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*Symposium: Lingering Tax Issues for the Twenty-First Century*

# The Vanishing Case For Flat Tax Reform: Growth, Inequality, Saving, And Simplification

Stephen B. Cohen

# Articles

# THE VANISHING CASE FOR FLAT TAX REFORM: GROWTH, INEQUALITY, SAVING, AND SIMPLIFICATION

**Stephen B. Cohen***

## I. INTRODUCTION

The Flat Tax has seized the public's attention, dominated our discourse on tax policy,[1] been a major issue in recent national elections,[2] and inspired most tax reform plans currently before Congress.[3] The so-called "Flat Tax" is in reality a tax on consumption at a flat 19% rate.[4] It

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[1] *See, e.g.*, Jane G. Gravelle, *The Flat Tax and Other Proposals: Who Will Bear the Tax Burden*, 69 TAX NOTES 1517 (1995); STAFF OF THE JOINT COMM. ON TAXATION, 104TH CONG., DESCRIPTION AND ANALYSIS OF PROPOSALS TO REPLACE THE FEDERAL INCOME TAX, (Jt. Comm. Print 1995) *reprinted in* Daily Tax Congressional Documents, June 6, 1995, at 3607.

[2] *See* Marvin A. Chirelstein, *The Flat Tax Proposal—Will Voters Understand the Issues*, 2 GREEN BAG 2d 147 (1999).

[3] *See* Michael Calegari, *Flat Taxes and Effective Tax Planning*, 51 NAT'L. TAX J. 711 n.3 (1998).

[4] For an excellent discussion of why the Flat Tax is essentially the same as a sales tax imposed on consumer purchases, see generally Chirelstein, *supra* note 2. As a formal matter, the Flat Tax is imposed at two levels. Business firms are taxed on receipts with deductions for purchases from other firms and for wages. Workers are taxed on wages in excess of personal and dependency exemptions. The equivalence of the Flat Tax and a tax on consumption can be demonstrated in at least two different ways.

A consumption tax can be imposed either by a retail sales tax or by taxing the value added by business firms at each stage of production. Under the value-added tax, each firm is taxed on its receipts with a deduction for purchases from other firms. A sale from one firm to another firm produces zero net revenue, because the inclusion of the proceeds by the seller is offset by the deduction of the proceeds by the buyer. Net revenue is collected only when a firm makes a sale to a consumer so that the inclusion of the proceeds by the seller is not offset by a deduction for the buyer. Therefore, the value-added tax is a tax on consumption. *See* STAFF OF THE JOINT COMM. ON TAXATION, *supra* note 1, at 17.

While the value-added tax is imposed only on firms, the Flat Tax is imposed on both firms and workers. Under the Flat Tax, each firm is taxed on its receipts with deductions not only for purchases from other businesses, but also for wages. Workers are then taxed on their wages. The overall tax base for firms and workers combined is therefore receipts of firms minus purchases from firms, the same as under the value added tax. Unlike the value-added tax, the Flat Tax attributes wages to individuals rather than to firms in order

was proposed by two Stanford University economists, Robert E. Hall and Alvin Rabushka.[5]

In 1983, Hall and Rabushka made a grim diagnosis:

> The U.S. economy is in terrible shape. Output has stagnated and unemployment threatens to linger indefinitely at 9 percent or higher. The stock market is at depression levels. Productivity is declining, an alarming reversal of its steady annual growth at 2 to 3 percent in earlier decades.[6]
>
> [T]he economy languishes in periodic recession, buffeted by high interest rates, high unemployment, depressed

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to provide an exemption for wages based on the wage earner's personal filing status and number of dependants. The Flat Tax is therefore a value-added tax under which workers receive personal and dependency exemptions. *See* Chirelstein, *supra* note 2, at 150-54.

The equivalence of the Flat Tax and a consumption tax can also be demonstrated from the tautology that the uses of income must equal the sources of income. Income has two uses, consumption and investment, and two sources, labor and capital. Thus, consumption plus investment equals labor income plus capital income. Subtracting investment from both sides of the equation produces the result that consumption equals labor income plus capital income minus investment. "One can now see why the Flat Tax is a consumption tax. In the aggregate, it taxes wages [labor income] (to individuals), and it taxes capital income minus investment (or savings) [to] firms." Gravelle, *supra* note 1, at 1519.

Gravelle notes that the actual construction of the Flat Tax tends to conceal its true nature. *See id.* "[T]his splitting and collection of the tax in pieces causes the tax not to look like a consumption tax to any particular taxpayer." *Id.* at 1519. "[T]he Flat Tax, the Value Added Tax, and the Sales Tax are essentially one and the same. Knowing that the term 'Sales Tax' has a most unpleasant ring to it, [Stephen] Forbes, [Jack] Kemp, [Richard] Armey, and other Flat Tax proponents tend to keep that fact to themselves." Chirelstein, *supra* note 2, at 150.

In a collection of essays on the Flat Tax published in 1996, Hall and Rabushka did acknowledge the equivalence of their Flat Tax with a value-added tax on consumption.

> Our proposal is based squarely on the principle of consumption taxation. To make consumption the base upon which the tax is calculated, we use the tested principle of taxing value added with a deduction for investment spending and family allowances to insure progressivity. The effect of our proposed tax is the same as a tax on retail sales of consumption goods but, with personal deductions added...

Robert E. Hall & Alvin Rabushka, *Putting the Flat Tax in Action, in* FAIRNESS AND EFFICIENCY IN THE FLAT TAX 4-5 (1996).

[5] *See* ROBERT E. HALL & ALVIN RABUSHKA, LOW TAX, SIMPLE TAX, FLAT TAX 1 (1983).

[6] *Id.* at 1.

> stock and bond markets, and falling real earnings for workers.[7]

Moreover, they warned, the U.S. economy would continue to perform abysmally unless their Flat Tax (or something like it) was adopted.

> The federal tax system deserves an important part of the blame for this mess.... Nothing less than a total overhaul of taxes is required.... A properly designed Flat Tax is just what we need to put the economy back on track.[8]

In 1983, Hall and Rabushka also made an important concession: that in the short-run, their Flat Tax would lower taxes on the rich and raise taxes for everyone else.

> The [flat] tax is not immediately a good deal for most Americans.[9]

> The immediate impact of [our] reform is to reduce taxes on the top earners and raise taxes on the average earner.[10]

> Tax reform would raise taxes by 3 to 5 percent of income from the lowest income groups up to those with incomes of $21,000. Then the effect would gradually die out, so that families with incomes of around $60,000 would come out even. Then the truly successful get a better and better deal. Families with incomes around $130,000 receive tax breaks of about 7 percent of income, those with incomes of $700,000 get 10 percent, and the handful with incomes approaching $2,000,000 get 13 percent.[11]

Hall and Rabushka forecast, however, that the incomes of the middle and lower classes would increase by more than enough to offset their larger tax burden.

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[7] *Id.* at 2.
[8] *Id.* at 1.
[9] HALL & RABUSHKA, *supra* note 5, at 53.
[10] *Id.* at 1.
[11] *Id.* at 59.

> [A]ll income groups will be better off...from the beneficial impact our flat-tax plan will have on the performance of the economy.[12]
>
> [I]t won't take too long for the taxpayers who lose at the outset to come out ahead. The worst immediate impact of the flat tax is to reduce after-tax income by 5 percent; as soon as the economy has grown by an extra 5 percent thanks to tax reform, those families will be back where they were. As growth continues, they will ultimately come out at least 4 percent ahead.[13]

The principal objection to the Flat Tax remains the same today as in 1983. In the short run, the Flat Tax decreases the tax burden on the upper classes and increases taxes for everyone else. In 1995, Hall and Rabushka, abandoning their earlier concession, asserted that their Flat Tax would not raise taxes on the lower classes and that its effect on the upper and middle classes was largely indeterminate.[14] However, nearly every other study finds that the immediate impact of the Flat Tax would be to dramatically shift tax burdens from the rich to the middle and lower classes.[15]

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[12] HALL & RABUSHKA, *supra* note 5, at 26.

[13] *Id.* at 60. Hall and Rabushka also sounded notes of caution:

> Unless the tax improves the performance of the economy, it will let a minority of high-income families off the hook for the very high taxes they are now paying and finance the move by slightly raising everybody else's taxes.

*Id.* at 53.

> Until a response to improved incentives takes place, it is an obvious mathematical law that lower taxes on the successful will have to be made up by higher taxes on average people.

*Id.* at 58

[14] *See* ROBERT E. HALL & ALVIN RABUSHKA, THE FLAT TAX 90-93 (2d ed. 1995).

[15] Precisely how the Flat Tax would change tax burdens in the short-run depends on the level of the flat rate and the size of personal and dependency exemptions. In 1995, Representative Richard Armey and Senator Richard Shelby submitted bills to implement the Hall-Rabushka Flat Tax with a 17% flat rate and personal exemptions of $21,400 for a married couple, $14,000 for a head of household, $10,700 for a single taxpayer, plus an additional $5,000 exemption for each dependent. *See* H.R. 2060, 104th Cong. (1995); S. 1050, 104th Cong. (1995).

