THE CENTRE FOR INDEPENDENT STUDIES

The Very Idea of a Flat Tax

Lauchlan Chipman

Perspectives on Tax Reform (6)

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CIS Policy Monograph 66

2004

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Foreword

Most human beings are cautious and conservative by nature. We establish patterns and routines for living, and for most of the time we stick to them, for life is easier if we do not have to think each day about what we have to do and how we are going to do it.

Our conservatism means not only that we are generally reluctant to change institutional arrangements, but that for much of the time, we do not even reflect on the possibility of changing them. The way things are is the way we expect them to be, and suggesting that things might be arranged differently is likely to provoke indifference, hostility or even incredulity among our peers. Unless and until things start to go badly wrong, we tend to take for granted our current practices as being the most 'natural' and 'obvious' way of organising our affairs.

In this, the sixth in a series of papers on tax reform published by The Centre for Independent Studies, Lauchlan Chipman questions a key principle that has long been embedded in our system of taxation and which most Australians probably accept as being self-evidently the 'best' and 'fairest' way of doing things—namely, the principle of 'progressive' taxation. Almost heretically, Chipman challenges the assumption that 'progressive' taxation is 'just', and he sets out the moral case for a 'flat' income tax. But challenging an article of faith like progressive taxation, Chipman is under no illusions about what response he is likely to provoke from the commentariat.

'Those who advocate a flat tax,' says Chipman, 'are commonly ridiculed as advocating the economic equivalent of "flat Earth science", or for lacking compassion and betraying callous indifference to social justice.' Because progressive taxation has been around for a long time, we have grown used to the idea that it is the fairest way of taxing people. This is an assumption shared on both sides of politics—the Prime Minister, John Howard, for example, has rejected the idea of a flat tax on the grounds that it is 'regressive'. But as Chipman points out, the fairness assumption does not hold water, and the Prime Minister's belief that a flat tax is regressive is just plain wrong.

Under a progressive tax regime, people lose an increasingly large proportion of their income as their earnings rise. With a flat tax, higher earners still pay more tax than lower earners, but everyone pays the same *proportion* of their income in taxes. A flat tax is therefore neither regressive nor progressive, but is even-handed. This is precisely why it can be considered more 'just' than a progressive tax, for it is consistent with the most fundamental principle of the Rule of Law which is that like cases should be treated alike while unlike cases should be treated in a way that is proportional to the relevant differences between them.

In this paper, Chipman makes a compelling philosophical case for a flat tax, systematically demolishing every one of the principled arguments that is commonly advanced in favour of progressive taxation. But as he himself acknowledges, he is up against an ideological and political inertia which simply *assumes* that progressive taxation is the fairest option. We tend to defend what we are used to.

Australia has operated a 'progressive' income tax system for a long time. At present, we have five different tax rates applicable at different levels of income. Up to $6,000 per year the tax rate is zero. We then pay 17% on every dollar earned between $6,001 and $21,600; 30% on every dollar between $21,601 and $58,000; 42% on every dollar between $58,001 and $70,000; and 47% on every dollar earned over $70,000.[1] The more you earn, the less proportionately you are allowed to keep.

Under a flat tax system, these different tax bands would be scrapped (although we might retain an initial zero-rate [tax-free] income threshold). Everyone would then pay tax at the same rate on all of their taxable income. If the rate were 30%, for example, somebody with a taxable income of $30,000 per annum would pay $9,000 tax, and somebody with a taxable income of $60,000 would pay $18,000. For reasons set out in his paper, Chipman demonstrates that this is a much fairer, more efficient and more transparent system.

But could it work? In principle there is no reason why not, for as Chipman points out, some Eastern European countries are already operating such a system. Latvia has a flat personal income tax rate of 25% with no tax-free threshold; Estonia has a flat personal income tax rate of 26% with a small tax-free threshold; and Russia has a flat rate of 13% on most categories of income. The trend in many western countries has also been towards flatter rates, and with increasing mobility of professional labour between countries, this trend is likely to strengthen in the future.

In Australia, a notionally low-tax Coalition has been in power for eight years but income tax remains steeply progressive, partly due to the strength of opposition parties in the Senate. Following the October 2004 federal election, however, this opposition has been weakened, and the Howard government now has a once-in-a-political-lifetime opportunity to press ahead with radical and long-overdue reforms.

Towards the end of his paper, Chipman explores some of the practical barriers to introducing a flat tax in Australia and considers ways they might be overcome. He suggests that a radical innovation like this would have to form part of a broader tax reform strategy which includes winding back some of the special deductions, rebates, credits and offsets that clutter up the current system, increasing GST with the increased revenue being retained by the federal government, and cutting total federal spending.

It could be done, and in this paper, Lauchlan Chipman sets out some compelling reasons why it should be done. If we lose this opportunity, we could regret it for many years to come.

Peter Saunders
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Endnotes

1 These tax bands are operative from 1st July 2004. From July 2005 the band for the 30% rate will increase to $63,000, and the 42% rate will extend up to $80,000. The Medicare levy, and surcharge for higher rate taxpayers, is additional to these marginal rates.

Executive Summary

A sound taxation policy is one that can be implemented efficiently and effectively in economic terms, but which is also fair, just, and equitable. Only when income is taxed on a uniform proportional basis (a 'flat tax') can these ethical standards be met.

It is often said that an income tax rate which is not flat but 'progressive' (i.e., takes not just more, but proportionately more, as income levels rise) is a disincentive to people to work harder and longer, because they know they will lose proportionately more in tax. But the opposite could equally be argued—that it is an incentive to work longer and harder than they otherwise would, in order to maintain growth in their take home pay. The fact is that different people react differently. The case for a flat tax does not rest on incentives.

Progressive income tax rates are sometimes defended on the ground that they reduce material inequality, by narrowing the income gap between high and low earners. But wages and salaries are negotiated with regard to take home pay, so a progressive rate inflates the gross salary of high earners, thus adding to business costs which are then reflected in the prices charged for goods and services. All income tax, whether flat or progressive, morphs into what is in effect a flat consumption tax paid by the end purchaser.

An acceptable personal income tax system must meet the requirements of horizontal equity (all those in comparable circumstances must be taxed comparably) and vertical equity (through the range, low to high, of taxpayer incomes). Both forms of equity are founded on the ancient principle of procedural justice, that 'like cases should be treated alike, and unlike cases differently, each in a way that is proportionate to its relevant difference(s)'. Only a flat rate of income tax achieves vertical equity; indeed it is the arithmetically perfect way of meeting it. Only through a flat rate can the principle of procedural justice, and therefore the requirement of vertical equity (as well as horizontal equity), be satisfied.

It is sometimes argued that a flat rate is regressive. It is not. It is wrong to infer that whatever is not progressive is regressive. It is because it is neither regressive nor progressive that a flat tax rate can be just.

Some contend there is another type of justice, 'social justice', which must take precedence over procedural justice. It is claimed that a progressive income tax rate is socially just because it tends to bring disparities of income within more tolerable bounds. But this idea of 'justice' should be rejected. The idea of devising a non-market just distribution of wealth is as much of a chimera as the idea of devising a non-market just wage.

There is no clamour for a change to a flat tax, and even some high income earners contend (wrongly) that it is 'only fair' that they pay not just more, but proportionately more, in income tax. But there is a glaring injustice in the present system which makes it imperative to move, albeit incrementally, toward a flat tax.

THE VERY IDEA OF A FLAT TAX

> 'The moment you abandon the cardinal principle of extracting from all individuals the same proportion of their income or of their property, you are at sea without rudder or compass, and there is no amount of injustice and folly you may not commit.'
>
> J.R. McCulloch, 'On the Complaints and Proposals Regarding Taxation', *Edinburgh Review* LVII (1833), p.164.

> 'In the last resort the problem of progressive taxation is, of course, an ethical problem, and in a democracy the real problem is whether the support that the principle now receives would continue if the people fully understood how it operates . . . That a majority should be free to impose a discriminatory tax burden on a minority; that, in consequence, equal services should be remunerated differently; and that for a whole class, merely because its incomes are not in line with the rest, the normal incentives should be practically made ineffective——all these are principles which cannot be defended on grounds of justice. If, in addition, we consider the waste of energy and effort which progressive taxation in so many ways leads to, it should not be impossible to convince reasonable people of its undesirability. Yet experience in this field shows how rapidly habit blunts the sense of justice and even elevates into a principle what in fact has no better basis than envy.'
>
> F.A.Hayek, *The Constitution of Liberty* (London: Routledge and Kegan Paul, 1960), p.322.

1. Preliminaries:

There is probably no area where the disciplines of economics and philosophy intersect more clearly than that of taxation policy. Philosophy is concerned with all those questions that cannot be solved by observation, calculation, or experiment. As Bertrand Russell once famously observed, if the day were ever reached when all the questions of the sciences were answered and safely stored in the archives, philosophy would be all the questions left over. Economics and philosophy are both concerned, inter alia, with value. In the sphere of personal and social conduct this applies particularly to that branch of philosophy known as ethics. The economist's interest however is more empirical. How do we tell what we and others in fact value? How are strengths of valuations measured? What are the interventions—incentives and disincentives, for example—that can lead people to change the value they assign to this or that aspect of their experience? What are the likely effects on current strengths of valuation of this or that possible intervention?

Addressing many of these empirical questions in turn depends upon work in the behavioural sciences, and in particular human psychology. Insofar as it constructs generalisations about human social behaviour following the introduction of novel stimuli (for economists, incentives and disincentives), human psychology is a pretty rough and ready science. Few generalisations are universal. Rarely is it possible to identify, let alone measure, all the variables that can impact on the applicability of an established generalisation in a hypothetical situation.

