The Myth of Neutral Taxation

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"A neutral mode of taxation is conceivable that would not divert the operation of the market from the lines in which it would develop in the absence of any taxation."

Ludwig von Mises, *Human Action* (1949)

Economists have long believed that government's tax and expenditure policy either is, or can readily be made to be, neutral to the market. Free-market economists have advocated such neutrality of government, and even economists favoring redistributive actions by government have believed that the service activities and the redistributive activities of government can easily be distinguished, at least in concept. The purpose of this paper is to examine the nature and implications of fiscally neutral government; the paper argues that all government activities necessarily divert incomes, resources, and assets from the market, and therefore that the quest for a neutral tax or expenditure policy is an impossible one and the concept a myth.

Structure of the Free Market: Consumers and Incomes

To evaluate the idea of a neutral government, we must first define what neutrality to the market may be. Any firm or institution is neutral to the market when it functions as part of the market. That is, both General Motors and Mom and Pop's Candy Store are part of the market, and insofar as their activities remain within the market, they are neutral to it.[1]

[1] Thus lobbying or other government-related activities by any business firm would *not* be neutral to the market.

We may analyze market institutions according to the following categories: (a) what and how much they produce, and (b) how much and from where the institution receives monetary funds. For every institution produces goods or services and receives money.

There are two types of market institutions. One is the business firm. The firm is guided by its expectations of monetary income from customers in payment for its products. The firm receives funds from two sources: (b1) customer expenditures, and (b2) entrepreneurial investments. Entrepreneurial investments are monies invested in the firm to purchase or hire factors of production to make goods and services to be sold to customers. The investments are savings spent in anticipation of greater returns from selling products to customers. Although the conspicuous resource and production decisions in the market are made by capitalist-entrepreneurs by the owners of the firm and its capital assets these decisions are made in accordance with their expectations of monetary income from customers. In short, businessmen are guided by the quest for monetary profits and the wish to avoid monetary losses, and their forecasting and anticipations must turn out to be good enough to reap profits from their production decisions. The intake of investment funds into the firm, then, is subordinate to the expected profit to be made from sales to customers.

Business firms and the structure of capital assets in the economy, as Austrian school economists have shown, are not a homogeneous lump: Production is a structure of stages, a latticework that moves from the most "roundabout" processes of production—the stages of production most remote from the consumers—down to nearer processes, and finally down to the production and sale of goods and services to the ultimate consumers.[2] The ham sandwich at the local coffee shop begins with the mining of ore for tools and machines and the growing of grain to feed hogs, and continues in stage after stage down through the wholesale and retail stages, until it arrives in the maw of the final buyer, the consumer. Thus, for our purposes, we can short-circuit the structure and refer to the consumer as the basic source of the income of business firms; ultimately, it is

[2] On the structure of production and capital, see among other works, Eugen von Böhm-Bawerk, *Capital and Interest*, 3 vols (South Holland, Ill: Libertarian Press, 1959), and Ludwig M. Lachmann, *Capital and Its Structure* (Kansas City: Sheed Andrews and McMeel, 1978).

consumer demand that provides profits or losses to business firms and either vindicates or not prior production decisions by investors.

Investments that bring money into the firm in anticipation of consumer demand, (b2), consist of two parts. The basic investment (b2a) is investment by the owner or owners of the firm in the form of personal savings, partnerships, or investment in corporate stock. Auxiliary investment (b2b), are loans to the owners of the firm by other capitalists, either in the form of short-term credit or long-term debentures. The willingness of the firm's owners to pay a fixed-interest return to lenders is, of course, a function of their anticipated profit in selling the product to the consumers. Willingness to pay interest will always be less than or equal to the anticipated profit rate; and in the long-run general-equilibrium world of changeless certainty—a world that has never and can never come into existence—the rate of return would be equal throughout the market economy. In that world, the rate of profit in every firm would be equal to the rate of interest on loans.[3]

For market firms, therefore, there is no mystery about the determination of their production decisions and income. The former are determined by firms' anticipation of consumer demand, and the latter by the reality of that demand. Hence, firms receive their income, in the final analysis, from serving consumers. The more efficiently and ably the firms anticipate and serve consumer demand, the greater their profits; the less ably, the less their profits and the more they suffer losses.

Finally, the owners of the factors of production—land, labor, and capital goods—receive their income in advance of production from the investor-owners of the firm. The more ably and productively a factor or factors are believed to serve consumer demand, the greater the demand for those factors by the owners, and the higher their

[3] Both would be determined by the social rate of time preference as determined on the market, the premium of present as compared with future goods—an agio which would be the resultant of all the time-preference schedules by individuals on the market, in much the same way as consumer demand is the embodiment of the marginal-utility schedules of individuals. See Murray N. Rothbard, *Man, Economy, and State*, 2nd ed. (Los Angles: Nash, 1970), 1, chap. 6; Frank A. Fetter, *Capital, Interest, and Rent: Essays in the Theory of Distribution* (Kansas City: Sheed Andrews and McMeel, 1977), pt.2.

income. Since capital goods themselves form part of the structure of production, ultimately factor incomes consist of the income from the exertion of labor energy (wages, salaries), the use of land (land rents), and the transfer of money (a present good) in exchange for anticipated future income (a future good)—that will yield interest (or long-run profit) for time preference, and entrepreneurial profits or losses. All these factor incomes then, are tied to the efficient service of anticipated consumer demand.[4]

Incomes to factors and entrepreneurs on the market, therefore, are tied inextricably to the effective satisfaction of consumer demand, a satisfaction that depends on the successful forecasting of the market conditions that will exist when and after the goods or services are produced. Income to the firm and to factors from consumers is linked inextricably to the satisfaction the consumers derive. In a deep sense, therefore, income to producers on the market reflects benefits to consumers.

The crucial point is that when consumers spend, they benefit, because the expenditures are voluntary. The consumers buy product X because they decide that, for whatever reason, it would benefit them to buy that product rather than use the money on some other product or save or add to their cash balances. They give up money for product X because they expect to prefer that product to whatever they could have done with the money elsewhere; their preference reflects a judgment of relative benefit from that, as compared to another, purchase. In my own terms, spending choices by consumers demonstrate their preference for one, as compared to another, way of using their money.[5]

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[4] That is, each unit of each factor will tend to receive its discounted marginal revenue product, its marginal value productivity discounted by the rate of interest. So each unit of land and labor will tend to receive its DMRP, and the capitalist (or lender) will receive the discount (in the form of interest or long-run profit). Only in the never-never land of general equilibrium would each factor always receive its DMRP; in the real world, the positive or negative differences would reflect entrepreneurial profits and losses. See Rothbard, *Man, Economy, and State*, cap. 7.

[5] On the concept and implications of "demonstrated preference," see Murray N. Rothbard, "Toward a Reconstruction of Utility and Welfare Economics" (New York: Center for Libertarian Studies, 1977), esp. pp. 2-7, 26-30; reprinted in *The Logic of Action One*.

And that is not all. The profit-and-loss tests of the market, the rewarding of effective producers and forecasters and the punishing of ineffective ones, ensures that the overall ability at any time of entrepreneurs to forecast and satisfy consumer demands will be high. Good forecasters will be rewarded with higher profits and incomes; poor forecasters will suffer losses and finally leave the business. So that the market tendency is toward a high level of fit between anticipation and reality, and for a minimum of erroneous investment. Producer income, therefore, reflects consumer benefit even more closely than we might at first realize.[6]

The second type of market institution—after the business firm—is the voluntary nonprofit membership organization: the bridge club, lodge, ideological organization, or charitable agency. Here, too, income and benefit are cognate. Income is no longer divided between investors and consumers. All income is obtained from members, either in the form of regular dues or systematic or occasional donations. The purpose of the organization is not to earn a monetary profit, but to pursue various purposes desired by the income-paying members. In a sense, then, the members are the "consumers," except that they consume the services of the organization not by purchasing a product but by helping the organization pursue its goals. The member-donors are at the same time the consumers and the investors, the consumers and the makers of the production decisions.[7] The organization will employ as much of its resources as the member-consumer-donors desire to contribute to the pursuit of their goals.

Membership organizations, while clearly part of the market, are necessarily limited in their scope, for they do not follow the division of labor necessary for most market production. In virtually all

[6] This, however, is a long way from saying, with conventional neoclassical economists, that general equilibrium and perfect knowledge are facts of reality, or, with the rational-expectations economists, that the market always perfectly forecasts the future. If this were true, there would be no room for entrepreneurship at all, and the most dynamic and vital aspect of the market economy would go unremarked and unexplained. See Gerald P.O'Driscoll, Jr., "Rational Expectations, Politics, and Stagflation," in *Time, Uncertainty, and Disequilibrium: Exploration of Austrian Themes,* Mario J. Rizzo, ed. (Lexington, Mass: Lexington Books, 1979,), pp. 153-76.

[7] For convenience, "members" and "donors" shall be used interchangeably throughout, although in many cases donors are technically not "members" of the organization.

other cases of production, the producers and the consumers are not one and the same: The producers of steel bars do not, Heaven forfend, use up those selfsame bars in their own consumption. They sell the bars for money and exchange the money for other goods that they would like to consume. In the case of membership organizations, however, the member-investors are the consumers of the service.

Even where the explicit goals of the organization are to help non-donors, this rule—that the consumers guiding production decisions are the donors—still applies. Suppose, for example, the organization is a charity giving alms to the poor. In a sense, the purpose is to benefit the poor, but the actual consumers here, the guides to production decisions, are the donors, not the recipients of charity. The charity serves the purposes of the donors, and these purposes are in turn to help the poor. But it is the *donors* who are consuming, the donors who are demonstrating their preference for sacrificing a lesser benefit (the use of their money elsewhere) for a greater (giving money to the charity to help the poor). It is the donors whose production decisions guide the actions of the charity.

In this case, presumably, the donors themselves will be guided, in their turn, by how effective the organization is in ministering to the poor. But the ways of judging this effectiveness lack the precision of monetary purchase, or profit and loss. They depend on subjective interpretation by the donors, an interpretation that is necessarily subject to a great deal of error. Donors, in the same way, are the consumers regardless of the purpose of the nonprofit organization, whether it is chess playing, medical research, or ideological agitation. In all these cases, precise profit-and-loss tests of effectiveness are lacking; in all these cases, too, donors voluntarily pursue their activity, preferring it to other uses of their resources.[8]

Nonprofit organizations also purchase and hire factors of production. To a large extent, these organizations compete with business firms for factors; to that extent, they must pay the factors at least the discounted marginal product they can earn elsewhere. To some extent, however, the factors may be specific to these

[8] The lack of precise guidance in nonprofit organizations is not a criticism of their existence; this lack is simply a part of the nature of the case, and it is take into account by the donors when they make their "investment" decisions in the organization.

organizations; to that extent their marginal product incorporates their service to the donor-consumers, that is, the extent to which they pursue the same goal as the sources of income. Thus, in both the profit-making and the nonprofit sectors, in their different forms, production decisions are guided by service to the consumers. The main difference is that in the case of business firms, the consumers are separate from the producers, and (we hope) recoup producers' investments by buying the products of the firm; while in nonprofit organizations, the consumers are the donor-investors.

We have been describing two polar cases: the business firm, and the nonprofit organization. Probably most real-world institutions on the market fall into one of these categories. In some cases, however, an organization can partake of both modes. Let us consider two cases. First, a charitable organization, instead of, or in addition to, giving away alms, may sell some products to the poor at a low, subsidized price. In this case, while the donors provide the overall thrust and guidance, part of the feedback gained by the firm is willingness to buy goods by the recipients. In some sense, the recipients of alms provide a guide to their interest in the organization. There are now two sets of consumers: the donors, and the charity recipients, each of whom demonstrates its preference for this organization in contrast to other uses for its money.[9] But the overall purpose of the organization is not to make a profit, but rather to serve the values and goals of the donors, and so the donors must be considered the regnant consumers in this situation.

