More Loophole Lobbyists, Please

By Thomas J. DiLorenzo

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Both of the major political parties in the U.S. long ago adopted the rhetoric of the socialist Left with regard to tax deductions. The mortgage interest deduction, the state and local taxes deduction, and all others, are denigrated either as "loopholes" that need to be slammed shut or as sources of needless confusion.

A November 8, 2004 Associated Press story about impending Bush administration tax reform proposals gave a glimpse of the latest round of socialistic rhetoric to come out of Washington. The Bush administration, the AP reports, wants "to simplify the nation's tax laws" by eliminating tax deductions, but the AP warns that such proposals are often thwarted by evil "Washington lobbyists determined to protect special [tax] breaks for their clients."

In his first post-election press conference, President Bush said he wanted tax reform that was "fair without tax loopholes for special interests" and that was also "revenue neutral," i.e., would not cause a reduction in total tax revenues. Republicans in the U.S. House of Representatives, said the AP, favored "a flat tax that gets rid of deductions," while other "conservative" tax reformers argue for reduced income tax rates that are "paid for" by "eliminating or scaling back tax deductions."

To call such proposals "socialistic" is no exaggeration, for the underlying premise of all such talk is that the state has a "right" to all income that is produced, and that "loopholes" deprive it of some of that income and should therefore be eliminated. This is, in fact, the premise behind *all* forms of direct taxation. As explained by Frank Chodorov in his classic book, *The Income Tax: Root of All Evil* (p. 11), the state is saying to its citizens: "Your earnings are not exclusively your own; we have a claim on them, and our claim precedes yours; we will allow you to keep some of it, because we recognize your need, not your right; but whatever we grant you for yourself is for us to decide." Moreover, "the amount of your earnings that you may retain for yourself is determined by the needs of government, and you have nothing to say about it."

When the income tax amendment was passed in 1913, wrote Chodorov, "the absolute right of property in the United States was violated." And "that, of course, is the essence of socialism. Whatever else socialism is . . . its first tenet is the denial of private property . . . all socialists, beginning with Karl Marx, have advocated income taxation, the heavier the better."

Academic economists – even some of those who call themselves "free market" economists – have provided plenty of intellectual support for socialistic tax policies. The most basic argument they have come up with is the notion that, by creating tax deductions, taxpayers are induced to spend time learning how to take advantage of those deductions, which often requires the employment of tax accountants or lawyers.

Worse yet, the existence of tax deductions spawns lobbying efforts for even more deductions. The problem with all of this, say the academic economists, is that, compared to an ideal world of a simple tax system, there is said to be a tremendous amount of "deadweight loss," which is also sometimes called "social cost" or social waste. All of that time spent trying to avoid taxes could have alternatively been spent producing goods and services, and is thus (supposedly) a drain on the economy.

Such rhetoric is ideologically loaded despite the economics profession's laughable argument that it is an example of scientific objectivity. For the underlying premise is that the government has taken too little of the citizens' income, and that "simplifying" the tax code, and taking more of the income of the citizens, would somehow be "efficient." But private individuals always spend their own money more efficiently than politicians and bureaucrats do. Thus, the absurd premise of the mainstream economists' argument is just the opposite of the truth: that "efficiency" can be obtained by letting government bureaucrats spend more of the citizens' hard-earned income. (The notion that this argument is ideologically neutral is even more absurd).

The time spent by citizens (and their tax accountants and lawyers) trying to legally avoid taxes is in fact a good investment: it is an investment in being able to keep, spend, and save your own income. The very fact that citizens continue to engage in such activities on a large scale, year after year, is a demonstration of its inherent *efficiency* in the minds of taxpayers. In short, tax lawyers or accountants who assist taxpayers in legally reducing their tax burdens are *heroes of the civil society*, just as smugglers like John Hancock, the most famous signatory of the Declaration of Independence, were heroes of their generation for helping their fellow citizens escape the tyranny of British protectionism. That's why the state, its court historians, and its kept media always portray tax lawyers and accountants as antisocial parasites who seek to unfairly rig "the system" for their undeserving clients.

As Murray Rothbard pointed out in "The Myth of Tax Reform" (*The Logic Of Action Two*, p. 119), "Every economic activity that escapes taxes and controls is not only a blow for freedom and property rights; it is also one more instance of a free flow of productive energy getting out from under parasitic repression. That is why we should welcome every new loophole, shelter, credit, or exemption, and work, not to shut them down but to expand them to include everyone else . . ."