Arguments about the desirability of this or that taxation measure or policy invariably involve assertions about their incentive effects on human behaviour. Will it lead people to making different choices? Are these choices better or worse than those that would otherwise have been made? The first of these questions is empirical; the second can only be answered in relation to whatever is postulated as the preferred set of desirable outcomes, and such postulates are essentially contestable. Inevitably, arguing about them leads us to more general tenets about social goods. Arguments about these tenets are, in the end, ultimately philosophical. In the course of these arguments, ethically laden terms like equity, equality, justice, fairness, and moral obligation shift from the wings to the centre of the stage on which the argument is conducted.

Although empirical in form, the first question—namely, what will be the impact on human choices—is very difficult to answer empirically, simply because it is a question of human psychology. We just do not know enough. Into the area that is not occupied by knowledge pour anecdotally supported inductions and intuitively grounded conjecture. It comes as no surprise therefore to find cases in which the impact anticipated as intuitively obvious turns out to be very different from the impact that actually resulted.

Of course questions about impact are easier to answer after the event than before. We are on relatively more secure ground (although it is far from rock solid) when we argue that the introduction of such and such an incentive in the past resulted in a particular set of changes in people's behaviour, than when we argue that the introduction of such and such an incentive in the future will likely produce certain specified results. Because most debate about taxation policy is focused on the future and only loosely grounded in the past, assertions about likely results commonly involve appeals to what seems to be obvious common sense—obvious, that is, until it is subjected to closer examination. In sum, given the limitations of the current state of the social sciences of human behaviour, decisions about the probable effects of this or that change in taxation policy must be made under conditions of considerable uncertainty.

Questions about what socio-economic objectives taxation policies ought to achieve are more broadly philosophical, being dependent ultimately on our vision for society. For example, there are many who regard material equality as a desirable social goal. As will become clear in the course of this paper, this is a philosophically contentious position and one which, it will be argued, is ultimately indefensible. Those who do believe in the social desirability of material equality will, *ceteris paribus*, favour those taxation policies that can be expected to lead to a 'more equal' distribution of wealth; or in other words, whatever else may be usefully accomplished by a particular taxation policy, it ought to contribute substantially to progressing society towards material equality in the distribution of wealth. On such a view, state mandated redistribution can be justified even if it is not necessary to raise more revenue to enable the other purposes of government to be fulfilled—the purpose of bringing the distribution of wealth in society closer to material equality is sufficient purpose in itself. Accordingly, the actual distribution of material wealth should be periodically re-ordered, by removing 'excess' wealth from those with most, and distributing it to those with least. Those who believe the best way to achieve this is by preventing such so-called excesses from accumulating will be attracted to a so-called progressive income tax (discussed further in Section 2, p.4) as one key mechanism.

There are many who regard material equality as a desirable social goal. This is a philosophically contentious position and is ultimately indefensible.

Most taxation policies are to some extent redistributive. (The rare exceptions are those that are wholly 'paternalistic', where the beneficiaries are identical with the contributors, and each beneficiary's benefit is funded entirely from his or her own contributions, e.g. compulsory savings or superannuation investment, unsupported by any taxpayer funded subsidy or co-contribution.) The vast majority involve extracting a contribution from a designated section of society, and making it available for spending on some preferred purpose or function, where the beneficiaries may be very different from the contributors.

Not all philosophies of the state take progress towards material equality as an end in itself. Indeed many are perfectly consistent with increasing material inequality. To take an extreme case, a minimalist or 'night watchman' philosophy of the state—that the role of government ought to be limited to providing for the security of its citizens against external or internal assault, and the enforcement of private law (contracts, torts, wills etc.)—has no implications for a preferred pattern of the distribution of material wealth.

Nor need a philosophy of the state which places a strong emphasis on human welfare and the maximising of opportunities for individual advancement (e.g. through taxpayer funded spending on education and anti-discrimination programmes) require taxation policies which result in a 'more equal' society, in the sense of a society in which the material distribution of wealth is tending towards greater equality. Australia at present is a perfect example of such a society, in which the rich are getting richer and the poor are also getting richer, although it must be acknowledged that true figures about what people actually receive in income are notoriously difficult to produce. This is because we can only estimate the extent of individual under-reporting. It is, incidentally, an all too common *non sequitur* to infer that if the gap between rich and poor is widening, then the poor are getting poorer. Not only is the inference fallacious, but there is also abundant evidence from experience to contradict it.

This paper will be concerned with only one form of taxation, namely personal income taxation. For the sake of argument, it will be assumed that taxation of personal income is in principle a morally legitimate way for governments to raise revenue. It is worth stressing that there is a very strong onus on those who do believe a particular tax—any tax—is morally legitimate to demonstrate why this is so. All taxation involves the forcible removable of the private property of another—a removal that, were it performed by another individual without the sanction of law, would be a felony. With the exception of the taxation of the proceeds of crime or civil fraud, taxation involves the confiscation of property rightfully acquired, and therefore rightfully owned, by the taxpayer. This is not to deny that taxation may be morally legitimate. But it is to say that all taxation, insofar as it necessarily involves the forcible transfer of rightful ownership to another, requires a morally compelling justification. Whatever else a tax cheat may be he or she is not a thief. The crime lies in not surrendering that to which the law has given an overriding entitlement to the state. Unlike the thief, it does not lie in securing and attempting to retain possession of something to which the perpetrator was never entitled.

No doubt some will (wrongly) consider this a distinction without a difference; however it is mentioned to underline the point that taxation always involves the imposition of a law which overrides the prior legal rights of the taxpayer. While one can understand the emotional appeal of rhetoric accusing tax cheats of 'stealing from the revenue', this is not literally correct. The otherwise honest tax cheat's wrong consists in wilfully failing to surrender to the state that to which the law maker has given the state an entitlement which trumps the tax cheat's own. By contrast, someone who 'steals from the revenue', for example a welfare cheat or a taxpayer who claims a bogus rebate, takes something to which the thief has no prior right, but to which the state does have (relative to the thief) a prior legally justified entitlement.

Whatever else a tax cheat may be he or she is not a thief. The crime lies in not surrendering that to which the law has given an overriding entitlement to the state.

In declaring that for the purposes of this paper, it will be assumed that state taxation of personal income is morally legitimate, it may be thought that this is simply assuming the obvious. This is not so. Indeed, the thought that it is reflects how pervasive income tax, although quite old in conception, has become in the developed world as its spread increased in the late nineteenth and early twentieth centuries. It is sometimes assumed that, unless one is an anarchist, one must accept that some form of taxation—be it an income tax, wealth tax, consumption tax, poll tax (standard lump sum per person), or some other tax or combination of taxes—is a given. This is also incorrect. A state could be funded through monopoly possession of a valuable resource, e.g. oil or gold, through a portfolio of foreign commercial investments, or through activities participation in which is voluntary, such as lotteries. Modern states commonly use some of these strategies not instead of taxation, but as a means of augmenting the revenue from taxation. As already indicated, taxation of anything, because it is a legally sanctioned confiscation of some part of the property to which the law abiding taxpayer has a prior legal entitlement, always requires a morally compelling justification. That done, a further such justification is required for making income subject to taxation. Hall and Rabushka remind us that Adam Smith, for example, expressed dismay at the prospect of income tax and:

> . . . strongly opposed direct assessment of income through an income tax, because it entailed an inquisition of each taxpayer. He felt that an income tax was too heinous a yoke to be imposed on any man because it would expose his finances to the scrutiny of the treasurer, who might then drag him through public disgrace. Smith viewed an income tax as especially harmful to the commercial classes, since it would likely have an adverse effect on capital formation . . .[1]

Smith notwithstanding, for the purposes of what follows, it will be assumed that an ethically convincing justification for taxation of income has been made.

Income tax rarely exists in isolation, and we are all familiar with arguments about what proportion of state revenue should be derived from taxation of income as opposed to other forms of taxation. Plainly, one's view about the rate of income tax that is reasonable is not independent of one's views about what the total state revenue should be (in turn dependent on one's views about what functions the state should perform) and how much of it should be derived from other forms of taxation, and other state activities that earn revenue. All of these are debatable. For these reasons, this paper will be concerned about principles only, and not about what the particular rates of income tax should be. It will also be concerned only with personal income taxation, and not with the taxation of the income of corporations or other entities, although some of the same principles will apply, *mutatis mutandis*.

2. Flat, Proportional, and Progressive Taxes

Popular rhetorical appeals to the desirability of a flat income tax can be confusing as 'flat tax' is not a term of art. Proponents of a flat tax are usually incensed at what they see as the steeply 'progressive' structure of personal income tax rates—that the higher one's income, *the higher the proportion* of one's income is lost to income tax. This is typically achieved by graduating the tax scale into several brackets, so that as one's income rises into another bracket, the dollars which fall within that bracket are taxed at a higher rate per dollar (commonly referred to as a higher marginal rate) than obtained in the bracket below, which in turn were taxed at a higher rate . . . and so on down, until one reaches a floor of zero income, or zero taxable income, should the scale recognise a threshold below which income is not taxable. By and large, proponents of a so-called flat tax do not object to high income earners paying more than low income earners in income tax. In other words none today, to the best of my knowledge, advocate a poll tax or uniform lump sum tax on incomes as the preferred form of income taxation, with every earner paying the same as every other, irrespective of the size of the income. If one were to be pedantic, this would be the purest form of flat tax, but it is plainly neither intended nor advocated by proponents of a so-called flat tax; indeed most would condemn such a tax as unfair.

A flat tax reduces the incentive to create or embrace schemes, often on the ill-defined edge of legality, to conceal or massage part of one's income to avoid the higher marginal rates.

Pedantics aside, what flat tax advocates (henceforth omitting 'so-called') really favour is a constant proportional rate of income taxation. They accept that high income earners should pay more of their income in taxation than low income earners. But they do not accept that high income earners should pay a higher proportion of their income in taxation. If the fraction of the income that had to be paid in taxation were the same for every income earner, whatever that fraction might be, then it would follow that the greater the income, the greater the amount surrendered in taxation. What is flat is not the amount but the proportion—it is the same proportion for all income recipients.

