



Why NZ, and everyone else, Needs a Flat Tax

Many libertarians put themselves into an impossible box when they claim that government should survive off voluntary contributions, without any form of compulsory taxation. The obvious response is that ordinary people, each endowed with a modicum of self-interest, will each shirk on their voluntary contributions, thereby starving government of the revenues needed for two vital functions: to preserve liberty and to create and maintain needed infrastructure, such as public roads and rivers.

So taxes we must have. But what form they should take? Those of us in the social contract tradition regard state coercion to fund public goods as a necessary evil. We accept that coercion, therefore, only when it works to the benefit of all individuals so coerced. That ideal is reached when the state provides benefits to all persons taxed greater than the exaction that it imposes.

The flat tax comes out first best under this criterion. To see why think of a simple partnership between individuals who wish to engage in some joint venture, like a road trip. They could argue endlessly over the division of costs, but in practice they quickly agree to split the cost equally. The elaborate bargaining games are effectively neutralized ninety-nine times out of one hundred by adopting this simple focal point.

Organizing political institutions is not as simple as putting together car trips. For one thing, in political society none of us gets to choose our fellow citizens. For another the

benefits to each person from public services depend at least in part on his or her relative wealth. Ideally, we should like to tax each person proportionate to the sum of their personal and financial gains from living in society. Alas, the former are too elusive to measure how do you put a reliable cash value on good health, for example? Thus we exclude these benefits from the tax base and concentrate on the receipt or consumption of wealth derived from labor or capital, or both.

Now the argument for the flat tax simply and sensibly assumes the benefits from social order and public services are roughly proportionate to income. Hence it would be a grievous mistake for the state to charge each person the same amount, as with a head-tax. There are too many individuals for whom the tax would eat up an inordinate portion of wealth. A flat tax always avoids that problem and increases the odds that any tax will work to the benefit of all people. A simple application of the basic partnership rule limits the dangers of political mischief.

Now this view of the flat tax engenders overt hostility from people who believe that one major function of the state is to equalize incomes across individuals. But there are two objections to their position. The first asks how the state comes to have that power over any individual. It is a vast expansion of public mission one fraught with countless administrative difficulties to confer on the state a power to transfer wealth

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between persons through taxation.

One reason is that this new mission often goes awry in practice. The political forces in favor of redistribution are not confined only to the transfers from rich to poor. The large social democratic state opens Pandora's box so that powerful political coalitions (farmers, unions, manufacturers) get favors that make their lives easier, and everyone else's harder. There are too many slips between cup and lip to think that any a program for income redistribution can steer clear of the political risks of capture.

Yet even if we could control those political risks, why think that progressive taxation helps the cause of income redistribution. The experience in the United States with the tax cuts on capital gains is most instructive. It is easy to condemn those cuts as favors to the rich. But it's wiser to praise them for increasing stock market liquidity while raising overall revenues at the same time. So it is with high taxation rates generally, which dull the incentives to earn and invest in the first place. Better to have a larger pie of revenue from a consistent flat tax than the reduced

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revenues (and added administrative complexity) of a progressive tax.

Ironically, we could have the best of both worlds. If the flat tax expands revenues it should leave enough aside for redistribution after all. But with this huge advantage: we do not want any people to be outside the tax system. No one in a democratic society should decide how to spend other people's money when their own is not at risk. The best way to moderate state spending is for each person to be conscious of the financial burden that he or she will bear once the tax rates go up. The flat tax thus imposes a moral discipline on public deliberation that reinforces its desirable economic characteristics.



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Muriel Newman
(founder & director of NZCPD)