Another case is a profit-making business firm where the owner or owners decide to accept a lesser monetary profit on behalf of some other goals of the owners: for example, because a certain line of product is considered immoral by the owners or because the owner wishes to hire incompetent relatives in order to keep peace in the family. Here once again, these are two sets of consumers—the buyers of the product, and the producers or owners themselves. Because of his own values as a "consumer," the owner decides to forego monetary profit because of his own moral principles or because he holds keeping peace in the family high on his value scale. In either

[9] In a trivial sense, of course, being willing to accept a free gift by a charity is also a demonstration of preference by the recipient, but only in the trivial sense that he prefers more of a good to less. The recipient is not sacrificing any good or service in exchange.

case, the owner is foregoing some monetary profit in order to achieve psychic profit. Which motive will dominate depends on the facts of each particular case. Since the market is generally characterized by a division of labor between producers and consumers, however, the general tendency will be for monetary profit, or service to non-owning consumers, to dominate the decisions of business firms.[10]

It is a basic fact that all voluntary actions are undertaken because actors expect to benefit from them. When two persons make a voluntary exchange of goods or services, they do so because each expects to benefit from the exchange. When A trades commodity X for B's commodity Y, A is demonstrating a preference—an expected net benefit—for Y over X, while B is demonstrating the opposite, a preference for X over Y. The free market is a vast latticework of two-person (or two-group) exchanges, an array of mutually beneficial exchanges up and down and across the structure of production.[11]

Robbery and the Market

Having dealt with this idyll of harmonious and mutually beneficial exchanges, let us now introduce a discordant note. A thief now appears, making his living by robbing and coercively preying on others: The robber obtains his income by presenting the victim with a choice: your money or your life (or, at least, your health)—and the victim then yields his assets. Or, to be more precise, the robber presents the victim with a choice between paying immediately or

[10] It is curious that statist critics of the market invariably denounce "production for [monetary] profit" as greedy and selfish, and instead uphold "production for use" as unselfish and altruistic. On the contrary, producers can only make monetary profits to the extent that they serve *other* consumers. Logically, altruists should deeply admire the successful pursuit of monetary gain on the market.

It is also curious that many writers believe that the maximum-(monetary)-profit assumption for business motivation may have been true for personally owned nineteenth-century firms, but that it no loner holds for the modern corporation. On the contrary, it is precisely the modern corporation where "impersonality" of investment and producer decision will tend to dominate, since the personal wishes of single owners are no longer nearly as important. Unprofitable nepotism, for example, is far more likely to reign in the mom and pop store than in the large corporation.

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waiting until the robber injures him.[12] In this situation both parties do not benefit; instead, the robber benefits precisely at the expense of the victim. Instead of the consumer's paying, guiding, and being benefited by the producer's activity, the robber is benefiting from the victim's payment. The robber benefits to the extent that the victim pays and loses. Instead of helping expand the amount and degree of production in society, the robber is parasitically draining off that production. Whereas an expanded market encourages increases in production and supply, theft discourages production and contracts the market.

It should be clear that the robber is not producing any goods and services at all. In contrast to consumers who purchase goods and services, or who contribute voluntarily to a nonprofit organization, no one is voluntarily purchasing from or contributing to our criminals at all. If they were, the criminals would not be criminal. In fact, what distinguishes a criminal group is that its income, in contrast to that of all other organizations, is extracted by the use of violence, against the wishes or consent of the victims. The criminals, then, are "producing" nothing, except their own income at the expense of others.

It has been maintained that the payments by the victims are "really" voluntary because the victim decides to transfer his funds under penalty of violence by the robber. This kind of sophistry, however, destroys the original, as well as the common-sense, meaning of the term "coercion" and renders *all* actions whatever "voluntary." But if there is no such thing as coercion and all conceivable actions are voluntary, then the distinctive meaning of both terms is destroyed. In this paper, we are defining "voluntary" and "coercion" in a common-sense way: that is, "voluntary" are all actions not taken under the threat of coercion; and "coercion" is the use of violence or threat of violence to compel actions of others. Robbery at gunpoint, then, is "coercion"; the universal need to work and produce is not. In a trivial sense, the victim agrees to be victimized rather than lose his life; but surely, to call such a choice or decision "voluntary" is a corruption of ordinary language. In contrast to truly voluntary decisions, where each person is better off than he was before the prospect of exchange came into view, the robbery victim is simply

[12] Burglars, as distinct from robbers, do not confront their victims directly and so present him with no choice; but they employ physical coercion by seizing his property without his consent.

struggling to cut his losses, for, in any case, he is worse off because of the entry of the robber onto the scene than he was before.

Just as the claim that the victim's payment to the thief is "voluntary" is patently sophistical, so is it absurd to claim that the robber is "producing" some service to the victim or anyone else. The fact that the victim paid him revenue proves no demonstrated preference or value; it proves only that the victim prefers the imposition to being shot.

The robber may well spin elaborate arguments for his productivity and for his alleged benefit to the victim. He may claim that by extracting money he is providing the victim a defense from other robbers. In attempting to achieve and maintain his monopoly of loot, he may very well act against other robbers trying to muscle in on his territory. But this "service" scarcely demonstrates his productivity to the victims. Only if the victims pay the robber voluntarily can any case be made for a nexus of payment and benefit. Since payments are now coercive instead of voluntary, since the consumer has now become the victim, all arguments offered by the criminal and his apologists about why the victim should have been eager to pay the criminal voluntarily are in vain, for the stark and overriding fact is that these payments are compulsory.

The robber takes the funds extracted from the victims and spends them for his own consumption purposes. The total revenue collected by theft we may call tribute; the expenditures of the robbers, apart from the small sums spent on burglars' tools, weapons, planning, and so on, are consumption expenses by the robbers. In this way, just as income and assets are diverted from the productive sector to the robbers, so the robbers are able to use that money (in their purchasing) to extract productive resources from the market.

We conclude, then, that the activities of thieves are most emphatically *not* neutral to the market. In fact, the robbers divert income and resources from the market by the use of coercive violence, and thereby skew and distort production, income, and resources from what they would have been in the absence of coercion. If, on the contrary, we adhere to the view that theft is voluntary and criminals productive, then criminal activities, too, would be neutral to the market, in which case the entire problem of neutrality would disappear by semantic legerdemain, and everything by definition would be neutral to the market because the rubric of the market would encompass all conceivable activities of man. In that case, nothing could be called "intervention" into the market. By labeling aggressive violence as "coercion" and as an interference into the market, we avoid this kind of absurd trap, and we cleave closely to the commonsense view of such concepts as "coercion," "voluntary," "market," and "intervention."

Government as Robber

We are now in a position to analyze government and its relationship to the market. Economists have generally depicted the government as a voluntary social institution providing important services to the public. The modern "public choice" theorists have perhaps gone furthest with this approach. Government is considered akin to a business firm, supplying its services to the consumer-voters, while the voters in turn pay voluntarily for these services. All in all, government is treated by conventional economists as a part of the market, and therefore, as in the case of a business firm or a membership organization, either totally or in part neutral to the market.

It is true that if taxation were voluntary and the government akin to a business firm, the government would be neutral to the market. We contend here, however, that the model of government is akin, not to the business firm, but to the criminal organization, and indeed that the State is the organization of robbery systematized and writ large. The State is the only legal institution in society that acquires its revenue by the use of coercion, by using enough violence and threat of violence on its victims to ensure their paying the desired tribute. The State benefits itself at the expense of its robbed victims. The State is, therefore, a centralized, regularized organization of theft. Its payments extracted by coercion are called "taxation" instead of tribute, but their nature is the same. The German sociologist Franz Oppenheimer saw this clearly when he wrote that

> there are two fundamentally opposed means whereby man, requiring sustenance, is impelled to obtain the necessary means for satisfying his desires. These are work and robbery, one's own labor and the forcible appropriation of the labor of others.. .. I propose .. . to call one's own labor and the

> equivalent exchange of one's own labor for the labor of others, the "economic means" for the satisfaction of needs, while the unrequited appropriation of the labor of others will be called the "political means."[13]

Oppenheimer then proceeded to identify the State as the "organization of the political means."[14] Or, as the libertarian writer Albert Jay Nock, vividly put it: "The State claims and exercises the monopoly of crime.... It forbids private murder, but itself organizes murder on a colossal scale. It punishes private theft, but itself lays unscrupulous hands on anything it wants, whether the property of citizen or alien."[15] Or, as Ludwig von Mises points out, this regularization establishes a systematic coercive hegemonic bond between the rulers of the State and the subject that contrasts vividly with the contractual bond of mutual benefit.

> There are two different kinds of social cooperation: cooperation by virtue of contract and coordination, and cooperation by virtue of command and subordination or hegemony. Where and as far as cooperation is based on contract, the logical relation between the cooperating parties is symmetrical. They are all parties to interpersonal exchange contracts. John has the same relation to Tom as Tom has to John. Where and as far as cooperation is based on command and subordination, there is the man who commands and there are those who obey his order. The logical relation between these two classes of men is asymmetrical. There is a director and there are people under his care. The director alone chooses and directs; the others—the wards—are mere pawns in his actions.[16]

In this coercive, hegemonic condition, the individual must either accept the orders of the ruler or rebel. To the extent that the person submits, this choice then subjects him to the continuing hegemony of the rulers of the State. Contrasting the contractual and the hegemonic, Mises states:

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[13] Franz Oppenheimer, *The State* (New York: Vanguard Press, 1926), pp. 24-27.
[14] Ibid.
[15] Albert Jay Nock, *On Doing the Right Thing, and Other Essays* (New York: Harper and Bros., 1928), p. 145.
[16] Mises, *Human Action*, p. 196.

> In the frame of a contractual society the individual members exchange definite quantities of goods and services of a definite quality. In choosing subjection in a hegemonic body a man neither gives nor receives anything that is definite. He integrates himself into a system in which he has to render indefinite services and will receive what the director is willing to assign to him. He is at the mercy of the director. The director alone is free to choose. Whether the director is an individual or an organized group of individuals, a directorate, and whether the director is a selfish maniacal tyrant or a benevolent paternal despot is of no relevance for the structure of the whole system.[17]

Mises goes on to contrast the system of contractual coordination that is responsible for much of the achievements of Western civilization with the hegemonic system embodied in the State, "an apparatus of compulsion and coercion... by necessity a hegemonic organization."[18]

The idea that taxation is voluntary seems to be endemic among economists and social scientists, though hardly so among the general public.[19] But if an individual refuses to pay his assigned tax, coercion will be wielded against him, and if he resists the confiscation of his property he will be shot or jailed. Failure to pay taxes subjects one to civil and criminal penalties. There should be little need to pursue the matter beyond this, were not economists determined to deny this patently obvious fact. As Joseph Schumpeter trenchantly declared: "The theory which construes taxes on the analogy of club dues or of the purchases of, say, a doctor only proves how far removed this part of the social sciences is from scientific habits of mind."[20]

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[17] Ibid, p. 197.

[18] Ibid., p. 198. this is not to imply that Mises believed that the State could or should be abolished; instead, he believed that the world should be *preponderantly* a product of contractual relations. (Italics mind.)

[19] We speak here of "voluntary" in the nontrivial sense that distinguishes it from the "involuntary" or "coerced" payment to thieves.

[20] In the preceding sentence, Schumpeter wrote: "The state has been living on a revenue which was being produced in the private sphere for private purposes and had to be deflected from these purposes by political force." Joseph A. Schumpeter, *Capitalism, Socialism, and Democracy* (New York: Harper and Bros., 1942), p. 198 no 198.