Plainly, a single proportionate rate has practical advantages over a progressive rate. The most obvious of these is simplicity, leading to lower costs to both tax payer and tax collector in the administration of the system. Depending on what scope there is for deductions, rebates, offsets and credits, completing and assessing tax returns is easier and so less demanding in terms of time. A related advantage is transparency—simple systems are easier to understand, and the impact of changes to them (e.g. a proposed change in the rate) is easier to assess.

A further advantage is that it reduces the incentive to create or embrace schemes, often on the ill-defined edge of legality, to conceal or massage part of one's income to avoid the higher marginal rates. Such incentives will always exist but the removal of higher marginal rates makes taking the risks (e.g. a subsequent disallowance or a court finding of illegality with possible impositions of penalties) associated with such schemes less attractive. Although difficult to prove or measure, there would appear to be compliance advantages with a single proportionate rate.

The practical advantages just sketched are relatively uncontroversial, and would generally be acknowledged even by those most strongly committed to progressive rates of income taxation. Thus while acknowledged, they are hardly seen as compelling. From here on in, the territory is vigorously disputed.

For example, one argument commonly given for a single proportionate rate is that higher marginal rates are a disincentive to effort. As high income earners are often highly talented and productive people, or possess especially valuable and/or rare skills (as their ability to earn a high income commonly testifies) anything that leads them to reduce their effort represents a loss to the economy of a valuable resource. When the economy loses, we all lose.

But there is an equal and opposite argument to the effect that high marginal rates are an incentive to even greater effort by the highly talented and productive. They have to work harder to secure a real rise in take home pay, as more and more of their salary is eaten up by taxation. High marginal tax rates enable the economy to 'squeeze more pips from the juiciest lemons'.

Who is right? The answer is surely, neither and both. There is evidence some people respond by curtailing their effort, others by redoubling it. A perfect illustration is the different attitudes employees of the same firm may have to the offer of voluntary overtime. Some say it is not worth the effort, should it take them into a higher marginal tax bracket; others, on the same base income, actively seek it out at every opportunity. Any additional money is better than none.

This clearly illustrates how difficult it is to give anything like precise weight to arguments about incentives. Different people in the same circumstances respond differently. Indeed if the second argument—that high marginal rates are an incentive to work even harder—has the greater weight, then perhaps we should have a deliberately regressive income tax system. With the highest rate of taxation at the bottom, then each bracket up the income scale taxed at a successively lower rate, one would have a powerful incentive to work one's way up the income scale as hard and as fast as one could, as one would keep more of each dollar earned in each successive bracket!

There is a further practical argument against progressive income tax rates along the lines that they are washed out by the remuneration system. When employers and employees, or their unions, negotiate agreements on wages and salaries, they do so conscious of the progressive income tax scale. Boards of directors commonly defend the high salaries paid to senior executives on the ground that they are not really so high when you take into account the loss through high marginal income tax rates. Unions justify their wage demands for skilled workers in terms of the take home amount; the amount left after taxation and other mandatory deductions are taken out of consideration. Thus bargaining and negotiating practice suggest that the gross wages and salaries paid to highly skilled, highly remunerated employees are higher than they would otherwise be, if these employees were not subject to higher marginal taxation rates.

> **So it will be consumers who pay the taxes because the prices of its goods and services reflect costs compensating employees for high marginal tax rates.**

And who pays these taxes? Although on paper they come from the employee, the employee's payment is a relatively painless one, assuming it has been largely compensated through the wage or salary level set. But the employer incurs the cost of a salary and wages bill higher than it would have been had the tax rate not been as high. If the employer employs a high proportion of highly skilled, highly remunerated employees, then that employer's payroll will reflect the high proportion of the employees paying higher marginal rates of taxation. The cost of payroll is a significant business cost, its significance dependent on the labour intensitivity of the business. Costs are reflected in prices. So it will be consumers—those who purchase the goods or services delivered by the business—who pay the taxes. This is because the prices of its goods and services reflect costs compensating employees for high marginal tax rates. (How precisely prices reflect these costs will of course depend on other factors also, such as elasticity of demand, retention of margins, and the extent to which competitors also incur such costs.) Since the price paid by the consumer does not vary according to the consumer's income, the progressive rates of income tax imposed on the employees of the business become a flat price component imposed on the consumers of its outputs. The progressiveness washes out through employee compensation and the pricing mechanism. A progressive income tax on higher earners morphs imperceptibly into what is in effect a flat consumption tax paid equally by all consumers.

Adam Smith expressed this 'washing through' argument in relation to income tax in general in his eighteenth century classic *The Wealth of Nations* (1776):

> A direct tax upon the wages of labour, therefore, though the labourer might perhaps pay it out of his hand, could not properly be said to be even advanced by him; at least if the demand for labour and the average price of provisions remained the same after the tax as before it. In all such cases not only the tax, but something more than the tax, would in reality be advanced by the person who immediately employed him. The final payment would in different cases fall upon different persons. The rise which such a tax might occasion in the wages of manufacturing labour would be advanced by the master manufacturer, who would both be entitled and obliged to charge it, with a profit, upon the price of his goods. The final payment of this rise of wages, therefore, together with the additional profit of the master manufacturer, would fall upon the consumer . . . [2]

It is difficult to run both this argument and the disincentive argument against progressive income tax, as this argument implies not that high marginal rates of taxation are a disincentive to extend productive effort; rather they are an incentive to negotiate higher remuneration for more of the same work. Where the arguments are comparable is in their conclusion that high marginal rates reduce productivity; the disincentive argument by claiming they deter additional endeavour by the highly skilled, the remuneration argument by claiming that they elevate the unit cost of such endeavour.

Once again, in practice both have some weight. Just as what will be a disincentive to one person may be an incentive to another in comparable circumstances, so some income earners may be in a position to negotiate a compensatory wage or salary increase, others may not, or may simply choose not to try.

The main difficulty with the argument about ‘washing out’ is that it assumes that the total payroll for a firm whose employees are paying a flat proportion of their income in taxation will be lower than it would be if the employees were subject to progressive rates of income taxation. This is impossible to know *a priori*. It all depends upon the mix of salary levels within the organisation and on the income tax rate(s) set, which in turn depend upon the preferred balance between income and non-income taxes, the total revenue the state seeks to acquire, and all the other variables which bear upon the rate at which a particular form of taxation is set.

The argument undermines the effectiveness of progressive rates of income taxation as a means for making the society ‘more equal’.

Where the argument does have merit is in undermining the effectiveness of progressive rates of income taxation as a means for making the society ‘more equal’ in the sense of bringing us closer to material distributive equality. (Whether such an end is desirable is considered, and rejected, in Section 3, p.7) The intended equalising effects of progressive rates of income tax are defeated through the combined mechanism of compensatory salary setting and the fact that rich and poor consumers pay the same for most goods and services. (While some pricing is consumer income sensitive, e.g. seniors’ discounts for theatre tickets are based in part on assumptions about the typical income levels of seniors, there are few products and services where prices are sensitive at the level of the individual consumer’s income. Exceptions include some unions and professional associations, where membership fees vary relative to wage or salary level.)

In the discussion so far it has been assumed that a flat tax cannot be progressive. However if the income tax system has a tax free threshold, so that what is sometimes called a ‘personal allowance’ or ‘subsistence allowance’ is exempt from income taxation, the application of a flat tax to all taxable income above the threshold will necessarily be progressive in its impact, relative to total income. If the rate is set at a flat proportion of taxable income, say 30 per cent, then the proportion of each person’s total income lost in tax will actually increase, the higher it is above the tax free threshold. It will never reach 30 percent of total income, but will move closer and closer to that limit as total income rises. Low income earners whose total income is not far above the tax free threshold will lose a lot less than 30 percent in income tax. Thus in a system which preserves a tax free threshold, the rate struck as the flat proportion of taxable income payable in tax will represent something like an ideal limit or ideal maximum—a rate that no one can ever actually pay, but to which their tax obligation will move closer and closer as their income rises. The higher the tax free threshold, the further up the income scale one would have to move before the proportion of total income paid in tax came extremely close to the proportion of income above the threshold paid in tax.

Thus, given a tax free threshold, a flat tax is progressive in impact. It is progressive because the higher one's total income, the greater the proportion lost in tax. While it is true, to continue with our hypothetical flat rate of 30 percent, that the first dollar over the tax free threshold is taxed at 30 percent, and the last dollar over is also taxed at that rate, the proportion of total income lost in tax rises automatically with distance above the threshold. The rise is much smoother than that associated with familiar bracketed progressive tax. Every successive dollar earned above the threshold is taxed at a marginally higher rate than the previous dollar earned. For this reason, it could be argued that it exhibits a more perfect form of progressivism.

Flat tax purists will argue that even this smooth and shallow raked inclination of progressiveness (once the threshold is crossed) is objectionable, because it imposes a proportionately greater burden on higher income earners. Moreover because it is progressive the incentive for high income earners to conceal or disguise income remains, in order to reduce the proportion of total income lost in tax. The only way to avoid this is to abolish the tax free threshold. Abolition carries another advantage in that serious attempts to develop flat tax models suggest that, to achieve a given revenue target, the rate required if a tax free threshold is set at some level approximating the level that applies in Australia today ($6,000) is very much higher than it needs to be if the tax free threshold is abolished.[3] This is incidentally indicative of the fact that, flat tax or not, taxpayers at large pay a high price so that the system can carry a tax free threshold. While it may well be politically difficult to abolish it, one can understand the reluctance of politicians to raise it to something credibly approximating the original idea of a bare individual subsistence allowance.

A flat tax is progressive because the higher one's total income, the greater the proportion lost in tax ... The only way to avoid this is to abolish the tax free threshold.

