The Ethics of Tax Evasion

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ABSTRACT

A wide and growing consensus views taxation as fundamentally coercive in nature. Regardless of the magnitude of the tax or the agents perpetrating it, this fundamental coercive element remains. Tax evasion must consequently be treated as an effort to convert this coercive behavior into voluntary transactions. By altering the conditions of payment and receipt of goods and services, taxation veils both consumers’ and producers’ preferences. Critics of tax evasion have left unanswered the question as to how society will efficiently allocate its scarce resources under coercively falsified preference signals. Accepting that preferences are best signaled voluntarily and via market participants directly, we argue that tax evasion must result in increased economic efficiency, as well as allow for a reinstatement of an individual’s right to contract freely.

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INTRODUCTION

Most commentators consider tax evasion profoundly unethical. There are some ambiguities regarding the meaning of the very word “taxation” that must be addressed while assessing this claim. We maintain that the meaning of taxation depends neither on the agents who collect it, nor on their objectives. This idea sheds a new light on the difficulties encountered by the detractors of tax evasion and allows us to show that at least some of them fail to reconcile inconsistencies.

There is a large consensus among scholars (Reidy and Riker 2008), overlapping our most common intuitions, that taxation is a form of coercive payment (Hodson 1983, p. 133). Insofar as physical coercion is employed to assure that a payment is made, it must be considered involuntary. Therefore, evasion must be regarded as an effort to convert a coercive into a voluntary payment. Moreover, coercion is coercion regardless of the perpetrating agent’s objectives.

Coercion entirely changes the nature of a disbursement. Unlike a voluntary payment, a coercive one cuts the intrinsic link between a good or service and the required payment for it (Rothbard 2009, pp. 1149–1253). A voluntary expenditure requires foregoing an amount of resources consented to by another person in trade for his possession or service. Hence, freely paying for a good or service intrinsically links it to the respective good or service, which would not be provided without the required payment. It is precisely this intimate connection that coercion cancels. The most distinctive feature of a forced transfer of funds is that neither a good nor a service is agreed upon.1 “[T]here is a disjunction between payment and receipt of service” (Rothbard 2009, p. 1245).

Insofar as coercion is effective, its features will always be the same. By disrupting the link between payment and receipt of service, compulsion veils the exact preferences of the agents who were dispossessed of their resources by allocating them according to the aggressors’ preference scales. The nature of taxation remains unaltered and independent of the perpetrators. Were a system of intimidation to be set up by one particular person, group, institution, democratic political arrangement, or
unicameral or bicameral parliament, its characteristics would remain unchanged. Furthermore, the nature of taxation remains unaffected whether I forcefully take from you $100 or $1,000,000, 10% or 80% of your weekly, monthly, or annual revenue.

Tax evasion has to be interpreted as an attempt to recover the link between the service and its correspondent payment and, thus, to unveil the taxpayers’ preference scales regarding the allocation of their own resources. The circle of those who advocate evasion must be more inclusive than the libertarian scholars (Rothbard 1998, pp. 161–175) who urge no taxation at all. Supposing that one opposes taxation at 80% of annual revenues, but supports with, for example, 10%; such a person would logically have to favor tax evasion to diminish levies from 80% to 10%. But a supporter of 10% taxation must answer this crucial question: “why choose a level of 10% instead of 0% as the compulsory payment since the nature of taxation remains unchanged whether it impinges on 80% or 10% of our revenues?” To be sure the answer to this question is not easy because it could only be grounded on an arbitrary claim.

The detractors of tax evasion must also note that in its absence, it becomes impossible to establish whether the pattern of resource distribution within the society fits the preferences of taxpayers. All political arrangements proposed for ensuring that the redistribution of resources within the society fits the preference scales of its members are, by and large, unsatisfactory. This fact can be attested by the numerous debates on which the democratic theory is engaged (Dryzek 2004, pp. 143–155). Tax evasion critics overlook the fact that taxation makes it impossible to determine who pays what and, consequently, it hides or overrides the preferences of the members of society. In the absence of a device able to reveal these preferences, tax evasion is the most natural and practical way for turning back to a more accurate distribution of resources (i.e., according to the contributors’ preferences). If we grant that preferences are better appreciated and satisfied by the subjects themselves, we must favor tax evasion (because tax evasion is a suitable device for unveiling and respecting the preference scale of the taxpayers within a society).
One of the foremost authors on the ethics of tax evasion defines taxation as the “compulsory taking of property by government” (McGee 1994). Many people would no doubt object to this view and claim that they pay taxes primarily voluntarily for public ends, yet they are nonetheless forced to cover that cost because the opportunity not to pay them does not exist. Taxes are compulsory: it is not a matter of psychological state of mind, but of institutional setting. Taxation rests on coercion in the sense that tax evasion is illegal, so that the government would initiate the use of force if a taxpayer did not comply with his fiscal obligations.

Because tax evasion is unethical, there must exist a moral obligation to pay one’s taxes—implemented through the compulsory character of taxation. Such an obligation may be described as “positive,” in the sense that it commands certain actions, while a “negative” obligation only forbids certain actions. More precisely, one can distinguish two types of positive obligations as a basis for taxation. Indeed, some taxes finance the production of so-called public goods furnished, presumably, to all members of society, while others finance public actions, which only, supposedly, benefit some.