The Treasury Office of Tax Analysis studied the effect of the Armey-Shelby proposal on tax burdens. It calculated that, in order for the Flat Tax to be revenue-neutral (that is, not to cause tax revenues to fall), either the flat rate would have to be modified to rise to 20.8% or the personal exemptions would have to fall by more than half. With either of the changes necessary for revenue neutrality, the Treasury estimated that after-tax incomes

Consequently, Flat Tax supporters must make a controversial claim to demonstrate a net improvement in the economic position of the middle and lower classes: that the Flat Tax will cause enough economic

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would rise for families with before-tax incomes over $200,000 and fall for families with incomes under before-tax incomes under $200,000. *See 'New' Armey-Shelby Flat Tax Would Still Lose Money, Treasury Finds*, 70 TAX NOTES 451 (1996).

A study published by the Brookings Institution reached similar results.

> Our analysis shows that the most prominent tax reform proposal—the flat tax—sharply lowers tax burdens on the top 1 percent of taxpayers. The rich pay less under the flat tax because its rate is well below the current average effective corporate and individual income tax rate for high-income families. The flat tax increases taxes on low-income families, largely because it eliminates the earned income tax credit. Taxes change little on average for families in the fiftieth to the ninety-ninth percentiles of the income distribution because elimination of deductions for charitable contributions and mortgage interest offset reduced rates and increased exemptions.

William G. Gale et. al., *Distributional Effects of Fundamental Tax Reform, in* ECONOMIC EFFECTS OF FUNDAMENTAL TAX REFORM 281, 283 (Henry J. Aaron & William G. Gale eds., 1996).

A more recent study also reached essentially similar conclusions, which did not vary under a variety of different assumptions concerning tax incidence, implementation, and compliance.

> Switching to the Flat Tax would increase the tax burdens of a majority of taxpayers, and it would significantly redistribute tax burdens, mainly from the top decile to other taxpayers....
>
> Adopting the...Flat Tax would decrease the marginal tax rate for higher income taxpayers, and it would tax capital income more lightly and labor income more heavily than the present system. The result would be a redistribution of tax burdens from recipients of capital income and higher income taxpayers to recipients of labor income and lower income taxpayers, with gains being concentrated in the top decile.

Amy Dunbar & Thomas Pogue, *Estimating Flat Tax Incidence and Yield: A Sensitivity Analysis*, 51 NAT'L. TAX J. 303, 321 (1998).

In the first edition of their book, published in 1983, Hall and Rabushka proposed a 19% flat rate with personal exemptions of $6,200 for a married couple filing jointly, $5,600 for a head of household, $3,800 for a single taxpayer, plus an additional $750 exemption for each dependent. *See* HALL & RABUSHKA, *supra* note 5, at 35. At that time, they conceded that their proposal would decrease taxes on the rich and increase taxes on everyone else. *See supra* notes 5-7 and accompanying text.

In the second edition of their Flat Tax book, published twelve years later, Hall and Rabushka continued to advocate a 19% flat rate, but proposed personal exemptions of $16,500 for married couples filing jointly, $14,000 for heads of households, and $9,500 for single taxpayers; and a dependency exemption of $4,500. *See* HALL & RABUSHKA, *supra* note 14, at 59. They asserted that this second version of the Flat Tax would not increase taxes on the lower and middle classes. *Id.* at 90-93. This assertion is contradicted by the other studies discussed above.

growth to raise incomes of the middle and lower classes by more than the increased taxes that the Flat Tax would require them to pay.

However, the actual performance of the U.S. economy since 1983 has seriously undermined this claim in two critical respects. First, despite the progressive rate income tax, there has been substantial economic progress, including the longest period of sustained peacetime growth in our history and the lowest rates of unemployment and inflation in decades.[16] Had the Flat Tax been enacted, it is doubtful that it could have stimulated much more growth than in fact occurred.

Second, during the past fifteen years, economic growth has not benefited all economic classes to the same degree. The upper classes have reaped most of the gains. The rising tide has lifted the biggest boats much more than all others.[17] As a consequence, economic inequality has increased. (Had the Flat Tax been in effect, reducing taxes on the rich and raising taxes on everyone else, economic inequality would probably have increased even more than it actually has.) This history of growing inequality suggests that, even in the unlikely event that the Flat Tax had generated significant extra growth, it is doubtful that middle and lower class incomes would have risen enough to offset the higher burden that the Flat Tax would have imposed on them.

To illustrate, assume that middle and lower class incomes need to rise by 6% to offset their higher taxes under the Flat Tax. If the Flat Tax caused a 6% rise in national economic output, then middle and lower classes would be no worse off, provided that their incomes also increased by at least 6%. But suppose that their incomes went up by less than the overall growth rate, as has been the case over the past fifteen years with increasing economic inequality. Even a generous 6% rise in the national economy would fail to make the middle and lower classes no worse off than before, given the unequal distribution of the benefits of growth. The national economy would have to grow by more than 6% for middle and lower class incomes to rise by the 6% required to offset the Flat Tax's immediate negative impact.

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[16] *See* U.S. President, ECON. REP. OF THE PRES. 19 (1999) [hereinafter ECON. REP. OF THE PRES.].

[17] In Frankfurt, Germany, President John F. Kennedy said, "As they say on my own Cape Cod, a rising tide lifts all the boats." President's Address in the Assembly Hall at the Paulskirche in Frankfurt, PUB. PAPERS 519 (June 25, 1963).

Moreover, any increase in incomes resulting from growth could hardly occur instantaneously. One recent study calculated that middle and lower class incomes would have to increase instantaneously by over 6% to offset the Flat Tax's immediate negative impact and by even more if the increase were delayed:

> [I]ncomes would have to increase about 6.4 percent to offset the...increase in tax burdens of the taxpayers who would lose from the switch to the flat tax. That is, if their incomes were to increase 6.4 percent the instant a flat tax was instituted, these taxpayers would as a group break even. Of course, any increase in income attributable to a change in tax systems would not materialize instantaneously; instead years would pass before favorable growth effects would be fully realized. Because of this delay, the ultimate increase in income would have to be considerably larger than 6.4 percent to offset the losses of taxpayers who would face tax increases under the flat tax. It therefore seems unlikely that losing taxpayers would as a group see their incomes grow enough to offset their higher tax payments.[18]

Of course, observing that the middle and lower classes would probably be worse off had the Flat Tax been enacted in 1983 does not mean that the Flat Tax would definitely have that same effect today. The past is not necessarily prologue, especially in economics. Nevertheless, the past record of significant economic growth but increasing economic inequality cautions us to view skeptically predictions that the Flat Tax would benefit the middle and lower classes.

Flat Tax supporters also cite the need to increase the savings rate, which has declined steadily since the 1950s and is now at the lowest level

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[18] Dunbar & Pogue, *supra* note 15, at 324. An earlier study reached the contrary conclusion that the Flat Tax would, in the long run, make all economic classes better off. *See generally* David Altig et al., *Simulating U.S. Tax Reform* (1997) (unpublished paper on file with author). Their econometric model assumes that all wages grow at the same rate. If the model incorporated a different assumption, namely that that upper class wages grow at a faster rate than middle and lower class wages, it would be less likely to predict that the Flat Tax would leave middle and lower classes better off. Conversations with Alan Auerbach, March 6-9, 1999. The latter assumption appears more consistent with trends in wages since 1983. *See, e.g.*, FRANK LEVY, THE NEW DOLLARS AND DREAMS 57-65 (1998).

in half a century or more.[19] By taxing consumption but exempting savings, the Flat Tax would raise tax incentives for saving. Individuals, it is assumed, would then respond to these incentives by saving more and consuming less, generating higher growth over the long run.[20]

However, it is uncertain how much *voluntary* saving would actually grow in response to greater tax incentives or even if it would grow at all. Moreover, the Flat Tax would eliminate the existing incentive for employers to establish qualified pension plans, which *compel* tens of millions of workers to save rather than to consume whether they would voluntarily choose to save or not. The Flat Tax would also probably include the repeal of withdrawal restrictions for existing retirement savings that compel saving. It cannot be determined *a priori* whether the response to increased incentives for voluntary saving (even if positive) would more than offset the effect of eliminating these features of current law that in effect force workers to save.

A further argument for the Flat Tax, perhaps the most politically appealing, is simplification. Hall and Rabushka promised to eliminate the "annual ordeal of tax preparation."[21] The Flat Tax would permit "tax returns...simple enough to fit on postcards"[22] in place of "tax forms...so complicated that it has become increasingly difficult just to calculate correctly taxes owed to the government."[23] Hall and Rabushka almost certainly exaggerated the simplification advantages of the Flat Tax.[24] Moreover, it is possible to achieve many of the real simplification benefits of the Flat Tax by reforming the existing tax on income at progressive rates.

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[19] *See* Eric M. Engen & William G. Gale, *The Effects of Fundamental Tax Reform on Saving, in* ECONOMIC EFFECTS OF FUNDAMENTAL TAX REFORM 83 (Henry J. Aaron & William G. Gale eds., 1996).

[20] *See* HALL & RABUSHKA, *supra note* 5, at 48.

[21] *Id.* at 5.

[22] *Id.* at 32.

[23] *Id.* at 4.

[24] *See* Calegari, *supra* note 3, at 689; Ronald A. Pearlman, *Transition Issues in Moving to a Consumption Tax: A Tax Lawyer's Perspective, in* ECONOMIC EFFECTS OF FUNDAMENTAL TAX REFORM 393 (Henry J. Aaron & William G. Gale eds., 1996); David A. Weisbach, *Implementing the Flat Tax* (1999) (unpublished paper on file with author). For an excellent discussion of the difficulties of implementing another proposed consumption tax, the so-called Nunn-Domenici USA Tax, see Martin D. Ginsburg, *Life Under a Personal Consumption Tax: Some Thoughts on Working, Saving, and Consuming in Nunn-Domenici's Tax World*, 48 NAT'L. TAX J. 585 (1996).