Or consider what **Mises** said at a 1952 conference in which people were complaining about loopholes: " Let us be grateful for the fact that there are still such things as those the honorable gentleman calls loopholes. Thanks to these loopholes this country is still a free country and its workers are not yet reduced to the status and the distress of their Russian colleagues. "

The opponents of tax deductions not only deny the right of private property – the very definition of a socialist – but they also appeal to egalitarianism, the second most defining feature of socialism. They do this by complaining that not every single citizen in society benefits from all tax deductions, therefore, no one should ever benefit from any of them. Of course, the same can be said of *all* economic phenomena – we don't all benefit equally from the workings of capitalism, nor would it be desirable for such a world to exist.

The "fairness" argument against tax deductions is the worst kind of utopian, egalitarian nonsense. Rothbard took the right approach to this topic as well: Proponents of a free and prosperous society should not complain about the alleged "unfairness" of tax deductions, but should work instead to see to it that more and more citizens can enjoy them.

Rothbard also pinpointed another flaw in the arguments of "mainstream" economists with regard to tax deductions. They typically argue that if tax deductions are given only to some industries but not all of them, then such policies will lead to more resources flowing to those industries than would be the case in a genuinely free market where no tax deductions at all existed.

This is true as far as it goes, but a vigorous application of opportunity cost reasoning reveals the fallacy of this argument. The mainstreamers leave out the crucial point, said Rothbard: "[W]hat is the alternative? If investment, energy, or other [tax] credits or deductions are abolished, resources will not automatically go into more productive areas; instead, they go into government, via higher taxes" and "will simply be wasted, thrown down the rat hole of unproductive and profligate government spending."

The academic economists usually ignore this argument completely and, indeed, they tend to ignore the entire expenditure side of the government's budget whenever they discuss tax policy. This allows them to pretend to be "objective" when in fact they are anything but. And whenever they do hint at discussing government expenditures, it is usually to proclaim the alleged desirability of "revenue neutrality." This is a, well, neutral-sounding phrase, but it means that under no circumstances should government expenditures ever decline as a result of any tax reform. In other words, in the name of "efficiency" they argue quite absurdly that no "good" tax reform should ever result in the citizens keeping more of their own income or the government being reduced in size and activity by even one-tenth of one percent.

"Conservative" tax reform advocates are sometimes either incredibly naïve when it comes to politics, or they are duplicitous liars. I refer here to the argument that was made on behalf of the 1986 federal tax reform, and which is being repeated today, namely, that it would be desirable to reduce income tax rates if any loss of revenue to the government can be "paid for" by eliminating loopholes and deductions. The basic assumption here is, once again, that all income belongs to the state and, once in the grasp of the state, should never be relinquished.

But aside from that, it does not take a political genius to recognize that such proposals could never be anything but a giant bait-and-switch scheme. "Give up your deductions, and we will reduce your income tax rate," the state tells us. This is what happened in 1986 and then, once most deductions were eliminated, the state proceeded in the next seven years to raise the top income tax rate from 28% to 39.6%, and institute an "alternative minimum tax" that was not indexed for inflation, so that today it ensnares millions of middle class Americans.

This is the oldest tax trick in the book, and was first played when the income tax was adopted in 1913. After 50 years of Republican Party protectionism in which the average tariff rate was in the 40-50% range, the promise was made that, in return for accepting the income tax, tariff rates would be sharply reduced, which they were. Then, within seven years the top rate of the "modest" income tax was increased from 7% to 70%.

Tariff rates escalated as well, first with the 1922 Fordney-McCumber tariff, which restored a high protective tariff rate that averaged 33.22%, and culminating with the Smoot-Hawley-Hoover tariff of 1930 which raised the average rate to 59.1%. "The historic fact is that tariffs rose higher than ever after income taxation was ultimately constitutionalized," wrote Chodorov (p. 40).

With Washington increasingly abuzz with talk of tax reform, Americans should expect to be bombarded with all of the same old myths about the evils of tax loopholes, the alleged imperative of "tax fairness," and the desirability of "revenue neutrality." All of this rhetoric merely masks the fact that taxes will be going up, making citizens poorer and the economy weaker, while the state continues on as one gigantic, overbloated parasite.

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