

What to Tax

By Carl S. Milsted, Jr.

Taxes.

Libertarians love to hate taxes.

And they think that Americans share that hate of taxes. Time and again I have heard Libertarian activists say we should “focus on the tax issue” and that “taxation is our best issue.”

Time for a wakeup call: *taxation is one of our worse issues!!* According to my 20,000+ data points gathered from quiz2d.com, the extreme libertarian position on taxation is the second most *unpopular* extreme libertarian position. It is 2-3 times more unpopular than the LP position on legalizing heroin. It is more unpopular than the LP position on immigration. It is 5-9 times less popular than the extreme Libertarian position on prostitution! (The ranges come from whether I look at all the data or if I filter out the LP hardliners from the data.)

To do away with all taxation is to opt for anarchy, and anarchy is *not* popular! Legal crack cocaine is more popular than a descent into anarchy. Yet in our supposedly more voter-friendly 2004 platform we:

d.) support the repeal of all taxation; and e.) support a declaration of unconditional amnesty for all those individuals who have been convicted of, or who now stand accused of, tax resistance. We oppose as involuntary servitude any legal requirements forcing employers or business owners to serve as tax collectors for federal, state, or local tax agencies. We oppose any and all increases in the rate of taxation or categories of taxpayers, including the elimination of deductions, exemptions or credits in the spurious name of "fairness," "simplicity," or alleged "neutrality to the free market."

The LP Platform calls for the repeal of *all* taxation and rejects tax simplification. Ergo, not only do we call for anarchy, we reject tax simplification as an interim step on the way to anarchy!

This is nuts! What is the point of doing the heavy lifting of political activism when you have a platform that guarantees electoral failure? How can the LP be a tool for “moving public policy in a libertarian direction” if it calls for terrifying the populace with visions of turning the U.S. into another Lebanon or Somalia. (Yes, I have heard some Libertarians point to Somalia as an example of good non-government.)

Yes, I believe in gun rights. No, I do not want to *have* to carry a gun around at all times in order to be safe. Call me a girly-man if you will, but I like the security and prosperity that comes with having a functioning army, police department and judicial system. And I am willing to pay for them – with taxes.

But I sure don't enjoy paying for them with our current system of ridiculously unfair and complicated taxes. And on that many Americans agree with me. Even liberals! Tax fairness and simplification is an idea that can be sold *right now*, and if we do get rid of our horrible tax code we will solve many social problems, which can lead to cuts in government.

But those cuts will not result in cuts in taxation for the foreseeable future. The Republicans and Democrats have already mortgaged our future to the hilt. The federal

government has trillions in bond debt and trillions more in annuity obligations. Yes, the feds do have quite a bit of property they could sell, but I am highly skeptical that the assets could cover the obligations. And calling for selling off all the national parks and forests is a surefire way to lose nearly everyone under 40; the young are concerned about the environment.

Given that the federal government is deeply in debt and running up more at the rate of \$400 billion/year, we need drastic cuts in spending to simply avoid national bankruptcy. Tax cuts are a bad idea unless you want to see social collapse.

Guess what: I have gotten responses to my earlier columns from Libertarians who *want* to see just that. They sagely inform me that we as a nation are doomed and that the faster the doom befalls us, the better. It has something to do with boiling frogs.

Well, I for one do not want to be a boiled frog! And neither do 99+% of the voters. I am not a Hegelian. I believe the way to make things better is to make them better. Starting now.

A Better Tax Code

We know that the income tax is a horrible thing. So what do we replace it with? “Nothing” is a non-starter for reasons already stated. I have seen several alternatives floated about in libertarian circles ranging from a “flat” tax to a national sales tax. Before stating which proposals are the best, let’s list some criteria for a better tax system.

1. The tax code should be simple. It is bad enough to have to pay high taxes; it is worse to have to spend hundreds of hours trying to figure out how much you owe.
2. The tax system should avoid violating privacy. This means that taxes should be based as much as possible on publicly available data. Otherwise, people have to give up their 5th Amendment rights in order for the tax system to work.
3. The new tax system should not cause an increase in the gap between rich and poor. The gap is wide enough already and we need lefty voters in order to win elections. I know many Libertarians chafe at this one, but this is the cost of electoral success. Most drug legalization advocates are on the Left, so if we are to build up a coalition that includes the drug issue, we must at least pacify the Left on the tax issue.
4. The tax code should be morally justifiable. Indeed, it is the problem of moral justification that leads to the current extreme LP positions.