But if taxation is coercive and a system of organized theft, then any "services" that the government may supply to its subjects are beside the point, for they do not establish the government as voluntary or as part of the market any more than a criminal band's providing the "service" of defending its victims from competing bands establishes that its services are voluntarily paid for. These services are not voluntarily paid for by the taxpayers, and we therefore cannot say that the taxes measure or reflect any sort of benefit. In the case of voluntary purchase on the market, as we have seen, the consumer demonstrates by his purchase that he values the good or service he buys more than the price he pays; but in paying taxes he demonstrates no such thing—only the desire not to be the recipient of further violence by the State. We have no idea how much the taxpayers would value these services, if indeed they valued them at all. For example, suppose that the government levies a tax of X dollars on A, B, C, and so on, for police protection—for protection, that is, against irregular, competing looters and not against *itself*. The fact that A is forced to pay $1,000 is no indication that $1,000 in any sense gauges the value to A of police protection. It is possible that he values it very little, and would value it less if he could turn to competing defense agencies. Moreover, A may be a pacifist; so he may consider the State's police protection a net harm rather than a benefit. But one thing we do know: If these payments to government were voluntary, we can be sure that they would be substantially less than present total tax revenue. Why? Because if people were willing to pay voluntarily, then there would be no need for the apparatus of coercion so intimately wrapped up in taxation.

A second important point is that, in contrast to the market, where consumers pay for received benefits (or, in nonprofit organizations, where members pay for psychic benefits), the State, like the robber, creates a total disjunction between benefit and payment. The taxpayer pays; the benefits are received, first and foremost, by the government itself, and secondarily, by those who receive the largess of government expenditures.

But if, under coercive taxation, tax payments far exceed benefits to the victim, and if benefits accrue to the government itself and to the recipients of its expenditures at the expense of taxpayers, then it should be quite clear that it is impossible for taxes ever to be neutral to the market. Taxation, whatever its size or incidence, must distort market processes, must alter the allocation and distribution of assets, incomes, and resources.

The Alleged Voluntariness of Taxation

Despite the fact that government and taxation are patently coercive, economists have devoted considerable energy, in numerous ways, to maintaining the contrary. If government and taxation were truly voluntary, then taxation would be akin to a market payment, and government could be deemed a part of, and therefore neutral to, the market.

By lumping government along with private expenditures as a gauge of the output of the economy, the conventional national income statisticians are implicitly assuming that government is neutral to the market because government provides those "services" that "society" desires it to supply. Government "output" is equated to the salaries paid to the bureaucracy. By employing the seemingly precise method of segregating some government expenses as mere "transfer payments"—the taxing of Peter to pay Paul—rather than productive purchases of goods and services, the national income statisticians are in reality making an unsupportable ideological judgment. For in what sense does the hiring of bureaucrats, or the purchasing of paper clips, add to the production of the economy and therefore become somehow voluntary, while transfer payments are frankly taxing one group to subsidize another? As we shall see further below, all taxation necessarily involves taking from one group to subsidize another; therefore all government expenditures, taken together, constitute one giant transfer payment.

Even if one does not go that far, it is a rare person who would not concede that at least 50 percent of government expenditures are sheer waste, which would mean that they should not form part of the estimated national product at all. Despite his recognition of this fact, as well as the shakiness of ranking government expenses along with market expenditures, Sir John Hicks finally sees no alternative. He puts it this way:

> I can see no alternative but to assume that the public services are worth to society in general at least what they cost.... One

> may feel considerable qualms about such an assumption—it is obvious that the government spends far too much on this, far too little on that: but if we accept the actual choices of the individual consumer as reflecting his preferences... then I do not see that we have any choice but to accept the actual choices of the government, even if they are expressed through a Nero or a Robespierre, as representing the actual wants of society.[21]

Elsewhere, Hicks explains that in constructing national product figures, "the social accountant... must work upon some convention which is independent of his individual judgment."[22] It is remarkable that Hicks can find security from the shoals of individual judgment in assuming that Nero or Robespierre embody "the actual wants of society." Can he really believe that this fictive "society" and its head of State adequately represent the preferences of individual citizens?

Collective Goods

More intellectually respectable is the contention that insofar as government supplies society with "collective goods" or "public goods," it is supplying a necessary service and is in a sense voluntary and neutral to the market. Collective goods are goods that allegedly cannot be supplied on the private market because they are indivisible and therefore cannot be allocated by having individual consumers pay for their own portions of the product. No consumer can be excluded from receiving the good. Like the sun, collective goods shine on all alike, and none can be made to pay for the service. Professor Buchanan, sympathetic to the idea of an "ideally neutral fiscal system," defines it as one that "uniquely aims at providing the social group with some 'optimal' or 'efficient' quantity of collective goods and services." Then, if "the fiscal system is conceived as the means through which collective goods and services are provided to members of the society without any subsidiary or supplementary social purposes," we have, says Buchanan, an "analogy with the market

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[21] John R. Hicks, "The Valuation of the Social Income," *Economica* (May 1940), cited in Alex Rubner, *Three Sacred Cows of Economics* (New York: Barnes and Noble, 1970), p. 54.
[22] Hicks to Rubner, Sept 28, 1966. In Rubner, *Sacred Cows*, p. 54n.

economy." The fiscal system is then "ideally neutral" to the market economy.[23]

In the first place, even if there were such things as collective goods, government supply would establish neither its voluntarism nor its neutrality. Even if there were no other way to supply these services, taxation to provide them is *still* compulsory. And since it is coercive, there is no standard, as there is on the market, to decide how much of these services to supply by taxation. And the more the government provides, the less people are allowed to spend on their own private consumption.

Furthermore, if there exists but one anarchist in any society, the very existence of the State coercively supplying a collective good constitutes a great psychic harm to that anarchist. The anarchist, therefore, receives not a collective service but an individual harm from the operations of the State. It follows therefore that the good or service cannot be truly collective; its "service" is separable, and distinctly negative, to the anarchists. Hence, the good can neither be truly collective (indivisible, and positive) nor can it be voluntary.[24]

No matter how "divisible" the service, furthermore, a collective good is not quite like the sum: The more resources the government expends, the greater will be its output. These resources will have to be extracted from other potential products. Take, for example, "defense" or police protection, which is often considered to be provided as a homogeneous lump to everyone. But every good or

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[23] James M. Buchanan, *The Public Finances*, 3rd ed. (Homewood, Ill.: Richard d. Irwin, 1970), pp. 62-63.

[24] After identifying the essence of government as coercion, and after carefully analyzing each type of government and "political entrepreneurship," Montemartini concludes that "there are no public, or collective needs in the strict sense of the word, as opposed to private needs. It is always real individuals who calculate the advantages of imposing on the community the production of certain specific goods." And these individuals' valuations will differ; "The calculations of economic advantage differ from one associate to another when it comes to determining the needs to be satisfied collectively." Hence, the production of "collective goods" is always coercive: "The collectivization of the satisfaction of some needs always aims at a participation in the costs of economic units which would not voluntarily have so participated." Giovanni Montemartini, "The Fundamental Principles of a Pure Theory of Public Finance," in *Classics in the Theory of Public Finance,* Richard Musgrave and Alan Peacock, eds. (New York" Macmillan, 1958), pp. 150-51.

service in the world, "collective" ones included, are provided, not in lump sum, but in marginal units. Yet strangely, economists, trained to think of marginal units everywhere else, suddenly start referring to defense as a "lump" when discussing government. In reality, however, there is a vast range of "defense" services that the government (or any other defense agency) could supply to its customers. To take two polar extremes, the government could supply one unarmed policeman for an entire country, or it could sink most of the national product into providing an armed bodyguard, replete with tank and flame throwers, for every citizen. The question that must be answered by any defense agency is not whether or not to supply defense, but how much defense to supply to whom? In the same way, the question confronting a steel company is not whether or not to produce steel, but how much steel of various grades and types to supply.

But this failure to provide rational criteria for amounts and types of collective services is an inherent flaw in any provision by government. The market's price system and profit-and-loss test tell private firms how much of what kind of steel to produce; rational criteria for satisfying consumers most efficiently are inherent in the free market. But government can have no such criteria. Since the consumers of defense do not pay for the service, since taxes do not measure the service, and since the government does not have to worry about losses that can be recouped by further taxation, there are no criteria of how much defense to provide to whom. Decisions are purely arbitrary, as well as coercive. If, on the other hand, defense were provided by private firms on the market, then these firms would, as in the rest of the market, supply efficiently the amounts and types of protection desired by particular customers. Those customers, for example, who desired and were willing to pay for round-the-clock bodyguards would do so; those who felt no need for protection—or pacifists aghast at the very idea—would pay nothing; and there might be a large spectrum of services in between.

More specifically: Only a minority of specific individuals find themselves in actual need of police or judicial protection during any given period. If A and B are attacked, the police can spring to the aid of these specific persons. It will be objected that even if only a few persons are actually attacked at any one time, no one can determine who will be attacked in the future, and so everyone will want to be sure of protection in advance, thus salvaging the notion of a "collective want." But, again, there will be a spectrum of opinion among individuals. Some persons may feel pretty sure that they will not be attacked, and will therefore be willing to opt out of protection, to take their chance rather than pay a protection tax. Others will be confident of their own ability to repulse an attack, or would only patronize another, competing private defense agency. Others may fear an attack so little that the cost of paying protection will not be worth the benefit. On the free market, individuals would be free to choose any or none of these protection-insurance packages.

Even if it be conceded that not all people demand protection, it might still be argued that defense is a "collective good" because no one can be excluded from receiving its benefits. But surely if the inhabitants of a particular block refuse to pay for the police protection, the police may simply exclude that block from its patrols or other services. In the case of judicial protection, the conventional case for a collective good is even weaker. For surely a court, financed by voluntary payment (either by insurance premium or by fee-for-service), can refuse to hear the case of a nonpaying plaintiff. Even in the case of national defense, which seems to be a particularly strong example of a collective good, the pacifist or anarchist receives a harm rather than a good, and exclusion can be practiced in such ways as not rushing troops or planes to defend nonpaying areas, or at the very least not to defend them as rapidly and as diligently as areas that do pay.

Thus defense cannot be a collective good so long as only one pacifist or one anarchist exists in the society, for these persons will receive a harm rather than a benefit when they receive the "service" of coercive defense. And defense is not a collective good because its recipients can be excluded and separated.

Professor Kenneth Goldin is one of the very few economists to recognize that defense service is separable and not indivisible. He also points out that increased police service requires increased expense:

> As communities grow, and more residents must be supplied with crime defense, most communities hire more policemen; clearly an increased cost. If more policemen are not hired, then new residents can be served only by decreasing service to others: more streets can be patrolled only if there are fewer

> patrols at night; more properties can be checked only if each one is checked less thoroughly, and only the more urgent calls can be responded to. Each of these service changes imposes costs on residents. Either they will suffer from more crime, or they will incur the costs of purchasing other types of crime defense. Many types of crime defense are selectively available such as locks, fences, guard dogs, guards, and also alarm companies which respond if the burglar alarm is tripped. And don't overlook private police patrols, which check selected houses on selected streets, as thoroughly and as often as each customer requests, for a fee.[25]

Court services are clearly separable, and private arbitrators are indeed generally more efficient than government courts. Goldin adds:

> To service more persons generally requires more judges and courtrooms. If more facilities are not acquired, additional users will impose costs on others, in the form of longer days for trial and/or less judicial time spent on each case. It is costless to serve additional persons only if they have no disputes.

To some extent, he goes on, even government courts charge fees to users and therefore charge for benefits received, although the fees usually do not vary with the difficulty of the case. And "private arbitrators are also available, selectively, to those parties willing to pay a fee. So, although adjudication is a fundamental service in any society, it does not follow that adjudication is a public good."[26]

And even in the case of national defense, Goldin points out,

> there is certainly some variation in protection, especially among cities (regarding protection by missiles), and among Americans who either travel or have property abroad. While the troops may be sent out to protect some Americans or their property from some foreign seizures (such as the Mayaguez), in other cases no action is taken (tuna boats). One of the firmly

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[25] Kenneth D. Goldin, "Equal Access vs. Selective Access: A Critique of Public Goods Theory," *Public Choice* 29 (Spring 1977): 60.
[26] Ibid. pp. 65-66.

