Special Report

OPTIMAL TAX ACT PASSES;
INCOME TAX REPLACED BY LUMP SUM LEVY

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Tax Notes is pleased to reprint — again from the Daily Planet — the following article written by the Planet’s distinguished financial editor, Dr. Walter T. McDuck. Walter T. McDuck is the secret identity of Wyman Hilsine.

President Carter signed into law early this morning the Optimal Tax Act of 1980 which repeals the personal income tax and replaces it with a lump-sum per capita levy of $10,000 on every man, woman, and child living in or pledging allegiance to the United States as of April 1, 1980. According to Congressional sponsors of the bill, its enactment will raise $2 trillion in tax revenue and will increase national wealth by over $40 trillion after a reasonable transition period. The bill was passed late yesterday evening by the Senate in a special closed session and received approval of the House just minutes before midnight. The bill is expected to eliminate taxes as a factor in all economic decisionmaking.

Economists Support Levy

The optimal tax has been promoted for years by many distinguished economists. This February, over 90 percent of the delegates to the Young Economists of America Convention held in Phoenix, Arizona, signed a petition urging Congress to “move suddenly and irreversibly to adopt an optimal tax for the United States.” The economists have become convinced by econometric studies that all other taxes produce bizarre incentives that cause a misallocation of resources and a slowdown in economic growth. In contrast, a lump sum levy imposed without notice cannot be avoided or anticipated and therefore has no effect on economic behavior.

After news of the tax change became public, the switchboard at every airport in the country was flooded by frantic calls from middle class Americans hoping to escape the tax by fleeing abroad. In Detroit, traffic lines over 40 miles long were reported at both the bridge and tunnel into Canada. Similar lines developed at Niagara, New York and many other popular cross points. Michael Macadamia, an economist at the Palo Alto University of Lifelong Learning and a leading theoretician of the optimal tax, laughed when he heard of the exodus of horrified taxpayers. “They fail to understand the genius of the tax,” he chortled. “They could join the Moslem rebels in Afghanistan
or hide in the Rann of Kutch and would not escape the tax. It became due as of 12:01 a.m. April 1 — wiggling, running, or crying in one’s beer won’t make any difference.”

Thomas F. Pasture, executive director of Taxation with Representation, an anti-English historical society, was uncharacteristically upset about the secrecy with which the optimal tax was enacted. “For years we have been trying to open up Congressional procedures to the public,” he complained. “These crazy economists think the optimal legislative process is an edict from George the Third.”

Professor Macadamia reacted sharply to Pasture’s comments. He pointed out that the optimal tax theory requires that the tax be “despotically imposed.” “Pasture is simply out of touch with recent developments in economics,” Professor Macadamia stated.

Special Interest Amendments Thwarted

According to Congressional sources, the Optimal Tax Act was introduced in the Senate as an amendment to a House bill that would have postponed for 17 years the scheduled repeal of the federal duty on imported limestone. The test vote on the Act took place on a proposed amendment by Senator Aroostook of Maine that would have exempted from the tax children under three and permanently handicapped persons over 65. However, Senator Longhandle, a recent convert to the tax expenditure concept, noted that the exemption would cost the Treasury over $10 billion and would open the floodgates to other special interest amendments. Aroostook’s amendment failed 47 to 44.

Senator Levintree of Michigan spoke against the Act, claiming the tax was a “capitation, or other direct tax” requiring apportionment under Article 1, Section 9, clause 4 of the United States Constitution, but in a rare show of discourtesy, he was interrupted by boos and catcalls and not allowed to finish his remarks. The Act soon after passed by a vote of 87 to 4. The debate in the House was even more abbreviated, and no amendments were permitted under a closed rule imposed by the Rules Committee.

Most Washington observers were amazed that Congress could act so quickly on a major tax bill. [p 437] Nicholas Tomatosoup, a Hill veteran practicing with the tax firm of Mullin and Dawdlin, thought the speedy action was produced by an emerging coalition of liberals and conservatives who have panicked over the alleged capital shortage. “There are guys up there who would vote to draft women for combat duty if some economist told them it would encourage private savings,” Tomatosoup smiled.
Labor and Press React

Whatever the reason for the speedy action, the political fallout was immediate. Douglas Fraser, head of the United Auto Workers, called the Act “an insult to the American worker.” “It’s the ‘trickle down theory’ gone berserk,” huffed Lane Kirkland, president of the AFL-CIO.

Margaret Streetwall, spokesman for the editorial board of the Wall Street Journal, called the Act the most insane piece of tax legislation in our nation’s history. “We have supported some irresponsible tax legislation in the past and I expect we will do so in the future, but we certainly have our limits,” Ms. Streetwall said. “Besides being bad for business, I do not see how it can be enforced without a system of debtors prisons, which we oppose.”

