y from women who did not get the same large tax break? Yes, articipation in the work force jumped three times as much.[16]

On the corporate side, high taxes can have a similar effect. High taxes lower a firm's return on investment, thereby providing less incentive to invest in plants, research, and other activities that lead to economic growth. Once again we are faced with an unpleasant trade-off: Raising taxes to provide generous benefits to disadvantaged Americans can simultaneously discourage the kinds of productive investments that might make them better off.

If tax rates get high enough, individuals and firms may slip into the "underground economy" where they opt to break the law and avoid taxes entirely. Scandinavian countries, which offer generous government programs funded by high marginal tax rates, have seen large growth in the size of their black market economies. Experts estimate that the underground economy in Norway grew from 1.5 percent of gross national product in 1960 to 18 percent by the mid-1990s. Cheating the tax man can be a vicious circle. As more individuals and firms slip into the underground economy, tax rates must go up for everyone else in order to provide the same level of government revenue. Higher taxes in turn cause more flight to the underground economy—and so on.[17]

The challenge of transferring money from rich to poor is not just on the taxation side. Government benefits create perverse incentives, too. Generous unemployment benefits diminish the incentive to find work. Welfare policy, prior to reform in 1996, offered cash payments only to unemployed single women with children, which implicitly punished poor women who were married or employed—two things that the government generally does not try to discourage.

This is not to suggest that all government benefits go to poor people. They don't. The largest federal entitlement programs are Social Security and Medicare, which go to all Americans, even the very rich. By providing guaranteed benefits in old age, both programs may discourage personal savings. Indeed, this is the subject of a long-

simmering debate. Some economists argue that government old-age benefits cause us to save less (thereby lowering the national savings rate) because we need to set aside less money for retirement. Others argue that Social Security and Medicare do not reduce our personal savings; they merely allow us to pass along more money to our children and grandchildren. Empirical studies have not found a clear answer one way or the other. This is not merely an esoteric squabble among academics. As we shall explore later in the book, a low savings rate can limit the pool of capital available to make the kinds of investments that allow us to improve our standard of living.

None of this should be interpreted as a blanket argument against taxes or government programs. Rather, economists spend much more time than politicians thinking about what kind of taxes we should collect and how we should structure government benefits. For example, both a gasoline tax and an income tax generate revenue. Yet they create profoundly different incentives. The income tax will discourage some people from working, which is a bad thing. The gasoline tax will discourage some people from driving, which can be a good thing. Indeed, "green taxes" collect revenue by taxing activities that are detrimental to the environment and "sin taxes" do the same thing for the likes of cigarettes, alcohol, and gambling.

In general, economists tend to favor taxes that are broad, simple, and fair. A simple tax is easily understood and collected; a fair tax implies only that two similar individuals, such as two people with the same income, will pay similar taxes; a broad tax means that revenue is raised by imposing a small tax on a very large group rather than imposing a large tax on a very small group. A broad tax is harder to evade because fewer activities are exempted, and, since the tax rate is lower, there is less incentive to evade it anyway. We should not, for example, impose a large tax on the sale of red sports cars. The tax could be avoided, easily and legally, by buying another color—*in which case everybody is made worse off.* The government collects no revenue and sports car enthusiasts do not get to drive their favorite color car.

This phenomenon, whereby taxes make individuals worse off without making anyone else better off, is referred to as "deadweight loss."

It would be preferable to tax all sports cars, or even all cars, because more revenue could be raised with a much smaller tax. Then again, a gasoline tax collects revenue from drivers, just as a tax on new cars does, but it also provides an incentive to conserve fuel. Those who drive more pay more. So now we're raising a great deal of revenue with a tiny tax and doing a little something for the environment, too. Many economists would go yet one step further: We should tax the use of all kinds of carbon-based fuels, such as coal, oil, and gasoline. Such a tax would raise revenue from a broad base while creating an incentive to conserve nonrenewable resources and curtail the CO_2 emissions that cause global warming.

Sadly, this thought process does not lead us to the optimal tax. We have merely swapped one problem for another. A tax on red sports cars would be paid only by the rich. A carbon tax would be paid by rich and poor alike, but it would probably cost the poor a larger fraction of their income. Taxes that fall more heavily on the poor than the rich, so-called regressive taxes, often offend our sense of justice. (Progressive taxes, such as the income tax, fall more heavily on the rich than the poor.) Here, as elsewhere, economics does not give us a "right answer"—only an analytical framework for thinking about important questions. Indeed the most efficient tax of all—one that is perfectly broad, simple, and fair (in the narrow, tax-related sense of the word)—is a lump-sum tax, which is imposed uniformly on every individual in a jurisdiction. Former British Prime Minister Margaret Thatcher actually tried it in 1989 with the community charge, or "poll tax." What happened? Britons rioted in the streets at the prospect of every adult paying the same tax for local community services regardless of income or property wealth (though there were some reduc-

gest poverty-fighting tools in recent years has been the earned income tax credit (EITC), an idea that economists have pushed for decades because it creates a far better set of incentives than traditional social welfare programs. Most social programs offer benefits to individuals who are not working. The EITC does just the opposite; it uses the income tax system to subsidize low-wage workers so that their total income is raised above the poverty line. A worker who earns $11,000 and is supporting a family of four might get an additional $8,000 through the EITC and matching state programs. The idea was to "make work pay." Indeed, the system provides a powerful incentive for individuals to get into the labor force, where it is hoped they can learn skills and advance to higher-paying jobs. Of course, the program has an obvious problem, too. Unlike welfare, the EITC does not help individuals who cannot find work at all; in reality, those are the folks who are likely to be most desperate.

When I applied to graduate school many years ago, I wrote an essay expressing my puzzlement at how a country that could put a man on the moon could still have people sleeping on the streets. Part of that problem is political will; we could take a lot of people off the streets tomorrow if we made it a national priority. But I have also come to realize that NASA had it easy. Rockets conform to the unchanging laws of physics. We know where the moon will be at a given time; we know precisely how fast a spacecraft will enter or exit the earth's orbit. If we get the equations right, the rocket will land where it is supposed to—always. Human beings are more complex than that. A recovering drug addict does not behave as predictably as a rocket in orbit. We don't have a formula for persuading a sixteen-year-old not to drop out of school. But we do have a powerful tool: We know that people seek to make themselves better off, however they may define that. Our best hope for improving the human condition is to understand why we act