WALL STREET JOURNAL.

EDITION WEDNESDAY, MARCH 25, 1981 (SE

The Attractions of a Flat-Rate Tax System

By ALVIN RABUSHKA

President Reagan has promised us a tax cut worth $30 billion to $40 billion in 1981. The centerpiece of his program, Kemp-Roth, would reduce personal income tax rates across-the-board by 10% a year for three years. Also, business depreciation would be accelerated to speed capital recovery. Is this tax package really the "tax cut" supply-siders have been working for?

The Reagan proposals represent the eighth in a series of congressional tax bills dating from 1954. Each bill was intended to offset the cumulative tax increases arising from the progressive structure of our tax system, intensified by inflation.

Federal tax receipts as a share of GNP have ranged from a low of 15% in 1949, following substantial postwar tax cuts, to a high of 21% in 1969, reflecting the Vietnam war. Beginning with the recodification of the tax laws in 1954, Congress passed further tax "reform" measures in 1964, 1969, 1971, 1976, 1977 and 1978. The accelerating frequency of congressional action reflects an exponential increase in the inflation rate.

The years of major tax cuts—1954, 1964, 1971 and 1976—show sharp reductions in tax receipts as a share of GNP. But the sequence of tax measures has not benefited all taxpayers equally, since the bulk of relief in dollar terms has gone to lower- and lower-middle-income households in the form of greatly increased personal exemptions and standard deductions. In postwar tax reform, rate reductions, either across-the-board or for upper-income households, have been more the exception than the rule and increasing numbers of taxpayers face higher and higher marginal rates.

Of course, Congress long ago could have corrected for the inflation-generated tax increases by indexing, but this would have removed from elected politicians the discretion to claim credit for tax cuts. A once-and-for-all indexing bill would only give politicians a once-and-for-all credit.

Congress's Joint Committee on Taxation has estimated, assuming an effective date of Jan. 1, 1981, that bracket-creep-induced tax increases in 1981 would offset 86% of the total dollar value of tax relief contained in Kemp-Roth, 72% in 1982 and 68% in 1983. Of course, if the inflation rate is higher than that contained in the joint committee's projections, the tax reduction in Kemp-Roth will be even smaller. Because Kemp-Roth is now proposed to take effect in July 1981, the tax cut is smaller still.

If the Reagan administration had been serious about tax cuts, it would have stuck with its original plan to first index the brackets and then cut the rates for a "real" tax reduction. This would put an end to a sloppy, inefficient substitute for indexing. The real issue is whether the adjustment of income taxes for inflation is to be automatic and continuous—with indexation—or discretionary and discontinuous.

Indexing would solve the bracket-creep problem. But it still would leave us with an inefficient tax system. For example, a flat rate of 11% on all personal income would bring in about as much revenue as the current 14% to 70% scale with its thousands of loopholes. If we want to retain some of the deductions from personal income currently in force, the flat rate need be only 15% of adjusted gross income (which would put an end to standard or itemized deductions). And even if we want to retain all of our present exemptions and deductions, a flat rate of 18% on taxable income would suffice. This latter rate would still exclude the very poor from the income tax net.

The benefits of a low-flat-rate tax system would be to stimulate individual initiative and economic growth. It would simultaneously reduce the incentives for barter, tax avoidance shelters and underground economic activity.

The tax base would widen and revenues would in all likelihood increase, thus permitting a further cut in tax rates. The government would raise all the revenue it needs to pay for current programs without penalizing or discouraging anyone from additional work. And, of course, there is "automatic indexation" with a flat-rate system, since inflation increases tax revenues and the tax base in proportion.

In this session Congress is likely to adopt some or all of Kemp-Roth and the administration's other tax cut proposals. Adoption of a low-flat-rate tax system is still very much in the future. But there is growing consensus that progressive taxation adversely affects the incentives to work, save and invest, thereby slowing economic growth. Perhaps the whole system of progressive taxation has outlived its usefulness.

Several Senators and Representatives are considering introducing bills in the next few months proposing a flat rate in place of the current progressive system. While only a first step, it nonetheless is a significant one in the movement to obtain a real supply-side tax system.

Mr. Rabushka is a senior fellow at the Hoover Institution of Stanford University and served as a member of President Reagan's tax policy task force.