Part II of this essay summarizes the record of overall U.S. economic performance since 1983 when Hall and Rabushka originally proposed the Flat Tax. Part III examines in detail the evidence of growing economic inequality over this same period. Part IV discusses whether saving would increase if the Flat Tax replaced the existing income tax. Part V describes how the income tax might be simplified without flattening rates or using consumption (rather than income) as the base for taxation.

## II. OVERALL U.S. ECONOMIC PERFORMANCE: 1983-1998

In 1983, Hall and Rabushka bemoaned an "economy languish[ing] in periodic recession" with "high unemployment," "depressed stock markets," "high interest rates," "falling real earnings," and "declining productivity."[25] They prophesied that without radical revision of the federal tax system along the lines of their proposed flat rate tax on consumption, economic stagnation would continue.[26]

Fortunately, this doomsday scenario did not materialize. Consider the following eight indicators of overall economic performance during the 1983-1998 period: gross domestic product, disposable income per capita, unemployment rate, civilian employment to population ratio, the stock market, interest rates, inflation, and productivity.

1) The gross domestic product, which measures the economy's total output of goods and services, increased in real terms from $4.849 to $7.567 trillion, an annual growth rate of 3.0%.[27] Growth occurred in all but one of the past 15 years.[28]

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[25] HALL & RABUSHKA, *supra* note 5, at 1-2.

[26] *See id.* at 1, 55.

[27] *See* U.S. Dept. of Comm., *Table 2A-Real Gross Domestic Product*, SURV. OF CURRENT BUS., May 1997, at 14; U.S. Dept. of Comm., Bureau of Econ. Analysis, *Gross Domestic Product: Third Quarter 1998 (Final)* (visited Feb. 18, 1999) <http://www.bea.doc.gov/bea/newsrel/gdp398f.htm >. The $4.849 trillion figure is for the third quarter of 1983. The $7.567 trillion figure is for the third quarter of 1998. *Id.* All figures are in constant 1992 dollars. The annual rate of growth was derived by the author from these figures by assuming continuous compounding over the fifteen-year period. *Id.*

[28] *Id.*

2) Real disposable income per capita rose by about one-third, from $15,332 in 1983 to over $20,000 in 1997.[29]

3) The unemployment rate fell from 10.4% in 1983 to 4.3% at the end of 1998.[30]

4) The ratio of civilian employment to the population rose from 58.8% to 64.2%.[31]

5) Stock market prices, no longer "depressed," reached record levels. The Standard and Poor 500 Average increased from 141 to 1229. The Dow-Jones Industrial Average rose from 1096 to 9181.[32]

6) Interest rates declined dramatically from 1983 levels. For example, the federal funds rate, the interest rate charged banks for the overnight use of federal funds, was over 9% in 1983 and nearly 10¼% in 1984.[33] This rate then began to fall and, although later rising and then falling, has remained substantially below 6% since 1991.[34]

7) Inflation moderated. The consumer price index (CPI) rose by 13.5% in 1980, by 10.5% in 1981, and by 6.2% in 1982.[35] Since 1983, the

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[29] *See* Table B-31-Total Per Capita Disposable Personal Income and Personal Consumption Expenditures in Current and Real Dollars, 1959-97. U.S. President, ECON. REP. OF THE PRES. 317 (1998) [hereinafter ECON. REP. OF THE PRES. II]. The figures are in constant 1992 dollars.

[30] *See* U.S. Dept. of Labor, *Bureau of Labor Statistics' Most Requested Series* (visited Jan. 14, 1999) <http://stats.bls.gov/top20.html> (data generated by author).

[31] *Id.*

[32] These are end-of-the-year figures, showing the increase from 1983 to 1998. The figures are given in current indexes and are therefore not inflation-adjusted. All figures for the Standard and Poor 500 average and the 1998 figures for the Dow-Jones Industrial Average were compiled from the edition of *The New York Times* published the day after the last business day of the calendar year. The other figures for the Dow-Jones Industrial Average were compiled as follows: for 1997, from U.S. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES, Table no. 836 (1998); for 1990-96, from U.S. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES, Table no. 813 (1997); for 1989, from U.S. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES, Table no. 808 (1992); for 1983-88, from U.S. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES, Table no. 837 (1990).

[33] *See* Federal Reserve Board, *Federal Reserve Statistical Release: Selected Interest Rates* (visited Jan. 11, 1999) <http://www.federalreserve.gov/releases/H15/19990111>.

[34] *See id.*

[35] *See* Table B-63–Changes in Special Consumer Price Indexes, 1960-97. ECON. REP. OF THE PRES. II, *supra* note 29, at 353.

CPI has increased by more than 5% in only one year, 1989.[36] Since 1992, the annual increase in the CPI has been 3% or less.[37]

8) Manufacturing productivity increased on average by an annual rate of more than 3%, and overall business productivity grew by about 1.5% annually.[38]

Admittedly, economic growth was not uniform during this entire 1983-1998 period. For example, the gross domestic product declined slightly from 1990 to 1991,[39] and the unemployment rate rose in 1991 and 1992.[40] In addition, the economy did not grow as quickly as during the two decades immediately following World War II, when the Gross Domestic Product increased at an annual rate of about 4%.[41]

It is possible that the adoption of a Flat Tax might have stimulated even greater growth during the 1983-1998 period, comparable to the more rapid increase in gross domestic product that occurred from 1945 to 1965. However, economic conditions were vastly different during the two decades immediately following World War II. In particular, U.S. business did not face intense international competition in a global economy. Moreover, it is doubtful that the Federal Reserve Board, which sets monetary policy, would have permitted faster growth than actually occurred in the 1980s and 1990s, given its emphasis during this period on moderating growth in order to reduce inflation.[42]

It is instructive to compare Hall and Rabushka's gloomy assessment of the U.S. economy in 1983 with the more favorable view of the President's Council of Economic Advisors in its Economic Report of the President for 1999.

> Real output increased [at a rate of] 3.7 percent.... Nonagricultural jobs increased by about 2.9 million during the year, and the average unemployment rate for the year dropped to 4.5 percent, the lowest level since 1969. The consumer price index rose by only 1.6

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[36] *See id.*
[37] *See id.*
[38] *See* U.S. Dept. of Labor, *supra* note 30. Productivity is measured by output per hour.
[39] *See* U.S. Dept. of Comm., *supra* note 27.
[40] *See* U.S. Dept. of Labor, *supra* note 30.
[41] *See* U.S. Dept. of Comm., *supra* note 27.
[42] *See, e.g.*, Richard W. Stevenson, *Inflation Whimpers, What's Next for Fed?, New Stresses at Home and Abroad*, N.Y. TIMES, Jan. 31, 1998, at D3.

> percent, its second smallest increase since 1964, and other measures of inflation were even more muted.[43]
>
> [E]conomic policies...have sustained what is now the longest peacetime expansion on record....
>
> More Americans are working than ever before, the unemployment rate is the lowest in a generation, and inflation remains tame. This record of achievement is especially noteworthy in light of the troubles experienced in the international economy in 1998.... [T]he fundamental soundness of the U.S. economy prevented it from foundering in 1998's storms.[44]

## III. EVIDENCE OF INCREASED ECONOMIC INEQUALITY

Despite the overall performance of the economy, there has been a critical failure. Different economic classes have not shared equally in economic growth. Upper classes have captured most of the benefits, with the result that economic inequality has increased. Part II discusses the evidence of increasing economic inequality during the fifteen-year period from 1983 to 1998. This evidence undermines the claim that the Flat Tax would raise middle and lower class incomes enough to offset the higher taxes that would be imposed.

### *A. Census Bureau Estimates of After-Tax Income*

In principle, differences in income, or income inequality, ought to be judged on the basis of income after taxes rather than before taxes. It is only income after tax that individuals can freely spend. Moreover, income inequality before tax may decrease, remain the same, or increase after tax, depending on whether the tax burden is progressive, proportional, or regressive.

Since 1980, the U.S. Census Bureau has provided estimates of after-tax income.[45] The estimates are based on surveys of 50,000 respondents

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[43] ECON. REP. OF THE PRES., *supra* note 16, at 45.
[44] *Id.* at 19.
[45] *See* U.S. Census Bureau, *Table RDI-3: Share of Aggregate Before and After Tax Income Received by Each Fifth and Top 5 Percent of Households: 1980 to 1997*, CURRENT POPULATION SURV. (visited Feb. 19, 1999) <http://www.census.gov/hhes/income/histinc/rdi03.html>.

conducted every March.[46] After-tax income is determined on the basis of the household, defined as including "all people who occupy a housing unit," whether related or unrelated.[47] Income is defined to encompass a wide variety of cash receipts (many of which are not subject to federal income tax) including the following:

Earnings
Unemployment compensation
Workers' compensation
Social security
Supplemental security income
Public assistance
Veterans' payments
Survivor benefits
Disability benefits
Pension or retirement income
Interest
Dividends
Rents, royalties, and estates and trusts
Educational assistance
Alimony
Child support
Financial assistance from outside of the household[48]

The taxes subtracted from before-tax income to arrive at an after-tax income figure include federal and state income taxes, FICA payroll taxes, and state and local real property taxes.[49]

1. After-Tax Income Shares: 1983-1997

Using this data, the Census Bureau estimates the shares (that is, proportions) of total after-tax income held by each of five percentile ranges of households ranked in ascending order from those with the