The problem with this argument for taxation is that it is impossible to determine which types of public goods are necessary, in which quantity, and which unsatisfied needs of one individual imply the duty of another. All ethical systems based on positive obligations legitimize coercion to implement them. But without any objective criterion of the precise content of one’s duty, such ethics come down to the following principle: one may resort to coercion in order to force other people to share in the costs of the satisfaction of any need one thinks should be satisfied.

If everyone may resort to coercion in order to impose on others what he considers their ethical obligation, then a general conflict must ensue, which we generally call “general elections.” A second consequence is, concretely and in practice, an ethical rule emerges that the strongest may properly force the weak(er) to obey his or her commands. And thirdly, such “ethics” imply, in fact, the negation of all ethical principles, because what it comes
down to is that one may initiate the use of force against others whenever he or she finds it justified.

Such a doctrine is not only wrong but is also false in the sense that it rests on a misconception of ethics. All doctrinaires of positive obligations conceive of ethics as commanding certain actions, and thus a basis on which to justify the initiation of force in some cases—a basis that, in fact, comes down to subjective opinion concerning moral duty. To the contrary, ethics only forbids certain actions: it merely contains the negative obligation not to initiate the use of force against other people. All members of society have diverging views on what “needs to be done.” They have what one may call various “moral codes”: schedules of ends to which they give relative and marginal values and that transcribe in their decisions to act.

For instance, one person will make regular and generous contributions to an association sheltering animals, and happily pay for the preservation of national parks, while another favors the education of orphans in underdeveloped countries, as well as a national system of public schools. On that basis, ethics do not say that one may resort to coercion in order to impose his preferences on other people whenever he thinks those ends are high enough to justify those means. To the contrary: a proper ethics mandates that no one may initiate the use of force in order to impose his own moral code on other people. If ethics cannot contain any positive obligations then tax evasion cannot be said to be unethical and, to the contrary, taxation must be so. Tax evasion cannot be said to be unethical, because one has no positive obligation to share in the costs of any public good or action, which other people, even a majority, find necessary and conceive as a moral duty.

THE ETHICS OF TAX EVASION

The nub of the debate on the ethics of tax evasion involves the distinction between just and unjust coercion. With the exception of pacifists, there is agreement among philosophers that not all forms of violence are unjust (Eickelmann et al. 2005). This accord also extends to the fact that in the category of morally permitted aggressions, we must include self-defense, i.e., a response to a
previous aggression (Thomson 1991; Wasserman 1987). Otherwise (i.e., if the defense against aggressors was not morally permitted), then any aggression could be legitimately initiated. Indeed, a theory that does not place any limit whatsoever on aggression cannot be called an ethical theory. However, beyond this large agreement, other examples of morally permitted aggression are far more problematic. To wit, the case in favor implies that some purely nonprovoked violent actions (taxation) can be brought against entirely innocent people.

The justification of such cases of pure initiatory violence encounters a twofold difficulty (Nagel 1991, p. 88). On the one hand, it must justify the grounds on which a pure violent action can be initiated, and on the other, it must explain why certain types of violence can be justified while others cannot (Nock 1928, p. 143). Concerning the former, it is important to note that if a purely violent action, such as a compulsory payment, can be justified, then, in this case, the right of self-defense (evasion of the respective compulsory payment) does not apply anymore, and the aggressed has no other alternative than to tolerate it. However, the criteria used for identifying the conditions in which it is morally permissible to initiate aggression, such as taxation, are subject to everlasting debates. To put it differently, those who maintain that nonprovoked violence can be justified in some particular circumstances, still disagree on the exact nature of these circumstances (Williams 1987, p. 61). Hence, the moral permissibility of tax evasion is based on the rejection of a particular ground for justifying taxation. The common intuition sees the debate on tax evasion as between the defenders and the critics of government. However, among the advocates of tax evasion, we should count, for coherency reasons, not only the libertarian authors pinpointing at the State's immorality per se, but also all those who disagree with the grounds justifying a specific form of government, a particular government, or a given policy.

Consider justifying an uninvited border crossing. The question to ask is: “why is taxation morally permissible, while other types of such violence are not?” One cannot simply answer: “because it is legal” without falling into the petito principii fallacy. The debate on the ethics of tax evasion cannot be based on the biased presupposition asserting that all legal actions are also just. There must be a possibility to evaluate legal actions on a positive basis
and to declare at least some of them unethical. Otherwise (i.e., if illegal by definition was also unjust), there could be no debate at all on the ethics of tax evasion. Tax evasion would be inevitably unjust because, by definition, it would be illegal. This is the fallacious doctrine of legal positivism: whatever the legislature, or the king, decides is necessarily just.

