



## A FairTax<sup>SM</sup> Rebuttal

### Honk if You Oppose a Fairer Tax

By Dan R. Mastromarco

*[T]he task of the taxing authorities is to "so pluck the goose as to obtain the largest amount of feathers with the least amount of hissing." We the taxpayers, of course, are the geese. -- Murray Rothbard*

If asked to articulate the guiding principles of tax reform, how would you respond? You may explain the destructive nature of taxes to Congressman Ron Paul. But what would you tell the other 534 Members of Congress who see taxes as a necessary evil? What would you tell one of the fathers of Austrian economics, Nobel Laureate Friedrich A. Hayek, who thought the government had to use its power of raising funds to provide those services not provided by the market?<sup>1</sup> Could you articulate a framework with which to analyze the least destructive method of tax collection for the benefit of libertarian ideals?

In an October 9<sup>th</sup> Daily Article entitled "The Fraudulent Tax"<sup>2</sup> Mises contributor Laurence Vance recommends responding by condemning the FairTax. Building upon last year's diatribe, "The FairTax Fraud,"<sup>3</sup> where Dr. Vance asks if "the [FairTax] cure [is] worse than the disease [the income tax]?" he answers in the affirmative. He concludes that the FairTax is a dishonest tax, no better than the income tax. Dr. Vance then recommends in descending order that the Congress repeal the income tax with no viable substitute, enact a head tax, eliminate withholding, or in the very least, roll back rates.<sup>4</sup>

Libertarians may take solace in the fact there are worse things in life than political failure.<sup>5</sup> No idea should be supported (or rejected) because it is deemed to be fashionable, especially by Congress. But if libertarians were to take Dr. Vance's bad advice, they would be more than disappointed by the prospect of being marginalized – they would be betrayed by the

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<sup>1</sup> Hayek, Friedrich A., *Law, Legislation and Liberty, Volume 3: The Political Order of a Free People*, Chicago, Illinois: The University of Chicago Press, 1979. In chapter 14 he states, "... we find it unquestionable that ... government ought to use its power of raising funds by taxation to provide a number of services which ... cannot be provided ... by the market. Indeed, it could be maintained that, even if there were no other need for coercion, because everybody voluntarily obeyed the traditional rules of just conduct, there would still exist an overwhelming case for giving the territorial authorities power to make the inhabitants contribute to a common fund from which such services could be financed."

<sup>2</sup> <http://www.mises.org/story/2327> (10/09/06).

<sup>3</sup> See <http://www.mises.org/story/1814> (5/18/2005).

<sup>4</sup> See <http://www.mises.org/story/1797> ("The Curse of the Withholding Tax," 4/21/2005). In the latest article, Dr. Vance states, "The income tax should be repealed, not replaced.... Tax reform should reduce taxes, not be revenue neutral. Government theft of the wealth of its citizens should be abolished, not adjusted."

<sup>5</sup> See <http://www.mises.org/story/1797> (op.cit.). In this article, Dr. Vance correctly concludes, "There is also one significant practical consideration that cannot be ignored. The chance that Congress would ever eliminate that which provides the government with a continual flow of revenue is zero."



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policy outcome. Supporting ideas that have no basis in political reality may be benign folly, but squandering political capital to perpetuate one of the most intrusive, autocratic, wasteful, malignant, and invidious systems ever devised by man is quite another endeavor. And by rejecting the FairTax, libertarians pass up the opportunity to support the one plan that is least destructive of the goals of Austrian economics and libertarian ideals.

This paper does more than debunk myths Dr. Vance is spreading about the FairTax – it suggests libertarians and Austrian economists should be prepared to engage the debate over tax reform other than by irrelevant clichés. Libertarians need not accede taxes are anything less than destructive in order to develop a framework by which the relative “demerits” of viable alternative replacement schemes can be evaluated. Different plans are more or less intrusive, more or less costly, more or less burdensome, more or less economically and socially destructive, and more or less visible – and should be evaluated under the crucible of these principles. When looked upon in this way, libertarians should see the FairTax as Winston Churchill saw democracy – the worst form of government except for every other one that has been tried.