Concern for journalistic integrity was not Ms. Streetwall’s only worry. Rumors were afloat that thousands of wealthy individuals were squirreling away their money in foreign banks. Apparently America’s capitalists were afraid that a Congress willing to impose a lump sum levy on the poor might seek other targets in the future.

Administrative Problems Are Unlikely

The administrative aspects of the optimal tax are unclear. In the optimal tax literature, the economists have estimated a zero cost for administration, but even enthusiastic supporters of the tax concede that some administrative costs are unavoidable. Critics of the tax argue that collection costs in particular will be high, but supporters believe that collections can be managed by moving IRS personnel from the audit and appeal sections, where they will no longer be needed.

One critic, the Very Reverend Harold Trapper, Abbot of Waterford Monastery near Worcester, Massachusetts, objected to the requirement that the tax be paid in cash. “As I understand the optimal tax literature,” Father Trapper said, “the whole point is to eliminate discrimination against alternative life styles. Those of us at the monastery are happy to contribute to the government with in kind payments. We would be willing, for example, to spend perhaps 20 percent of our time praying for peace, or for the failure of the Summer Olympic Games in Moscow. The optimal tax, however, will force us full time into the jam and wine business.”

Ironically, the Optimal Tax Act was passed only three days after a Library of Congress study had found that optimal tax research “has wasted tens of millions of federal dollars, plus untold amounts from state and private sources, on studies that have no conceivable utility.” The study also charged that as a result of optimal tax research, “our finest universities are producing economics graduates ill equipped to deal with even the most basic practical problems of economics.”
Tax Viewed as "Forceful," and a "Turning Point"

Most senators who voted for the optimal tax were surprised and angry by the outpouring of opposition. One senator, in an off-the-record statement, complained that the public was fickle and impatient. “The polls showed that the voters wanted forceful action and we gave it to them. Now they seem unwilling to give the new tax a fair trial,” he said.

The senator mentioned a study prepared by use of the Chase Econometric Model predicting a doubling of the growth rate over the next 60 years and a 40 percent rise in the average prices of stocks within three months. The reliability of the Chase study, however, is unclear. Chase officials conceded in a prepared statement that the predicted rise in the stock market was due entirely to a dummy variable arbitrarily inserted into their computer model in 1978 which they had been unable to retrieve.

Marian Fellhammer, an economist professor at-large and president of the Economics Study Tank, a Washington-based lobby, also was unhappy with the public response. “Two hundred years from now,” she exclaimed, “the passage of this Act will be seen as a great turning point in world history. Those complaining about the harsh burden this tax places on the poor — and I do not deny that the burden appears harsh — know nothing, or, even worse, almost nothing about economics. Within 100 years, the economy will have digested the tax, and those who seem to be paying a lot now will have had their tax and much more returned to them through the increased productivity of the economy.”

According to Dr. Fellhammer, the only ones being treated unfairly by the tax are those previously enjoying tax preferences under the income tax. “These people made investments in good faith reliance to advance clearly defined societal goals,” Fellhammer stated. “The least that Congress can do is to compensate them for the loss they suffered when the favored position they effectively paid for was taken from them by the Congress.”

In the excitement over passage of the Optimal Tax Act, only two commentators challenged its economic foundations: Robert S. Winesap and Anne Humor of the Tax Reform Forum, a public interest tax lobby. According to Humor, the lump sum levy would be neutral only if the amount of the tax were very small, perhaps a nickel per person. “The economists have figured out a way to add a straw to the camel’s back without any perceptible consequences,” Humor stated. “Now they have applied that method to add 10,000 pounds of straw and think the camel won’t notice.” [p. 438]

Winesap looks to the kitchen for an appropriate metaphor. “What we have is some economists who have developed a recipe for a 6 egg souffle. They are using this recipe for a 600,000 egg souffle and think they will get the same result. I think they are dead
wrong. I think they’ll end up with egg on their faces, and I think the economy will go flat as a pancake.”

Professor Macadamia dismissed the point made by Winesap and Humor as “correct but trivial.” “What those people are trying to say is that the optimal tax is neutral only at the margin, which of course is true. They fail to realize, however, that almost all economic predictions relate to marginal responses.”

*Irony Feared Wasted*

The only economist willing to speak on the record against the Act was Jasper Merrily, the progenitor of the optimal tax theory. Merrily found the Act “monstrous, malevolent, and unimaginable stupid.” “If you will note,” said Merrily, “my paper that began this whole business was published on April 1, 1971. I meant this whole thing as an April Fools joke. I thought I was demonstrating the folly of those economists who were treating common notions of fairness with disdain. I am saddened to learn that irony is wasted on most of my colleagues in the economics profession.”