Legality does not imply that any political arrangement that succeeds in imposing the law on a given territory is *ipso facto* just (Groarke 2004). Otherwise, it would be impossible to declare totalitarian regimes or slavery institutions unjust when they are legal. Within such societies, it would be the emigrants, the revolutionaries or the secessionists who evade taxation; their actions would be licit. It is particularly important to note that given the special circumstances of a totalitarian regime, evasion would be considered just by most of the scholars who currently oppose it.3

The nature of taxation is not influenced by the agents who ask for it or their objectives. As such, the double standard of judgment toward the same situation cannot be pertinently explained. Be it just or unjust, the nature of taxation cannot change dependent on the institution collecting the taxes—totalitarian or democracy (McGee 2004).

A fashionable line of reasoning (Nagel 1991, pp. 75–91) consists in connecting the unjustness of tax evasion to the legitimacy of the respective political arrangement (Paul et al. 2006). This is to say that it would be morally impermissible to disobey the laws of a *legitimate* government, and evade taxation. The implicit presupposition of this line of argumentation is that the government legitimacy does not necessarily coincide with the taxpayers’ will. Otherwise, i.e., if the concept of legitimacy was voluntarist and if it depended on the taxpayers’ will, then the government would be a mere association (Simmons 1999) and the entire debate on the ethics of tax evasion would be pointless. Hence, the detractors of tax evasion must consider that this idea of legitimacy, whatever it may be, is necessarily divergent from the taxpayers’ will.

One may remark that this does not solve the initial problem. Now, the question to be answered is: “Why is the taxation imposed by a certain kind of government legitimate while the taxation imposed by another type is not?” Let us suppose that we have an arbitrary answer to this question. We may believe that a government is legitimate if it is established within a democratic
political framework (Buchanan 2002). The tax evasion in this case becomes morally permissible in the eyes of all those who disagree with this particular conception of legitimacy (Braithwaite 2003). The authors who go beyond the difficulty of justifying nonprovoked aggression must concede that tax evasion is morally permissible for all those who are not convinced about the legitimacy of a given government.

Furthermore, the circle of pro “tax evasion” must be even larger than this and must also include the opponents of a particular government or redistribution policy. This idea appears clearer when we see tax evasion as an illegal tax cut (McLaren 1998) and as an illegal form of redistribution of resources (Porcano 1984). Given that the nature of taxation is not influenced by the agents who ask for it, nor by their objectives, the adversaries of tax evasion must be able to argue why the legal tax cut and the legal redistribution (made by the government) are morally permissible while an illegal tax cut and an illegal redistribution (i.e., tax evasion) are morally impermissible. Again, and for the same obvious reasons, the answer: “because the illegal cut tax and the illegal redistribution are illegal” cannot be considered a pertinent response. The tax evaders chose to redistribute the resources currently in their possession according to the ends they consider more appropriate and especially more just than the ones chosen by the government (Becker and Spicer 1980; Lundstedt and Spicer 1976). This shows that among the advocates of tax evasion we must also count all the opponents of a particular type of compulsory redistribution who disagree with some particular types of statist redistributions (Smith 2005).

If we take into account the risks that the tax evaders assume by breaking the law in order to grant themselves a tax discount and, implicitly, so as to direct their resources towards the ends corresponding to their own preferences and standards of justice, then tax evasion must be considered as a vote against government legitimacy. Instead of “voting with his feet” (Hirschman 1970)—as an emigrant would—a tax evader chooses a riskier alternative, to remain and to vote against government legitimacy by evading taxes.

Contrary to a government violently overthrown, tax evasion is more akin to nonviolent secession (Tucker 1884). Scholars who maintain that special rights or autonomy should be granted to
some minorities of one country (Moore 1998) must see tax evasion as a privileged form of secession because of its nonviolent characteristics. Kymlicka (2007) asserts that minorities who were victimized by violent occupation must be granted the right to autonomy. But this is the case of all tax evaders. In spite of their diversity and of their various justifications and objectives, they all demonstrate by their own actions that they would prefer to be ruled by a different political regime. If we believe that it is morally permissible for some minorities in a given territory to evade taxation, and eventually to secede, why should this right not apply to everybody? This holds true especially if we think that tax evaders may represent a coherent and homogeneous group of persons having the same goal: to not pay taxes.

ETHICS AND THE INFLATION TAX

Although much attention has been focused on more conventional direct taxation, there is a more encompassing levy that is commonly overlooked—inflation. Even though it is often overlooked, this tax might be considered the most important one for government finance. Compared with other taxes, it is a more indirect, concealed form of expropriation of the wealth of citizens. Thus, the ethics of inflation tax evasion are of outmost interest due to its veiled nature. This tax may be defined as an increase of the money supply by a government agency or the fractional reserve banking system in benefit to the government and in detriment to its subjects.4

Balac (2008) reports that the inflation tax has been well documented by modern economists since at least as early as David Hume’s (1711–1776) monetary writings where he focused on the unit-change aspects of monetary stock inflation and how such incremental changes were irrelevant to individuals (Hume 1970). In fact, this levy can be traced back even further to the Spanish scholastic Juan de Mariana (1536–1624) who regarded inflation as an operation which: “taxes those who had money before and, as a consequence thereof, are forced to buy things more dearly.”5 Characteristically, this tax provides such a latent force that it is difficult to notice. It is for this reason that it has historically been the preferred method of governments to fund unpopular projects.
The workings of this concealed tax are simpler than direct taxation schemes. A centralized monetary authority—usually a central bank such as the Federal Reserve System—has the monopoly power to control the money stock of a nation. Increases in the money supply tend to reduce the value of all formerly existing monetary units. As a result, individuals with cash balances see their real purchasing power dwindle. Conversely, the first recipients of this augmented money supply benefit from an increase in their purchasing power at the expense of others. From the first recipient, the new money spreads via Cantillon effects throughout the whole economy. As a result, there is redistribution of wealth from the first recipients of the new money to latter recipients. As the central bank increases the money supply primarily through purchasing government bonds with the expanded money supply, it is the Treasury, and ultimately the government, which gains directly through this inflationary policy.