Arguments about the efficiency and effectiveness of a tax free threshold are very familiar and, purity apart, they are pretty well the same irrespective of whether a flat tax or a bracketed progressive tax is under consideration. If there is no tax free threshold, then those at the bottom of the income ladder are simultaneously income tax payers (for every taxable dollar they earn) and, as welfare recipients, beneficiaries of income tax transfers. While it might be possible to argue there are macro-efficiencies in this two way transfer, anecdotal evidence from talkback callers and editorial letter writers suggest it is resented, indeed regarded as risible, at the micro level. If such attitudes are representative, they are not helpful in encouraging voluntary compliance with the taxation system. Moreover it is not unreasonable to assume the transaction costs associated with preparing and processing tax returns for very low income earners consume much if not all of the revenue raised. Because they are not unique to the flat tax debate, these arguments will not be pursued further here.

3. A Flat Tax and Vertical Equity

It is generally agreed that justice and fairness require that an income tax system should embody horizontal and vertical equity. Expressed crudely, horizontal equity requires that taxpayers in comparable income circumstances be taxed comparably. Exceptions should only be of general application, i.e. apply equally to all and only those who meet the conditions on which the exception is based, and be ethically fair in substance, as opposed to merely opportunistic or pragmatic. While not denying that comparability of circumstances requires judgement, and reasonable people can disagree in their judgements about whether particular circumstances are comparable, the jurisprudential principle behind it is straightforward. In its rejection of arbitrariness or capriciousness in the administration of the tax law it simply reflects the ancient doctrine of the rule of law, while its emphasis on comparability and the generality of exceptions it reflects a key component of procedural justice—that like cases should be treated alike.

By contrast, vertical equity is equity not across the breadth of taxpayers, but through the range, low to high, of taxpayer incomes. While it is taxpayers who *pay* the tax, it is their *incomes* that are being taxed. And, as we know, incomes are very different from one another. The corollary of the procedural justice principle requiring that like cases be treated alike is usually expressed, 'and unlike cases unlike, each in a way that is proportionate to its relevant difference(s).' A high income is unlike a low income in size. Is this a relevant difference from the point of view of equitable taxation treatment? If it is, how does one reflect this difference in the way they are treated for taxation purposes, to ensure that the difference is treated proportionately? To answer these questions is to put forward a theory of vertical equity in the treatment of income tax.

Stated like that it seems obvious that the just way to tax incomes of different sizes would be through a flat proportional rate. Indeed, it would seem to be the arithmetically perfect mechanism for achieving vertical equity in a way that is procedurally just. In the end it is contended that this view is in fact correct. However, there are three main arguments that this is not so. For simplicity, they are treated here as discrete arguments, although in practice they are often bundled (critics would say muddled) together. The first (considered in 3.1 below) argues that the value of each dollar in the hands of the earner is not equal. If this is correct, then—contrary to appearances—a flat proportionate tax is not really procedurally just, and thus fails the test of vertical equity. The second and third argue that there are other considerations which override the requirement of procedural justice. They both argue that because a flat proportionate rate is consistent with huge disparities in after-tax income, which is true, it should be rejected in favour of a mechanism reducing such disparities, and perhaps ideally eliminating them altogether. The second (considered in 3.2) argues that the disparities of income which are left untouched by a flat proportionate rate (or barely touched if it includes the progressivism consequent upon a tax free threshold) are so harmful, particularly to those with lower incomes, that considerations of utility should override the requirement of procedural justice. The third (considered in 3.3) argues that there is another form of justice relevant to vertical equity, namely social justice, which is (or so it is contended) ethically prior in its application to the requirements of procedural justice.

3.1 Is Every Earned Dollar of Equal Value?

Consider first the argument that the value of each dollar in the hands of each earner is not equal. A low income earner would miss the last dollar he or she earns more than would a high income earner. Therefore, if required to surrender the last dollar, the sacrifice made by the low income earner would be much greater than that made by the higher income earner. But what if each were made to surrender the same proportion of their income, as required by a flat proportionate rate of tax? This 'sacrificial disparity' would still remain, indeed must remain, if the income gap between the two is wide enough. Stay with our hypothetical flat tax of 30 percent. The person earning $100,000 surrenders $30,000, leaving a net after tax income of $70,000. The person earning $50,000 surrenders $15,000, leaving a net income of $35,000. From the point of view of the flat tax they have both been treated equally, each surrendering 30 percent of their income.

The only way of ensuring that the value of the last after tax dollar is the same for low and high income earners is to have a tax regime that ensures absolute equality of net income.

Plainly, if we accept the premise that the value of the last dollar earned increases as total income declines, the inequality of sacrifice remains. But has this *relative* inequality *increased* as a result of the application of the flat tax? Is the value gap between retained dollar number 35,000 and retained dollar number 70,000 greater than that between gross dollar number 50,000 and gross dollar number 100,000, in the hands of their respective earners? It is not obvious that it is. Certainly the gap has not been reduced, let alone eliminated. The only way of ensuring that the value of the last after tax dollar of the low income earner is the same as that of the high income earner—assuming that this is a proper aim of an income tax system—is to have a tax regime that ensures absolute equality of net income. This may appeal to fanatical egalitarians who fantasise that personal material reward can be totally disconnected from productive labour, but does an income tax regime that brings this about really implement equality of sacrifice? To insist that it does would be to insist that the person with the multi-million dollar annual income was simply being required to make precisely the same sacrifice as the person who was earning, say, $100 more than whatever is proposed as the uniform net income. This is manifestly implausible.

An analogy will underline this. A critical oil shortage arises and it is decided to ration petrol. Henceforth all motorists, irrespective of their current usage patterns, are limited to a maximum purchase of 50 litres per week. Whatever the merits of such a limit, it could not be defended on the ground that the person currently consuming 500 litres per week was simply being required to make the same sacrifice as the person now consuming 60 litres per week.

No doubt it will be protested that money is not like petrol. Petrol, unlike money, does not have a 'declining marginal utility'. The last dollar earned by a high income earner is of a lower marginal utility—and therefore will be missed less—than the last dollar earned by a low income earner. Equality of sacrifice may not require perfect equality of net incomes, but it does require equality in how much we miss what we have been required to give up. This may not result in perfect equality of net incomes, but it will produce a greater tendency towards equality than does the application of a flat tax. Equality of financial outcome gives way to equality of pain.

The assumption on which this contention rests is quite indefensible. How much a person misses the lost part of their income is not a function of the size of the loss in relation to what would otherwise have been the total. It depends upon the person's desires, tastes, ambitions and goals, together with their standing legal and personal commitments, as well as all of their surrounding circumstances. (The same, incidentally, is true of petrol.) These are all aspects of life's rich tapestry in which we vary from one another and which, at the individual level, there are variations over time. Even if it were possible to measure the intensity of all of these variables on a common scale, the best we could get would be a highly individualised measure of felt loss. Some money hungry might contend they could never have too much money, such is their appetite for what it will buy, or such is the gratification they derive from simply hoarding it. And even this would fail to account for huge differences in the level of pain felt in adjusting to a felt loss. The only thing we could be certain of is that income tax scales predicated on the need to achieve equality of felt loss would be unlikely to result in any two individuals with identical incomes being subject to the same income tax rates. If this is what is required to achieve vertical equity, then it can only be achieved by abandoning horizontal equity.

But the key question is whether the disparities are bad. There is a real danger that the assumption that they are will be taken as axiomatic.

To compound this absurdity, it would make it rational for people with a large appetite for money to cultivate a deep sense of loss at any deprivation, thus minimising their tax! It would not be a pretty world. Fortunately, such a world is not a practical possibility. (We return to the issue of declining marginal utility under 3.3 in this section.)

In fact the only way of achieving an *objectively measurable* form of equality of sacrifice is through a flat proportionate tax rate without a tax free threshold. No two taxpayers on different incomes sacrifice the same amount in tax, but every taxpayer sacrifices exactly the same proportion of his or her income as every other. If equality of sacrifice is one of the *desiderata* for an ethically sound income tax system, then a flat proportionate rate would appear to achieve it better than any of its rivals.

3.2 Are Income Disparities Harmful?

If disparities in income are a bad thing, and progressive income tax rates represent an efficient mechanism for reducing such disparities (or at least a more efficient mechanism than a flat tax rate), then this would represent an ethically significant argument for favouring a progressive rate. But the key question is whether the disparities are bad. There is a real danger that the assumption that they are will be taken as axiomatic. Day after day it is repeated that the 'income gap' between rich and poor is a blight on society, and the fact that it is widening is a social disgrace which politicians must do more to address. Such lamentations come not just from 'the usual suspects'—the clerical left, the social welfare lobby, the Greens and the education unions—but are often echoed uncritically by middle of the road social and economic commentators. Rarely do they elicit a rejoinder, even from conservative politicians and commentators.

This is partly explained by two common assumptions, both of which are flawed. The first is that if income disparities exist, then those on the lowest incomes do not have enough to live a life of reasonable sufficiency and dignity. Sadly, this is sometimes true. But it is not *necessarily* true, and it is not always *in fact* true. Where it is true, it can be addressed by measures which need not have a long term implication for reducing any growth in top to bottom income disparities. What these measures must ensure is that, whatever happens, the lowest incomes are always, in real terms, above whatever is agreed as the minimum threshold for reasonable sufficiency and dignity. Almost certainly, this will require tax transfers (whether derived from income tax or otherwise) to those who would otherwise fall below the threshold, but this has no implication whatsoever for *movements* in the size of the income gap, or the direction of its subsequent movements (although there will be an immediate shrinking of the gap if the transfers to the poor take the form of cash payments, financed disproportionately from high income earners). In sum, disparities of income do not necessarily imply that the lowest incomes will be inadequate by any reasonable standard, nor do they imply, if the lowest are in fact inadequate, that this can only be addressed by measures which reduce the income gap *over the medium to long term.*

The second false assumption is that a widening of the income gap is in fact a bad thing, *even if it does not result in the lowest incomes falling below the threshold of reasonable adequacy.* Unfortunately, it seems as if our ears are still ringing from the words of the 1940s popular song, that 'the rich get rich but the poor get poorer … ain't we got fun.' As already suggested, present day Australia may well be a perfect counter-example. High incomes and low incomes are both rising, with the highest incomes rising at a faster rate than the lowest incomes.