### **Making the gaggle of geese “hissed”**

Dr. Vance’s article clearly attempts to echo Murray Rothbard’s “The Consumption Tax: A Critique” which sought to temper Alan Greenspan’s rational exuberance towards a consumption tax.<sup>6</sup> But anyone who has read and understood what Mr. Rothbard was saying about taxes<sup>7</sup> would not recognize Dr. Vance’s opinions as a seamless datum on the continuum of Rothbard’s logic. Mr. Rothbard’s article was intended to make an important point then obscured in the debate over tax reform: Economists should concern themselves less with the form of confiscation than with the level of burden the State and privileged tax-consumers impose on economic freedoms. His point was simply that economists who support consumption taxes just to make the extraction more efficient miss this main point.

In this assertion, Mr. Rothbard was both right and wrong. He was right to identify reduction in the size of the government as a critical goal on the libertarian agenda. He was right to assert a tax system that exacts the maximum revenue most efficiently does not necessarily promote liberty. But he was wrong to assume the form of taxation has nothing to do with these goals.

American taxpayers, like the geese Mr. Rothbard referred to in his article, cannot get “hissed” unless they feel the pain of the tax system. In the immortal words Mr. Rothbard attributes to Jean-Baptiste Colbert, the more hidden the taxes, the more we can look forward to having our feathers plucked. This same sentiment was expressed in a different way by Friedrich A. Hayek, who stated, “It is probable that the whole complexity of the tax structure we have built up is largely the result of the efforts to persuade citizens to give the government more than they would knowingly consent to do.”<sup>8</sup>

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<sup>6</sup> See <http://www.mises.org/story/1768> (3/18/2005).

<sup>7</sup> Ibid.

<sup>8</sup> Hayek, op. cit. In chapter 17 he continued, “Current methods of taxation have been shaped ... by the endeavor to raise funds ... [so] as to cause the least ... resentment on the part of the majority who had to approve the expenditure.



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Today, taxes and their effect are camouflaged. By its very nature, the income tax stimulates the corruption, rent seeking, and unconstrained growth of government spending that libertarians find repugnant.

To begin with, nearly half of the U.S. population today pays no income tax to the IRS and feels more pleasure than pain. More precisely, an estimated 43.4 million tax returns, representing 91 million individuals, will report a zero or negative income tax liability in 2006. Adding to this figure the 15 million households and individuals who will file no income tax return at all, roughly 121 million Americans – or 41 percent of the U.S. population – and will see themselves as fully unvested with the income tax, except for what the revenues can do for them.<sup>9</sup> Regardless of the assumptions we draw over incidence, the portion who pay payroll taxes see these taxes as the employer's responsibility. Even those who pay income taxes are more or less numb to the more than \$270 billion in compliance costs, \$307 billion in corporate taxes, the \$771 billion in payroll taxes or the \$26 billion in death taxes that fall back on the factors of production.

Indeed, some who endorse checks to the "I.R.S." see the income tax as a honey pot for political entrepreneurship which further misappropriates resources. Our tax code is literally written by special interests whose job is to ensure that every industry and taxpayer is treated differently, creating a constant jockeying for competitive advantage and extraction of rents. And when these changes to the tax system are made, tax increases are largely hidden in the 10,000 pages of minutiae, creating a Tammany Hall effect where economic rents are auctioned off to the highest political bidder.

Hidden costs go well beyond the question of economic incidence versus legal incidence or the compliance burden. Every tax system distorts economic decisions, alters economic behavior, and retards economic output below that which otherwise would occur, resulting in what economists agree is the "deadweight loss" or "excess burden" of taxation. Deadweight loss is a hidden extraction cost of taxation – the machine that didn't spin, the worker who didn't show up – which represents a depletion in purchasing power perhaps more nefariously improvident than if the government had collected that resource. The average worker is of course completely anesthetized to the deleterious economic effects of a tax system that imposes a drag on economic growth, despite its nontrivial implications. The current system imposes such a severe relative drag on economic growth vis-à-vis the FairTax that it will reduce capital per unit of human capital 5.0 percent over the course of the century for an 18.0 percent long-run decline in after-tax take-home pay.<sup>10</sup>

The FairTax corrects these problems in ways no other viable tax replacement plan can. First, it ensures everyone – from the illegal alien to the poorest American – is vested in the tax

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They certainly were not designed to assure responsible decisions on expenditure, but ... to produce the feeling that somebody else would pay for it."

<sup>9</sup> Hodge, Scott A., "Number of Americans Paying Zero Federal Income Tax Grows to 43.4 Million," Tax Foundation *Fiscal Facts* No. 54, March 30, 2006.