There are two basic ways that the banking system benefits the Treasury to the detriment of its citizens. First, the central bank creates new money in order to purchase Treasury bonds. This can be done directly by buying them from the Treasury or indirectly if the banking system first acquires bonds through open market operations. In this way, the government finances its deficit without having to directly confiscate or borrow the savings of the general public. This tends to reduce the purchasing power of money. Moreover, the purchase of government bonds by the central bank increases the reserves of the banking system. Therefore, via the banking multiplier, banks may expand credits, further increasing the money supply.

Second, the government realizes an additional benefit. By buying government bonds, the central bank not only finances the deficit but also, through the loss of purchasing power, the real burden of the existing government debt is reduced. These gains to the government are paid by its subjects through a decrease in the purchasing power of money, i.e., the inflation tax.

A FAIR TAX?

The inflation tax primarily affects those with cash holdings through its continual erosion of purchasing power. A simple solution to
avoiding this tax entails a reduction of cash holdings by increasing consumption.\textsuperscript{6} While this may seem to effectively avoid the tax on the face of it, it misses the more salient point that the ensuing spending will cause prices to increase even faster. Workers especially lose during such a price inflation as wages rarely manage to keep pace with the increase in the general consumers’ price index. As a result, real wages decrease leading to lower purchasing power per labor unit worked.\textsuperscript{7} This is amply evident with fixed income individuals (i.e., retirees), but also with those at the bottom of the pay scale (i.e., young and low unskilled individuals earning minimum wage).\textsuperscript{8} As a result, inflation serves to affect all individuals as more real earnings are needed to purchase the same amount of goods, \textit{ceteris paribus}. A decline in real wealth occurs. The wealth of the citizens is partly expropriated by the government.\textsuperscript{9}

\section*{A PRIORI FOUNDATIONS OF ILLEGAL INFLATION}

Ethical implications may be grounded in natural law, an approach elaborated by Rothbard (1998). However, as Rothbard (1998, p. 10) points out, there is a defensive line arguing against this approach. One may ask, after all, who will establish the alleged truths about man necessary for the natural law foundation to be universally applicable. The answer is that man’s reason is objective—it may be employed by all individuals to yield universal truths about the world. This does not imply that men’s decisions will be infallible. Many natural rights theories require a process to discover and establish them.

It is with this absolute realm of human reason that we must establish first the legitimacy of inflation and its concomitant tax, prior to assessing the ethics of combating it. It is important to remember that in our current system, the inflation tax does not result solely from the increase of money by the government itself but also via the credit expansion of the banking system that purchases government bonds and multiplies the new reserves that the central bank creates.

Let us first look at the legitimacy of the production of fiat money by the government. This is illegitimate, as real money, i.e., a commodity such as gold and silver, has been expropriated by
the government and substituted with fiat money by force. In fact, today’s fiat money could only be introduced as a result of gold holdings being expropriated from citizens (Rothbard 2008). Furthermore, fiat money stays in existence only because of legal tender laws that compel people to accept it. The government additionally maintains its privilege of force to print units of fiat money. As the initiation of force must be regarded as illegitimate (Block 1991; Hoppe 2006; Rothbard 1998), the expropriation of gold, legal tender laws, and the government monopoly of fiat money production is illicit and in violation of property rights.10

Let us now turn to the propagation of the fiat money production of the government in our current fractional reserve banking system. The banks use an initial increase in fiat money to increase the money supply several times more. As loans are issued in excess of the amount of money held on demand, an excess of property titles to monetary units results (Bagus and Howden 2009; Huerta de Soto 2006). From a property-rights viewpoint, this increase resulting in more property titles than properties in existence is fraudulent (Block 1988; Hoppe et al. 1998; Hülsmann 2008; Rothbard 1974). Inflation produces more titles to the wealth represented by money than actually exists. Hence, inflation results in a monetary expansion, which makes it appear that there is a greater amount of wealth in existence.