> embedded myths of modern public finance is that it doesn't matter if population increases: The costs of defending the U.S. from external attack will not change. But consider two points. First, the new population must live somewhere. If they cause an increase in the U.S. land area, then either more defenses must be provided, or there will be a decrease in the level of protection to earlier residents and either way the marginal cost of protecting additional persons is positive.... Second, even if the new population resides within the existing boundaries, they will generally increase the amount of physical and human wealth which might be coveted by an enemy. That is, foreign attack is (at least partially) an economically motivated action, and is more likely to occur if there is more capital worth coveting.[27]

Not only does total cost of national defense vary with population, but the service of protection against foreign attack can be variable. First, there once existed private armies, and such armies, serving private individuals or groups, still exist today. Goldin mentions the armies of religious groups in contemporary Lebanon, as well as a Central American army owned by Robert Vesco. These armies, as Goldin states, "yield benefits primarily to their owner."[28]

Second, even a collective State army can vary its services to individual citizens:

> A military force also protects people from theft of property and kidnapping by foreigners. Exclusion from this service is relatively easy: The military force simply makes no attempt to stop theft or kidnapping of named persons. These persons would either hire their own guards, or suffer the damages of theft or kidnapping by foreigners.... Americans with substantial property abroad or at sea might well prefer to

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[27] Ibid., pp. 60-61.

[28] Ibid., p. 61. Goldin amusingly adds: "A medieval lord could scarcely be a 'free rider' on a neighboring lord's defense efforts. If he did not have his own defenses, he would probably suffer attacks from his neighbor." Cf. Wicksell: "Side by side with the national army, many countries have voluntary rifle clubs and similar institutions which sometimes constitute no mean military force." Knut Wicksell, "A New Principle of Just Taxation," in *Classics in the Theory of Public Finance,* Musgrave and Peacock, eds., p. 90.

> provide their own anti-theft defenses, rather than pay for a communal army which cannot be counted on to protect their property.... Contrary to public goods theory, even in this key case of defense from external attack, exclusion is not impossible and the marginal cost of serving additional persons generally is not zero.[29]

Moreover, as Buchanan concedes, a collective defense may be a service to one citizen and be considered a distinctly negative "service" by another:

> The common availability of collective goods or services does not, of course, imply that similar evaluations are placed on these by different persons. The Vietnam War effort demonstrated this point. The services of the plane that bombed North Vietnam in October, 1968, were equally available to all U.S. citizens. But the value placed on these services may have ranged from significantly positive levels .. . to significantly negative levels for those who felt that continued bombing was both immoral and a barrier to peace negotiations.[30]

To Professor Buchanan, the "classic" example of a collective good is the lighthouse. The beams of the lighthouse are indivisible: "If one boat gets all the light beams, all boats may do likewise."[31] Or, as Samuelson has put it, "A businessman could not build it for a profit, since he cannot claim a price from each user."[32] The theory is that it would be virtually impossible for a lighthouse keeper to row out to each boat to demand payment for use of the light. And that hence lighthouses have always been supplied by government.

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[29] Goldin, "Equal Access vs. Selective Access," pp. 61-62.
[30] Buchanan, *Public Finances*, pp. 25-26. Buchanan errs, however, in claiming that "few persons" would place a negative value on internal law and order. Pacifists would, and how "few" they may be will vary, and their number is unknown in any case. Even the existence of one pacifist negates the very concept of defense as a collective good, just as the existence of one anarchist negates the very concept of a collective good supplied by the State.
[31] Ibid., p. 23.
[32] Paul A. Samuelson, *Economics*, 6th ed. (New York: McGraw-Hill, 1964), p. 159. In his 10th edition, Samuelson, perhaps in an unacknowledged response to Professor Coase's noteworthy article (see below), gives the case away by adding, after "from each user" the words "without great difficulty" (p. 160). For he thereby concedes that lighthouses are *not* "collective goods."

But, first, the problem has now been eliminated by modern technology. It is now technologically highly feasible for a lighthouse's rays to be available only to that boat that has the proper electronic equipment, and to pay a fee for the use of that equipment. But, apart from this, it turns out, as Ronald Coase has discovered, that from the seventeenth until the early nineteenth centuries, the British lighthouse system was developed and operated by private enterprise. The lighthouse owners hardly bothered about collecting a fee from each boat on the spot. Instead, the owners employed agents at ports who found out what routes each ship entering the port had sailed and therefore what lighthouses the ship had passed and charged them accordingly.[33] Furthermore, additional users of lighthouses will impose higher costs for providing them. More ships will increase the likelihood of congestion in the protected waters and will require more navigational aids.[34]

In his trenchant critique of the offhanded way in which economists, from Mill to Samuelson and Arrow, have wrongly used the lighthouse as an example of a collective good, Coase concludes:

> These references by economists to lighthouses are not the result of their having made a study of lighthouses or having read a detailed study by some other economist. Despite the extensive use of the lighthouse example in the literature, no economist, to my knowledge, has ever made a comprehensive study of lighthouse finance and administration. The lighthouse is simply plucked out of the air to serve as an illustration. . ..
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> This seems to me to be the wrong approach. . .. [G]eneralizations are not likely to be helpful unless they are derived from studies of how such activities are actually carried out within different institutional frameworks…

[33] "The tolls were collected at the ports by agents (who might act for several lighthouses)… The toll varied with the lighthouse and ships paid a toll, varying with the size of the vessel, for each lighthouse passed. It wasnormally a rate per ton (say 1/4d or 1/2d) for each voyage. Later, books were published setting out the lighthouses passed on different voyages and the charges what would be made." Ronald H. Coase, "The Lighthouse in Economics," *Journal of Law and Economics* 17 (October 1974): 364-65.
[34] Goldin, "Equal Access vs. Selective Access," p. 62.

> The account in this paper of the British lighthouse system .. . shows that, contrary to the belief of many economists, a lighthouse service can be provided by private enterprise.. .. The lighthouses were built, operated, financed and owned by private individuals, who could sell the lighthouse or dispose of it by bequest. The role of the government was limited to the establishment and enforcement of property rights in the lighthouse. The charges were collected at ports by agents from the lighthouses. The problem of enforcement was no different for them than for other suppliers of goods and services to the shipowner.[35]

The analogous navigational aid for air traffic, the services of the air-control tower, can be and is sold separately to individual consumers. Control towers will distribute radar information, for example, to whoever has radar equipment, but the equipment must be purchased by individual users. And heavier use of airspace or airport runways requires more navigational aids and therefore more expenses to service the users.[36]

Radio and television have been cited as collective goods since servicing another viewer allegedly involves no additional cost. But additional service is far from costless, and viewers are separable and excludable; therefore radio and TV fail both tests of a collective good. An increased viewing audience means supplying more, and more varied, programs. And new users must either be supplied with a stronger signal or may require cable or stronger antennas because of the increased congestion. Moreover, consumers are excluded now from television. To watch television programs they must buy sets and then must either pay as they go (various forms of pay TV) or else

[35] Coase, "The Lighthouse in Economics," p. 375. As Goldin remarks, "Lighthouses are a favorite textbook example of public goods, because most economists cannot imagine a method of exclusion. (All this proves is that economists are less imaginative than lighthouse keepers.)" Goldin, "Equal Access vs. Selective Access," p. 62.

[36] Since commercial airports are all owned by (largely municipal) government, the pricing of their runway and other services is scarcely akin to market pricing; generally, landing and takeoff fees are set far too low to clear the market, and the resulting shortage is rationed by increased and dangerous air congestion. See Ross D. Eckert, *Airports and Congestion* (Washington, D.C.: American Enterprise Institute, 1972).

advertisers must pay, imposing on many viewers the psychic costs of commercials. And public television imposes on its viewers the psychic costs of being subjected to lengthy requests for donations.[37]

Moreover, in a sense the collective goods case for radio and television proves too much. For movies may also be said to be "costless" if additional viewers fill empty seats in a theater. Must movies, too, be nationalized, be supplied only by government, and perhaps be free to all?

Research has also been termed a "collective good"; don't we all enjoy the benefits of the research and inventions of Edison, Faraday, et al., without paying for them? But of course we do pay for the fruits of research, and we pay separably. For we must purchase the papers or books of researchers, or pay fees for lectures, demonstrations, or consulting. Those who do not pay such fees are excluded from learning of or absorbing these new ideas. And, of course, the holders of patents and copyrights are able to obtain the income from these inventions or discoveries while excluding other producers.[38]

Again, this argument proves too much. For not only patents and inventions are produced by creators: There is also art, sculpture, music, literature, philosophy. Are we to say that all these products of the human spirit are "collective goods" because we cannot be fully excluded from enjoying the products of Beethoven, Shakespeare, or Vermeer? Must all artists therefore be nationalized?

Another commonly cited example of a collective good is insect control by airplane spraying. It is alleged to be impossible to exclude land underneath from being sprayed, and the marginal cost of adding more land sprayed is zero. But if new residents live in previously uninhabited areas, then extra cost is incurred in servicing them, and the same is true if they are engaged in activities that attract insects. More airplane time and fuel must be used as well as more spray. Furthermore, the airplane could often, if it wished, exclude specific parcels of land from its spray. And more important, many of those receiving this "service" have not wanted it and have objected to

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[37] See Goldin, "Equal Access vs. Selective access," pp. 64-65.
[38] Ibid., pp. 63-64.

the spraying as vigorously as the pacifist has protested the use of violence in defense. Indeed, a shift in public attitudes toward chemical sprays has greatly reduced their use in recent years. But if some people consider a service such as a spray as "bad," how can it be an indivisible, positive collective good?

Moreover, as Goldin points out, individual consumers have another option: to buy their own spray guns and spray their own property. In that case, each individual could choose and pay for the type and amount of spray that he precisely desires.[39]

For many reasons, then, there are no collective goods, and even if there were, as we have already seen, their supply would be coercive if furnished by government and taxation. But there is yet another vital point: For even if a good or service could only be supplied "collectively," why must that collection be compulsory? Why couldn't individuals pool their resources voluntarily, as in club dues, and make voluntary contributions for the supply of the service?[40] Or, as Gustave de Molinari argued, couldn't a government even contract for the supply of collective services with private, competitive, and therefore more efficient firms?[41]

Or, as Spencer Heath urged, on the model of real estate developments, shopping centers, and hotels, couldn't such "collective" or "public" goods as police, fire, roads, sanitation, and so on, be supplied by a large private firm with tenants paying for these services in their rents?[42]

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[39] Ibid., p. 54.
[40] Cf., Melvin w. Reder, "Review of Baumol's *Welfare Economics and the Theory of the State*," *Journal of Political Economy* (December 1953): 539.
[41] Gustave de Molinari, *The Society of Tomorrow* (New York: G.P. Putnam's Sons, 1904), pp. 71-72, 84-86. In earlier years, this Belgian-born nineteenth-century French economist believed that all services now supplied by government could be supplied better and more efficiently by privately competitive firms on the free market. See Gustave de Molinari, The Production of Security (New York: Center for Libertarian Studies, May 1977); and David M. Hart, "Gustave de Molinari and the Anti-Etatiste Liberal Tradition" (history, honors thesis, Macquarie University, Australia, 1979).
[42] Spencer Heath, Citadel, Market and Altar (Baltimore, Maryland: Science of Society Foundation, 1957). For the most developed work on the Heathian proposal, see Spencer Heath, *The Art of Community* (Menlo Park, Califor.: Institute for Humane Studies, 1970). Disney World is a spectacular example of a successful business firm supplying all of these services out of tourists' fees.

Finally, if we look at human history, we find that every good, without exception, that economists glibly term a "collective good" has actually been successfully supplied by the free market. Not only do private guards and patrols exist, and private lighthouses in the past, but there have been societies, such as medieval Ireland, that supplied a complex network of defense service and insurance—including police, crime insurance, and competitive courts—without a State or taxation. Competing market courts serviced for centuries the vitally important fairs of Champagne in the Middle Ages. Common-law courts were marked by competitive, nongovernmentally appointed judges. Private guards and private arbitrators exist successfully even in our society where the State monopolizes most forms of defense.[43]

It seems clear, then, that voluntary rather than governmental supply of the collective good would be possible in every case; the only objection might be, not that the good—defense, firefighting, or whatever—could not be supplied, but that "too little" would be supplied. But that brings us to the second line of argument by the proponents of government.