A quick look at the above criteria leads to quick rejection of some popular proposals. For example, a “flat” income tax has most of the problems of the current income tax. It still requires assessment of income, and this is *not* a simple matter. If it was a simple matter, we wouldn’t have a college degree called “accounting.”

Likewise, a national sales tax also fails. While sales receipts are far more straightforward to count than income, a sales tax still requires the government to have an open search warrant on every business that does retail sales in order to check receipts. And the government would have to exercise those warrants to a far greater degree than it currently audits income taxes. The income tax works as a “voluntary” system because people report on each other. One business’ deduction is another business’ revenue. This is not the case with a retail sales tax.

Further, a case can be made that either of these tax proposals would be a huge tax break for the rich vs. the poor and thus are non-starters politically.

So what should Libertarians advocate? Let us focus on the moral issue first since that is how we currently derive our no-tax position. After that, we can have another look at the first three criteria.

A Moral Tax Code

I can think of two moral justifications for taxation:

1. Fee for service rendered. You use it; you pay for it.
2. Fee for externality imposed. You impose a cost onto society, you pay society back for the privilege.

A tax code based on these criteria is a moral tax code as long as the amount of tax is reasonable.

User Fees

Like it or not, there are some critical services that tend to be natural monopolies: country roads, criminal courts, and military protection are among them. As such, it is hard to have a market for these services. Thus, democratic government makes sense as a way for maximizing utility for these services; at least we appease the majority when determining the correct balance of cost and service in these areas.

(OK, we could have something of a market for these services by having many small independent countries with open immigration policies. Restoring state's rights would be a step in this direction. However, this solution is not without problems: more legal systems to learn, tolls, and tariffs come to mind.)

This does not justify an open-ended social contract as statist infer. It only gives the government the right to tax for services that cannot be economically provided by private means.

For example, there are huge economies of scale in the field of military protection. Satellite defense systems have a huge overhead cost, but once up they can be used to defend a huge amount of territory. Likewise, the area of a nation (and thus the population) goes up as the square of its border length, so big nations are easier to defend than tiny principalities, city-states – or subdivisions.

These economies of scale are so great that even with the inherent inefficiencies and corruptions of government, governments can provide these services far more cheaply than the open market.

We have a historical example to back up this assertion. When the Roman government was functioning, the rich could afford palaces and pleasure slaves. When Rome fell, the rich had to put their money into castles and henchmen. These are expensive! Property taxes to support a central government are a much better deal for wealthy property owners!

And having the rich invest in private military protection is not that good a deal for the poor, either. Once in the business of providing government services, the rich became mini-governments.

So how should we make people pay for this service of protecting property? How about a property tax? Hmmm, the more property that you have, the more value there is to having it protected...seems kind of fair.

Yet, I have heard many libertarians whine about property taxes, claiming that you only “rent your property” when you have a property tax. Well duh! Owning property generally costs money. Houses need painting, lawns need mowing, etc. Yet these costs are not considered “rent.” Why should protection costs be considered rent? Tax or no tax, those costs will be paid by someone. Under anarchy, property owners would pay even more “rent” in the form of protection expenses than you would pay in property taxes with government even when those taxes include waste, fraud, abuse and public schools.

Or how about roads? Sure, we could put tolls on some limited access highways and this would help reduce peak-load congestion. But overall, tolls would be a pain and would reduce privacy if we had automatic toll monitoring. How about a general tax based on how much you use the roads? The more miles you drive the more you pay. The bigger the vehicle (and thus the more wear on the road) the more you pay. How about a fuel tax? Fuel consumption correlates rather nicely with road use, and gas stations are very public entities.

Or consider the fact that you can park your car in a public place and usually find it is still there when you get back. You don’t generally have to hire an armed guard. Police protection, though imperfect, is still valuable. Who is consuming more protection service? The person driving an old clunker, or the person who drives a \$60,000 jewel? Perhaps the fee should be based on the value of the protection? How about a car tax based on the price of the car?