As a result, entrepreneurs are misled into falsely believing that there is more material wealth and resources with which to undertake larger-scale projects. Entrepreneurs expand production capacity under the expectation that more resources and wealth are available than is the case. The over-issuance of property rights results in an artificially expanded boom, which will hit a binding resource constraint eventually and turn to bust.11

Furthermore, there are legal principles grounded in natural law that can be used to assess the creation of inflation by a fractional reserve banking system financing government expenditures. Huerta de Soto (2006) uses the distinction between deposit and loan contracts to demonstrate that inflation of bank deposits violates established legal norms. Indeed, this line of argument encompasses the aforementioned property-rights viewpoint and places it on a more solid foundation. Historically, deposits have specified a safekeeping contract, implying that the deposited item must be not used but rather guarded until it is asked for by the
depositor (or in cases of fungible items, a similar quantity and quality of goods may be returned on demand). Loans, in sharp contrast, entail a transfer of ownership resulting in allowing the borrower the full use of the good over the term of the loan, with only a promise to return an item at a defined future date. Banks enjoy a legal privilege of being allowed to treat deposits as loan contracts, and hence, to make additional loans against them instead of holding them in safety. As such, an inflation tax is created, as more monetary units are produced than would otherwise have occurred.

The ability to pervert the established legal principles and effectively tax money holders through inflationary policies has occurred as powerful interests have effectively changed the positive law reflecting this practice. Consequently, banks today enjoy a privileged legal position that enables them to profit at the detriment of others. By inflating the money supply, they reap the benefits while existing money holders are “taxed” to pay for this fraudulent practice.

Hence, the inflation tax created by a fractional reserve banking system must be assessed as fraudulent and unethical. As more property titles are created than actual property at any given time, credit expansion must be considered as a form of counterfeiting. As a result of this expansion, entrepreneurs are defrauded into thinking that more resources exist than actually do. Moreover, by expanding credit to fund a government deficit directly or indirectly, banks pervert the legal definitions of deposit and loan contracts. As deposits are treated as loans, an increase in the money supply impairs the wealth positions of existing holders of monetary units. Most egregiously, these are typically the depositors who have their savings expropriated to cause the inflation, thus levying the tax most heavily on them.

THE UNETHICAL POSITION OF THIS INFLATIONARY ARRANGEMENT

Ramifications of this unusual legal arrangement have led to some controversial opinions. Indeed, those in the position to understand its effects best—monetary economists—often fail to comment on this accepted legal agreement. The reason is, as Hülsmann (2008, p. 87) points out:
Economists are reluctant to dwell on the moral dimensions of social facts, and rightly so, because moral questions are outside their customary purview. But one does not need to be a moral philosopher to know that certain incomes are illegitimate; that they derive from a violation of the fundamental rule of society.\textsuperscript{12}

This fundamental rule of society is a universal respect for property rights. As the inflation tax erodes the value of each existing unit of money, any money holder will suffer from an invasion of his right to his property's value as a result of the forced decline through inflationary measures.\textsuperscript{13} In fact, the general principle behind the inflation tax is one of counterfeiting. By producing and selling "fake" claims on wealth, the counterfeiter will realize a gain at the expense of the individuals coerced into accepting these fake claims (Rothbard 2008, p. 52).

Although the situation where individuals are coerced into accepting the fake claims that comprise the inflated money supply remains the most obvious, there is an even more insidious element involved. Individuals need not actively participate in the inflationary process to be harmed by its effects. It also affects individuals who, to a great degree, refrain from participating in the inflationary process. Retirees on fixed incomes, for example, may have their deposits placed in a bank awaiting future use. As banks misappropriate these funds to make loans, inflation ensues via an increase in monetary units. The retiree has not consented to this act; indeed, he is likely totally unaware of its occurrence.\textsuperscript{14}

In fact, all individuals with cash savings will be affected by this tax, regardless of whether their money is directly appropriated for inflationary purposes or not. The homogeneity of money makes it impossible to distinguish between monetary units that have been and have not been inflated.\textsuperscript{15} Consequently, even a wholly innocent bystander with no knowledge of the process will be affected by the inflation tax as it removes wealth from his accumulated savings.

The inflation tax is also unethical in that it conceals the real cost of government policies. Huerta de Soto (2006, pp. 756–758) has argued that the inflation tax is not compatible with democracy because one of its principles is that government finance must be objective and openly discussed. While other taxes are
often mentioned in the parliament, the inflation tax typically finances expenditures without formal debate.\textsuperscript{16} Thus, politicians can avoid the politically more difficult route required by other direct taxes by pursuing a more hidden expropriation of citizens' wealth.\textsuperscript{17} In fact, without an inflation tax, a government would have to fully reveal expenditures and sources of income.\textsuperscript{18} This would have the beneficial effect that citizens would become aware of all costs involved and be enabled to better monitor state agencies. This would probably lead to fewer wars and more peaceful cooperation as von Mises (1983, p. 163) indicates:

One can say without exaggeration that inflation is an indispensable intellectual means of militarism. Without it, the repercussions of war on welfare would become obvious much more quickly and penetratingly; war-weariness would set in much earlier.\textsuperscript{19}

\textbf{IN DEFENSE OF INFLATION TAX EVASION}

If fiat inflation is fraudulent and is unethical at its foundation, we should be quick to support any action which prohibits its expansion. Hülsmann (2008, pp. 97–98) explains that there is a natural process that combats this subtle tax:

The function of counterfeiters resembles the function of the many viruses that subsist in a healthy human body. Fighting the virus keeps the body alive and strong. Similarly, the ever-present danger of counterfeiting stimulates vigilance in monetary affairs and thus helps to preserve sound money. People watch their gold and silver coins closely because they know that counterfeiting affects them directly. They strive to learn more about distinguishing good coins from bad coins, and good banknotes from bad ones. They apply such knowledge and teach it to their families and others. And once they discover any sort of fraud, they stop using the fraudulent coins and banknotes, and switch to other certificates.