External Benefits

If forced to retreat from the "strong" concept of collective goods, the advocates of government supply or subsidization of such goods, fall back on a "weak," and therefore more plausible argument. Even though every collective good might be furnishable by private means, "not enough" will be supplied because of the difficulty or impossibility of capturing enough payment from "free riders" who benefit from these services without paying for their benefits. Government supply, or taxation of free riders to subsidize supplies, then becomes required in order to "internalize the external benefits" acquired, but not paid for, by the free riders.[44]

[43] Thus see Joseph R. Peden, "Property Rights in Celtic Irish Law," *Journal of Libertarian Studies 1* (Spring 1977): 81-95; Bruno Leoni, Freedom and the Law (Los Angeles: Nash, 1972); and William C. Wooldridge, *Uncle Sam the Monopoly Man* (New Rochelle, NY: Arlington House, 1970).

[44] Gordon Tullock advances the curious argument that revolutions are impossible (or virtually so) because individual revolutionaries work and sacrifice whereas the entire public reaps the benefits; hence the public are free riders on the efforts of revolutionaries. (Gordon Tullock, "The Paradox of Revolution," *Public Choice 9*

But this argument generates far more difficulties than it solves. It proves too much in many directions. In the first place, how much of the deficient good should be supplied? What criterion can the State have for deciding the optimal amount and for gauging by how much the market provision of the service falls short? Even if free riders benefit from collective service X, in short, taxing them to pay for producing more will deprive them of unspecified amounts of private goods Y, Z, and so on. We *know* from their actions that these private consumers wish to continue to purchase private goods Y, Z, and so on, in various amounts. But where is their analogous demonstrated preference for the various collective goods? We know that a tax will deprive the free riders of various amounts of their cherished *private* goods, but we have *no idea* how much benefit they will acquire from the increased provision of the collective good; and so we have no warrant whatever for believing that the benefits will be greater than the imposed costs. The presumption should be quite the reverse. And what of those individuals who dislike the collective goods, pacifists who are morally outraged at defensive violence, environmentalists who worry over a dam destroying snail darters, and so on? In short, what of those persons who find other people's good their "bad?" Far from being free riders receiving external benefits, they are yoked to absorbing psychic harm from the supply of these goods. Taxing them to subsidize more defense, for example, will impose a further twofold injury on these hapless persons: once by taxing them, and second by supplying more of a hated service.

Since the tax-and-subsidy, or government-operation, route abandons the process of the market, there is no way of knowing who the "negative free riders" are, and how much they will be suffering from an increased tax. We do have a pretty good idea, however, that one or more of these people exists: that there is at least one pacifist,

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[Fall 1971]: 89-99.). If he were consistent, Professor Tullock should therefore advocate that government tax people and subsidize revolutionaries in order to solve the problem of "underproduction of revolution!" In point of fact, of course, revolutions *do* take place from time to time, and they occur because much of the public has placed high on their values scales the success of the revolution. In short, a strongly held ideology among the public can overcome the free-rider problem for revolution. People's "interest" is not only job or immediate monetary payment, but also the attainment of such concepts as justice, liberty, and so on, none of which has any place in the economic calculus of the public-choice theorists.

anti-dam environmentalist, anarchist opposed to all government actions, and so on, in every society. But in that case, the free-rider as well as the "stronger" collective-good argument for the neutrality of government falls to the ground.

The young Herbert Spencer, in his great treatise Social Statics, declared that an individual should be able to opt out of taxation, to "ignore the State," and to renounce its services.[45] Criticizing his own work a half-century later, Spencer, in his *Autobiography*, employs the free-rider argument. "Mr. Spencer," he charges,

> actually contends that the citizen may properly refuse to pay taxes, if at the same time he surrenders the advantages which State aid and State protection yield him! But how can he surrender them? In whatever way he maintains himself, he must make use of sundry appliances which are indirectly due to governmental organization; and he cannot avoid benefiting by the social order which government maintains. Even if he lives on a moor and makes shoes, he cannot sell his goods or buy the things he wants without using the road to the neighboring town, and profiting by the paving and perhaps the lighting when he gets there. And, though he may say he does not want police guardianship, yet, in keeping down footpads and burglars, the police necessarily protect him, whether he asks them or not. Surely it is manifest .. . that the citizen is so entangled in the organization of his own society that he can neither escape the evils nor relinquish the benefits which come to him from it.[46]

The later Spencer was properly refuted, on his own earlier grounds, by "S.R." "S.R." points out first that on the later Spencer's own grounds, a man at least has the right to refuse to pay for advantages that he can relinquish. "S.R." then quotes from the earlier Spencer's application of his "law of equal freedom":

> If every man has freedom to do all that he wills, provided he infringes not the equal freedom of any other man, then he is

[45] Herbert Spencer, *Social Statics* (London: John Chapman, 1851), chap. 19, "The Right to Ignore the State," pp. 206-16.
[46] Herbert Spencer, *An Autobiography* (New York: d. Appleton, 1904), 1, pp. 417-18.

> free to stop connection with the State—to relinquish its protection and to refuse paying toward its support. It is self-evident that in so behaving he in no way trenches upon the liberty of others; for his position is a passive one, and while passive he cannot become an aggressor.. .. He cannot be coerced into a political combination without a breach of the law of equal freedom; he can withdraw from it without committing any such breach; and he therefore has the right to withdraw.

"S.R." then proceeds: "Is a man who refuses to pay for incidental advantages he has not solicited an aggressor? Is it a breach of the law of equal freedom to withdraw from a combination that, in working for itself and pursuing its own benefit, indirectly benefits one who is perfectly willing to forego the blessings of the uninvited beneficence?" "S.R." then points out that Spencer is implicitly modifying his equal freedom formula to say that anyone can do whatever he wishes, provided not only that he does not infringe on anyone else's freedom, but also provided "that no one confers upon him benefits which he cannot wholly surrender while remaining a producer and trader."

"S.R." then tellingly supplies the logical reductio of the free-rider argument:

> Has an individual the right to withhold proper contributions from neighbors who, individually or collectively, benefit him by caring for their own interests? If my neighbors hire private watchmen, they benefit me indirectly and incidentally. If my neighbors build fine houses or cultivate gardens, they indirectly minister to my pleasure. Are they entitled to tax me for these benefits because I cannot "surrender" them?[47]

Thus the free-rider argument proves far too much. After all, civilization itself is a process of all of us "free-riding" on the achievements of others. We all free-ride, every day, on the achievements of Edison, Beethoven, or Vermeer. When capital investment increases, and technology improves, the real wages of workers and the standard of living of consumers increase, even

[47] "S.R.," "Spencer as His Own Critics," *Liberty* 14 (June 1904): 2.

though they have contributed nothing to these advances. By simply continuing to work and consume, laborers and consumers receive the benefits of the inventions and investments of others without paying for them. So what must we infer from this? Are we all to wear sackcloth and ashes? If our neighbors are wiser, prettier, or happier, we all benefit in countless ways. So what must we do about it? Must we all be taxed to subsidize their beauty and wisdom?

And if people feel that not enough beauty, wisdom, inventions, police protection, and so on, will be provided by consumer payment and because of free riders, they are perfectly at liberty to subsidize provision of such goods on their own, individually or through societies or foundations. By doing so, the donor will demonstrate that, to him, the expected psychic benefit from his subsidy is worth more than the money he pays.

It will be objected that potential donors will not donate if they are rankled by the spectacle of free riders who stubbornly refuse to donate for the benefits they receive. And, further, that consumers on the market will not be willing to purchase these goods if they know that free riders abound. If we wished to moralize here, we might respond that these persons might be well advised to attend to their own affairs without wallowing in envy at benefits received by others. But, in any case, if the rankling at the existence of free riders is strong enough, these persons are always free to boycott the miscreants, either by not trading with them or by general ostracism.[48]

The consumers or donors can also, if they wish, get around the free-rider problem by making contracts, either singly or in organized fashion, that will pay for the "collective good," but only on condition that everyone else, including the potential free riders, pay as well. This form of contract would enable those willing to pay, in effect, to

[48] Attacking the late Spencer's argument, in Man vs. the State, for taxation for defense based on the free rider, "S.R" points out that that Spencer "overlooked the fact that there are several methods of securing cooperation for necessary ends, some manifestly non-aggressive and consonant with the principle of equal freedom. It is, of course, unfair for any man to enjoy the benefits of pace and stability while declingin to share the risks, sacrifices, and burdends entailed by actual and probable attacks from within or without; but such an unsocial and mean-spirted individual can br brough to terms by the boycott, material and moral." "S.R.," "Spencer and Political Science," *Liberty* 14 (February 1904): 2.

put the choice to the free riders: Either you join in paying or the service will not be provided.[49]

Transaction Costs

It has been objected that the "transaction costs" of identifying the free riders or channeling donations, or organizing boycotts or of making conditional contracts, are "too high," and that therefore those who want these services are justified in turning to the government to force the free riders to pay.

There are several grave fallacies in the transaction costs argument for taxation. In the first place, it ignores the transaction costs of the government process itself. The implication is that government is a costless Mr. Fixit, levitating angelically above the fray and busily correcting "market failures." If private persons have difficulty in identifying free riders, will government be able to limit its taxation to free riders only? What of the external costs of the inevitable taxation beyond the free rider? And, as we have seen, since market and demonstrated preference through individual action is not available to government, there is no way that government can either identify the free riders or the "negative free riders," or to discover how much benefit each person would derive from the subsidized supply and therefore how much each person should be taxed. There are also the inevitable grave inefficiencies in the political supply of goods and services and in the political process itself that need not be expounded here. At any rate, there is no reason to assume that the transaction costs of turning to government will be lower than those of private operation, and every reason to assume the opposite.

Second, another definitive rebuttal of the transaction-cost argument for government is the impossibility of comparing transaction costs, not simply of private and government action, but at any time and in any situation. For costs, like utilities, are subjective, and therefore nonmeasurable and noncomparable between persons. There is no such thing as social transaction costs or any social costs

[49] I am indebted to Dr. David Gordon of the Center for Libertarian Studies for pointing this out to me.

whatever.[50] Any government action will impose enormous psychic cost on the anarchist; any private action will do likewise for the dedicated totalitarian. How are we to compare them? If an entity does not and cannot exist, then it is senseless to take as one's goal that it be minimized.

And third, even if transaction costs were measurable and comparable, we must ask: What is so terrible about transaction costs? On what basis are they considered the ultimate evil, so that their minimization must override all other considerations of choice, freedom, or justice?[51] After all, if minimizing these dread costs were truly the be-all and end-all, we could all pledge to obey one dictator, one Brezhnev or Idi Amin, in all things, and then everyone would have the assurance of knowing everyone else's relevant value-scales. Other problems would abound, but at least transaction costs would be forced down to a minimum.

Coercion as "Really" Voluntary

A final fallback argument for the voluntariness of taxation and government asserts that every member of society wishes to pay for the collective goods but will do so only if everyone else pays. Therefore the seeming coercion of taxation is a fallacy, for everyone voluntarily pays in the serene knowledge that all beneficiaries are paying. In a kind of Hegelian leap, we are all voluntarily and cheerfully forcing ourselves to be free.[52]

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[50] Even Professor Buchanan, one of the founders of public-choice theory, admits the subjectivity and hence the noncomparability of costs. James M. Buchanan, *Cost and Choice: An Inquiry in Economic Theory* (Chicago: Markham, 1969).

[51] If transaction costs are to be absolute and override all other considerations, then the transaction cost theorists are taking the very same position they deride in ethicists: that is, rendering their values absolute, with no trade-off for other values. If transaction-cost economists are to scorn ethicists for ignoring cost-benefit considerations, why are *they* to be allowed to ignore ethics?