Our ears are still ringing from the words of the 1940s popular song, that 'the rich get rich but the poor get poorer … ain't we got fun.' But present day Australia may well be a perfect counter-example.

But some will argue this is still a bad thing. The gap itself is bad, and the fact that it is widening means that it is worsening. But why? Consider two different hypothetical societies A and B. In both these hypothetical societies, nobody's income is below whatever is taken as the base level of reasonable sufficiency. In Society A incomes range from a minimum of $50,000 per annum to a maximum of $70,000—a gap of $20,000. In Society B incomes range from a minimum of $50,000 to a maximum of $80,000—a gap of $30,000. Nobody in Society B is worse off than the worst off in Society A. But some people in Society B are markedly better off than anyone in Society A. Assuming both societies have the same number of people and all other morally significant factors are equal as between A and B, which is the better society? Society A has the narrowest income gap. But Society B has the greatest total wealth.

At this point, we encounter a fundamental difference of intuitions. Those who regard egalitarianism as an overwhelming social good will favour Society A—end of story. So let us now consider both societies in one year's time. Both make real material progress from which every income earner benefits (assume internal income relativities are evenly distributed and remain constant throughout). In Society A in one year's time (Society A+1) incomes now range from a lowest of $60,000 to a highest of $75,000. The income gap has been narrowed to $15,000 while its income floor has been raised by $10,000 and its ceiling by $5,000. In Society B+1 incomes have also grown, now ranging from a minimum of $65,000 to a maximum of $110,000. But the income gap has widened, from $30,000 to $45,000. A year ago the income gap between lowest and highest in Society B was 50 percent greater than it was in Society A—now it is three times as much.

Once again, intuitions will differ as to which is the better society a year later. But it is worth contemplating the price the egalitarian is now paying. To prefer A+1 over B+1 is to say reducing the income gap is to be preferred, even when it means not only the highest incomes but also the lowest incomes are lower than they are under an alternative scenario. Given a choice, the egalitarian not only prefers A to B, but prefers a transition from A to A+1, over a transition from B to B+1. Indeed, in terms of maximising social improvement, the egalitarian's preferred task would be to engineer a transition from Society B to Society A+1. This involves the maximum reduction in the income gap. It is doubtful whether anyone who experienced the transition from Society B to B+1 from within would agree.

Do we just throw up our hands at this point and say we are stuck with a conflict of intuitions about moral preferability? Is there *anything* the egalitarian can point to in order to justify preferring a progressive income tax regime because of its net income equalising impact? There are two further considerations. One is to argue that although a society in which the gap between higher and lower income earners is increasing need not make low earners materially worse off, they nonetheless suffer a hurt of a non-economic kind, even if their material circumstances are improving. The other is to argue that a society with a widening income gap violates considerations of social justice. (The appeal to social justice is dealt with separately under 3.3.)

What sort of non-economic hurt might lower income earners suffer? It is contended that when the gap between lower income earners and higher income earners is not narrowing, lower income earners *feel* they are making no progress, even if their material circumstances are improving. And if the gap between their income and that of higher earners is growing, they *feel* that they are *going backwards*. The fact that their material circumstances may also be improving does not alter this feeling, since their feeling is based on their perception of their relative income standing, and this relative income position, although rising relative to their own past position, is declining relative to the position of the highest earners. Objectively, they are better off in their materially absolute position, but worse off in their socially relative position. Subjectively, it is their socially relative position that is the source of their feelings as to how well they are doing.

'Keeping up with the Joneses' in the end counts for more in many people's self assessment of how they are travelling than simply being better off than one used to be.

This argument represents a shift in emphasis in the egalitarian's position from that of favouring a society in which the gap between higher and lower incomes is narrowing in absolute terms, to one in which it is narrowing in relative terms. While it may indeed be a good thing that both the rich and the poor are getting richer, egalitarianism also requires that the relative gains favour those on lower incomes. Granted, the poor who are getting richer are not hurt economically by the rich getting even richer at a faster rate, but their relative income position does slip. Why does this matter? It matters because people's perception of how well they are doing is based on where they see their relative position. This perception gives rise to the feeling they are falling behind, and this overrides the reality that they are materially getting ahead, being materially better off than they were previously. 'Keeping up with the Joneses' in the end counts for more in many people's self assessment of how they are travelling than simply being better off than one used to be.

How widespread are such feelings? It is difficult to tell from such evidence as there is in polls purporting to measure 'public satisfaction', however there is no doubt feelings of this type do exist. For the sake of argument, let us assume that they are extremely common. The question then becomes, do they matter, and if so, how much do they matter? Do they represent a compelling consideration in favour of a progressive income tax designed to do what a flat proportionate tax rate cannot do; namely narrow the net income gap between high and low earners, in such a way that low earners improve their relative position?

Sometimes we consider it appropriate to protect people's feelings by passing laws intended to reduce the chances of their feelings being hurt. Thus laws against offensive language recognise that in certain circumstances the hurt that people feel when demeaned by the words of others is something they should not have to suffer; so much so that it is worth imposing an appropriate legal restriction on the principle of freedom of expression. (Such laws also support a public good, namely civility of discourse.) In other cases we consider it less appropriate to 'pander' to people's hurt feelings. For example, policies that prevent the performance of school pupils being graded in terms of pass and fail, or ranked in order relative to one another, because this could damage the 'self esteem' of those who are failed or ranked near the bottom, are widely condemned by those outside the school systems. To critics, minimising hurt feelings in these circumstances is far less important than enabling parents, communities, and the children themselves to have maximum information about their performance relative to published standards and each other. In other words, we have to be satisfied that the price paid for preventing or reducing the incidence of hurt feelings in a particular context is worth it.

If we are to justify taxing high incomes in such a way that the relative position of those on lower incomes improves, it has to be because we consider that their feelings of treading water or being left behind—even when there is an absolute improvement in their material circumstances—

are so bad that higher earners should pay the price for ensuring that these feelings do not occur. At the other extreme we might respond by saying, 'Just get over it.' After all, the mere existence of a feeling does not mean that the attitude or judgement grounded on it is justified. Thus we sometimes tell people to stop wallowing in self-pity, or condemn their feeling sorry for themselves as self-indulgent, especially if we judge that they are responding disproportionately to something they have experienced as an adversity. Moreover, we know that it is possible to have some degree of control over one's feelings. For example, the critically important 'consciousness raising' strategies of revolutionary socialism, radical feminism and countless other ideologies involve motivating people to feel grossly indignant, offended and upset about things (like being asked to make coffee) to which they were previously indifferent, or which they found a comparatively minor irritant.

It is sometimes said (e.g. by Hayek in the quotation at the head of this paper) that the hurt feelings of low income earners to which we are responding in defending a progressive rate of income tax are really just feelings of envy. There is no doubt that the envious can derive satisfaction from the fact that high earners have to sacrifice a higher proportion of their income in taxation than they do. Indeed, the sin of envy has been described as the most destructive of all of the seven deadly sins because it derives its satisfaction from seeing the object of envy stripped of the attribute which is the source of envy, even if nobody else, including the envious themselves, benefits as a result. John Stuart Mill called envy 'the most anti-social and evil of all passions.' [4]

There is probably little that attracts less sympathy than the tax woes of high income earners, even when these woes result from the operation of tax policies which are manifestly unjust or opportunistic. The reality of envy certainly makes it attractive for politicians to promise to 'soak the rich' in order to finance their policies. As Hayek and Nozick, among others, have pointed out, underlying envy makes a progressive income tax system politically clever because it guarantees that, however much a taxpayer is forfeiting, most—all but the very highest earners—can console themselves with the thought that there are others who are forfeiting not just more but proportionately more.[5]

The reality of envy certainly makes it attractive for politicians to promise to 'soak the rich' in order to finance their policies.

If it is true that it is to feelings of envy to which progressive rates of income tax defer, then we can only conclude that respecting and reinforcing such feelings, far from overriding considerations of procedural justice, represents an ethically unacceptable basis for such a policy. To have one's envy triggered is not to suffer a non-economic hurt that must be ameliorated or as fas as possible prevented. On the contrary envy, whether or not one agrees it is the most destructive of the seven deadly sins, is an all too common defect of character that we should do our very best to overcome.

While there is no doubting the reality of income envy, is it really as widespread as critics claim? I am not aware of any recent empirical study demonstrating just how extensive it is and, of at least equal importance, how intensively it is felt. We know it exists. We know it is not universal. But where it sits between these two extremes is unclear. For that reason, it is dangerous to claim, at least implicitly, that it is the only or the most dominant feeling to which progressive income tax rates pander.

There is another feeling easily confused with envy, namely resentment. It is manifest that people on modest incomes commonly resent the fact that there are others with incomes not only many times greater than theirs, but many times greater than anything within their prospects, no matter how long and hard they work. If their income is also rising faster, resentment compounds. Resentment-fuelled anger is not just directed at those whose very high incomes result from borderline illegality or conduct which, while technically legal, is plainly unethical, or at least arguably so. At the same time, it is directed selectively. When the very high earner is a sporting hero, rock star, novelist, or Hollywood celebrity, the resentment disappears. Indeed, an almost affectionate 'Good luck to them' is a common response. At the other extreme, if that very high income is a salary paid to a chief executive officer of a major corporation or a senior government bureaucrat, then words like 'obscene'—a word that can have no literal application to an income—are hissed with undiluted venom.

Plainly, the differences in resentment level are not a function of the level of the high income. Moreover, they are reflected in a difference in attitudes to strategies taken to avoid income tax.

An international rock star who manipulates his or her domiciliary and banking arrangements to avoid the bite of the income tax laws that would otherwise apply is rarely condemned by the fans, and often regarded with some sympathy, even as smart. The corporate executive on a comparable income who does the same is dismissed as wicked and contemptible for calculated tax evasion.