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[46] *See* U.S. Census Bureau, *Overview*, CURRENT POPULATION SURV. (visited Feb. 15, 1999) <http://www.bls.census.gov/cps/overmain.htm>.
[47] *See* U.S. Census Bureau, *Historical Income Tables—Definitions: Household*, CURRENT POPULATION SURV. (visited Feb. 19, 1999) <http://www.census.gov/hhes/income/defs/household.html>.
[48] *See* U.S. Census Bureau, *Historical Income Tables—Definitions: Income*, CURRENT POPULATION SURV. (visited Feb. 19, 1999) <http://www.census.gov/hhes/income/defs/income.html>.
[49] *See* U.S. Census Bureau, *supra* note 45.

lowest to the highest incomes.[50] The Bureau also makes an additional calculation of the share of after-tax income held by the 96th to the 100th percentile, the richest 5% of all households.[51] From 1983 to 1997 (the last year for which figures are currently available), the shares of after-tax income received by households in each category decreased or increased as follows:

1st to 20th percentile—decreased by 6% (from 4.7% to 4.4%)
21st to 40th percentile—decreased by 5% (from 11.1% to 10.5%)
41st to 60th percentile—decreased by 6% (from 17.4% to 16.3%)
61st to 80th percentile—decreased by 3% (from 24.8% to 24.0%)
81st to 100th percentile—increased by 6% (from 42.1% to 44.8%)
96th to 100th percentile—increased by 20% (from 15.0% to 18.0%)[52]

The data indicate a significant increase in income inequality. The share of after-tax income received by the richest one-fifth of all households increased, while the shares of after-tax income received by all other household categories declined. At the top of the scale, the share of the richest 5% of households rose the most.

2. Limitations of the Bureau's After-Tax Income Data

The Census Bureau emphasizes several limitations of its measure of after-tax income. First, most noncash benefits are excluded. Thus, neither the value of government goods and services nor imputed income from property is included.[53] Second, capital gains are not counted at all.[54] Third, because the Census Bureau relies on the responses of those surveyed, its income figures are vulnerable to underreporting.

Different deficiencies in the definition and measurement of income have different impacts across income classes. The effect of the exclusion of government goods and services depends on how one believes that government benefits are distributed across income classes.[55] The

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[50] Once the raw data has been assembled, it needs to be organized in order to judge the degree of economic inequality. As a first step, households are arranged in rank order from poorest to richest. This ranking is then divided into equal percentiles. Each percentile's share of society's total income or wealth is then computed. Year-to-year changes in the relative shares of income held by different percentiles can then be observed.

[51] *See* U.S. Census Bureau, *supra* note 45.

[52] *See id.*

[53] *See* U.S. Census Bureau, *supra* note 48.

[54] *See* U.S. Census Bureau, *supra* notes 45 and 48.

[55] The U.S. Census Bureau asserts that this exclusion benefits primarily the lower classes, who receive most direct government goods and services. *See id.* This assertion appears to

exclusion of imputed income from property and of capital gains will tend to understate the position of upper income groups the most. So will the exclusion of unreported income, which consists mostly of income from property and is therefore concentrated among the upper classes.[56]

In the aggregate, these biases may cause the degree of economic inequality to be overstated or understated for any given year. Nevertheless, if the biases have not had significantly different effects from one year to another, then they should not affect conclusions about whether inequality has increased or decreased over time.

However, over the past fifteen years, the effects of excluding government goods and services and capital gains have probably changed. Government programs benefiting the poor, such as welfare, have steadily contracted. With a booming stock market, capital gains, accruing mostly to the upper classes, have increased. An uncounted component of the income of lower classes has declined, while an uncounted component mainly accruing to the upper classes has increased. Therefore, the data on after-tax income shares discussed above probably *understate* the increase in income inequality.

3. Gini Coefficients and Income Definitions

In order to facilitate comparisons of income inequality, economists have devised a single index number, the Gini Coefficient, which provides a summary measure of the degree of economic inequality.[57]

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ignore indirect benefits that may accrue largely to the upper and middle classes. *See* Boris I. Bittker, *Second Lecture, in* CHARLES O. GALVIN & BORIS I. BITTKER, THE INCOME TAX: HOW PROGRESSIVE SHOULD IT BE? 48-50 (1969).

[56] The Census Bureau has concluded, "[b]ased on an analysis of independently derived income estimates...that respondents report income earned from wages or salaries much better than other sources of income and that the reported wage and salary income is nearly equal to independent estimates of aggregate income." U.S. Census Bureau, *supra* note 48.

[57] To derive this figure, economists graph the cumulative percent of the population (the x-axis) against the cumulative percent of the income or wealth held by that percent of the population (the y-axis). To provide a frame of reference, a line is drawn to represent perfect economic equality. Under perfect economic equality, the two percentages would always be equal. 1% of the population would receive 1% of the income, 2% of the population would receive 2% of the income, and so on. Thus, the graph showing perfect economic equality would comprise a straight line drawn at a 45-degree angle. In the real world of economic inequality, the cumulative share of the population is always greater than the share of income that it receives. As a result, the real world line deviates from the diagonal line. The greater the deviation from the diagonal line, the greater the deviation from perfect economic equality. The Gini Coefficient is a mathematical measure of the degree of deviation. *See* RUBEN P. MENDEZ, INTERNATIONAL PUBLIC FINANCE 94-96 (1992).

The Gini Coefficient measures the degree to which the actual distribution of income deviates from perfect income equality. The higher the Gini Coefficient, the greater the deviation from perfect equality and therefore the more unequal the actual distribution of income.

The Census Bureau publishes Gini Coefficients for fifteen alternative definitions of household income.[58] The definitions differ in the degree to which they account for taxes, government transfers, noncash benefits, and imputed income from property.[59] For example, Definition 1 is the least comprehensive. It includes only money income, excluding capital gains, and is calculated before taxes.[60] Definition 15 is the most comprehensive. It includes realized capital gains, noncash government transfers, and imputed income from housing and is calculated after taxes.[61]

For each of the fifteen different income definitions, without exception, the Gini Coefficient rose during the period from 1983 to 1997.[62] For example, the Gini Coefficient for Definition 1 (the least comprehensive) increased from .412 to .438 and for Definition 15 (the most comprehensive) from .368 to .397.[63]

In addition to Gini Coefficients for income for *households*, the Census Bureau calculates Gini Coefficients for before-tax money income (exclusive of capital gains) for *families*.[64] For this purpose, a family is defined as "a group of two or more people related by birth, marriage or adoption who reside together."[65] The Gini Coefficient for family income before-taxes increased from .382 in 1983 to .429 in 1997.[66]

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[58] *See* U.S. Census Bureau, *Table RDI-5: Index of Income Concentration (Gini Index), by Definition of Income: 1979 to 1997*, CURRENT POPULATION SURV. (visited Feb. 19, 1999) <http://www.census.gov/hhes/income/histinc/rdi05.html>.

[59] *See id.*

[60] *See id.*

[61] *See id.*

[62] *See id.*

[63] *See id.*

[64] *See* U.S. Census Bureau, *Table F-4: Gini Coefficients for Families, by Race and Hispanic Origin of Householder: 1947 to 1997*, CURRENT POPULATION SURV. (visited Feb. 19, 1999) <http://www.census.gov/hhes/income/histinc/f04.html>.

[65] *See* U.S. Census Bureau, *Historical Income Tables—Definitions: Family*, CURRENT POPULATION SURV. (visited Feb. 19, 1999) <http://www.census.gov/hhes/income/defs/family.html>.

[66] *See* U.S. Census Bureau, *supra* note 64.

These Gini Coefficients demonstrate that trends in economic inequality are the same for a broad range of different definitions of income. The data all point consistently in the same direction. Whether income is measured before tax or after tax, whether income includes or excludes various kinds of nonmarket items, and whether income is determined on a household or family basis, economic inequality has increased since 1983.

4. Adjusting for Household and Family Size and Income to Poverty Ratios

The Census Bureau data for income shares and Gini coefficients do not take into account the *number of people* residing within the household or family unit. However, smaller units need less income to achieve a given standard of well being. Therefore, if the average size of a household or family varies with the unit's income, the data will either exaggerate or understate the degree of economic inequality for any given year.

For example, suppose that in a given year, wealthy families are larger on average than all other families. The data for that year will exaggerate the relative advantage of the average wealthy family whose income must be shared by more members than in other families. Conversely, suppose that, in a given year, poor families are larger on average than others. The data for that year will understate the relative disadvantage of the average poor family whose income must be shared by more members than in other families.[67]

Provided such differences in average family size do not vary significantly from one year to another, they should not affect conclusions about whether inequality has increased or decreased over time. However, if lower and middle class families are becoming relatively smaller (or larger) than wealthy families, then the data will overstate (or understate) increases in economic inequality.