There is one line of defense that individuals may pursue in escaping this tax: by avoiding the use of a given monetary unit
altogether and instead contracting in a different medium. Benefactors of this tax realize this and have combated such an escape with “legal tender laws” that force individuals to accept a specified money (i.e., legal tender) in settlement of all debts. These coercive laws have been established to aid those who gain from inflating the money supply.

Legal tender laws on their own are not effective in eliminating all competing currencies. By only forcing the acceptance of a specified money, buyers and sellers may still contract in a different medium, thus limiting the effects of a money prone to inflation. Legal tender laws are a mere complicating factor if not for an ancillary stipulation that historically has been combined with them. Hence, legal tender notes are established by fiat to be accepted in exchange for a type of competing, and valuable money. As a result of this proviso, Gresham’s Law takes hold, namely, bad money (that subject to inflation and reduced in value) drives out good money (that which has maintained its value and is expected to do so). As the two monies’ values are equilibrated by fiat, individuals strive to rid themselves of all “bad” money first, while hoarding the “good” money.

Some may still argue that individuals are still “voluntarily” using a money, regardless of whether they know they face detrimental effects from doing so. In reality, individuals are coerced to use only government issued fiat money for debt settlements. A defining characteristic of legal tender laws is that all payment of public debts must be made in the legal tender. Failure to do so will result in a hefty penalty until such a time that the public debt is paid in legal tender.20 One may also look to the consequences of counterfeiting a legal tender note. It is apparent that strict penalties are assessed when individuals attempt to redirect the inflation tax in their own favor in this way.21

The ultimate evasion or abolition of the inflation tax would entail a monetary reform that would make it impossible for an inflation tax to occur, such as the establishment of a 100-percent gold standard (Rothbard 1991). Here, neither the government nor the banking system would have the ability to increase the money supply to finance government expenditures. Consequently, actions to eliminate interventions that prevent such a monetary reform are ethically legitimate.
MARKET EFFICIENCY AND TAXATION

The economic analysis of taxes and taxation adopts two distinctly different perspectives. In traditional economic theory, taxation is studied as a restriction of the market and hence a force that lowers the value surplus created through trade, creates inefficiencies, and lowers overall utility. But in the subfield of law and economics, the aim is to analyze the efficiency component of market regulations such as taxation in order to find that regulation which is most efficient from a governmental point of view. In this tradition, it is presupposed that “economics provides a useful normative standard for evaluating law and policy. Laws are not just arcane, technical arguments; they are instruments for achieving important social goals” (Cooter and Ulen 2008, p. 4).

The analysis of taxes in this field of study is commonly made in order to establish the degree of “neutrality” of specific taxation schemes. The purpose was to discover a means of taxing the populace in order to collect the desired amount of revenue for the government without having too much of a misallocative effect on the market. This perspective, in other words, aims for minimizing the disturbance to the market while assuming the necessity of intervention for the sake of some common good.

More important for our purposes is, however, the law and economics argument for government production and supply of supposed public goods (or sanction of public bads) and their consequent financing through tax collection. Even though this issue is in many ways closely related to the problems discussed earlier, the addition of direct taxation adds to the level of complexity. Consider the following example in Cooter and Ulen (2008, pp. 3–4):

Suppose that a manufacturer knows that his product will sometimes injure consumers. How safe will he make the product? For a profit-maximizing firm, the answer depends upon two costs: first, the actual costs of making the product safer, which depend in turn upon facts about design and manufacture of the product and the costs of issuing warnings to users; and the “implicit price” of injuries to consumers imposed through the manufacturer’s legal liability.
The Posnerian solution to this problem is for the judiciary to allocate property rights (liability) in such a way that lower transaction costs are facilitated (Posner 1987, p. 5). This could be done by forcing the manufacturer to internalize sufficient costs of product safety or relieving consumers of the costs of injury. Through estimating the “social cost” of risk of injury and comparing it to the cost of implementing product safety-enhancing procedures, the enlightened judiciary aspires to minimize total social costs on an aggregated collective level. The efficient solution is that allocation of resources and liabilities that maximizes total (social) welfare.

The law and economics philosophy would furthermore provide guidance on how the necessary taxation to finance the public good of liability allocation should be levied. The object is to: (1) minimize adverse effects on the market through providing a general taxation scheme characterized by “neutrality” in how actors are burdened by the tax; or (2) pinpoint taxation on goods they think contribute to public bads and thereby discourage consumption of such goods, for example, hang gliding, fatty foods, cigarettes, alcohol. Both of the objectives are used to guide law and economics scholars and lawmakers alike, to the extent taxation is not used for redistributive purposes, in their aspiration to find efficient and legitimate approaches to taxation. They are used as bases in decision making, aiming to lubricate the market and increase, if not maximize, social welfare.