[52] Professors Buchanan and Tullock and the public-choice theorists are the outstanding modern proponents of this theory, which was also enunciated by Professor Baumol. See William J. Baumol, *Welfare Economics and the Theory of the State* (Cambridge, Mass.: Harvard University Press, 1952), and idem, "Economic theory and the Political Scientist," *World Politics* (January 1954): 275-77.

This argument adds a heavy dose of mysticism to the other collective goods and external benefits arguments. For how do we know that everyone is voluntarily paying knowing that everyone else is doing so? There is no evidence, there is no social compact whatever to that effect. Is all that they pay supposed to be voluntary, or just some? Are they perhaps in mourning that their payments are not higher? And what of the anarchist and the pacifist and the tax rebel? Is *their* bitter opposition to taxation only a cloak for their cheerful acceptance? On what basis are we supposed to accept this curious doctrine?

There is, in short, no warrant whatever for Baumol's contention that every individual prefers to be coerced into paying for a service rather than have none of it supplied at all. Moreover, this argument ignores the options as discussed above, of conditional contracts to finance the service voluntarily, or of voluntary boycotts of free riders.[53]

A popular argument holds that the fact of democracy establishes the voluntary nature of government. This idea need not detain us here long. As Herbert Spencer pointed out, democracy at best can only reduce the number of people being coerced; it does not eliminate coercion:

> By no process can coercion be made equitable.. .. The rule of the many by the few we call tyranny: the rule of the few by the many is tyranny also.. .. "You shall do as we will, and not as you will," is in either case the declaration; and if the hundred make it to the ninety-nine, instead of the ninety-nine to the hundred, it is only a fraction less immoral. Or two such parties, whichever fulfills this declaration necessarily breaks the law of equal freedom: the only difference being that by the one it is broken in the persons of the ninety-nine, whilst by the other it is broken in the persons of a hundred. And the merit of the democratic form of government consists solely in this, that it trespasses against the smallest number.[54]

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[53] See Rothbard, *Toward a Reconstruction of Utility and Welfare Economics*, pp. 33ff. On collective goods and external benefits, also see Rothbard, *Man, Economy, and State*, 2, pp. 883-90.

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Spencer concludes that "the very existence of majorities and minorities is indicative of an immoral state." For the "enactment of public arrangements by vote," he points out, "implies that the desires of some cannot be satisfied without sacrificing the desires of others .. . implies therefore, organic immorality."[55]

Spencer goes on to point out that the doctrine that men may only be taxed by their own consent implies their right not to pay taxes, to "ignore the State." He then notes the reply of the statists that "this consent is not a specific, but a general one, and that the citizen is understood to have assented to everything his representative may do, when he voted for him." Spencer's rebuttal to this democratic mythos is definitive:

> But suppose he did not vote for him; and on the contrary did all in his power to get elected some one holding opposite views—what then? The reply will probably be that, by taking part in such an election, he tacitly agreed to abide by the decision of the majority. And how if he did not vote at all? Why then he cannot justly complain of any tax, seeing that he made no protest against its imposition. So, curiously enough, it seems that he gave his consent in whatever way he acted—whether he said yes, whether he said no, or whether he remained neuter! A rather awkward doctrine this. Here stands an unfortunate citizen who is asked if he will pay money for a certain preferred advantage; and whether he employs the only means of expressing his refusal or does not employ it, we are told that he practically agrees; if only the number of others who agree is greater than the number of those who dissent. And thus we are introduced to the novel principle that A's consent to a thing is not determined by what A says, but by what B may happen to say![56]

The Unanimity Principle

Sensing the problems of coercion by majority rule, social theorists from Calhoun (the "concurrent majority" theory) to Wicksell and Buchanan (the Unanimity Principle) have been trying to arrive at a

[55] Ibid., p. 211.
[56] Ibid., pp. 211-12.

polity free of this coercion. Although the search for a way out of coercion may be commendable, the seeming voluntariness of the Unanimity Principle suffers from two grave flaws. First, Wicksell and Buchanan apply the Unanimity Principle only to changes in the status quo, that is, to new acts of taxation and expenditure. But this simply ratifies existing property titles, and assumes that these existing property titles are just and must be maintained. In short, the ratification of changes from the zero point only by unanimous consent, virtually freezes that zero point permanently. But should it be? Suppose that, previous to the installation of the Unanimity Principle, a group of persons, either by their own violent conquest or through State action, had stolen and confiscated the property of another large group and called that property their own. The Unanimity Principle would then prohibit the victims from taking back their property, since such action would have to gain the consent of the robbers. In his classic article on the Unanimity Principle, Knut Wicksell first acknowledged this problem and then brusquely dismissed it. Thus Wicksell first concluded:

> If there are within the existing property and income structure certain titles and privileges of doubtful legality or in open contradiction with modern concepts of law and equity, then society has both the right and the duty to revise the existing property structure. It would obviously be asking too much to expect such revision ever to be carried out if it were to be made dependent upon the agreement of the persons primarily involved.[57]

But having admitted that, Wicksell then proceeded as if it had not been said, asserting that "no [such] measure should be carried out unless it have the prior unanimous or at any rate overwhelming support of the whole people."[58]

Second, the Unanimity Principle turns out to be something less than unanimous. Pacifists, tax rebels, and anarchists are apparently inconvenient to the goal of achieving unanimity in taxation, so the proponents speak of "relative unanimity" (Buchanan

[57] Knut Wicksell, "A New Principle of Just Taxation," in *Classics in the Theory of Public Finance*, Musgrave and Peackock, ed., p. 109.
[58] Ibid.

and Tullock), "approximate unanimity" (Wicksell), or "virtual unanimity" (the later Spencer). But these are all oxymorons, comparable to the phrase "only a little pregnant." Unanimity must mean consent by all and nothing less.[59] Anything less is necessarily coercive and not voluntary.[60]

J.B. Say on Taxation

In contrast to almost all other economists, J.B. Say was astonishingly clear-sighted about the true nature of the State and of taxation. In Say there was no vain, mystical quest for a truly voluntary State or for a benign quasi-business firm supplying services to the grateful public. Say saw clearly that government supplies services to itself and its favorites, that all government spending is therefore consumption spending by the politicians and the bureaucracy, and that that spending is extracted by coercion at the expense of the taxpaying public.

As Say points out: "The government exacts from a taxpayer the payment of a given tax in the shape of money. To meet this demand, the taxpayer exchanges part of the products at his disposal for coin, which he pays to the tax-gatherers." Eventually, the government spends the money on its own needs, and so "in the end .. . this value is consumed; and then the portion of wealth, which passes from the hands of the taxpayer into those of the tax-gatherer, is destroyed and annihilated." Were it not for taxes, the taxpayer would

[59] Thus, "S.R."'s critique of the later Spencer's argument for compulsory military service, compulsory justice, and compulsory taxation, to the effect that there is "virtual unanimity" behind these forms of State action, pointed out: "The word virtual is fatal. The question is evaded, not answered. Has the one man, or the insignificant group of men, that refuses to support the State, even in the simplest of its functions, the right to stand alone, to ignore it? Spencer never refuted his own early demonstration of this right." "S.R," "Spencer and Political Science," p. 2.

[60] Here we might note the curious position of Laffer-Wanniski that the tax rate that maximized government revenue along the "Laffer curve" is, for some obscure reason, the *point at which the electorate desires to be taxed*. (Italics Wanniski's.) Jude Wanniski, "Taxes, Revenues, and the 'Laffer Curve'" in *The Economics of the Tax Revolt*, Arthur Laffer and Jan Seymour (New York:" Harcourt Brace Jovanovich, 1979), p. 8.

have spent his money on his own consumption. As it is, "The state... enjoys the satisfaction resulting from the consumption."[61]

Say goes on to attack the "prevalent notion, that the values, paid by the community for the public service, return to it again .. . , that what government and its agents receive, is refunded again by their expenditures." Say is indignant:

> This is a gross fallacy; but one that has been productive of infinite mischief, inasmuch as it has been the pretext for a great deal of shameless waste and dilapidation. The value paid to government by the tax-payer is given without equivalent or return: it is expended by the government in the purchase of personal service, of objects of consumption.[62]

At this point Say revealingly quotes with approval Robert Hamilton's likening of government to a robber in refuting the argument that taxation is harmless because the money is recirculated into the economy by the State. Hamilton compares this impudence to the "forcible entry of a robber into a merchant's house, who should take away his money, and tell him he did him no injury, for the money, or part of it, would be employed in purchasing the commodities he dealt in, upon which he would receive a profit." Say then adds "that the encouragement afforded by the public expenditure is precisely analogous."[63]

Say bitterly goes on to denounce the "false and dangerous conclusion" of writers who claim that public consumption increases general wealth. "If such principles were to be found only in books," Say went on, "and had never crept into practice, one might suffer them without care or regret to swell the monstrous heap of printed absurdity." But unfortunately they have been put into "practice by the agents of public authority, who can enforce error and absurdity at

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[61] Jean-Baptiste Say, *A Treatise on Political Economy*, 6th ed. (Philadelphia: Claxton, Remsen and Haffelfinger, 1880), pp. 412-13.
[62] Ibid., p. 413.
[63] Ibid., p. 413 n. Say likens government to a robber at another point. He states that government's claim to a right over individual property, which it makes through taxation, is pure usurpation. The government is no more the proper owner of its claimed property than a thief over the property he has robbed. Ibid., p. 414 n.

point of the bayonet or mouth of the cannon.[64] Once again, Say sees the uniqueness of government as the naked exercise of force and coercion.

Taxation, then, is the coercive imposition of a burden on members of the public for the benefit of consumption by the ruling class, by those in command of the government. Say writes:

> Taxation is the transfer of a portion of the national products from the hands of individuals to those of the government, for the purpose of meeting the public consumption of expenditure.. .. It is virtually a burthen imposed upon individuals, either in a separate or corporate character, by the ruling power .. . for the purpose of supplying the consumption it may think proper to make at their expense; in short, an impost, in the literal sense.[65]

Thus Say is not impressed with the notion, properly ridiculed by Schumpeter, that all of society somehow voluntarily pay their taxes for the general benefit; instead, taxes are a burden coercively imposed upon society by the "ruling power." Neither is Say impressed if the taxes are voted by the legislature: For "what avails it .. . that taxation is imposed by consent of the people or their representatives, if there exists in the state a power, that by its acts can leave the people no alternative but consent?"

Taxation, Say clearly pointed out, cripples rather than stimulates production, for taxation robs people of resources that they would rather use in a different way:

> Taxation deprives the producer of a product, which he would otherwise have the option of deriving a personal gratification from, if consumed .. . or of turning to profit, if he preferred to devote it to any useful employment.. .. [T]herefore, the subtraction of a product must needs diminish, instead of augmenting, productive power.[66]

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[64] Ibid., pp. 414-15.
[65] Ibid., p 446.
[66] Ibid., p. 447.

Say continues with a devastating critique of the argument that taxation is useful in stimulating people's exertions and the development of industry. But first, industry is looted to satisfy the demands of the State, and hence productive capital is crippled:

> Mere exertion cannot alone produce, there must be capital for it to work upon and capital is but an accumulation of the very products, that taxation takes from the subject: .. . in the second place, it is evident, that the values, which industry creates expressly to satisfy the demands of taxation, are no increase of wealth; for they are seized on and devoured by taxation.

As for the argument that taxes stimulate exertions:

> To use the expedient of taxation as a stimulative to increased production, is to redouble the exertions of the community, for the sole purpose of multiplying its privations, rather than its enjoyments. For, if increased taxation be applied to the support of a complex, overgrown, and ostentatious internal administration, or of a superfluous and disproportionate military establishment, that may act as a drain of individual wealth, and of the flower of the national youth, and an aggressor upon the peace and happiness of domestic life, will not this be paying as dearly for a grievous public nuisance, as if it were a benefit of the first magnitude?[67]

Say is also properly critical of Ricardo for maintaining that the suppression of one branch of private industry by taxation will always be compensated by a diversion of capital to some other industry. Say rebuts that:

> I answer, that whenever taxation diverts capital from one mode of employment to another, it annihilates the profits of all who are thrown out of employ by the change, and diminishes those of the rest of the community: for industry may be presumed to have chosen the most profitable channel. I will go further, and say, that a forcible diversion of the current of production annihilates many additional sources of profit to industry. Besides, it makes a vast difference to the public

[67] Ibid., pp. 447, 447n-448n.