Contract enforcement is a service that even Ayn Rand suggested that the government charge for. No pay = no enforcement. While it might be difficult to assess value for all contracts, there are some standard contracts with standard valuation. How about a tax on corporate stock based upon market cap? How about a tax on bonds? No government = no enforcement of these contracts. This is fee for service.

You write a book and want to get paid. Well, you won’t be without a government to enforce copyright laws. How about a copyright tax based on the author-assessed value of the work? No tax = no government enforcement; i.e., the work goes into the public domain. Under assess the value and someone gets to buy at the low price that you set. We could do the same with patents. We could do the same with broadcast licenses.

Note the lack of need for tax prison for these fees for service. You fail to pay a tax and you lose the property or right protected/provided by the government and nothing more.

Externality Fees

Some people like cheap electricity. Others prefer clean air. Generating cheap electricity means burning lots of coal in aging power plants that do not use the latest technology. We have a conflict, one which is *not* resolvable with contract law.

The users of electricity and the breathers of air are both legion. Getting them together in a court of law is not feasible. Having representatives of each fight it out in a class action lawsuit to be decided on by a jury of 12 is not an efficient or wise solution.

Democratic government is not the perfect representative of society as a whole that the statist would say it is, but it is the best we have. A fee that goes to the government which is then dispersed as either tax rebates or services is the closest thing we have to victim compensation when the victims are so widely dispersed.

Fees for power plant emissions of sulfur dioxide, nitrogen oxides and mercury are morally appropriate – nay, they are morally *demand*ed. This does not mean that we completely eliminate these toxins, only that the power plants – and indirectly the consumers of electricity –

pay compensation for those affected by the pollutants. If the fee approximates the externality cost of the pollutants, then we will get as close as possible to the market optimum of pollution. The market will weigh the trade-off between cheap electricity and pollution.

Such externality taxes should be levied wherever one group is imposing a cost on a widely-dispersed other group. I would call for a tax on noisy trucks, motorcycles, and air compressors. These are drive-by irritants. Tort law is an inconvenient and inefficient way of resolving the dispute between those who want quiet and those who want to make noise. A fee would create a market-based decision. In some cases noise reduction technology would be cheaper than the fee; in other cases paying the fee would be the cheaper option.

Ditto for light pollution.

Ditto for global warming.

And if we take into account a more general theory of natural rights, even land ownership is an externality. Your right to privacy restricts my right to walk my dog. Followers of Henry George make a big deal of this and push hard for the “single tax,” a tax on land but not on what is built on the land. Do web searches on “Henry George” and “Geolibertarian” for more information.

Note that externality taxes are not the same as so-called “sin taxes.” Sin taxes are taxes meant to affect personal behavior that is not the government’s business. Externalities *are* the government’s business.

Back to the Other Criteria

Suppose we were to advocate the moral tax ideas above. How do we fare regarding the first three criteria?

Well, property taxes are certainly simple enough. And they go back to colonial times. They predate sales taxes. If we restrict such taxes to that which is easily detected – real estate, broadcast licenses, registered copyrights, etc. – then we preserve privacy.

As for the Left, a system of property taxes is one that hits the rich harder than a system of income taxes. Income taxes hit those who are *getting* rich. Property taxes are wealth taxes; they hit those who *are* rich. A system of flat rate property taxes would be more progressive than our current labor and income tax system. If we have a homestead deductible for a poor person’s amount of property, then we end up being more progressive. If we implement the idea of a citizen’s dividend (divide up a surplus equally among all citizens) then we become more progressive yet.

As for externality taxes, externalities are almost by definition public. Sure, this does mean some government inspection and monitoring of those who pollute, but such is not imposed without probable cause. If your pollution is not detectible from a distance, then your externality is limited to near neighbors at best (with some exceptions).

Conclusion

Yes, it would be nice to have lower taxes as well as better taxes. But we cannot have lower taxes without libertarians in government. And we will not have libertarians in government without reasonable libertarian tax proposals.

Once we get the tax code fixed, then spending cuts become easier. The current tax code causes many social problems that lead to socialist solutions. We need to start fixing the problems first; then we can get rid of the bad solutions.