So why do common attitudes to high income earners vary so dramatically depending on how the income is earned? Where the income is a reward for a personal performance the fruits of which are obvious to all, resentment diminishes or disappears. But where the high earner's personal contribution is a contribution to the work of an organisation, possibly through the exemplary discharge of highly onerous leadership responsibilities, resentment levels rise. One view is that this is because so many modest earners are paid to perform duties of various levels of difficulty and complexity for so many hours per week. Such earners find it easy to understand how reward may vary according to the level of difficulty of the tasks, the time devoted to them, and the arduousness of the circumstances in which they are required to be performed. But they find it incomprehensible, when their earning ceiling may be, at best, \$100,000 per year that the salary paid to their chief executive is measured in millions. Leadership by the captain of the team may be a decisive factor in a winning performance, but how can it be worth *that much* more? It is the struggle to express this breathtaking incomprehensibility that lies behind the branding of such salaries as obscene.

The high rewards earned by successful rock stars, footballers, and novelists are defended on such grounds as the fact that these entertainers bring so much enjoyment to millions of people, each of whom pays comparatively little to access their output. But in the case of the corporate executive, however successful he or she may be, there is no such evident nexus between choosing to pay something toaccess the product of the organisation, and voting to express appreciation of what the executive does. Indeed most consumers have no idea of who the executives are, what they actually do, and what the relationship is between the executive's contribution and the goods or services for which the consumers pay. Why is it then, if the entertainer's earnings are not obscene, that those same earnings by a senior corporate executive are? Plainly, it is not the quantum of the income, but the facts that the consumer chooses to spend money to appreciate the very performance that is being rewarded, and can comprehend the relationship between payment and performance, that are the most obvious differences.

Resentment takes the form of a felt sense of injustice or unfairness. Hence the rock star's high income is not a source of resentment unlike that of the corporate executive.

There are two morals. First, for what it is worth, it is simply not true that the public at large regards very high income levels as *per se* obscene. The second is that it is not the quantum of the income, but the way in which that very high income *appears* to be earned, that is the source of resentment. If these morals are correctly drawn, then it is missing the point to see income disparities in general, and a widening of the income gap in particular, as a direct cause of the felt hurt, be it expressed through attitudes of envy, resentment, or anything else for that matter, experienced by low income earners.

The existence of such resentment, albeit selectively directed, means that politicians who defend higher marginal tax rates for high income earners are more likely to be applauded than condemned. Resentment is not the same as envy, and it is submitted that resentment, more than envy, is the attitude to which high marginal tax rates pander. To feel resentment is to feel hurt or offended by the apparently more favourable treatment of someone with whom one regards oneself as comparable. It often takes the form of a felt sense of injustice or unfairness. This explains why the rock star's high income is not a source of resentment (except possibly among other rock wannabes) unlike that of the corporate executive.

Thus the most important difference between resentment and envy is that resentment, unlike envy, is grounded in a sense that the advantage enjoyed by the person who is resented has been awarded on a basis that is unfair or unjust, relative to one's own position. Accordingly, behind the feeling of resentment is the sense that the advantage enjoyed by the other has an unethical basis. It is not implied that the beneficiary has behaved unethically; rather, the implication is that the person, or the system, that has conferred that advantage is ethically defective. Given that felt resentment, unlike envy, has an apparently ethical source, does this mean that it is something that should be addressed through a progressive tax scale?

The answer, once again, is no. First of all, the fact that someone's advantage appears to arise from conduct by another which *appears* unethical does not mean that it is unethical. Moreover, the enterprise of trying to establish what has been called comparative wage justice on an objective basis, or equal pay for work of equal value, is one that has repeatedly failed. For all its imperfections, we really have nothing more robust for the pricing of work than an open and well informed market. Inevitably, such a market will price some tasks as performed by some people at levels that surprise. Third, even if some of these surprises are thought simply unacceptable, they cannot be addressed by progressivism in the income tax scale. This relates only to the quantum of the income and thus does not discriminate between two incomes of identical amounts, even if it is agreed that one is justly based and the other not. The only way of avoiding such an outcome is through a centralised wages and salaries system under which all wages and salaries are set according to a non-market judgement as to the value of the work performed. History shows conclusively that such a system is simply unworkable.

The upshot is that feelings of resentment based on disparities of income, even when it is thought that such felt hurts do merit being addressed, provide no basis for introducing progressivism into rates of income tax.

For all its imperfections, we really have nothing more robust for the pricing of work than an open and well informed market.

3.3 Vertical Equity and Social Justice

Given a choice between a just society and an unjust society, most of us would opt for a just society. But behind this screen of rhetorical agreement, there lurks quite profound disagreement as to what (if indeed anything) is meant by social justice. The disagreement boils down to this. Is there more to social justice than a society in which individuals and institutions always act justly to one another? Is there more to a just society than the aggregate of universal respect for each other's rights (whatever these may be); governance in accordance with the rule of law; procedural justice in the application of laws, rules, and regulations; and proportionality and consistency in the imposition of penalties and punishments? It is agreed that there may well be more to a *good* society than is constituted by this aggregate—after all 'just' and 'good' are not synonyms.

If there is more to social justice, what more might there be? The most common answer, although its popularity is rather recent relative to the two millennia plus recorded history of philosophising about justice, is *distributive* justice. Distributive justice relates to the justice of the way in which material wealth, including income, is distributed.

Nobody would seriously argue for or defend a *maldistribution* of material wealth—a distribution which is the traceable consequence of wrongdoing in the acquisition and/or transfer of material wealth. To the extent that it is practically possible to track and allocate responsibility for such wrongdoing, justice demands restitution and/or compensation, together with retributive punishment where appropriate.

But can there be a distribution of material wealth which is socially unjust, even though this distribution is in no significant way the result of wrongdoing? What of the situation, for example, when a section of the population has insufficient material wealth to meet even their bare subsistence needs? Agreed, this is an unacceptable situation and one which must be remedied, and preferably prevented in the future. On pain of trivialising the concept of justice however, we must not fall into the trap of labelling every social evil and every social ill an injustice. The fact that an evil ought to be expunged does not make its existence, even its continuing existence, an injustice. Our obligation to assist those in need is grounded ultimately in the virtuous sentiments of sympathy and compassion, which in turn are prompted by our awareness and understanding of their need. That need, of course, might well arise from their being innocent victims of injustice. Then, again, it might not. For example, it might well arise from their being victims of misfortune or misadventure, or from what insurance companies call an act of God. Need has many parents.

Those who are most concerned about large and growing inequalities in the distribution of material wealth, including widening disparities of incomes, often claim that such a distribution violates any reasonable standard of distributive justice. It is worth noting once again, this time with particular acknowledgement to Nozick, that these inequalities and disparities need not be a consequence of wrongdoing.[6] To take a simple hypothetical example to make the point, imagine two things that are utterly improbable. The first is that, from midnight tonight, there is perfect equality in the distribution of wealth, including equality of incomes. Moreover the common level of wealth is way above subsistence level. Second, imagine that this is a society in which what we might call the doctrine of original virtue applies. Nobody sins. Nobody steals, cheats, or deceives. Nobody ever knowingly hurts or disadvantages their fellows. How long would it be before inequalities in material wealth emerged? One act of generosity, one act of giving, or one act of love expressed through material benefaction would be enough to reintroduce inequality. As people expressed their affections by giving elements of their wealth to others, inequalities would inevitably emerge. Then there is the fact that some people like, and therefore value, some things more than others. Through barter and trade, based on their subjective valuations, further inequalities in wealth will develop. Then there is the fact that some will live longer than others, some will incur more illnesses and misfortunes than others, and some will be more frugal by inclination than others. Combine all of these factors and we see how quickly, and inevitably, this society of perfectly virtuous equals will grow in material inequality. And it will happen without there being one vicious or malicious deed. Even the abolition of wrongdoing and a perfectly equal starting point will not stop growth in material inequality.

While much inequality results from wrongdoing, much does not. It also arises from differences in personal taste, frugality, affections proneness to illness, luck ...

As Nozick points out, controlling such growth in inequality would require perpetual state intervention to cancel out all these new disparities as quickly as possible. Perhaps there could be confiscatory death duties and taxes on gifts in the hands of recipients, together with laws which criminalise allowing one's wealth to drop below a certain level. There is no need to take the hypotheticals further; the point is clear. Moreover the same point applies whether we favour perfect equality in the distribution of material wealth or, as is more commonly contended, limiting inequalities to a range between an upper and lower band deemed tolerable. The level of intervention by the state required to contain inequalities, *whatever* the breadth of the proposed tolerance range, must be comprehensive, wide ranging and incessant. The relationship between enforced material equality and freedom—even wholly virtuous exercises of freedom—is confirmed once again as inimical. It would seem that, starting with an initial distribution of wealth which is perfectly equal and more than adequate for anyone's needs, we will progress inexorably, solely by conduct that is ethically impeccable, to a distributive outcome which the distributive egalitarian will condemn as unjust. Two wrongs may not add up to a right, but two rights—indeed many thousands of rights—will inevitably add up to a great big wrong. We may well accept that the road to hell is paved with good intentions. It is harder to accept that it is paved with good deeds.

While it is true, in the real world, that much inequality results from wrongdoing, much does not. It also arises from differences in personal taste, frugality, affections and the way we choose to express them, proneness to illness, luck, and our differing subjective valuations of all that life has to offer, material and immaterial. It is to counteract these, and not just wrongdoing, that the forces of the state animated by the ideal of minimising distributive inequality must be directed. Is it really worth it? Or is it rather the ideal of minimising distributive inequality—in pursuit of which progressive rates of income tax are a major instrument—that is the bewitching mirage?

