together represent the largest private

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sector industry in Washington, D.C. Over half of them are there for the precise purpose of manipulating the tax code to their own advantage. As House Majority Leader Dick Armey warns, this not only costs our economy billions of dollars but turns the political process into a free-for-all for special interests.

Washington attorney Leonard Garment says, "Whatever corruption may exist here is what happens wherever government is given large amounts of money to dispense, great power over people's lives, and great discretion in using that power, whether it is in a poverty program, or the Small Business Administration, or the Department of Defense....It is a corruption that occurs almost universally when government has too much discretionary power and individuals too little."

#### *Civic Corruption*

Taxes also have a corrosive impact on our civic life. Our individual sense of responsibility and trust is destroyed—eaten by the acid of big government spending sprees and confiscatory taxes. Today, many of us view taxes as a form of legalized plunder, and we have little faith that the earnings

we are forced to surrender to Uncle Sam will be used wisely or properly. So we do not scruple to look for ways to avoid compliance with the tax code whenever possible. We don't think of ourselves as "tax cheats" but as "tax rebels." But no matter what we call ourselves, we have the uneasy sense that high taxes, like welfare, can steal our sense of self-reliance and integrity.

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#### *Cultural Corruption*

When we look around our nation, we see more illegitimacy, more illiteracy, more crime, more drug abuse, more broken families, and more members of a permanent underclass than ever before. In the name of "compassion," we have spent trillions of tax dollars on all these crises, and all we have done is to make them worse.

If we truly wish to be compassionate, we should adopt a flat tax that exempts the poorest citizens and offers all Americans real and practical ways to climb the ladder of successful living. Moreover, the flat tax allows us, not the federal government, to decide how best to solve our own problems. It puts responsibility back into the equation and sends a powerful moral message.

## What Is the Flat Tax?

The flat tax is a simple, fair, and uniform system. It is a sound system, with widespread support from Nobel Prize winning economists as well as former cabinet members and other political leaders. And it is a moral system because it means more take-home pay for wage earners, more savings and investment, more businesses, more jobs, more efficiency, more products and services, more price cuts, and more personal decisions as opposed to state planning. When people can keep more of what they earn, they tend to spend it on their children's education, on preparing for careers, on solving social problems, on going to church, and on volunteering instead of working overtime. The flat tax can actually provide a moral imperative to rebuild our lives and our communities.

Under my flat tax proposal, every individual would have a tax exemption of \$13,000; every child \$5,000. For a family of four, the first \$36,000 of income would be free. (There would be generous exemptions for smaller and larger families and for single individuals, too.) Currently, a family of four typically owes over \$3,000 in taxes for the first \$36,000 in income. With the flat tax, they would owe nothing, and their income over \$36,000 would be taxed at a flat 17 percent rate. There would be no tax on personal savings, pensions, Social Security benefits, capital gains, or inheritances. For businesses, the 17 percent rate on net profits would also apply, and investments would be written off in the first year. Constantly changing and complicated depreciation schedules would be eliminated. The IRS would no longer be able to define arbitrarily the life of an asset.

The flat tax would get America's economy moving again. But it has been attacked through a

nationwide campaign of misinformation based mainly on six myths:

Myth 1: *The flat tax would raise taxes on the middle class.* How many families of four do you know that have \$36,000 of exemptions under the current tax code? The flat tax will actually lower taxes on the middle class. Yet one New Hampshire state official ran ads during the last presidential primary saying the flat tax would hike taxes on families of four in his state by \$2,000-\$3,000. How did he come up with these numbers? He ignored the \$36,000 tax exemption and applied the 17 percent to their entire income.

Myth 2: *The flat tax would hurt the housing industry and property owners.* But even President Clinton's Treasury Department acknowledges that the flat tax would lower interest rates by one-fourth to one-third. Lower interest rates mean lower down payments and monthly mortgage payments. More people can become homeowners for the first time, and current homeowners can save more of their earnings for other expenses. The need for mortgage deductions (which would be phased out gradually rather than all at once) would end because the flat tax would bring far greater savings and superior benefits.

Myth 3: *The flat tax would destroy municipal bonds.* The lower interest rates introduced by the flat tax would not hurt existing municipal bonds or future ones. New purchasers would be more concerned with where their money was going than how their taxes were affected. This would lead to greater accountability in public finance, and bond prices would even be likely to rise a little as general interest rates came down.

Myth 4: *The flat tax would hurt charitable giving.* The American people don't need to be bribed by the tax code to give when they live under a fair

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and equitable system. We were a generous and giving nation long before the federal income tax was instituted. And the tax cuts in the 1980s actually resulted in a huge, historic increase in charitable giving. In short, when the American people have more, they give more.

*Myth 5: The flat tax is a giveaway because investment income, or what liberal economists love to call "unearned income," would not be taxed.* Wrong: Under the flat tax, all income would be taxed. But investment income would be taxed only once instead of two or three times as the current code mandates. When a company makes a profit, it would pay a 17 percent rate tax.

*Myth 6: The flat tax would increase the budget deficit.* The only way we are going to cure the budget deficit is by cutting government spending and cutting taxes. This will lead to an economic boom. In the 1960s and 1980s, tax cuts increased rather than decreased government revenues. Why? Because, as I mentioned earlier, taxes are a price. When the American people can keep more of the resources they create, they create more resources. And whenever tax rates are reduced, compliance goes up because people find it easier to work productively than to figure out how to get around the shoals of the tax code.

The flat tax would mean more than just a financial savings—it would save time, too. Right now, individuals and businesses spend more than five billion hours a year filling out tax forms. The flat tax form would be the size of a postcard and would take almost no time to fill out. Imagine what we could achieve with all the time we would save. Imagine the benefits for our families, our schools, our churches, our charities, our communities, and our businesses.

## Let Individuals Choose

There is a moral case for the flat tax because the flat tax is fundamentally about freedom. I am not talking about the freedom that the great free market economist Ludwig von Mises condemned as

the freedom to "let soulless forces operate." That is not freedom at all; that is just tyranny in another guise. Rather, I am talking about the freedom to "let individuals choose."

Time and time again, the evidence has shown that the federal government cannot preserve our families, reawaken our faith, restore our values, solve our social problems, or create prosperity. Only free individuals can. ▲



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## "The Future of American Business"

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May 1996



*Former Secretary of Education Bill Bennett spoke about the vital connection between public virtue and the marketplace.*



*Mrs. Virginia Townley was recognized as the founder of the Thomas Lewis Latane Temple Tradition Award that provides scholarships for numerous Hillsdale College students.*



*Center for Equal Opportunity President Linda Chavez spoke about the true victims of discrimination.*



*Edward Lowe Foundation President, Chairman, and CEO Darlene Lowe with Forbes Editor-in-Chief Steve Forbes*



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