The uncertainty caused by the undermining of private property rights also affects entrepreneurs’ ability to imagine opportunities for future profit, which could result in severe consequences for future welfare created (or, better, not created) in the market (Klein 2008). Even though the effects of this factor are impossible to estimate, the case of entrepreneurship offers an important example of effects that may be unseen and unidentified—which are thus seldom analyzed (Bastiat 2007).

Because the market economy is spontaneously structured to satisfy consumer wants, we can infer that any costs generated by the measures discussed above will be passed on to the consumer. This is a conclusion also implied in the framework of law and economics and explains why this line of research is focused on maximizing overall welfare. Any increases in efficiency achieved will ultimately benefit the consumer.
There is a strong case to be made for the evasion of the taxes proposed by law and economics scholars. Not only is the normative Coase theorem based on a number of erroneous assumptions likely to adversely affect individual market actors, but it is unlikely that their sanction against public “bads” will do any good.

Evasion of taxes levied to control behavior, presumably in a welfare-maximizing way, may very well increase economic progress. Such evasion will furthermore have an undermining effect on attempts to reallocate property rights and thereby, at least potentially, provide a basis for increased consistency in property rights enforcement and therefore a lowering of artificially high governmentally induced uncertainty.

An equally strong case can be made for evasion of taxes imposed to mitigate costs potentially incurred through the use of specific products or services. Such “penalty taxes” are expected to raise costs for potentially socially harmful behavior and therefore provide incentives to consume substitute goods and services. But history shows that prohibition of goods with genuine demand in the market tends to aggravate the situation and cause problems of much greater magnitude (Thornton 1991). And the same applies to prohibitively high taxes imposed on items such as drugs, alcohol, or cigarettes. Evasion of such taxes, even if they are well intentioned on the part of government, would undermine the risk of organized crime while satisfying true consumer wants.

It should be stressed that evasion of taxes imposed to deter consumers from consumption of certain goods (“bads”) creates opportunity for gains from trade—and trade is a prerequisite for prosperity. It furthermore increases the competitive discovery process (Hayek 1978) through the discovery of means and procedures for unsupervised and unregulated trade, thereby further lowering transaction costs within and across markets. The achievement of free and unpenalized trade also allows for and stimulates increased market allocation of resources to better uses based on consumers’ preferences exercised in action.

CONCLUDING REMARKS

A growing majority views taxation in its true light: coercive and potentially welfare reducing. Arguments relying on magnitude
considerations—i.e., that taxes are on the net disruptive, but small taxes will be less disruptive than others and should therefore be permitted—are shown to commit logical fallacies. When assessing the ethical circumstances of taxation an “all or nothing” approach must be maintained. Something is right or else it is wrong.

Likewise, advocates deeming taxation as legitimate owing its legal status fall into the *petitio principii* fallacy. We must not base an analysis of justness on the presupposition that all legal actions are just.

Taxation cannot, by definition, be based on voluntary interactions. Although tax adherence is improved when taxation serves ends aligned with consumer preferences, the answered question remains: “If taxation served consumer preferences, why would consumers not just pay for the services provided via taxation directly?” The answer is that taxation is a coercive arrangement, which alters the conditions of exchange and severs the link between payment and receipt of goods and services. Distortions must arise—both on goods’ markets faced with direct taxation, and money markets faced with indirect taxation.

Tax evasion is best viewed as a method to substitute coercive interventions for more preferred voluntary transactions. Accepting that preferences are best signaled voluntarily, we advance the literature by demonstrating a previously unaddressed question by critics of tax evasion: How society will efficiently allocate scarce resources under falsified preference signals.

Evasion of taxes serves two ends. First, by removing a coercive action from the market a more natural state of affairs is substituted for an artificially obtained one. The ethical infringements committed via the original taxation are, at least minimally, reverted via evasion. Second, economic efficiency is increased by allocating resources as per revealed preferences. As the use of tax proceeds can only be allocated on presumed preferences (however attained), we argue that economic efficiency must be increased beyond the conventional dead-weight loss analysis as production may proceed more fully aligned with consumer preferences. Lacking a removal or reduction in tax levels, evasion will allow for an at least partial reinstatement of individuals’ rights of association, with resultant improvements in ethical considerations as well as economic efficiency.
NOTES

1. If a good or a service is ever said to compensate a mandated expenditure, it still does not mean that it fits the preferences of the coerced contributors (Kearl 1977). For example, the good that we may give you after we forcibly take $100 from you cannot be said to fit your preferences; otherwise, you would have voluntarily tendered that $100.

2. “Rather than regarding tax evaders as sinners, it might be more accurate to say that it is the tax collectors who sin because it is they who facilitate the taking of property without the owners’ consent” (McGee 1994, p. 17).

3. Such a double standard is also applied in the case of Mafia-type organizations. Anderson (1979) considers it unjust for the Mafia to evade the democratic State’s taxation while it would be just for individual persons to evade the Mafia’s tax system.

4. Also, decreases in the quality of money to the benefit of the government may be considered an inflation tax. Bagus (2009) explores some of the causes and ramifications of a reduction in the quality of money.