> prosperity, whether the individual or the state be the customer.. .. [In the latter case] wealth and production decline in consequence, and prosperity vanishes, leaving behind the pressure of unremitting taxation.[68]

Say concludes with a scornful attack on the very idea that taxation and government spending add to national wealth:

> It is a glaring absurdity to pretend that taxation contributes to national wealth, by engrossing part of the national produce, and enriches the nation by consuming part of its wealth. Indeed, it would be trifling with my reader's time, to notice such a fallacy, did not most governments act upon this principle, and had not well-intentioned and scientific writers endeavored to support and establish it.[69]

Say's basic recommendation on the tax question was, in consequence, simple, trenchant, and clear-cut: "The best scheme of finance is, to spend as little as possible; and the best tax is always the lightest."[70] In short, that government is best that spends and taxes least. But then, paraphrasing Thoreau's and Benjamin R. Tucker's logical extension of the similar conclusion of Jefferson: May we not say that that government is best that spends and taxes not at all?[71]

The Neutral Tax

[68] Ibid., p. 452 n. In a charming aside, Say chides Ricardo for erring because of his penchant for introducing "the unbending maxims of geometrical demonstration." For, "in the science of political economy, there is no method less worthy of reliance."

[69] Ibid., p. 447.

[70] Ibid., p. 449. Here we may note with amusement Frederic Bastiat's reaction to these passages of Say. In the light of Bastiat's reputation as a laissez-faire extremist" in contrast to Say's "moderation," we might note that Bastiat was shocked at the extremism of Say's views: Doesn't the State supply some services to the public? Frederic Bastiat, *Economic Harmonies* (Princeton, N.J.: D Van Nostrand, 1964), p. 567.

[71] In a famous passage, Thoreau wrote: "I heartily accept the motto—'That government is best which governs least,' and I should like to see it acted up to more rapidly and systematically. Carried out, it amounts to this, which also I believe—'that government is best which governs not at all.'" Or, as Tucker concluded succinctly: "That which governs least is no government at all." Henry D. Thoreau, "Civil Disobediance" [1849], in *Walden and Other Writings* (New York: Modern Library, 1937), p. 635; Benjamin R. Tucker, *Instead of a Book* (New York: Br.r. Tucker, 1893), p. 14.

Any quest for a nonredistributive neutral tax, such as free-market economists indulge in, must succeed in providing criteria for two basic questions about taxes: (a) how much taxes should be paid? and (b) who should pay them? The freemarket answers questions of "who" and "how much" very easily for its goods and services. But free-market economists have been singularly unsuccessful in providing either of these criteria for taxation.[72] Thus the answer of *laissez-faire* economists to the former question—that taxation should be limited strictly to protection or defense—founders, not only on the coercive nature of the payment, but also on the nonhomogeneity of the defense service. Defense, as we have seen above, is not a homogeneous lump but a good available in different quantities and qualities, in marginal units. Since the free market has been abandoned in this area, there is no way to arrive at any rational criteria for the optimal total amount or distribution of government defense, or of any other good or service.

Taxpayers and Tax-Consumers

It might be claimed that neutral taxation could be achieved in one way, if in no other: if the precise amounts that each individual paid in taxes were returned to him in government expenditure. Thus if A paid $1,000 in taxes in a certain year, B paid $500, and C $300, and so on, then A would receive $1,000, B $500, and so on. It might be thought that such a taxation system would be at best absurd; for why construct

[72] Thus Ludwig von Mises, by far the most thoughtful and systematic of free-market economists, devotes only a few unsatisfactory paragraphs to the subject of a neutral tax, or indeed to taxation in general While conceding the impossibility of a neutral tax in the real world, he maintains without demonstration that it would be possible in a world of general equilibrium. And, despite its conceded impossibility, he seems to advocate pursuing the neutral tax as an ideal. (He also does not explain why everyone's income would be equal in general equilibrium.) Apart from this, Mises maintains that taxes, despite "directly curtail[ing] the taxpayer's satisfaction," are "the price he pays for the services which government renders to…each of its members." He warns that taxes should remain "low," but the only criterion offered for this lowness is that they "do not exceed the amount required for securing the smooth operation of the government apparatus"; in that case, "they are necessary costs and repay themselves." We may here reiterate all the questions we've discussed above, emphasizing such problems as: How much service? To *which* members? How about pacifists? Who pays the necessary costs and who gets repaid and then some? And *what* exactly is the "smooth operation of the government apparatus," and [why] should that be the overriding desideratium? Mises, *Human Action*. Pp. 730-31, 733-34, 738.

an elaborate machinery that would simply take and then give back the same amounts to each person? Why then have taxation at all? But there is a grave flaw even in this attempt at a neutral tax: neglect of the bureaucratic handling charge.

For even if such a precisely equal tax-and-payment mechanism were constructed, there would have to be salaries paid to the bureaucracy administering the system (and to the politicians ruling the administrators). But these bureaucrats, then, would, in contrast to the rest of society, be net tax-receivers, and hence by at least the amount and dispensation of their salaries, the fiscal system could not be neutral to the market economy. For even if A, B, C, and so on, paid and received the equivalent amounts, bureaucrats B1, B2, B3, and so on, would be net tax-recipients, and in essence, would be paying no taxes at all. Their net incomes functioning in the bureaucracy will necessarily have to be subtracted from the net incomes of other members of society. And therefore the very existence and operation of government, as John C. Calhoun brilliantly pointed out, establishes at the very least a class struggle between the net tax-recipients and the net taxpayers. Calhoun's analysis is worth quoting at length:

> So deeply seated, indeed, is this tendency to conflict between the different interests or portions of the community that it would result from the action of the government itself, even though it were possible to find a community where the people were all of the same pursuits, placed in the same condition of life, and in every respect so situated as to be without inequality of condition or diversity of interests. The advantages of possessing the control of the powers of the government, and thereby of its honors and emoluments, are, of themselves, exclusive of all other considerations, ample to divide even such a community into two great hostile parties.. .. And what makes this evil remediless through the right of suffrage of itself .. . is the fact that, as far as the honors and emoluments of the government and its fiscal action are concerned, it is impossible to equalize it. The reason is obvious. Its honors and emoluments, however great, can fall to the lot of but a few, compared to the entire number of the community and the multitude who will seek to participate in them. But without this there is a reason which renders it

impossible to equalize the action of the government so far as its fiscal operation extends.. ..

Few, comparatively, as they are, the agents and employees of the government constitute that portion of the community who are the exclusive recipients of the proceeds of the taxes. Whatever amount is taken from the community in the form of taxes, if not lost, goes to them in the shape of expenditures or disbursements. The two—disbursement and taxation—constitute the fiscal action of the government. They are correlatives. What the one take from the community under the name of taxes is transferred to the portion of the community who are the recipients under that of disbursements. But as the recipients constitute only a portion of the community, it follows, taking the two parts of the fiscal process together, that its action must be unequal between the payers of the taxes and the recipients of their proceeds. Nor can it be otherwise; unless what is collected from each individual in the shape of taxes shall be returned to him in that of disbursements, which would make the process nugatory and absurd. Taxation may, indeed, be made equal, regarded separately from disbursement. Even this is no easy task; but the two united cannot possibly be made equal.

Such being the case, it must necessarily follow that some one portion of the community must pay in taxes more than it receives back in disbursements, while another receives in disbursements more than it pays in taxes. It is, then, manifest, taking the whole process together, that taxes must be, in effect, bounties to that portion of the community which receives more in disbursements than it pays in taxes, while to the other which pays in taxes more than it receives in disbursements they are taxes in reality—burdens instead of bounties. This consequence is unavoidable. It results from the nature of the process, by the taxes ever so equally laid.. ..

Nor would it be less a bounty to the portion of the community which received back in disbursements more than it paid in taxes because received as salaries for official services, or payments to persons employed in executing the works required by the government, or furnishing it with its various

> supplies, or any other description of public employment—instead of being bestowed gratuitously. It is the disbursements which give additional and, usually, very profitable and honorable employments to the portion of the community where they are made .. . and hence, to the extent that the disbursements exceed the taxes, it may be fairly regarded as a bounty. The very reverse is the case in reference to the portion which pays in taxes more than it receives in disbursements. With them profitable employments are diminished to the same extent, and population and wealth correspondingly decreased.
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> The necessary result, then, of the unequal fiscal action of the government is to divide the community into two great classes: one consisting of those who, in reality, pay the taxes and, of course, bear exclusively the burden of supporting the government; and the other, of those who are the recipients of their proceeds through disbursements, and who are, in fact, supported by the government; or in fewer words, to divide it into taxpayers and tax-consumers.
>
> But the effect of this is to place them in antagonistic relations in reference to the fiscal action of the government and the entire course of policy therewith connected. For the greater the taxes and disbursements, the greater the gain of the one and the loss of the other, and vice versa; and consequently, the more the policy of the government is calculated to increase taxes and disbursements, the more it will be favored by the one and opposed by the other.
>
> The effect, then, of every increase is to enrich and strengthen the one, and impoverish and weaken the other.[73]

Thus if a bureaucrat receives an income of $30,000 per year, and pays $10,000 to the government in taxes, he is in reality not paying taxes at all. His tax payment is a bookkeeping fiction; in reality, he is simply a net tax-consumer to the tune of $20,000.

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[73] John C. Calhoun, *A Disquisition on Government* (New York: Liberal arts Press, 1953), pp. 14-18./

Calhoun has thus shown that the very existence of taxation creates at least two conflicting classes: the ruling and the ruled, and that the ruling class are the net tax-consumers and the ruled the net taxpayers. The ruling classes comprise the full-time politicians and bureaucrats receiving government salaries, as well as the private sellers of goods and services to the governments or recipients of outright government subsidy. There is hence no way for government or for taxation to be neutral. Moreover, the greater the amount and degree of taxation/expenditures by government, the more important will be this unneutrality, this diversion of output and income from producers on the market to the State and the receivers of its largess. The greater the extent of government operation, therefore, the greater the class conflict in the society.

Proportional Taxation

Setting aside for a moment the problem of inherent nonneutrality stemming from the existence of taxation and expenditures, let us examine further the specific types or forms of taxes. Is there any form that might be called neutral to the market? Many economists have assumed that proportional taxation for each taxpayer (whether on incomes, property, or intangible "sacrifice") will leave the distribution of income or wealth the same as before, and therefore be neutral to the market. Thus to Edwin Cannan proportional property taxation serves as a "sufficiently accurate standard" of neutrality, so that "the distribution of wealth between individuals" is the same as "it would be in the absence of State action."[74] To Blum and Kalven, proportional sacrifice, presuming this intangible could be measured, has "the virtue...that it remains neutral as to the relative distribution of satisfactions among taxpayers. Under it they are all equally 'worse off' after taxes."[75]

At first blush, proportionality appears to leave market distribution the same. If, for example, a tax of 10 percent is levied on all incomes, is not the distribution of incomes left the same (setting aside the above insoluble problem of net tax-consumers)? It is true

[74] Edwin Cannan, "Minutes of Royal Commission on Local Taxation," 1899," in *Readings in the Economics of Taxation*, Richard Musgrave and Carl Shoup, eds. (Homewood, Ill: Irwin, 1959), pp. 182-83.
[75] Walter Blum and Harry Kalven, Jr., *The Uneasy Case for Progressive* Taxation (Chicago: University of Chicago Press, 1953), p. 44.

that if A earns $30,000 a year, B earns $20,000, and C earns $10,000, and each pays 10 percent, the relative proportions of their income after taxes will remain the same as before ($27,000, $18,000, and $9,000). But this question misconceives the very idea of the neutral tax. The point of a tax neutral to the market is not to leave the income distribution the same as if a tax had not been imposed. The point of a neutral tax is to affect the income "distribution" and all other aspects of the economy in the same way as if the tax were a free-market price. Only if a tax has the effect of a surrogate free-market price, only if, in a profound sense, it is *part of the market*, could it be neutral to that market. And it should be evident that no free-market price leaves income distribution the same. If every market price were proportional to the income of the purchaser, if David Rockefeller had to pay $1,000,000 for a box of Wheaties, then there would be no point in having a higher income, and we would have an extraordinarily complex and unworkable form of compulsory equality of incomes.

