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### The Tax Structure

By Bruce Bartlett

The other day I was at a meeting of conservative activists and a young woman addressed the group asking for support in opposing plans to tax cosmetic surgery. Assuming taxes have to be raised somehow, taxing cosmetic surgery sounded like a pretty good idea to me -- the tax is essentially voluntary and falls mainly on the well-to-do. But everyone else in the room agreed that it would be a travesty to tax fake boobs.

It occurred to me that conservatives have increasingly become just like liberals on tax policy in an important philosophical way. Neither liberals nor conservatives really care about the structure of taxation any more. Liberals support every tax without

reservation and conservatives oppose every tax just as dogmatically.

When I first became involved with tax policy back in the 1970s, while working for then-congressman Jack Kemp, things were different. We wanted to cut taxes, of course, but we were just as concerned about the tax structure as we were about the level of taxation. Whenever I would talk about cutting taxes, Jack would sternly correct me and say that we were cutting tax rates, not "taxes."

He was right. It was important to maintain control of the rhetoric in order to prevent our effort from veering off into the wrong direction. Our goal

was to cut marginal tax rates because we firmly believed that this would provide the greatest economic boost to the economy. And we knew that other types of tax cuts would not only have no economic benefit, but could actually be economically harmful.

Ideally, we wanted a tax system that was as close to neutral as possible. That is, we wanted people to make economic decisions based on market forces, not because of some provision in the tax law. In this respect, tax subsidies were as bad as tax penalties. Both caused economic activity to deviate from what would exist in a free market, thus creating inefficiency and reducing growth.

The biggest problem we had was convincing economists that the tax structure mattered for growth. At that time, most economists followed Keynesian economics, which said that the only way taxes affected growth was through their impact on disposable income. In the Keynesian model, all that mattered was spending. Incentives were of no importance. Consequently, to Keynesians, a 20 percent tax rate and a 100 percent tax rate with an 80 percent rebate would have exactly the same economic effects.

Because they saw the world this way, Keynesians saw no particular benefit in cutting tax rates even when they went as high as 91 percent, as they did in the 1950s. If the government wanted to stimulate growth, it would make more sense to raise government spending. For this reason, some liberal economists actively opposed the Kennedy tax cut in 1963. John Kenneth Galbraith, for one, wanted spending increased instead.

We believed that how the government raised taxes was as important as the amount that it took out of

our pockets. Some taxes hurt growth a lot, others had very little effect. We held that we should strive for a tax system that taxes least those factors that can most easily escape taxation and taxes most heavily those factors that are least able to escape taxation.

Unfortunately, this lesson has been lost among most conservatives these days. Just like the Keynesians of old, the Right today sees no difference between one tax and another. All tax cuts are equally good and all tax increases are equally bad, goes the thinking. The result has been that wrong-headed but politically popular tax cuts like the child credit have been enacted at the expense of more economically beneficial tax-rate cuts. These wrong-headed tax cuts have also made it extraordinarily difficult to enact fundamental tax reforms like the flat tax.

As the Tax Reform Commission is in the process of discovering, implementation of a flat tax must contend with the fact that things like the child credit would have to be eliminated to really clean up the tax code. But the

popularity of the credit makes this politically impossible. In short, the Republican tax cuts over the last four years have effectively taken fundamental tax reform off the table for good.

I still think it would be highly desirable to have a flat tax. But I see no way of getting there without raising taxes on many poor and middle class people, even with a low rate and a high exemption. Millions of people now get tax rebates from the earned income tax credit even though they don't pay any income taxes, so imposing a zero tax rate on such people would constitute a de facto tax increase. This just isn't going to happen.

Until Republicans learn that not all taxes or tax cuts are created equal, we will continue to have a dysfunctional tax system.

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