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### A Taxing Dilemma

By Bruce Bartlett

Lately I have irked some fellow conservatives by attacking the idea that a national retail sales tax can replace our current federal tax system, while at the same time endorsing a value-added tax as a new tax on top of our current system. To many of my friends, it looks as if I have switched sides. For their benefit, I would like to explain myself and assure them that I am still a conservative in good standing.

On tax reform, I have been a supporter of the flat tax ever since I read the first article about it by Hoover Institution scholars Robert Hall and Alvin Rabushka in the Wall Street Journal on December 10, 1981. In fact, while on the staff of the Joint Economic Committee, I organized the first congressional hearing on

the flat tax in 1982.

Over the years, my support for the Hall-Rabushka plan has only grown. In particular, I think the way it defines the tax base is elegant and ingenious. It is, in my view, far more important to get the tax base straightened out -- avoid double taxation, stop taxing things that ought not to be taxed, start taxing things that should be taxed -- than it is to just have a single tax rate.

While there would be some gain to having a flat rate with our current tax system, most of the benefits of Hall-Rabushka come from its changes to the tax base. In essence, all saving and investment would be removed in the Hall-Rabushka plan. Since there are only two things that can be done with income -- it

can be saved or spent -- eliminating the taxation of saving necessarily leaves a tax that falls only on consumption.

In this respect, I agree with supporters of a national retail sales tax. We should have a tax system that taxes only consumption. My objection to the national retail sales tax is that it would tax consumption in a way that just won't work administratively. One might as well replace the tax system with voluntary contributions to the government. It's a nice idea, but utterly unworkable. By contrast, I think Hall-Rabushka would work if it could be implemented. One reason is that the business side of the plan is a type of VAT, a proven revenue-raiser.

Sadly, I have become very

pessimistic about the possibility of fundamental tax reform -- either the flat tax or any other plan that would completely uproot the current system and impose something entirely new from scratch. It just isn't going to happen politically. Those who benefit from the current system are too powerful and there is no way of cementing any new system in place to avoid it from being corrupted in the future.

In 1986, we got as close as we ever will to a flat tax when the top rate was reduced to 28 percent in return for eliminating many deductions and preferences from the tax code. But just four years later, the first President Bush double-crossed taxpayers by raising the top rate to 31 percent without restoring the lost deductions. This paved the way for Bill Clinton to raise the top rate further to 39.6 percent. This betrayal has, I believe, doomed fundamental tax reform for the foreseeable future.

I now believe that the best we can hope to do is make incremental improvements to the existing tax system and hopefully prevent it

from getting worse. Unfortunately, because the current President Bush and the Republican Congress have allowed spending to get totally out of control, I believe that higher taxes are inevitable. In particular, the enactment of a massive new Medicare drug benefit absolutely guarantees that taxes will be sharply raised in the future even if Social Security is successfully reformed.

Too many conservatives delude themselves that all we have to do is cut foreign aid and pork-barrel spending and the budget will be balanced. But unless Republican lawmakers are willing to seriously confront Medicare, they cannot do more than nibble around the edges. With Republicans having recently added massively to that problem, and with a Republican president who won't veto anything, I have concluded that meaningful spending control is a hopeless cause.

Therefore, we must face the reality that taxes are going to rise a lot in coming years. I believe that a VAT is the least bad way of getting the hundreds of billions of dollars per year that will be needed. The alternative is

higher tax rates that will be far more debilitating to economic growth.

If we end up with a VAT, the fault will not be mine. The blame will go to those Republicans who created an extraordinarily expensive new entitlement program just to buy a few lousy votes. It is they who will bear the ultimate responsibility when financial markets demand that deficit reduction be once again the order of the day and tax increases become mandatory.

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