

Republi-Taxes and Demo-Grants

C. Eugene Steuerle

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Flat taxes and flat grants. Equal rate taxes and equal size expenditures. Republi-taxes and Demo-grants. The resemblances are many. Each promises to simplify an extraordinarily complicated and inefficient side of government, either the ways it generates revenues or dispenses outlays.

As a stylized system, each has much to offer. Although now associated with one political party and parodied by the other, each can be designed to meet a variety of both conservative and liberal goals. By the same token, as a stylized system, each fails to face up to many real world problems of taxation and spending. Therein lies their Achilles heels and why they cannot entirely replace taxes or spending in their current forms. Don't entirely abandon the ships, however. While neither may be capable of conducting all voyages, they provide some fairly sturdy hulls on which to carry much of the freight of government.

At their simplest, flat taxes promise to tax either all consumption or all income at a flat rate; flat grants offer an equal amount of expenditures per individual. Put the two together, and one does not have a government that simply taxes and then gives back to each taxpayer what he or she pays. Together they do not wash; the taxes per individual do not cancel out the expenditures. In fact, they create a combined system that is fairly progressive and redistributes a significant amount from rich to poor. Those with above average consumption or income would pay more than they receive; those with below average would receive more than they pay.

Flat grants, if adopted, could replace large portions of the welfare and expenditure system. The elimination of administrators would increase the amount that could be paid out or reduce the amount that had to be paid by taxpayers. A number of years ago, a similar argument was made for a negative income tax that would essentially create a flat grant and then phase it out or tax it away as income increased. Two Nobel Prize winners, James Tobin and Milton Friedman, favored this type of system as a significant improvement on the welfare system. Tobin probably was more interested with issues of equity and making more even the amounts received by the poor throughout the country. Friedman emphasized the efficiency gains by allowing individuals to spend money as they saw fit.

Flat taxes, if adopted, could replace large portions of the tax system. The reduction in the number of IRS administrators would increase the amount that would be collected on net or reduce the amounts that needed to be paid by taxpayers. Despite the current association of flat taxes with conservatives, many liberals have favored value added taxes in the past. Today's flat tax proposals are nothing more than variants of a VAT. Some advocates emphasize the administrative advantages that derive from collecting taxes from payors with little or no extra filing required by those who earn or consume. Others view VATs and flat taxes as simplifying replacements for part or all of the income tax.

Republicans attack Demo-grants as too redistributive, but then they prefer welfare and social insurance systems that are even more redistributive and targeted even more to the poor. Democrats attack Republi-taxes as inadequately redistributive, but then they back taxes such as social security that are essentially flat rate taxes that are even less progressive than most current flat tax proposals. The VAT, moreover, is a major reason for higher government spending in most European and other industrial countries.

If one examines the existing social security system on both the tax and expenditure sides, it is less redistributive than a combination of a flat tax with a flat grant. Why? Most flat tax proposals actually provide for a tax-free level of income that is not allowed under social security. Meanwhile, social security grants rise with household income rather than providing an even amount of benefit per individual. This is just the opposite of welfare, where higher benefits are granted to those who are poorer during their lives.

As stylized systems, unfortunately, Demo-grants and Republi-taxes ignore much of reality. Perhaps a Demo-grant would be superior to the existing welfare system, but there are solid reasons for not simply

transferring money to everyone. Some individuals have considerable wealth even though their realized income is small; others cannot handle money well. Those who pay for the transfers may prefer to make donations of !PG 128 !EP education and health, or to emphasize equality of opportunity rather than result. For some services like roads and parks, individuals do not require the same level of benefit. For some types of insurance systems, it is probably appropriate to return to individuals benefits that are related to premiums paid. For some disabled, a flat grant is not enough to cover all expensive needs.

Perhaps a pure flat tax would be superior to the existing tax system, but there are solid reasons for not taxing everyone at a single rate. Some taxes should be related to ability to pay, others to benefits received. Winners and losers may require different treatment by the tax system. If flat taxes are always superior, why not apply them to roads and parks regardless of whether or not a person uses them? For some types of welfare systems, it is probably appropriate to assess a higher tax rate on those who work or otherwise demonstrate an ability to make it on their own.

To gain perspective on this debate, therefore, one has to move beyond the simple stylized models put forward by academics who assume away a good part of reality and beyond the simplistic political statements made by both advocates and detractors. In truth, one needs to consider both taxes and expenditures together when deciding how to design government programs. From this perspective, a flat grant and a flat rate tax is a solid, if incomplete, base on which to evolve, although it certainly forces one to state more rigorously just when and why deviations should occur.

While a combined flat grant and flat rate tax system cannot replace all of government, many recent and proposed changes take steps in this direction. The Social Security Advisory Commission is putting forward proposals to move benefits under that system closer to a flat grant supplemented by individually owned accounts where saving would be accrued. The current Democratic Secretary of Housing and Urban Development, along with his recent Republican predecessors, is trying to move housing benefits more toward an equal-grant voucher system and away from a public housing system with long queues and very uneven levels of benefits. Almost all of the tax increases of the past few decades in both the United States and Europe have come about through taxes that are approximately flat rate such as social security or VATs. Not surprisingly, in the real world of policy making, what one often finds are Repuli-grants of equal size and Demo-taxes with equal rates.

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- C. Eugene Steuerle
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