

The Season for Giving

By BRUCE BARTLETT

One of the unacknowledged legacies of "supply-side economics" is that it stimulated a great deal of research on tax policy. Before the supply-siders started talking about the effect of high rates on incentives in the 1970s, the subject had been a neglected area of economic research for nearly 50 years. Until then, almost all academic discussion of taxation had taken place within a Keynesian framework that emphasized the aggregate level of taxation and its effect on total disposable income. The idea that the tax structure could have important consequences for individual effort and investment—as well as economic growth and well-being—was not seriously discussed.

In general, the new research supports the basic point that the supply-siders were trying to make—namely, that the level of



Bookshelf

"Taxing Ourselves"

By Joel Slemrod and Jon Bakija

"The Failure of U.S. Tax Policy"

By Sheldon D. Pollack

taxation creates incentives and disincentives and that both matter to growth and general prosperity. These facts are clear from an excellent survey of the latest economic research on taxation, "Taxing Ourselves: A Citizen's Guide to the Great Debate Over Tax Reform" (MIT Press, 299 pages, \$25) by Joel Slemrod and Jon Bakija, both of the University of Michigan. "Taxing Ourselves" is one of the best books on taxation I have ever read. Not only is it accessible to a general audience, but it also has much to teach experts in the field.

The book begins with an overview of the U.S. tax system, including a brief history and a comparison with foreign systems. Messrs. Slemrod and Bakija make the important point that the Reagan tax cut of 1981 didn't really cut taxes at all but only stopped taxes from rising. Revenues did decline relative to gross domestic product, they note, but only from levels "that were historically high." Revenues in fact ended up at "levels close to the average for the postwar era."

An important section of the book deals with the somewhat theoretical question of what the correct base for taxation should be. Unfortunately, the authors discuss only one view, treating the so-called comprehensive tax base as the sole correct definition of taxable income. Under this definition, developed in the 1930s by economists Robert Haig and Henry Simons, both savings (broadly defined) and consumption should be taxed. But an alternative definition, accepted by many economists and tax lawyers today, would tax only consumption—for example, through a sales tax or a flat tax that exempted savings.

(Our current system is a hybrid that corresponds only fitfully to either tax-base theory.) In any case, Messrs. Slemrod and Bakija concede that, even under the Haig-Simons definition, all capital losses should be fully deductible (they are only partially deductible now) and capital-gains taxes should apply only to inflation-adjusted gains (they are not now indexed for inflation).

The chapter on tax fairness rises above the usual rhetoric on this issue. In it the authors refer to a 1989 survey showing that most Americans believe that half of all millionaires pay no income taxes at all. The true figure, they point out, is actually about 2%. "The professed desire for more progressivity," they dryly conclude, "may in part stem from a lack of understanding of how progressive the system really is."

The most important chapter in "Taxing Ourselves" discusses the relation between taxation and economic growth. The authors look at the effect of taxation on labor supply, saving and investment; risk-taking and entrepreneurship; international competitiveness, jobs, education and training; and tax evasion and avoidance. While taking a moderate view themselves, they present strong evidence that high marginal tax rates are injurious to growth.

The balance of the book takes the analysis presented in the first part and applies it to various tax reform proposals, such as the flat tax and the value-added tax. They suggest that a VAT "is probably doable" but "entails a radical shift in tax burden from the affluent to poor and middle class families" and thus is unlikely. A retail sales tax may work at low rates, they say, but it would be impossible to administer equitably at a rate necessary to replace various incomes taxes. Of the consumption-tax alternatives to the income tax, they conclude, the flat tax "stands as the most attractive."

In the end, the authors do not endorse any particular tax reform but do endorse the idea of reform. The tax system can and should be improved, they assert, and they offer some general principles—e.g., "beware of hidden taxes," "simpler isn't necessarily better, but it helps"—by which any attempt at tax reform can be judged.

A useful supplement to this analysis may be found in "The Failure of U.S. Tax Policy" by Sheldon D. Pollack (Penn State Press, 321 pages, \$29.95). Mr. Pollack looks at tax policy in practice, especially the recent history of tax legislation. He emphasizes the inherent *political* character of any debate over taxes and observes that external events, such as wars, have far more effect on how we are taxed than academic theories. Scholars take note.

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