The market does not form prices proportional to incomes; the market is characterized by uniform pricing, by a strong tendency toward the same price for the same good or service regardless of the income or personality of the buyer.[76]

Taxation and Benefits

If the market charges all consumers the same price for a particular service, it would seem that some form of equal (rather than equiproportional) taxation might be neutral to the market. One time-honored criterion attempting to arrive at such neutrality is the "benefit" principle: that each should pay taxes in accordance with the benefits he receives from the State. Those receiving the same benefits would pay the same amount of tax. There are many grave problems with this approach, however. First, in contrast to the marketplace, there is no way whatever for an external observer to gauge anyone's benefits as derived from government. Since "benefits" are subjective, we cannot measure anyone's benefit on the market either, but we can conclude, from a person's voluntary purchase, that his (expected) benefit was greater than the value to him of the money given up in exchange. If I buy a newspaper for 25 cents, we can conclude that my

[76] A similar critique could be leveled against any form of proportional tax, for example, on sales or property.

expected benefit is greater than a quarter. But since taxes are compulsory and not voluntary, we can conclude nothing about the alleged benefits that are paid for with them. Suppose, in analogy, that I am forced at gunpoint to contribute 25 cents for a newspaper and that that newspaper is then forcibly hurled at my door. We would be able to conclude nothing about my alleged benefit from the newspaper. Not only might I be willing to pay no more than 5 cents for the paper, or even nothing on some days, I might positively detest the newspaper and would demand payment to accept it. From the fact of coercion there is no way of telling. Except that we can conclude that many people are not getting 25 cents' worth from the paper or indeed are positively suffering from this coerced "exchange." Otherwise, why the need to exercise coercion? Which is all that we can conclude about the "benefits" of taxation.[77]

To Adam Smith, the benefit principle dictated proportional income taxation: "The subjects of every state ought to contribute toward the support of government, as nearly as possible .. . in proportion to the revenue which they respectively enjoy under protection of the state."[78]

Other writers have even used the benefit principle to justify progressive taxation. Yet there is no warrant whatever for assuming equi-, or even more than, proportional benefit from government. In one model the alleged benefit from government is to be simply deduced from one's income, and it is claimed that this indicates a proportionately greater "benefit from society." But there are many

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[77] In contrast to benefit theory, which naively assumes that people "purchase" government services in much the same way as they purchase goods and services on the market, at least sacrifice theory assumes in the words of Blum and Kalven, "that the taxes are a necessary evil falling up on a distribution of money, and therefore upon a distribution of satisfactions, which is otherwise acceptable." *Uneasy Case for Progressive Taxation*, p. 44. The basic problem with sacrifice theory is that it doesn't explain *why* people must bear the burdens of sacrifices of taxation, why that is, we must turn from talk of benefits and free choice on the market to talk to burden and sacrifice in the sphere of government.

[78] Adam Smith, *The Wealth of Nations* (New York: Modern Library, 1937), p. 777. Smith added immediately that "the expense of government to the individuals of a great nation, is like the expense of management to the joint tenants of a great estate, who are all obliged to contribute to their respective interest in the estate." Presumably, however ,these tenants also get benefits from the estate greater than their pro-rata expenses, and if they do not, or even if they do, they can sell their share and leave—an option not available to the taxpayer.

flaws with this approach. For first, since everyone benefits from participating in society, the fact that A earns more than B must be attributed to individual differences in ability or productivity rather than to the benefits of society. And second, "society"—the pattern of voluntary exchanges of goods and services—is most emphatically not identical to the State, the coercive extractor of taxation.

If, indeed, we are to tax people in accordance with their benefit from government, we would have to tax all the net tax-consumers to the amount of their subsidies. We would have to tax 100 percent of the salaries of bureaucrats, of the incomes of welfare recipients and of defense contractors, and so on. We would then have our ideal model of the neutral tax where all recipients of government funds would systematically repay them to the taxpayers—an absurd if rather charming state of affairs. If we leave subsidies to concentrate only on supposedly common services such as police protection, then we would have to conclude that the poor benefit far more from police protection than the wealthy, since the wealthy could far better afford to pay for their own protection. We would therefore have to conclude, not that the rich benefit as much as or more than the poor, but far less. We would have to conclude that the poor and the infirm, far more in need of protection than the rich, should be taxed far more heavily than the rich and the able-bodied.[79]

Moreover, the market is misconstrued by the benefit principle. For on the market people do not pay in accordance with benefits received. The chess addict and the indifferent players pay the same price for the same chess set, and the opera enthusiast and the novice pay the same price for the same ticket. On the market, people tend to pay the same price for the same good, regardless of benefit. The poor and the weak might be the most eager for protection, but, in contrast to the benefit principle, they would not pay more for the same degree

[79] Mill put the case very well: "If we wanted to estimate the degrees of benefit from the protection of government we should have to consider who would suffer most if that protection were withdrawn: to which question if any answer could be made, it must be, that those would suffer most who were weakest in mind or body, either by nature or by position. Indeed, such persons would almost infallibly be slaves. If there were any justice, therefore, in the theory of justice now under consideration, those who are least capable of helping or defending themselves, being those to whom the protection of government is the most indispensable, ought to pay the greatest share of its price." John Stuart Mill, *Principles of Political Economy* (New York: D. Appleton, 1901), 2, pp. 398.

of protection on the market. And finally, everyone on the market enjoys a net benefit from exchange. If the entire benefit were taxed away (assuming this subjective concept could be measured), then this practice would totally violate market principles, where net benefits from exchange are always maintained.

The Equal Tax

If the market means having everyone pay the same price for the same service, perhaps then each person should pay the same tax, equal in absolute amount? The equal tax, or "poll tax," is surely a far closer approximation to neutral taxation than any of the more common forms of taxation. It would indeed preserve the market principle of same price for same service. It would also be particularly appropriate for a democratic polity, where one person, one vote prevails, or for a regime that attempts to adhere to the principle of "equality before the law."[80]

But even the equal tax cannot be said to be neutral to the market. In the first place, it is impossible for observers outside the market, such as government, to gauge what service is "equal" to another service. Equality of service is not technological identity but similarity in the minds of the consumers. Only the free market, then, can determine different qualities or degrees of a service. Second, and even more important, there is no indication that for a particular taxpayer, the government is supplying a "service" at all. Since the tax is compulsory, it may well be that the "service" has zero or even negative value for individual taxpayers. Thus, a pacifist, philosophically opposed to any use of violence, would not consider a tax levied for his and others' police protection to be a positive service; instead, he finds that he is being compelled, against his will, to pay for the provision of a "service" that he detests. In short, equal pricing on the market reflects demands by consumers who are voluntarily paying the price, who, in short, believe that they are gaining more

[80] In recent years, the poll tax was used to designate a voting requirement, in effect a tax on voting, in the southern states. But originally, the poll tax was simply an equal tax per head, and the payment for voting was imply one method of enforcing the tax. On poll taxes, see Merlin H. Hunter and Harry K. Allen, *Principles of Public Finance* (New York: Harper and Bros., 1940), pp. 265-70. Many early poll taxes were graduated rather than uniform. C.F. Bastable, Public Finance (London: Macmillan, 1895), pp. 433-34.

from the good or service than they are giving up in exchange. But taxation is imposed on all people, regardless of whether they would be willing to pay such a price (the equal tax) voluntarily, or indeed whether they would voluntarily purchase any of this service at all.

The poll tax works particular hardship on those who would not ordinarily be participating in the market economy. Hence it (as well as the income tax) is payable in money and has been used as a fearsome whip to force natives in undeveloped countries out of subsistence or barter production and into working for money wages. Working for capitalists becomes the only way these natives can pay the tax. Thus Sir Percy Girouard, the British governor of Kenya, freely admitted, in the early twentieth century, that taxation was levied on the native to force him to go to work for British employers. The hut tax "is the only method," opined Sir Percy, "of compelling the native to leave his reserve for the purpose of seeking work. Only in this way can the cost of living be increased for the native."[81] In the Congo Free State, the problem in that Belgian colony, as Parker Moon put it, was: "Would the natives willingly go out into the jungle to collect rubber and tusks for the State?" For, "little appreciating the dignity of labor, the Congo negroes evinced a marked distaste for the task which their humane sovereign expected them to perform. Accordingly, another civilized innovation was introduced—taxes."[82] Moon illuminates the relationship between taxation and forced labor in colonial countries:

> In tropical Africa...the problem is how to make the natives work at all, for Europeans. Actual slavery is everywhere condemned, and vanishing.... Compulsory labor, once the fashion in Central Africa, is falling more and more under censure, though it is still utilized by governments when they

[81] Cited in Parker T. Moon, *Imperialism and World Politics* (New York: Macmillan, 1930), p. 132. In South West Africa, the British accomplished the same purpose with a dog tax, levied per native dog. "Many of the natives, of course, were too poor to pay any such tax, and consequently in four months over one hundreds members of the Bondelzwarts tribe along were condemned, for non-0payment of the tax, to pay a fine of two pounds or spend two weeks in jail. To obtain eth money for tax and fines, the natives would have to work for white ranchers and mine-owners." Ibid., p. 504.
[82] Ibid., p. 86.

> need natives for railroad or road construction, or other public works.. ..
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> Taxation is a favorite method of stimulating native industry. In many African colonies hut and poll taxes are imposed, ranging from fifty cents to several dollars per capita. The amount seems small enough, by our standards, but to the negro without money it is a large sum. He can earn it by working on a plantation or in a mine, for white employers, at wages that vary from five cents a day, or less, in Congo, Northern Rhodesia, and other regions, to six or seven cents in Kenya, perhaps twenty cents in the interior of Nigeria, and fifty cents or more in South Africa. At such wages it takes a native months to save enough to pay the tax for his family.[83]

Conclusion

Free-market economists have successfully extended their critical analyses of government to all areas of State operation and intervention—all except one. Taxation, the heart and soul of government, has escaped unscathed. Free-market economists have either avoided the topic of taxation altogether or have provided concepts that, while claiming to help limit government, have in reality offered apologies for the extension of State power. The view that income taxes are "better" than excise taxes; the call for proportional or degressive income taxation; the Friedman negative income tax; the Buchanan-Tullock Unanimity Principle; and the collective-goods, external-benefits, and transaction costs arguments for government and taxation, have all served to place the imprimatur of economics on the status quo or on extensions of government rather than to limit or roll back State power. All this has followed the course traced by Bertrand de Jouvenel three decades ago: From the idea of divine right down to modern times concepts originally meant to limit State power have been turned by the State and its advocates into rationales for its further extension.[84]

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[83] Ibid., p. 563.

[84] Bertrand de Jouvenel, *On Power, Its Nature and the History of Its Growth* (New York: Viking Press, 1949).

Much the same thing has happened to the noble concept of neutral taxation. The idea that taxation, and therefore government's fiscal operation, should be neutral to the market—should not disturb the operations of the market nor divert it from its free course—is a noble but impossible one. As we have seen here, taxation can never be neutral to the market, and the impossibility of this dream is rooted in the very nature of taxation and government. Neutral taxation is merely a chimera. It is perhaps because of this impossibility that this concept, in the hands of the modern public-choice theorists and others, has so quickly become yet another device for ratifying the status quo of State power.

We are forced, then, to the realization of crucial points from which free-market economists seem to have been fleeing as from the very plague. That neutral taxation is an oxymoron; that the free market and taxation are inherently incompatible; and therefore either the goal of neutrality must be forsaken, or else we must abandon the institution of taxation itself.