To correct for differences in family size, the Census Bureau employs yet another measure of economic inequality: the ratio of actual family income to income at the poverty threshold. The poverty thresholds vary

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[67] *See* Appendix K, *in* HOUSE COMM. ON WAYS AND MEANS, 103D CONG., 1ST SESS., OVERVIEW OF ENTITLEMENT PROGRAMS: 1993 GREEN BOOK—BACKGROUND MATERIAL AND DATA ON PROGRAMS WITHIN THE JURSIDICTION OF THE COMM. ON WAYS AND MEANS 1465, 1488-89 (Comm. Print 1993) [Hereinafter Appendix K].

to reflect both the number of family members and economies of scale in supporting those members.[68] The higher the ratio of actual income to the income at the poverty threshold, the greater the family's economic well being. The Census Bureau organizes the data to show the average income to poverty threshold ratios for five different ranges based on percentile rankings.[69] The table below displays the *changes* in such ratios between 1983 and 1997:

1st to 20th percentile—increased by 4.4% (from .91 to .95)
21st to 40th percentile—increased by 11.1% (from 2.07 to 2.30)
41st to 60th percentile—increased by 12.7% (from 3.06 to 3.45)
61st to 80th percentile—increased by 15.7% (from 4.26 to 4.93)
81st to 100th percentile—increased by 40.5% (from 7.13 to 10.02)[70]

According to these figures, the ratio of income to the poverty threshold was higher for all five groups in 1997 than in 1983. However, the ratio increased more for families higher up the income scale. The increase in the ratio for the richest 20% of families was nearly ten times the increase for the poorest 20%. The changes in income to poverty threshold ratios demonstrate that, even when variations in family size are taken into account, economic inequality has significantly increased over the past fifteen years.

5. Concentration at the Very High End

The Census Bureau data do not provide information about the income share at the very high end, which might be defined as the top 1% or those who fall within the 99th to 100th percentile. This information is not available because the Census Bureau records income amounts only up to fixed limits. Income above the limit is recorded simply as being

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[68] *See* Daniel Weinberg, *A Brief Look at Postwar U.S. Income Inequality*, *in* U.S. CENSUS BUREAU, CURRENT POPULATION REPORTS: HOUSEHOLD ECONOMIC STUDIES (visited Apr. 19, 1999) <http://www.census.gov/hhes/income/incineq/p60asc.html>.
The Census Bureau calculates poverty thresholds by using the Economy Food Plan published by the Department of Agriculture. Since a Department of Agriculture survey indicated that families spent about one-third of their income on food, the thresholds were set at three times the cost of the Economy Food Plan. Conversation with Joe Dalaker, Statistician, Poverty and Health Statistics Branch, Housing and Household Economic Statistics Division, U.S. Census Bureau, Feb. 24, 1999.
[69] *See* U.S. Census Bureau, *Table F-18: Average Income-to-Poverty Ratios for Families, by Income, Quintile, Race, and Hispanic Origin of Householder: 1967 to 1997*, CURRENT POPULATION SURV. (visited Feb. 19, 1999) <http://www.census.gov/hhes/income/histinc/f18.html>.
[70] *See id.*

above that amount. For example in 1966, the Census Bureau recorded incomes above $1 million as being $1 million or more.[71]

The Congressional Budget Office (CBO) has estimated the after-tax income share of the top 1% by supplementing the Census Bureau data with Internal Revenue Service statistics on incomes reported on federal tax returns.[72] Although its estimates are based on Census Bureau data, CBO used different assumptions to calculate after-tax income, and the estimates themselves cover a different (although overlapping) period from 1977 to 1990.[73] CBO has calculated that shares of after-tax income received by households in each category decreased or increased as follows:

1st to 20th percentile—decreased by 24.6% (from 5.7% to 4.3%)
21st to 40th percentile—decreased by 13.8% (from 11.6% to 10.0%)
41st to 60th percentile—decreased by 7.4% (from 16.3% to 15.1%)
61st to 80th percentile—decreased by 4.4% (from 22.8% to 21.8%)
81st to 90th percentile—decreased by 3.8% (from 15.6% to 15.0%)
91st to 95th percentile—increased by 2.0% (from 9.8% to 10.0%)
96th to 99th percentile—increased by 9.8% (from 11.2% to 12.3%)
99th to 100th percentile—increased by 67% (from 7.3% to 12.2%).[74]

These data indicate that increases in income shares were concentrated in the very richest families at the very high end. From 1977 to 1990, the after-tax income share of the richest 1% of families went up by a striking 67%, while the share of families in the 96th to 99th percentiles rose by less than 10% and the share of families in the 91st to 95th percentiles by only 2%. Families below the 91st percentile experienced *decreases* in their shares.

Daniel Feenberg and James Poterba have used the Internal Revenue Service data to calculate the before-tax income share of the top one-half of 1%, that is from the 99.5th to 100th percentile. They estimate that this rarified group's share of all adjusted gross income increased from 6% in 1979 to 10.7% in 1994, an increase of 78.3%.[75]

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[71] *See* LEVY, *supra* note 18, at 205.
[72] The CBO estimates are described in Appendix K, *supra* note 67, at 1481-85. *See* Martin J. McMahon, Jr. & Alice G. Abreu, *Winner-Take-All Markets: Easing the Case for Progressive Taxation*, FLA. TAX REV. (forthcoming 1999).
[73] *See* Appendix K, *supra* note 67, at 1483-84.
[74] *See Table 18, in* Appendix K, *supra* note 67, at 1507.
[75] *See* LEVY, *supra* note 18, at 119-20.

Both the CBO and Feenberg-Poterba estimates point to the same conclusion. Increasing income inequality has especially favored those at the very top of the income distribution. In particular, among the top 5% of families, the richer the family, the greater the increase in the family's income share.

6. The 1995-1998 Boom in Stock Prices

During the three-year period from the beginning of 1995 to the end of 1998, stock market prices skyrocketed. The Dow Jones Industrial Average increased by 139% and the Standard and Poor 500 Average by 168%.[76] The estimates of income inequality discussed above largely exclude the effect of this dramatic rise in stock market prices. Even the Census Bureau's most comprehensive definition of income, which counts in kind benefits and realized capital gains, does not include unrealized stock appreciation.[77] Likewise, the Internal Revenue Service statistics likewise include only realized gains and do not reflect increases in individual net worth due to unrealized appreciation.[78]

Joel Slemrod and Jon Bakija have calculated income shares for 1997 to measure the effect of excluding unrealized appreciation in publicly traded stock.[79] Rather than rely on Census Bureau data supplemented by Internal Revenue statistics on reported incomes, they used income data collected by the Federal Reserve Board's triennial Survey of Consumer Finances.[80] The Federal Reserve data has the advantage of recording actual income figures reported by respondents, no matter how high their incomes, rather than recording incomes above a fixed level as simply being above that amount.[81]

Slemrod and Bakija calculated before-tax income shares both excluding and including unrealized appreciation in stock prices. They reported that if income is defined to include unrealized stock appreciation, the reported income shares increase or decrease as follows for 1997:

1st to 20th percentile—decreased by 18.5% (from 2.7% to 2.2%)

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[76] *See supra* note 32.
[77] *See* U.S. Census Bureau, *RDI-5*, *supra* note 58 and text accompanying notes 58-61.
[78] *See* Treas. Reg. § 1.61-6 (1960).
[79] *See* Joel Slemrod & Jon Bakija, *Does Growing Inequality Reduce Tax Progressivity? Should It?* (1999) (unpublished paper on file with author).
[80] *See id.* at 22.
[81] *See id.*

21st to 40th percentile—decreased by 15.2% (from 7.9% to 6.7%)
41st to 60th percentile—decreased by 14.8% (from 13.5% to 11.5%)
61st to 80th percentile—decreased by 9.7% (from 20.7% to 18.7%)
81st to 90th percentile—decreased by 5.8% (from 15.6% to 14.7%)
91st to 95th percentile—increased by 4.7% (from 10.7% to 11.2%)
96th to 99th percentile—increased by 16.4% (from 14.6% to 17.0%)
99th to 100th percentile—increased by 24.5% (from 14.3% to 17.8%).[82]

These data indicate that if unrealized stock appreciation had been counted, income inequality would have appeared to be even greater. This result is not surprising. Stock ownership tends to be concentrated in the upper economic class. When stock prices are rising, excluding unrealized stock gains will understate upper class income the most and thus, in any given year, understate the degree of income inequality.

A separate issue is how excluding stock gains affects the degree to which inequality appears to have increased. For 1995-1998, the annual rate of increase in stock prices was about double that of 1983-1995.[83] Therefore, excluding unrealized appreciation has probably understated the income of the upper classes to a greater degree from 1995 to 1998 than from 1983 to 1995. If this appreciation were taken into account, the upward adjustment in top incomes would be greater for the 1995-1998 period than for the earlier years. In other words, the exclusion of such appreciation from the Census Bureau Data further understates the reported increase in income inequality. If the booming stock market were taken into account, income inequality would appear to have increased even more than the Census Bureau data indicate.[84]

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[82] *See id.* at Table 1.

[83] The Standard and Poor 500 Average rose at an annual rate of 10.7% from 1983 to 1995 and 24.5% from 1995 to 1998. The Dow-Jones Industrial Average rose at an annual rate of 11.8% from 1983 to 1995 and 21.8% from 1995 to 1998. *See supra* note 32.

[84] This is particularly true for the period between 1993 and 1997. According to the Census Bureau data, the entire increase in income inequality during the 1983-1997 period had occurred by 1993. Between 1993 and 1997, the data indicate that the share of after-tax income received by the richest households declined, and the shares of all other households increased slightly or remained steady, as indicated below.