<sup>10</sup> Jokisch, Sabine and Laurence J. Kotlikoff, "Simulating the Dynamic Macroeconomic and Microeconomic Effects of the FairTax," NBER Working Paper, September, 2006.



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system. The way to produce downward pressure on government is to make every participant in the economy an equal stakeholder, exposed to the true cost of the federal government on the receipt of each item they buy. Second, the FairTax makes the current hidden taxes transparent and keeps politicians honest by eliminating the ability to raise taxes on others by hidden loopholes.

And because everyone pays the FairTax, and pays it at the same rate, the visibility of the FairTax ensures a built-in downward pressure on the size of the government in the most effective way: By requiring the government to change the rate for everyone – even for a seemingly insignificant loophole. And the FairTax minimizes the economic harm caused by taxes that serve as a stealthy exaction. A shift to the FairTax raises marginal labor productivity and real wages over the course of the century by 18.9 percent and long-run output by 10.6 percent higher than it otherwise would be. It does not eliminate the drag taxes impose on the economy, but instead reduces the hidden confiscation to the maximum degree by not taxing the same income more than once with highly progressive marginal rates.<sup>11</sup>

Dr. Vance understood these points when seeking elimination of withholding partly because it would restore an element of visibility and pain to the taxpayer. He criticizes the revenue-neutral rate of the FairTax for being too high, even though it is guilty of painfully exposing only the hidden cost of the government exaction today. Necessarily, Dr. Vance, by opposing the FairTax, supports continuing most of the hidden elements of the current tax system.

The tax reform “solutions” advanced by Dr. Vance, with the exception of the unviable *per capita* tax, do not make the hidden taxes visible, and therefore cannot exert the same downward pressure on the size of government as the FairTax. Even if the Congress were willing to unilaterally make the tax system less efficient by eliminating withholding, taxes and compliance costs would still be hidden from the taxpayer in the prices of goods and services, in the loss to economic activity, and in the fact that not all taxpayers bear the same marginal rate. Even if the Congress were temporarily successful at rolling back rates, the rates would soon multiply and rise and the base erode with each passing year special interests hammer away at policy makers.

By exposing all the hidden taxes and vesting everyone in the tax system with a uniform stake, the FairTax accomplishes the primary objective that ought to be of importance to Mr. Rothbard – it helps to ensure a smaller government. That is almost by definition an honest tax.

**The FairTax advances libertarian goals by being least intrusive.**

Dr. Vance’s article asserts the FairTax dishonestly claims it is a “voluntary tax” because even “under the present [voluntary] system, if someone doesn't work then he doesn't pay any income tax.” Dr. Vance argues the FairTax falsely claims it abolishes the IRS when simply “exchang[ing] one federal agency for another.” Again Dr. Vance invokes Mr. Rothbard’s characterization of a retail sales tax as a “permission-to-live” tax with the implication that it is worse than the income tax.

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<sup>11</sup> Ibid.



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FairTax.org has never claimed its exaction is voluntary: That compliance is as legally optional as a charitable contribution. The FairTax, like any of the “reforms” Dr. Vance suggests, is by definition enforced by the power of the state. The relevant distinction is not whether one pays tax by his own volition or is coerced, but rather the degree to which the various plans suppress economic and civil liberties. By not taxing returns on capital or labor, savings, gifts, charitable contributions or education the FairTax impinges the least on economic freedom. Under the FairTax, taxpayers are no longer forced to choose between work or leisure, investment or consumption because the fruits of one’s labor or capital are not taxed until consumed and then taxed but once. By exempting expenditures before the poverty level from taxation, the necessities of life are untaxed. The taxpayer is given the maximum choice over legal ways to avoid and time taxation. Equally important, because the FairTax is least destructive of economic growth, it extracts a lower proportion of the return to work or savings than any competing plan.

Similarly, Dr. Vance argues FairTax supporters prevaricate by claiming the IRS would be dismantled; however, the IRS *is* literally eliminated.<sup>12</sup> Legally, state sales tax authorities, most of which already collect state sales taxes (in the 45 states that have them), will collect the FairTax with another line on the tax return requiring only a small oversight bureau to monitor the states.

No, the FairTax would not eliminate all the practical issues that arise from the necessity of distinguishing between business and personal activities in defining consumption – no tax would unless it were to resemble the cascading turnover taxes adopted by France in the 1930’s. But asking retailers how much they sold to consumers is a lot less intrusive than requiring every person, natural or legal, to be a tax collector and tax filer. Along with the legal disestablishment of the IRS, the FairTax restores the civil liberties sacrificed for income tax enforcement, eliminating privacy intrusions and overwhelmingly reducing compliance burdens.

