Can Government Cut Taxes? … Wrong Question!

*The **only way** a government can indirectly effect a **real** tax reduction is **by cutting spending**.* Government can "approve" tax cuts all day long, but such legislation will have "0" causation in the reduction of the real tax burden. If "taxes are cut" in the traditional sense and current spending is greater than tax revenue, then increased deficits result immediately.

What is Tax?

Webster defines tax as: (noun) …to levy a tax on
(verb) … a charge usually of money imposed by authority on persons or property for public purposes

Other credible sources define tax as:

- A contribution for the support of a government required of persons, groups, or businesses within the domain of that government.

- A fee charged ("levied") by a government on a product, income, or activity

- A charge imposed by a government on a service, product, or activity in order to raise revenue. Tax can be levied on business or personal income.

In the traditional context tax is a contribution or sacrifice of money (or some form of wealth) by an individual or business, where proceeds are presumably utilized for the benefit of the public. The key question is: WHEN does the real tax sacrifice by individuals, businesses, or societies occur?

Why Split Hairs?

There are two very different views on WHEN the real tax occurs! First, is the real tax a levy on current and/or *future* individuals/businesses, or alternatively, is the real tax an immediate sacrifice by the collective body of society?

> The first context implies the tax burden of the ***taxpayer*** can be born in current real-time **OR** intertemporally. For example, if an investor buys a Treasury bond, then he is enduring the "sacrifice" immediately by not purchasing a good or service today with the expectation of purchasing a good or service when he cashes the bond later. Once he does decide to cash the bond, taxes must be incrementally raised on a future ***taxpayer*** (unless in the unlikely event spending is cut elsewhere) to *transfer* wealth satisfying the bond redemption, thus spreading the sacrifice intertemporally (over time).
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> In contrast, the second alternative context implies tax is the sacrifice ***made immediately in real-time*** by the ***entire society*** for a government purpose, and can thus **NEVER** be shifted intertemporally. The tax really occurs precisely the moment in time the labor and natural resources are engaged to perform a current government service or fabricate a government product for future delivery. In this second context the aforementioned Treasury bond purchaser bears the real tax burden at the time of the bond purchase by sacrificing the immediate acquisition of goods or services anticipating he will enjoy his acquisitions later.

From an "Austrian Enginomic" perspective accepting the second context especially helps to clarify understanding of the "real" economy and prevents government from misleading taxpayers. If the tax in the first context was strictly viewed as a burden (an IOU to the government), which could theoretically be shifted to our children, a government official could rightfully promise a cut

in taxes **today** WITHOUT A SPENDING REDUCTION, and ***ignore*** mentioning the commensurate tax INCREASE on future taxpayers hoping the economy will somehow disguise that real increase by growing out of a deficit condition. The truth is that EVEN IF THE TAX WAS VIEWED AS A BURDEN THAT CAN BE SHIFTED LATER IN TIME (the first context), IT CAN NEVER BE RECOVERED! *The spent labor and natural resources can NEVER be recovered*. Thus, *a tax cut is* ***impossible*** *without a spending cut* regardless of who ultimately pays the tax burden. At best, if the tax burden is shifted later in time, the only result may be a future *transfer* of wealth (from the future tax payers to the current bond purchasers), not the *creation* of new wealth.

GAAP Accounting is NOT Applicable for Macroeconomics!

The concept of a business investing in new enhanced equipment to enable a productivity improvement, thus improve profits and keep pace with the competition and to retain healthy profits is one of the pillars of a capitalistic system. Financial analysts within a business calculate the viability of an investment by modeling the initial investment amount, the returns expected from the investment, depreciation, obsolescence, and the cost of money (interest). There is a general acceptance that once the investment is made (sunk), that you will never retrieve the investment. It will depreciate, wear out, become obsolete, etc., notwithstanding an insignificant salvage value. The expectation is that the enhanced productivity, hence profit, will not only equal the cost of the investment, but return enough above and beyond the investment considering all relevant factors to justify it initially compared to doing nothing. Even if bond financing was utilized to purchase the equipment, you should expect to repay the bond with the enhanced profits over the life of the equipment, but never directly recover the initial investment cost. The entrepreneur is betting that future profits will reward his decision of the initial sunk investment.

If government operated the same way, then a government incremental "investment", for example, in a new, more efficient non-toll public highway financed by Treasury bonds (equivalent to deficit spending), should require an immediate announcement of an associated general tax increase to begin immediately upon highway completion or sooner. Proceeds from the tax increase would be utilized to repay the bonds. However, this tax increase would be a non-starter in today's political environment, and never get off the ground. Rather, the government typically chooses to approve the highway expenditures without announcing the necessary tax increase in the future. Thus, the unannounced stealth real tax increase will happen via debasement of our currency (inflation) to all those holding dollars or dollar-based assets, or inflation pushing taxpayers into higher tax brackets, or elimination/reduction of another government service (rare).

Bottom line…. Since there is rarely an announced future tax increase or plan to pay for the government "investment" that resulted in a more efficient highway in our example, those who sacrificed to purchase the bonds are holding "paper securities" that immediately become part of the now more diluted massive pool of all other "paper securities". This illusory financing method is in sharp contrast to use of GAAP in business where the management knows the health of their business is dependent upon the success of the equipment installation in meeting its modeled goals.

Who Really Suffers Paying the Deficit-Spending Tax Burden? …. Inflation is the Culprit!

In theory the notion of an intertemporal tax burden shift is feasible through the process of selling and redeeming government bonds. Why not let the kids bear some of the burden of fighting an expensive war (e.g. WW-2)? Unfortunately, the reality is that the "kids" will bear very little of the real future tax burden! Who will? Our stealth government will effectively hose all holders of

dollars and dollar-based financial assets the moment our Central Bank monetizes federal debt, which debases our currency (inflation). Generally, since most of the holders of "dollars and dollar-based financial assets" are the Boomers and retirees, they will bear the heaviest weight of the asset devaluation, hence purchasing power loss, and ***not*** the "kids".

Conclusion:

If a government official speaks of "cutting taxes", unless the allocation of **resources** (labor and natural resources) is immediately reduced (a real spending cut), then the statement is ingenuous at best, or more accurately fraudulent. See "If Government Collected NO Tax, Would We be Taxed?[1]" to better understand the logic. The "right question" is: Can Government Cut Spending?"….!

By Russell Randall 1-09-2009

References:

1) "If Government Collect NO Tax, Would We be Taxed?" by Russell Randall (9-21-'05), http://austrianenginomics.com/IftheGovernmentCollectedNoTaxWouldWebeTaxed.pdf