1st to 20th percentile—increased by 2.3% (from 4.3% to 4.4)
21st to 40th percentile—increased by 1.0% (from 10.4% to 10.5%)
41st to 60th percentile—did not change (remained at 16.3%)
61st to 80th percentile—did not change (remained at 24.0%)
81st to 100th percentile—decreased by 4.4% (from 45.0% to 44.8%)
96th to 100th percentile—decreased by 0.6% (from 18.1% to 18.0%)

### 7. Historical Trends in Income Inequality: 1947-1997

To place rising income inequality since 1983 in a broader historical context, it is necessary to rely on data for before-tax *family* income, which the Census Bureau has provided beginning with the year 1947.[85] The Census Bureau began compiling data for before-tax *household* income beginning only with 1967[86] and for after-tax household income beginning only with 1980.[87] As noted above, from 1983 to 1997, changes in before-tax family income inequality closely resembled changes in household income inequality measured by a wide variety of before-tax and after-tax definitions. Therefore, it is plausible to rely on before-tax family income data as a reasonable indicator of historical trends in income inequality.

The data divide into two distinct periods: 1947-1968 and 1968-1997. From 1947 to 1968, there was a more or less steady decrease in income inequality. During this earlier period, shares of before-tax family income changed as follows:

1st to 20th percentile—increased by 10.7% (from 5.0% to 5.6%)
21st to 40th percentile—increased by 2.5% (from 11.9% to 12.4%)
41st to 60th percentile—increased by 4.1% (from 17.0% to 17.7%)
61st to 80th percentile—increased by 2.6% (from 23.1% to 23.7%)
81st to 100th percentile—decreased by 5.8% (from 43.0% to 40.5%)
96th to 100th percentile—decreased by 10.9% (from 17.5% to 15.6%).[88]

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*See* U.S. Census Bureau, *supra* note 45. However, if capital appreciation on stock is taken into account, the apparent declines in the income shares at the top would surely turn into increases, given the concentration of stock ownership among upper income classes. *See* Slemrod & Bakija, *supra* note 79, at 22-26.

[85] *See* U.S. Census Bureau, *History*, CURRENT POPULATION SURV., ANNUAL DEMOGRAPHIC SURVEY (visited Feb. 19, 1999) <http://www.bls.census.gov/cps/ads/shistory.htm>. Starting with 1947, questions were asked about two categories of money income: employment income and income from all other sources. *Id.* The number of questions has now expanded to cover "more than 50 different sources of income, including noncash income sources such as food stamps, school lunch program, employer-provided group health insurance plan, employer-provided pension plan, personal health insurance, Medicaid, Medicare," and other forms of government aid. *Id.*

[86] *See* U.S. Census Bureau, *Table H-2: Share of Aggregate Income Received by Each Fifth and Top 5 Percent of Households (All Races): 1967 to 1997*, CURRENT POPULATION SURV. (visited Feb. 19, 1999) <http://www.census.gov/hhes/income/histinc/h02.html>.

[87] *See* U.S. Census Bureau, *supra* note 45.

[88] *See* U.S. Census Bureau, *Table F-2: Share of Aggregate Income Received by Each Fifth and Top 5 Percent of Families (All Races): 1947 to 1997*, CURRENT POPULATION SURV. (visited Feb. 19, 1999) <http://www.census.gov/hhes/income/histinc/f02.html>.

The shares of income received by the all categories of families below the 80th percentile increased during this 1947-1968 period, with the share received by the poorest 20% increasing the most. The share received by the top 20% of families decreased, with the share received by the richest 5% decreasing even more.

Since 1968, the trend has reversed, with income inequality increasing rather than decreasing. The increase in income inequality from 1983 to 1997, discussed above, is part of this larger trend. From 1968 to 1997, shares of before-tax family income changed as follows:

1st to 20th percentile—decreased by 25.0% (from 5.6% to 4.2%)
21st to 40th percentile—decreased by 20.2% (from 12.4% to 9.9%)
41st to 60th percentile—decreased by 11.3% (from 17.7% to 15.7%)
61st to 80th percentile—decreased by 3.0% (from 23.7% to 23.0%)
81st to 100th percentile—increased by 16.5% (from 40.5% to 47.2%)
96th to 100th percentile—increased by 32.7% (from 15.6% to 20.7%).[89]

The shares of income received by all categories of families below the 80th percentile decreased during the 1968-1997 period, with the share of the poorest 20% decreasing the most. The share of income received by the top 20% of families increased, with the share received by the richest 5% increasing by nearly one-third.

The numbers for the Gini Coefficient indicate the same result of decreasing income inequality from 1947 to 1968, followed by increasing inequality from 1968 to 1997. From 1947, when the Census Bureau first began collecting data, until 1968, the Gini Coefficient for before-tax family income declined more or less steadily from .376 to .348.[90] Since 1968, however, the Gini Coefficient has risen from .348 to .429.[91]

A Census Bureau report described these changes in Gini Coefficients:

> [T]he Gini index...indicated a *decline* in family income *inequality* of 7.4 percent from 1947 to 1968. Since 1968, there has been an *increase* in income inequality, reaching its 1947 level in 1982 and increasing further since then.

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[89] *See id.*

[90] *See* U.S. Census Bureau, *Table F-4: Gini Ratios for Families, By Race and Hispanic Origin of Householder: 1947-1997*, CURRENT POPULATION SURV. (visited Feb. 15, 1999) <http://www.census.gov/hhes/income/histinc/f04.html>.

[91] *Id.*

> The increase was 16.1 percent from 1968 to 1992 and 22.3 percent from 1968 to 1994....
>
> The Gini index for households indicates that there has been growing income inequality over the past quarter-century. Inequality grew slowly in the 1970's and rapidly during the 1980's. From about 1987 through 1992, the growth in measured inequality seemed to taper off, reaching 11.9 percent above its 1968 level.... This was followed by a large apparent jump in 1993, partly due to a change in survey methodology. The Gini index for households in 1994 was 17.5 percent above its 1968 level.[92]

*B. Estimates of Wealth Inequality*

Wealth provides an alternative measure of economic inequality.

> Why is wealth important, over and above income? Family wealth by itself is a source of well being, independent of the direct financial income it provides. There are four reasons. First, wealth in the form of owner-occupied housing provides services directly to its owners. Second, wealth is a source of consumption, independent of the direct money income it provides, because assets can be converted directly into cash and thus provide for immediate consumption needs. Third, the availability of financial assets can provide liquidity to a family in times of economic stress, such as occasioned by unemployment, sickness, or family break-up. Fourth, in a representative democracy, the

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[92] Daniel Weinberg, *supra* note 68. *See also* Jack McNeil, *Changes in Median Household Income: 1969 to 1996, in* U.S. CENSUS BUREAU, CURRENT POPULATION REPORTS: HOUSEHOLD ECONOMIC STUDIES (visited April 19, 1999) <http://www.census.gov/hhes/www/mednhhldincome.html> (data showing mean income increasing more rapidly than median income provides another indicator of increasing economic inequality; if mean income rises more than the median income, as it has, then more of the benefits of the rising mean accrue to upper income groups above the median).

> distribution of power is often related to the distribution of wealth.[93]

Edward N. Wolff has estimated changes in wealth inequality between 1983 and 1995, relying principally on data collected by the Federal Reserve Board's triennial Survey of Consumer Finances, supplemented by Internal Revenue Service statistics.[94] For this purpose, wealth is defined as net worth[95] and is measured on a household basis.[96] Changes in the shares of net worth held by different ranges of households during this period are listed below.

1st to 40th percentile—decreased by 77.8% (from 0.9% to 0.2 %)
41st to 60th percentile—decreased by 13.5% (from 5.2% to 4.5%)
61st to 80th percentile—decreased by 9.5% (from 12.6% to 11.4%)
81st to 90th percentile—decreased by 7.6% (from 13.1% to 12.1%)
91st to 95th percentile—decreased by 5.0% (from 12.1% to 11.5%)
96th to 99th percentile—decreased by 2.2% (from 22.3% to 21.8%)
99th to 100th percentile—increased by 13.9% (from 33.8% to 38.5%).[97]

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[93] Edward N. Wolff, *Recent Trends in the Size Distribution of Household Wealth*, 12 J. ECON. PERSP. 131 (1998).

[94] *Id* at 132.

[95] *Id.* at 133. Net worth includes the following assets (minus liabilities):

> Owner-occupied housing
> Other real estate
> Savings deposits
> Bonds
> Cash surrender value of life insurance
> Cash surrender value of pension plans
> Corporate stock and mutual funds
> Equity in unincorporated businesses
> Equity in trust funds

*Id.*

[96] *See id.* at 132.

[97] *See id.* at 136. Wolff also did calculations using a different definition of wealth, referred to as "net financial wealth." *Id.* at 133. Net financial wealth consists of net worth minus the equity in owner-occupied housing. Wolff, *supra* note 93, at 133. Both concepts, net worth and net financial wealth, exclude consumer durables and the noncash surrender value of life insurance and pensions, which usually can be converted into cash, if at all, only at a fraction of their market value. *Id.* Wolff found almost identical results for the changes in the shares of net financial wealth.

> 1st to 40th percentile—decreased by 44% (from -0.9% to —1.3%)
> 41st to 60th percentile—decreased by 18% (from 1.7% to 1.4%)
> 61st to 80th percentile—decreased by 12.7% (from 7.9% to 6.9%)
> 81st to 90th percentile—decreased by 8.2% (from 11.0% to 10.1%)
> 91st to 95th percentile—decreased by 7.3% (from 12.3% to 11.2%)
> 96th to 99th percentile—decreased by 2.0% (from 25.1% to 24.6%)

For the 1983-1995 period, shares of total net worth decreased for 99% of all households. Only the top 1% of households, above the 99th percentile, saw their share of net worth increase. Using this data, Wolff also found that the Gini Coefficient for net worth rose during this period from .80 to .83.[98]

In addition, Wolff estimated the changes in average wealth holdings for various groups between 1983 and 1995. (The amounts shown in parentheses are in constant 1995 dollars.)