Those who favour progressive rates of income tax tend to emphasise the benefits to the recipients of redistribution (e.g. through direct transfers or means tested programmes) rather than the costs to those who make the proportionately greater income tax contribution. Once again the argument is often conducted in terms of declining marginal utility of the income sacrificed as incomes rise—an approach which we have already seen is flawed. But even if it were not flawed, even if we grant—for the sake of argument—the claim about declining marginal utility, it still would not follow that progressivism was ethically justified.

Consider an analogy; again with acknowledgement to Nozick.[7] Let us suppose that advances in organ transplant technology continue as rapidly over the next five decades as they have over the past five. Rejection is no longer a problem. The marginal loss to a person with two perfectly healthy kidneys, of one kidney, is very much smaller than the marginal gain to someone with two failed kidneys, of one healthy kidney. The marginal loss to someone, with two strong arms (or legs, or eyes, or whatever) is very much smaller than the marginal gain to someone who is armless (or legless, blind, etc.) Therefore, in order to ensure there is sufficient supply to assist those who are most in need, the healthy will be required to contribute their 'surplus organs' to a central organ bank, with the most healthy and strongest required to make the largest contributions. This is, after all, only fair. They have the greatest capacity to contribute. And their marginal loss is much smaller than the loss for a person with average or indifferent health. In the end this will bring us much closer to the ideal of reducing bodily inequality.

Is it just the gruesomeness of this scenario that inclines us to reject it? Let us try to put this understandable emotion to one side. After all, we celebrate those who, out of a very strong desire to save the life of a family member, or in some cases a stranger, donate a healthy kidney. The question is what would be wrong—subject to appropriate advances in transplant technology—in moving from this Good Samaritan or charitable approach, to an approach based on legal obligation?

No doubt some utilitarians would say nothing. But this would simply be yet another case in which utilitarianism (or 'moral rationalism') yields counter-intuitive results. Nor is our objection to legal compulsion based on doubts regarding the claims about marginal utility. Is it just that we feel more 'attached' to our organs and bodily parts than we do to our money? One dollar is as good as any other, but my kidneys are special because they are parts *of me*. This feeling of personal integrity may well be part of it, but it is not the whole of it. Rather, it is that the very healthy and fit are *no more responsible* for the plight of those in medical need than are those of good or average health. Indeed, in the first of two different ways of understanding moral responsibility about to be distinguished, this is not an issue of responsibility at all.

Our moral obligation to assist the poor by contributing to enabling them to cross whatever is deemed the threshold for a life of sufficient adequacy and dignity is an assumed responsibility.

Moral responsibility may be either historic or assumed. You are historically responsible for something only if you *caused* it, whether by act or omission, and you are morally responsible, in this historic sense, only if you caused it voluntarily and with an understanding of the likely consequences. You are responsible for something in the assumed sense if you are obliged to deal with it (e.g. by maintaining it or correcting it, as appropriate), although you were not historically responsible for it. Where this obligation is a moral obligation (as opposed to, e.g. a legal duty, a duty of your office, or a regulatory requirement) then you are morally responsible for dealing with it.

An assumed responsibility for something does not presuppose a historic responsibility for it; indeed it typically assumes its absence. Contrary to some of the rhetoric, those who are well to do in an open market economy are not (with some spectacular individual exceptions) historically responsible for the plight of the poor. You cannot be historically responsible for something which would have been exactly the same, even if you had never existed. An assumed responsibility is so-called because the obligation derives not from what you caused but from where you are now placed. Likewise the very healthy have no historic responsibility for the plight of those with organs or bodily parts in need of replacement unless they deliberately or with culpable negligence caused them injury.

Our moral obligation to assist the poor by contributing to enabling them to cross whatever is deemed the threshold for a life of sufficient adequacy and dignity is an assumed responsibility. It derives fundamentally from our status as fellow citizens of the same community, who together have the capacity to lift them over the line. How is this proved? I know of no direct proof. Rather, a community is sustainable in the long term only if all citizens, rich and poor, believe that it can confer a life of decency on them and all their fellows, or at the very least a life superior to any reasonably likely alternative. (True, it might survive for a time—as many have—with mass oppression and impoverishment, or poverty-stricken ghettoes of degradation overseen by a strong police presence, but the members of any such degraded sub-community could hardly be credited with any *moral* responsibility, whether historical or assumed, for the well being of the wider community.)

Granted, this is far from a compelling argument, but it at least has the merit of seeing our assumed responsibilities to those below the threshold in our community as a natural extension of the assumed responsibilities with which we have long been familiar in well-functioning families, clans, and tribes. However a proper examination of this argument would take us well beyond the scope of this paper.

More to the point, assumed responsibilities have nothing whatsoever to do with distributive justice, or indeed justice in any form at all. Recognition that another has a fundamental need that is beyond their power to meet naturally begets sympathy or compassion. And sympathy in turn prompts acts of generosity to assist in meeting that need. Some people are naturally more generous than others, and some needs tug at the heart more than do others. In a large and complex society, reliance on sympathy and generosity at the micro level is neither efficient nor effective as a mechanism for ensuring common basic needs are consistently and comprehensively met. It is this natural sympathy generalised that ultimately drives the emergence, and eventual acceptance, of the idea of a shared willingness of those above the threshold to *assume* responsibility for those below. It is important to be clear that the proposition that the position of those below the threshold is *unjust,* or that their being permitted to remain in that position is an *injustice*, forms no part of the argument, and adds nothing of substance to it whatsoever. What it does add is a rhetorical flourish which, to take the words attributed to Bertrand Russell in another context, has all of the ethical advantages of theft over honest toil. The moral obligation to assist those in need derives *from* the assumption of responsibility, not the reverse, and the ultimate foundation of this assumption is sympathy. It is our heart that rules our head.

'A just price, a just wage, a just rate of interest is a contradiction in terms ... The only valid questions are what he can get in return for his goods or labour, and whether he ought to sell them at all.'

When it comes to those whose needs can only be met by the supply of vital or very important bodily organs or parts from among the living, our sympathy is just as real, but insofar as there is an assumption of responsibility it expresses itself only in terms of financial support—the supply of the organs and parts themselves is seen as wholly within the realm of private generosity of a highly commendable sort. (Why this is so is an important but separate topic.) Once again, it is simply wrong to suggest that whatever we may do to support those with a desperate need for bodily parts and organs is founded on justice. Their suffering is not an injustice, and its correction or amelioration is not the remedying of an injustice. Exceptional circumstances aside, the person in need—whatever that need may be for, and whatever may be necessary to address it—is not the victim of some form of *distributive injustice*, in this case a physiological distributive injustice, albeit one that was never designed or intended. Therefore there can be no claim founded on justice for access to the ethically acquired resources of those who have the capacity to assist in meeting it. That claim is justified only if the person to whom it is directed is *responsible* for the need (whether the responsibility be historical or assumed) and therefore has a moral obligation to address it. All else is generosity and charity.

The idea of determining *a priori* the correct, or indeed the best, way of distributing society's wealth is as misconceived as that of determining the 'true' (non-market) value of work of a certain sort, or the socially just wage for each occupation. While it is beyond the scope of this paper to examine them here, in the end they all fail because they are unconvincing in their choice of over-arching value (e.g. equality) and/or they require a continuing level of intervention by the state that unduly compromises other ideals such as freedom, including the freedom of people to express their tastes and affections in ways that violate no plausible moral standard (e.g. through giving). In addition, they also give rise to familiar economic disutility, as non-market pricing of labour distorts costs, prices, and patterns of skill formation, and disrupts productive market investment. Perhaps the position was best summarised by the sadly overlooked philosopher R. G. Collingwood when he concluded nearly 80 years ago:

> A just price, a just wage, a just rate of interest is a contradiction in terms. The question what a person ought to get in return for his goods and labour is a question absolutely devoid of meaning, The only valid questions are what he *can* get in return for his goods or labour, and whether he ought to sell them at all.[9]

4. Conclusion

Those who advocate a flat tax as understood in this paper are commonly ridiculed as advocating the economic equivalent of 'flat Earth science', or for lacking compassion and betraying callous indifference to social justice. True, a flat tax has often formed a plank in platforms advocated by fringe groups who are in other respects extremist or just plain 'nutters'. It is all too easy for critics to point to mad policy envelopes whose contents include a flat tax in order to imply that a flat tax is fatally infected by the company it keeps.

Yet the upshot of the arguments collected in this paper—many of which have bounced around the literature in various forms for much of the last century—is that it is *progressivism* in rates of income tax that cannot be squared with the demands of justice. We have seen that, on the face of it, a flat proportionate rate of income tax meets the requirements of procedural justice with text book arithmetical perfection. It involves treating like cases alike, and unlike cases differently, each in proportion to their relevant difference(s). This is no doubt why Hayek, in the passage quoted at the head of this paper, singles out justice as one of the fundamental standards violated by income tax progressivism. It also explains why he elsewhere describes 'social' in 'social justice' as a 'weasel word' in the derivative sense in which the word 'weasel' is applied to certain people, namely 'cunning or sneaky'.

We have reviewed, and dismissed, arguments designed to show that a single proportionate rate really violates the requirement of procedural justice, for example because of the alleged declining marginal utility of additional dollars as one progresses up the income scale, or because it violates an ethical requirement for equality of sacrifice. We have also considered whether an unconstrained income gap between low income and high income recipients harms low income earners unduly, even if one assumes a level of redistribution that guarantees they will not fall below a nominated threshold for a life of reasonable material adequacy and dignity. It has been argued that, subject to this qualification, income disparities do not harm lower income recipients, either absolutely or relatively, in any way that warrants avoidance or repair through an introduction of progressivism into the income tax scale. Nor have we been able to mount a credible case for maintaining that the requirements of procedural justice should be displaced by a prior requirement of social justice, and in particular distributive justice in relation to access to wealth, including income.

A flat proportionate tax rate is neither progressive nor regressive. That is precisely why it is just.