This past year, Americans were assessed 28,767,480 civil penalties, and paid more than \$270 billion in compliance costs just to enforce a system with a net tax gap of more than \$345 billion. For FY 2005, they filed 1.5 billion information returns,<sup>13</sup> 131 million individual returns, 2.5 million partnerships returns, and 6 million corporation returns for a total of 224 million tax returns.<sup>14</sup> The IRS made more than 4 billion contacts and sent out 8 billion forms and instructions so taxpayers could attempt to comply.

Contrast this with the FairTax, where individuals would no longer need to file returns. Retailers would be provided a credit compensating them for the costs of sales tax compliance. Even if all approximately 25 million business establishments in the U.S. were retailers, the number of returns filed would decline 86 percent.

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<sup>12</sup> TITLE III— SEC. 301 provides:

APPROPRIATIONS.—Appropriations for any expenses of the Internal Revenue Service ... for years after fiscal year 2009 shall not be authorized.

...

RECORDS.—Federal records related to the administration of taxes repealed by title I of this Act shall be destroyed by the end of fiscal year 2009....

<sup>13</sup> <http://www.irs.gov/pub/irs-soi/05db25ir.xls>.

<sup>14</sup> <http://www.irs.gov/pub/irs-soi/05db02nr.xls>.



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Regardless of what Dr. Vance would have the reader believe, Mr. Murray Rothbard understood the matter was of degree. He said that:

Of the various forms of consumption tax, the sales tax surely has the great advantage ... of eliminating the despotic power of the government over the life of every individual, as in the income tax, or over each business firm, as in the VAT. It would not distort the production structure as would the VAT, and it would not skew individual preferences as would specific excise taxes.

In comparing this to the income tax, he continued:

Income taxes are collected in the course of a coercive and even brutal examination of virtually every aspect of every taxpayer's life by the all-seeing, all-powerful Internal Revenue Service. Each taxpayer ... is obliged by law to keep accurate records of his income and deductions, and then, painstakingly and truthfully, to fill out and submit the very forms that will tend to incriminate him into tax liability.

If Mr. Rothbard were alive today, he may have vehemently opposed the title of the "FairTax" bill on the basis of principle. However, he would have hardly reached the conclusion that the income tax is no worse.

### **Conclusion**

Taxes are not a good thing. In fact, the FairTax might be more aptly named the Fairer Tax so as not to offend Dr. Vance's sensitivities. But supporters would beg to differ with Dr. Vance's characterization of the FairTax as fraudulent. We would disagree wholly with Dr. Vance's view that all replacements that are not either politically unviable or unenforceable are equally bad.

As much as we might despise taxes, they are a necessary evil. And as long as we suffer taxes, we should make them as painful, visible and obvious, least intrusive, least costly, least burdensome, least economically and socially destructive as possible. If all we do is rail against a system that makes them so, libertarians make themselves irrelevant.

### **What is the FairTax Plan?**

The FairTax Plan is a comprehensive proposal that replaces all federal income and payroll based taxes with an integrated approach including a progressive national retail sales tax, a prebate to ensure no American pays federal taxes on spending up to the poverty level, dollar-for-dollar federal revenue replacement, and, through companion legislation, the repeal of the 16<sup>th</sup> Amendment. This nonpartisan legislation (HR 25/S 1025) abolishes all federal personal and corporate income taxes, gift, estate, capital gains, alternative minimum, Social Security, Medicare, and self-employment taxes and replaces them with one simple, visible, federal retail sales tax – administered primarily by existing state sales tax authorities. The IRS is disbanded and defunded. The FairTax taxes us only on what we choose to spend on new goods or services, not on what we earn. The FairTax is a fair, efficient, transparent, and intelligent solution to the frustration and inequity of our current tax system.

### **What is Americans For Fair Taxation (FairTax.org)?**

FairTax.org is a nonprofit, nonpartisan, grassroots organization solely dedicated to replacing the current tax system. The organization has hundreds of thousands of members and volunteers nationwide. Its plan supports sound economic research, education of citizens and community leaders, and grassroots mobilization efforts. For more information visit the Web page: [www.FairTax.org](http://www.FairTax.org) or call 1-800-FAIRTAX.

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