1st to 40th percentile—decreased by 79.6% (from 4,400 to 900)
41st to 60th percentile—decreased by 11.6% (from 51,900 to 45,900)
61st to 80th percentile—decreased by 6.5% (from 124,900 to 116,800)
81st to 90th percentile—decreased by 5.3% (from 260,600 to 246,800)
91st to 95th percentile—decreased by 2.3% (from 482,600 to 471,700)
96th to 99th percentile—increased by 0.5% (from 1,110,000 to 1,115,000)
99th to 100th percentile—increased by 17.4% (from 6,708,000 to 7,875,000).[99]

Average wealth decreased for all groups of households up to and including the 95th percentile. Average wealth increased only slightly for households from the 96th to 99th percentile. The only significant advance occurred for the top 1% of households whose wealth increased by over 17%.[100]

In an earlier study, Wolff noted that increasing wealth inequality in the 1980s represented a reversal of earlier historical trends. From 1929 until about 1970, wealth inequality, like income inequality, steadily

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99th to 100th percentile—increased by 12.4% (from 42.9% to 47.2%)
*Id.* at 136.

[98] *Id.* at 136. Wolff also calculated that the Gini Coefficient for net financial wealth rose during this period from .89 to .91. *Id.*

[99] *Id.* at 137.

[100] The results for average net financial wealth, defined *supra* note 97, were similar. *See id.* at 137.

1st to 40th percentile—decreased by 68.3% (from —6,300 to —10,600)
41st to 60th percentile—decreased by 7.8% (from 12,300 to 11,200)
61st to 80th percentile—decreased by 5.3% (from 57,000 to 54,000)
81st to 90th percentile—decreased by 0.1% (from 158,700 to 158,500)
91st to 95th percentile—decreased by 0.5% (from 354,000 to 352,200)
96th to 99th percentile—increased by 6.4% (from 906,000 to 963,000)
99th to 100th percentile—increased by 19.6% (from 6,187,000 to 7,400,000)

declined.[101] In addition, Wolff believes that on the basis of comparative data, increasing wealth inequality has reversed the relative position of the U.S. vis-à-vis other industrialized nations.

> [T]he evidence seems to suggest that in the early part of this century..., wealth inequality was much lower in the United States than in the United Kingdom, while U.S. figures were comparable to Sweden. America appeared to be the land of opportunity, whereas Europe was a place where an entrenched upper class controlled the bulk of wealth. By the late 1980s, the situation appears to have completely reversed, with much higher concentration of wealth in the United States than in Europe.[102]

## IV. SAVINGS INCENTIVES

The U.S. savings rate has declined steadily since the 1950s and is now at the lowest level in half a century or more.[103] Hall and Rabushka argued that the Flat Tax would increase savings and therefore stimulate greater economic growth.[104] Their argument rests on the equivalence between the Flat Tax and a consumption tax, which exempts savings from the tax base.[105] It is uncertain, however, whether moving from the existing income tax to a consumption tax would increase savings for two different reasons.

First, the additional savings incentive provided by the Flat Tax over the existing income tax is less dramatic than may be apparent. Under current law, the so-called income tax is actually a hybrid with significant consumption tax features.[106] Fundamental structural features of the income tax law, such as the realization principle, preferential rates for capital gains, cash method accounting, accelerated depreciation, and

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[101] *See* EDWARD N. WOLFF, TOP HEAVY: THE INCREASING INEQUALITY OF WEALTH IN AMERICA AND WHAT CAN BE DONE ABOUT IT 2 (1995).
[102] *Id.* at 21.
[103] *See* Engen & Gale, *supra* note 19, at 83.
[104] *See* HALL & RABUSHKA, *supra* note 5, at 48.
[105] *See, e.g.*, Chirelstein, *supra* note 2; Gravelle, *supra* note 1.
[106] *See, e.g.*, William D. Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, 87 HARV. L. REV. 1113 (1974).

exemptions for retirement savings already produce consumption tax treatment for many items.[107]

Of course, the Flat Tax would apply consumption tax treatment across the board for all forms of savings and therefore provide even greater savings incentives. However, whether this increased incentive would on balance cause saving to increase depends on how people respond. Target savers, those who save with a particular dollar goal in mind, would save less.[108] Others who are mindful of the relative tax advantage of saving a dollar rather than spending it would save more.[109]

Therefore, Michael Graetz has noted,

> [the effect of] replacing the income tax with a consumption tax often depends critically on the assumed responsiveness of savings to changes in the rate of return. Economists admit that this is "one of the more contentious issues in public finance."[110]

Martin Feldstein has suggested that savings might even fall in response to increased incentives.

> Consider for example a person at age 40 who wishes to save for retirement at age 65. This individual expects to obtain an average real after-tax return of 4 percent. For every $100 per year that he saves during the next 25 years, he will be able to dissave $357 per year from the time he is 65 until he is 80. In light of this opportunity he decides to save $1400 per year and thus have $5000 of dissaving each year when he is retired. Now consider what happens if his net rate of return rises from 4 percent to 5 percent. This implies that every $100 per year saved from age 40 through 64 will buy substantially more retirement consumption; more specifically with a 5 percent return the individual could dissave $422 per year instead of $357 obtained at 4 percent. Faced with this lower price of retirement consumption, the

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[107] *Id.*

[108] *See* MICHAEL J. GRAETZ, THE DECLINE (AND FALL?) OF THE INCOME TAX 207-08 (1997).

[109] *Id.*

[110] *Id.* at 179 (quoting Charles E. McLure, Jr. & Goerge R. Zudrow, *The Study and Practice of Income Tax Policy, in* MODERN PUBLIC FINANCE 177 (John M. Quigley & Eugene Smolensky eds., 1994)).

> individual is very likely to increase the level of planned retirement consumption. *But if this new level of retirement consumption does not increase sufficiently, current saving will actually fall.* For example, if the individual decides to increase his annual retirement dissaving from $5000 to $5500, he can actually lower his current saving from $1400 to $1303. Only if annual retirement dissaving increased to at least $5900 would current saving increase. Since we do not know how the demand for retirement consumption responds to its net cost, it is not possible to say whether saving would increase or decrease in response to a higher net rate of return.[111]

A second problem is that the Flat Tax negates features of present law that have the effect of compelling employees to save for retirement, whether they wish to or not. Under the current income tax, pension plans must satisfy minimum participation and nondiscrimination rules to obtain consumption tax treatment.[112] To assure compliance with these rules, employers often require employees, as a condition of employment, to save for retirement through employer pension plans, regardless of whether the employees would voluntarily choose to save for retirement or not.

The Flat Tax, however, would provide consumption tax treatment for all savings.[113] The current tax advantage of employer pension plans would cease to exist. The Flat Tax would therefore eliminate the tax incentive for employers to establish qualified pension plans that *compel* tens of millions of workers to save rather than to consume.[114] (Moreover,

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[111] Martin Feldstein, *Commentary, in* WEALTH REDISTRIBUTION AND THE INCOME TAX 61 (Arleen A. Leibowitz ed., 1977).

[112] *See* BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS, ¶¶ 61.3-61.4 (2d ed. 1990).

[113] Consumption tax treatment can be achieved by one of either two methods. Under the cash flow method, there is an exemption for savings and the yield on savings, but withdrawals from savings are taxed. Under the yield exemption method, savings are taxed but the yield is exempt from taxation, and so are withdrawals. *See, e.g.*, Andrews, *supra* note 106. The Flat Tax would continue current law's application of the cash flow method to employer pension plans. *See* HALL & RABUSHKA, *supra* note 5, at 35. However, the Flat Tax would apply the yield exemption method to all other savings. *See* Gravelle, *supra* note 1.

[114] *See* Daniel I. Halperin & Michael J. Graetz, *Comprehensive Tax Reform and Employee Benefits: The Case of Employment-Based Pensions and Health Insurance, in* TAX MROFER: IMPLICATIONS FOR ECONOMIC SECURITY AND EMPLOYEE BENEFITS 35, 39 (Dallas L. Salisbury ed., 1997); GRAETZ, *supra* note 108, at 239 ("one unintended casualty [of the Flat Tax] could be the nation's private pension system"); Robert E. Heitzman, American Academy of

with all other saving automatically eligible for consumption tax treatment, there would be little reason to insist that employer pension plans alone satisfy special minimum participation and nondiscrimination rules.)

Taxpayers are forced to save by yet another feature of current law that might not survive adoption of the Flat Tax. The beneficiaries of qualified pension plans and other tax-sheltered savings are generally restricted from withdrawing funds before reaching a specified age.[115] Taxpayers who violate these restrictions must pay a significant penalty tax on withdrawals. These withdrawal restrictions, like the minimum participation and nondiscrimination rules, compel individuals to save when they might prefer to withdraw savings for consumption. However, adoption of the Flat Tax is likely to include repeal of withdrawal restrictions, because the Flat Tax would afford consumption tax treatment generally to all new savings without special restrictions on withdrawing funds.[116]

With the decline or demise of compulsory savings resulting from employer pension plans and withdrawal restrictions, savings will tend to fall, especially savings by lower and middle income families trying to make ends meet under tight budgets. Even a modestly affluent tax professor has noted that absent such provisions, he would have saved less:

> The Flat Tax would...eliminate incentives for employers to offer their employees pensions....