Assuming the arguments in this paper are sound, there remain huge challenges in the path of the introduction of a flat tax. Like student vouchers for education, the resistance is political rather than logical. For example, it is commonly claimed that a flat tax is politically unacceptable because it is regressive. Thus Australian Prime Minister John Howard, prior to his re-election in October 2004, while conceding that the highest marginal rate of personal income tax was 'too high' and that he may consider a case for reducing it 'should there be the capacity', volunteered that he would stop short of supporting a flat tax 'because it is regressive'. The fact is that it is not. Regression is the contrary, not the contradictory, of progression. A flat proportionate tax rate is neither progressive nor regressive. That is precisely why it is just.

It is also argued that switching to a flat tax would involve increasing taxes to the lowest earners while slashing them for the highest. As it involves replacing a progressive rate the savings to very high earners would be spectacularly greater than the income forgone by the lowest earners. What rational politician would contemplate trying to persuade an electorate that this was acceptable? Even those who embrace the logic of the case for a flat tax argue that the pain to the lowest earners involved in making the transition is so great that it outweighs the advantages of changing to a just system. There is no great clamour to change. Many, possibly most of those who currently pay the highest marginal rates do not grumble very audibly. Some even think, wrongly, that the disproportionate burden placed upon their income is 'only fair'. No wonder the political response is to leave well alone.

In his nomination acceptance speech at the Republican Convention in 2004, US President George Bush declared that if elected for a second term, one of his first priorities would be a comprehensive overhaul of the United States income tax system. Little more was heard on this subject from either contender in the run up to the November 2004 election—apart from Senator Kerry's promise to 'reverse Bush's tax cuts for the rich' (i.e. to once again steepen the rake of the present progressive income tax system). In his speech President Bush cited, among other things, the sheer volume of the relevant income tax legislation and the incomprehensibility of so much of it. The same speech would have rung true in Australia. The new Howard government will have the strongest position in the Australian Senate from July 2005 of any Australian government since the Fraser government more than two decades ago. The opportunity for comprehensive legislative reform, including reform of the law relating to personal income tax, is thus unprecedented in recent times. It is an opportunity that will not last, and may be a long time returning.

The only practically conceivable way of making the change from a progressive to a flat income tax rate is in the context of a comprehensive review of all taxation. We have seen how quickly a tax option can change from a brave political option, to a dead duck never to be revisited, to a credible political option once again, to something that is accepted and unchallenged by all major political parties. This is the history of the Australian Goods and Services Tax (GST) in less than a decade. The fact that a flat rate of personal income tax, for all its jurisprudential merits in terms of justice, now seems to reside in a political no go zone, should not blind us to the fact that these perceptions can be made to change relatively quickly.

If everything else was left as it is, including the tax free threshold and the current income tax revenue target, there is no doubt that we would have to set a flat rate (more precisely, an almost flat rate, as the retention of a tax free threshold entails a degree of progressivism) at a level which would involve a very big jump in the tax rate for low to middle income earners. This is hardly surprising; given that recent work by Sinclair Davidson, cited by Peter Saunders and Barry Maley, shows that in Australia more than 64 percent of income tax revenue comes from the top 25 percent of taxpayers.[8] (So much for the view of the populist left that high earners do not pay their fair share of income tax.) The costs to government of transition arrangements to make this more acceptable would be considerable. These would include encouraging employers of lower wage earners to increase gross remuneration levels to maintain after tax wages, while reducing those of the highest earners to keep take home pay close to constant. Given differences in the wage and salary profiles of each business, the costs to industry would vary significantly, with risks of socially unacceptable price increases and/or layoffs in many areas. It is not obvious that these would be offset by falls in prices for goods and services in industries dependent on a high proportion of highly paid employees.

There must be a hard look at all of the deductions, rebates, credits, offsets, and so on that so complicate the income tax system.

If a flat income tax is such a good idea, then why are not more countries introducing one? The answers would appear to lie in the perceived political difficulties involved in making the transition. It is therefore interesting to note that, in the revolutionary situation that followed the collapse of the Soviet Union, a number of the former constituent republics opted for a flat rate of personal income tax—thus Russia (for most categories of income) has a flat rate of 13 percent, Latvia 25 percent with no tax-free threshold, and Estonia 26 percent with a small tax-free threshold. Estonia is perhaps the most interesting case because, in relative terms, it is probably the most economically successful of the post-Soviet republics. According to the OECD, the Estonian tax system has been relatively stable since the present system was introduced in 1994, apart from a step by step increase in the tax-free threshold for physical persons, and the abolition of corporate income tax on re-invested profits.[10] Prior to the country's accession to the European Union a number of Estonians told me they feared this might ultimately oblige them to make their personal income tax progressive in the name of 'tax harmonisation'. It is ironic that their flat rate may have been seen as giving them an unfair advantage, relative to other long standing members of the EU!

In order to develop a practicable case for changing to a flat tax, it is imperative that a number of other issues be considered at the same time (every one of which is worthy of review in any case). First, there must be a hard look at all of the deductions, rebates, credits, offsets, and so on that so complicate the income tax system. While there is a strong case for retention of deductions relating to costs reasonably incurred in order to generate the income in question, the case is not nearly as powerful in relation to those tax concessions which are intended to achieve specific socio-political objectives. These include, for example, deductions for charitable gifts and investment in favoured industries. The point is not that these objectives necessarily lack merit. Rather, it is that if they have merit, there are ways in which they can be achieved without complicating the tax system.

Second, the assumption that personal income tax reform should be 'revenue neutral', meaning that it should be assumed that the total revenue available to government as a result of reform should be neither greater nor less than it is now, must be questioned in two ways. First, *even if* we accept that the total revenue collection must not go up or down, it does not follow that the share of it derived from personal income tax must remain constant. To take just one option, it is worth recalling that the GST as originally canvassed was proposed at 15 percent, not the current 10 percent. When first introduced at 10 percent, the concessions and exemptions originally proposed, and compromised out as a condition of Senate acceptance, were far more limited—confined, for example, to areas such as health and education. (Purists would have had no exemptions at all.) Removing exemptions and concessions would increase the share of total revenue derived from a much fairer GST with lower compliance costs. Increasing the rate from 10 to 12.5 percent, with the additional 2.5 percent retained by the Commonwealth, would also take some pressure off the share of government revenue derived from personal income tax.

Ultimately however the challenge is to reduce the total government revenue target. This means raising the justificatory bar for every area of government spending, including a much more full blooded approach to privatisation, with government funding focused much more sharply on supporting those in need to have affordable access to quality services, rather than government provision of those services, often with either monopoly supply, or a privileged market position. (Education at all levels, from primary to postgraduate, is a classic example of an area ripe for continuing and accelerated privatisation.)

Ultimately however the challenge is to reduce the total government revenue target. This means raising the justificatory bar for every area of government spending.

Realism in relation to progress towards all these objectives teaches that it will be at best incremental. In turn incremental progress, however small each incremental step, will only be achieved if it is disciplined, systematic, and consistent. That means resisting temptations to make opportunistic reversals, or creating exceptions or exemptions which may have immediate electoral appeal, but ultimately corrupt an otherwise improving system with epicycles of variance or ad hoc adjustments, which will ultimately destroy or undermine confidence in the whole process.

Is this incremental journey one that is worth taking, given the absence of clamour, and the need to spend time and effort in the forum of public debate addressing and dismissing superficially appealing but ultimately indefensible arguments against it? In short, if it is not an issue to most people, why bother—especially if few of the few who think it is an issue would rate it high on the scale of important national priorities?

The answer is that it is a journey worth taking, and it is a subject that is worth bothering about, because the evident integrity of the tax system is essential to the maintenance of a regime of predominantly voluntary compliance. Integrity applies not only to its day to day administration, but to the ethical principles governing the elements and instruments with which compliance is required. The fact is that a central element of one of the instruments, namely progressivism in the rate of income tax, demonstrably violates the requirement of vertical equity, in turn founded, like horizontal equity, on the jurisprudential principle of procedural justice, while a flat proportionate rate—uniquely—does not.

Is this requirement of justice absolute, meaning that nothing should ever be allowed to override or temper it? Many utilitarians would say not, however a consideration of all of their arguments would require an examination of the philosophical foundations of utilitarianism, and take us too far afield. If it is absolute, then tempering a flat tax with a tax free threshold would be ethically unacceptable. Yet there is a case for a tax free threshold, and a threshold that is much higher than it is at present. One reason is that it would on balance increase efficiency, thereby reducing costs, by cutting out the two way traffic that involves all recipients of income below the threshold simultaneously paying income tax and receiving tax transfers to compensate them for their (further depleted) low income. Would we be justified in compromising the vertical equity involved in a pure flat tax to achieve this efficiency?

There is an alternative way of looking at it, although some will see it as a mere semantic trick. That is by *defining* a taxable income as an income above whatever is selected as the threshold. Vertical equity in relation to total taxable income is preserved, while gross income is consequently progressively taxed, cutting in relatively sharply for incomes not far above the threshold, through a tapering continuum as incomes rise.

This involves conceiving of an income as made up of two components, a basic entitlement which is not subject to tax, together with all income in excess of the basic entitlement which is taxable. The basic entitlement is allocated by the state if, and only to the extent that, the potential recipient demonstrates an inability or incapacity to reach that threshold by personal exertion, or through other reasonable means. (Other welfare transfers may of course apply above the threshold in response to demonstrated special need.)

Because this approach preserves vertical equity *among taxpayer incomes* it cannot be dismissed as just a semantic trick. Moreover, it embodies a rhetorical advantage because it enables the flat tax, in such a world, to be defended as not merely non-regressive but mildly progressive relative to total incomes, for all incomes that exceed the threshold, i.e. for all income recipients obliged to pay income tax. It might even be politically saleable—eventually.

Endnotes

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CIS Policy Monograph • PM66 • ISSN: 0158 1260 • ISBN: 1 86432 109 1 • AU$9.95
Published November 2004 by The Centre for Independent Studies Limited. Views expressed are those of the authors and do not necessarily reflect the views of the Centre's staff, advisors, directors or officers.

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