Taxation

Above the entrance to the headquarters of the Internal Revenue Service on Constitution Avenue is chiseled the quotation from Oliver Wendell Holmes: “Taxation is the price we pay for civilization.” It is easy enough to see why state officials would want to put that quotation on display, for it counsels people to be pleased with the taxes they pay. It’s not so easy, though, to determine the accuracy or the moral force of that quotation. Taxation represents the replacement of the handshakes of commerce with the threat of rifles as an instrument for human governance. While some libertarians think rifles are totally unnecessary to human governance, others think some modest use, while unfortunate, is unavoidable. This makes taxation a form of Faustian bargain: some modest use of rifles is thought necessary to promote peaceful social order, but mere possession of the power to employ rifles will almost inevitably expand their use beyond their necessary limits.

TAXATION AND THE TRANSFORMATION OF PROPERTY RELATIONSHIPS

In their treatise on A History of Taxation and Public Expenditure in the Western World, Carolyn Webber and Aaron Wildavsky observe that all political cultures are uneasy mixtures of individualist and collectivist sentiments and orientations. In individualist cultures, human relationships are governed primarily by principles rooted in private property and freedom of contract. In collectivist cultures that governance becomes rooted in common or collective property. Taxation is an instrument in a continuing form of culture war over how
human relationships are to be constituted. As taxation recedes, handshakes and promises become more prominent in human governance. As taxation expands, duress, threats, and rifles take on greater significance.

Economists distinguish between private and common or collective property. Budgetary operations transform private property into collective property, thereby changing the governance relationships that operate within a society. An average tax rate of 40 percent, for instance, means that approximately 60 percent of the economy is organized through private property relationships, with the remaining 40 percent organized through collective property. This disjunction between private and collective property has a number of significant implications. One is that private property generally secures greater economic efficiency than collective property because, with private property, people who make economic decisions bear directly the value consequences of their decisions. By contrast, with collective property those value consequences are diffused throughout the entire political unit. Another significant implication concerns differences in the character of human relationships. When those relationships are grounded in private property, economic relationships occur among equals, in that any kind of joint activity must be mutually agreeable. In contrast, relationships grounded in collective property are those of rulership, with there being grantors on the one side and supplicants or petitioners on the other.
TAXES AS PRICES, A CORRUPTIBLE SIMILE

Some taxation is almost surely necessary to secure an economic order grounded in private property, and such taxation would be likely to command close to universal support. Actual levels of taxation, however, are surely significantly higher than whatever this minimal level might be. The primary line of justification that has been advanced for the power to tax is the problem of free ridership. If taxes were replaced by voluntary contributions, it would be impossible for anyone to claim that the state was involved in expropriating private property. At the same time, however, people would have strong incentives to take free rides on the contributions of others. As a result, such common valued services as civil order and national security, which require expenditures on military, police, and courts, are likely to be underfunded.

Taxation thus represents a type of “forced exchange,” as Richard Epstein explains in *Takings*. This term might appear a bit oxymoronic at first glance, but it conveys an important truth. Government is not limited to purely voluntary exchanges, and the problem posed by free riding might make some modicum of taxation nearly universally acceptable. Under this idealized image of taxation, taxes should mirror the voluntary payments that people would have been made were it not for free riding.

The difficulty, of course, is that there is no way truly to know what the pattern of those voluntary contributions would have been. In actual tax systems, forced carrying, whereby people pay to support activities they do not value, is also a significant feature. The principle of forced exchange treats taxation as a
means of pricing state-supplied services to the citizenry. To speak of taxes as prices also has its problematical side, however, because this simile is easily corruptible. In some cases the forced exchanges that taxation makes possible might be beneficial to all. But in other cases, taxation will be used as an instrument for the deprivation and abridgement of property. The dark side of the Faustian bargain is that the power to tax can also be used to expropriate property, which would never happen with truly voluntary contributions. Among three adjoining neighbors, two might steal asparagus from a patch owned by the third. Should the three neighbors comprise a government and the majority support a tax on asparagus, what otherwise would have been theft will have been converted into tax policy. The best tax, after all, is always one that someone else pays, and governments offer plenty of scope to do just this.

TAX DISCRIMINATION AND THE VENAL IMPULSE

The central feature that enables government to abridge rights of property through taxation is its ability to practice tax discrimination. This can be seen by comparing a state that possesses an unlimited power to tax with one whose power to tax is limited by a constitutional requirement of generality or nondiscrimination in taxation. If all income is taxed at, say, ten percent, there is no scope for government to discriminate among taxpayers by their sources or uses of income, or by any other personal characteristic. The range of political controversy regarding taxation is limited to its rate alone.
The opportunity to practice political price discrimination expands greatly the scope for venality in politics. The possession of an unlimited power to tax increases the value of holding political office for two reasons, reasons that are political cousins to bribery and extortion. The political cousin to bribery is called “rent seeking” by economists. If tax discrimination is a permissible outcome of tax legislation, interest groups will seek to secure favorable tax treatment. This will take the form of exemptions, deductions, or exclusions from the tax base, the consequence of which is to generate a higher rate of tax applied to a narrower base. There will be, as it were, a market for tax legislation, whereby interest groups lobby for particularly desired tax provisions.

The political cousin to extortion is “rent extraction.” Rent extraction is represented by threats to tax that are rescinded if the tax target responds as desired by the threatening politician. A possible change in a tax provision can be announced and a hearing scheduled, only later to be canceled if sufficient opposition materializes, with opposition being signified by such things as campaign contributions. In this case, money is being paid for nothing but a continuation of the present tax status. In contrast, with rent seeking money is being paid to secure some change in tax status.

TOWARD CONTRACTUAL GOVERNANCE

A centerpiece of democratic ideology is the belief that taxation is something we do to ourselves, and do so for our common benefit. This makes it reasonable to speak of taxing ourselves, in contrast to speaking of victors as
taxing the vanquished. A principle of generality in taxation leads naturally to support for broad-based taxation. Although broad-based taxation would not eliminate all possible claims of tax discrimination, it would severely restrict the practice. A broad-based tax on income, where the entire base is taxed at the same rate, would conform to reasonable notions of generality in taxation. There would be no scope for political position to influence a person’s tax liability. The same rate of tax would apply to everyone, and each person’s tax liability would depend simply on his own income or consumption in conjunction with the tax rate that was enacted through the political process.

Broad-based, nondiscriminatory taxation impedes efforts to use taxation to reward or punish certain forms of activity. The very principle of nondiscrimination is one that asks the state to be neutral toward all kinds of activities. Yet a great deal of tax legislation rewards or punishes specific forms of activity. The principle of nondiscrimination clashes with the use of taxation to punish and reward. Once a government acquires the power to reward or punish particular types of activity, the principle of broad-based, nondiscriminatory taxation quickly evaporates under the heat of politics. What results is an unlimited power to tax, where the only limit on the reach of the tax collector is the pragmatic one of political pressure and votes.

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Bibliography