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Actuaries, *Report on Consumption Taxes and Pensions*, quoted *in* 23 PENS. & BEN. REP. (BNA) 278 (1996) ("If all forms of savings were given tax-favored treatment, employer-sponsored pensions could be jeopardized. Losing this major source of private savings would ultimately work counter to the goal of increasing the nation's savings rate.").

[115] *See* BITTKER & LOKKEN, *supra* note 112, at ¶¶ 61.12, 62.3.4.

[116] *See* Engen & Gale, *supra* note 19, at 107-08. Hall and Rabushka proposed that Flat Tax reform include the repeal of withdrawal restrictions on existing IRA and Keogh accounts. *See* HALL & RABUSHKA, *supra* note 5, at 83-84. On the other hand, the Flat Tax would probably also eliminate or negate requirements of current law that compel individuals to consume rather than to save. The participant in a tax-favored retirement plan is required to "begin drawing benefits no later than age 70 ½ . . . in a form likely to exhuats the participant's accrued benefits . . . during the lives of the participant and his spouse." BITTKER & LOKKEN, *supra* note 112, at ¶¶ 61.12.3. However, it is doubtful that this requirement causes a significant increase in consumption. Most individuals retire by age 70 and need to draw on their tax-favored retirement savings (if any) for support, whether required by law or not.

> I can say with absolute certainty that if my pension savings, which are my only real savings, had been available to me without any tax penalty during my twenties and thirties, I would have driven faster cars, taken more expensive vacations, drunk better beers and scotch, and perhaps even worn fancy clothes. Today I would have far less in my retirement savings than I do. Small amounts of savings compound to substantial sums when left to grow for thirty or forty years. Much psychological and economic evidence suggests that, without special tax incentives for retirement and corresponding tax penalties for pre-retirement withdrawals, many people in their twenties, thirties, and even forties would put much less money into this form of long-term savings.[117]

To summarize, it is uncertain whether moving from current law to the Flat Tax (or other consumption-based tax) would increase savings. On the one hand, tax incentives for voluntary savings would increase and people might respond, on balance, by causing voluntary savings to grow, although even that is not certain. On the other hand, qualified pension plan minimum participation and nondiscrimination rules, which compel individuals to save, would probably disappear, causing savings to fall. In addition, if adoption of the Flat Tax included the repeal of withdrawal restrictions on retirement savings, it "could cause a spurt in consumption as households gained access to some of these funds."[118] It seems impossible to tell, *a priori*, which of these effects would predominate.

The low national savings rate is a troubling and persistent problem. It may be that saving will increase only if we depend more, rather than less, on measures such as the minimum participation and nondiscrimination rules of qualified employer pensions and withdrawal restrictions that compel saving. If so, the objective of raising national savings may create a dilemma: reconciling such additional compulsion with principles of individual liberty and consumer sovereignty.

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[117] GRAETZ, *supra* note 108, at 238.
[118] Gale et al., *supra* note 15, at 84.

## V. SIMPLIFICATION

Hall and Rabushka promised that the Flat Tax would produce enormous simplification for both individual and business taxpayers, permitting postcard-size tax returns.[119] Simplification for individuals would result from two sources. First, individual deductions and credits would be eliminated. There would be no deduction for charitable contributions, interest expense, state and local taxes, extraordinary medical expenses, unreimbursed business expenses, and the like.[120] There would be no earned income credit, dependent care credit, or education credit.[121] The only remaining individual allowance would be the personal and dependency exemptions.[122] Second, individual investment income would be exempt from tax. Dividends, capital gains, interest, and rents would not be reported.[123]

However, instead of enacting the Flat Tax, Congress could eliminate the same personal deductions and credits from the existing income tax, thereby providing much of the Flat Tax's promised simplification for individuals.[124] Congress could also simplify the reporting of investment income for individuals under the existing income tax. The principal difficulties in reporting investment income arise from two sources: the multiple preferences for capital gains[125] and limits on deducting interest expense.[126] Congress could reduce the multiple capital gains preferences to one basic preference and change the form of the preference from a lower rate to a percentage deduction. To simplify further, Congress might even repeal the capital gains preference altogether. Congress could also recognize the difficulties of distinguishing among kinds of

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[119] HALL & RABUSHKA, *supra* note 5, at 35-36. In making this argument, they ignore two critical considerations. First, for most individuals, who do not itemize, the existing income tax is already not really much more complicated than the Flat Tax. Second, the Flat tax would introduce new complications, such as requiring all self-employed individuals to file two separate returns. *See supra* note 24.

[120] *Id.* at 36, 79, 83.

[121] *Id*, at. 35-36.

[122] *Id.*

[123] *Id.*

[124] *See* GRAETZ, *supra* note 108. "Much of the simplification that would be achieved under the flat tax could also be accomplished under the income tax if Congress were willing to make trade-offs in favor of simplification similar to those the flat tax proposal makes." *Id.* at 232.

[125] *See* I.R.C. §§ 1(h), 1222 (1994 & Supp. II 1996).

[126] *See* I.R.C. § 163 (1994).

interest expense[127] and either deny the deduction of all individual interest or permit deduction without limit.

If individual deductions and credits were repealed and the treatment of capital gains and interest expense were simplified, one could even imagine a system under which most individuals would not even have to file tax returns at all. Employers already provide the IRS with information concerning each employee's wage compensation, and financial institutions provide information concerning each depositor's or investor's investment income. For individuals who are not self-employed and whose investment income (if any) derives solely from financial assets, the IRS might take information provided by their employers and financial institutions and, based on the taxpayer's marital status and number of dependents, fill out forms and calculate the tax due.[128]

These changes in the existing income tax would not affect the degree of complexity encountered by business. The Flat Tax is simpler for businesses because it is based on cash flow, allowing an immediate deduction in full for business expenses.[129] The income tax involves complicated rules for depreciation schedules, inventory accounting, and the like to track as accurately as possible annual changes in business net worth.[130] However, even if the Flat Tax were adopted, businesses would presumably continue to compute their income for nontax financial reporting purposes, with similarly complicated rules for depreciation, inventory, and the like. Arguably, the additional burden imposed on businesses by the income tax, over and above the burden of nontax financial reporting, arises principally from differences between tax and nontax rules.

Even if desirable, this proposal for simplifying the individual income tax could have difficulty attracting public support.

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[127] *See e.g.*, William A. Klein, *Borrowing to Favor Tax Favored Investments*, 1962 WIS. L. REV. 608.

[128] This assumes that the financial institutions can provide information regarding the investor's basis and that the taxpayer's investment vehicles do not include complex instruments, such as options or derivatives, which may be subject to special rules. In addition, taxpayers with income from nonfinancial investments (other than owner-occupied homes) would still need to do additional work to report their income. However, gains on owner-occupied homes under $250,000 for a single taxpayer or $500,000 for a married couple can be ignored. *See* I.R.C. § 121 (1997).

[129] *See e.g.*, Andrews, *supra* note 106.

[130] *See id.* at 1136.

> Are taxpayers willing to give up the mortgage interest, state income tax and charitable contribution deductions...? I doubt it; but if so, there is nothing inherent in our present income tax that requires us to retain those deduction items even now. The fact is that we *choose* to retain them despite the record-keeping burdens they entail just because we consider that the activities they support — home-ownership, for example — are deserving and desirable and merit a subsidy via the tax system. Much of the complexity in our tax law, insofar as it relates to individual taxpayers, exists for precisely that reason.[131]

The existing income tax reflects the idea that the tax burden should be carefully tailored to fit individual circumstances. In the abstract, the public strongly supports less complexity and a looser fit. In practice, the public seems wedded to ever finer tailoring despite the extra complexity. Consider the HOPE Scholarship and Lifetime Learning Credits, prolix and intricate provisions,[132] enacted and signed into law in 1997 with overwhelming support as the President, Congress, and the public were loudly condemning complexity and demanding tax simplification.[133]

## VI. CONCLUSION

The immediate impact of the Flat Tax would be to decrease the tax burden on the upper classes and to increase taxes for everyone else. Supporters claim that the Flat Tax would soon cause additional economic growth, raising incomes of the middle and lower classes by more than enough to offset the increased taxes that the Flat Tax would impose.

However, the progressive rate income tax has not prevented substantial economic growth since 1983, and it is doubtful that the Flat Tax could have stimulated much more growth than in fact occurred. Moreover, upper classes have benefited disproportionately, and economic inequality has increased. This history of growing inequality suggests that, even in the unlikely event that the Flat Tax had generated significant extra growth, not enough of the benefits would have reached the middle and lower classes to offset the higher taxes that the Flat Tax

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[131] Chirelstein, *supra* note 2, at 154-55.
[132] *See* I.R.C. § 25A (1997).
[133] *See* William G. Gale, *Tax Reform in the Real World*, 15 YALE J. ON REG. 387, 406 (1998).

would have required them to pay. Predictions that the Flat Tax would benefit the middle and lower classes should be viewed skeptically.

While low national savings are a persistent problem, the Flat Tax seems as likely to decrease as to increase savings. The Flat Tax would increase incentives for *voluntary* saving, but it is uncertain how much voluntary saving would rise in response to increased incentives, or even if it would rise at all. Moreover, the Flat Tax would negate features of current law, notably the minimum participation and nondiscrimination rules for employer pension plans and withdrawal restrictions on retirement savings, which compel workers to save rather than to consume.

Finally, much of the Flat Tax's promised simplification for individuals could be achieved by reforming the existing income tax. The affirmative case for Flat Tax reform has mostly vanished.