5. As quoted in Huerta de Soto (1999, p. 6).

6. One of the most detrimental effects of the inflation tax is to raise individuals’ general time preference scales (Hoppe 2006, p. 36; Hülsmann 2008). As a result, society becomes more present oriented, focusing on consumption at the expense of saving and investment. The detrimental long-term result is a diminished growth rate because of reduced capital accumulation.

7. Just as Hayek (1960, p. 314) noted that a progressive income tax can never be considered neutral, the inflation tax will also impact certain groups more than others. The main difference is that the inflation tax will impair all who are contained within a monetary system in some negative way, while direct taxation schemes will benefit one at the expense of another. Additionally, there are always Cantillon effects whereby the first receivers of the new money benefit to the detriment of the last receivers. The inflation tax is, therefore, highly unequal and redistributive. Allais (1993, p. 331) states that money creation has the same effects as taxes on those whose real income is diminished by the rise in prices.

8. von Mises (1998, p. 412) looks into the different ways that inflation will benefit and harm those who are affected by it depending on which position they are in regarding the inflationary process—the creators or bystanders. More recently, Erosa and Ventura (2002) have found that welfare costs of inflation are substantially higher for low-income
individuals than for their high-income counterparts. This is so because people with low income usually have greater problems avoiding the tax. The rich, by investing a larger portion of their wealth in real assets and proportionately less on consumption spending, are better able to avoid it. Additionally, many of the wealthy are among the first receivers of the new money and may even benefit from the inflation. This contrasts with the conventional result that direct taxes negatively affect high-income individuals to a greater degree than their lower-income counterparts, a result widely studied since Allinghman and Sandmo (1972), Hazlitt (1978, p. 41), and Clotfelter (1983).

9. It is for this reason that the inflation tax is so preferred by governments. In fact, it answers the question that Andreoni et al. (1998) have identified as being as old as taxes themselves, namely, how to maximize tax compliance.

10. While private enterprises have their spending kept in check by the threat of bankruptcy, the government can always compel citizens to accept an inflation tax through legal tender laws (Chodorov 1954, pp. 42–43). Hence, this particular tax has a secondary effect: it allows the government to function with essentially no check on its financial position—it need not worry about personal bankruptcy as it can impose this on its citizens through inflation.

11. Some may argue on utilitarian grounds that the increased “wealth” seemingly created through inflation more than compensates for whatever costs are incurred by this process. Schulak (2009, p. 112) argues that the modern era has bred economists focusing on aggregates when assessing justice, rights, compensation, etc., at the loss of a more individualistic approach. Regarding the extent of an ensuing inflationary bust, Adams (1993, p. 103; 1998, pp. 173–174) outlines how the Roman Empire eventually collapsed, in part, under the weight of its inflationary tax policies.

12. Flanders (1948) makes one such compelling case that ethics and economics must coincide owing their respective subject matter. As economics should, according to him, concern itself with the optimal long-term results, ethics is seen as complementary. However, while early economists would be more likely to call themselves moral philosophers and be attracted to these questions, the more recent breed is inclined to leave ethical issues as subsidiary concerns, at best.

13. Hoppe and Block (2002) demonstrate that a man can only own his physical property, not the market value of it (which is determined by market participants). On the basis of this, one might think that the
example in the text is compatible with libertarian property rights theory. This is not so, however, because it is engendered by coercion and fraud.

14. One pertinent example of a certain ambiguity is the practice of bankers regarding “time deposits.” As time deposits have a term and the saver sacrifices the availability of the money for this term in exchange for interest, time deposits are loans to the bank; they are not deposits. Hence, it is confusing to call them “time deposits.” The clear-cut economic and legal distinction between demand and time deposits becomes blurred.

15. As Block (1991, p. 96) argues when counterfeiting money, as it is essentially impossible to distinguish the counterfeit unit from a legitimate one, the losses cannot be incurred by any one individual, but rather are shared by society.

16. Congressman Ron Paul is of course a counter example to this claim.

17. Goldman (1980) asserts that most would find the unbridled pursuit of profits unethical. Indeed, while most profit-oriented processes are constrained by some factor (i.e., consumer wants, available resources, etc.), the profit garnered through the inflation tax is essentially limitless, establishing it as perhaps the most unethical corrupt profit earning activity one can partake in.

18. Ignoring “off budget” items.

19. Salerno (1999) discusses the propensity for modern wars to be financed through the inflation tax as opposed to direct taxation to make the costs indirect, and hence, less obvious. Hazlitt (1978, p. 39) makes note that government spending expenditures that are met with financing troubles through direct taxation are “almost inevitably” funded through the inflation tax.

20. Roubini and Sala-i-Martin (1992) argue that governments will maximize their tax revenue by repressing financial innovation. By reducing private financial alternatives, an increase in demand for government-issued money results—an increase in inflation tax revenue (or seigniorage) will be obtained.

21. See Rothbard (2009, p. 1249, fn86) for a look at implications of “voluntary” taxation. Block (1991, pp. 93–104) defends the motives of private counterfeiters, while noting the injustices from coercively imposed government counterfeiting. Block has been criticized on this by Murphy (2006), Machaj (2007), and Davidson (2010), and replied in Block (2010a, 2010b).
REFERENCES


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