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Income Tax

The very idea of income tax is so widely accepted that coming out against it exposes a person to harsh criticism for being socially insensitive, intransigent, etc.

Arguments in favor or against income tax tend to be based on reasons of a fiscal nature, on justice, principles of democracy, or healthy economic policy. They should be analyzed on their merit, without assuming that those with different opinions, whether for or against, are blind or evil. Intellectual intransigence should not come into play. I mention this in order to appeal to the objectivity that we all have to some degree, because I am convinced that taxation on income is highly damaging for everyone; for the wealthy, but even more for the poor. Let's remember that, historically, income tax has served to finance the expenses of war and to redistribute wealth; it was not designed to promote economic development or to increase the wealth or total production of countries.

I will expound on some premises, elementary as they may seem:

Man's material standard of living depends on his capacity to consume. In other words, his material standard of living depends on the amount of satisfaction he can obtain from his own work or by exchanging the product of his work (except, of course, gifts, thefts, lotteries, etc.).

A person's capacity of consumption is conditioned by his production capacity and by the production capacity of others. It is clear that in general what is consumed cannot exceed what is produced and, in particular, one person alone cannot exchange more than he produces. In other words, man's standard of living depends on his production.

Daily production capacity (productivity) and, thus, daily consumption capacity are limited by many factors, such as time, natural resources, human physical capacity, etc. These can be increased with education, organization, mechanization, and other factors. Without underestimating the benefits of education and organization, we can say that the greatest increase in productivity is achieved through the use of what we call capital assets; that is, through the use of better tools. For example, transportation by truck instead of carts; land removal with tractors instead of shovels; carpentry with electric instead of hand tools; farming land with tractors instead of oxen, etc. This is what we mean when we talk about using capital assets. They are the product of previous labor that was saved (accumulation of capital). They are not consumed with use, rather the opposite: they are utilized day after day (see note 1).

We can appreciate how capital investment is the main factor in raising productivity if we imagine its absence. Undoubtedly, we would return to a semi-primitive state. Admittedly some people today would not have to return, because there hasn't been enough accumulation of capital for their current condition of poverty to have disappeared.

Investment is necessarily preceded by the accumulation of capital. This happens when a person manages to save, either because his income exceeds his consumer needs or he restricts his consumption in order to save. This accumulation can be private, when people own the fruit of their labor, inventiveness, or initiative. Or it can be entirely or partially owned by the state, obtained through taxes on consumption or income and concentrated in the hands of the state (see note 2).

The urgent need to increase the amount of capital invested per capita (whether state or private) becomes clear when you calculate how much money we need to invest in order to create jobs and increase productivity enough to raise the standard of living of present and future populations.

For example, how much capital is needed to employ a person can be calculated easily: divide the capital invested in each business by the number of workers employed. Although the number is an average and also relative, it is absolutely certain that without this capital you cannot have employment. In general, the higher the average of capital invested per job, the higher the salary. Reality not only confirms this, but logic also explains it. In general, real salaries go up as more value is produced by the worker. For example, in the U.S., the average amount of capital invested per worker is over $20,000. In Guatemala, the average amount of capital invested per worker probably does not reach Q1,000. I believe that the fundamental difference between an underdeveloped country and a developed one lies in the difference in capital invested per capita.

Income tax is really a tax on any income above minimum consumption needs; on income *available to form capital based on saving. As the tax rate gets progressively higher with income, it affects precisely that income most likely to be saved; in other words, income that would be available for investment.*

Clearly, if we consume or tax income available for capitalization, mid-term consumption suffers. However, it is not so much the consumption of people with higher income. They pay the tax not by cutting back on consumption, rather by sacrificing the money that they would otherwise accumulate. It is the consumption of poor people that suffers most, since their capacity to consume depends so much on capital accumulation of those wealthy minorities. Actually, the poorer people are, the more seriously affected they will be.

The future consumption capacity of our people depends on accumulation of capital today. If we tax capital accumulation—instead of taxing our current consumption—we are only postponing the problem, lowering our future capacity for consumption, our children's, our grandchildren's, etc. Ultimately, to sustain government *the only thing we can tax is consumption. What we have to decide is what consumption; today's, to a small degree, or tomorrow's to a much more serious degree?; our consumption or our children's?*

Among the options for financing government are taxes based on everyone's consumption. There is much opposition to taxing consumption: it affects the cost of living, it falls on people of lower economic means, etc.

Just how true is this, and in relation to what era? A good illustration is the carpenter who taxes his own consumption (capitalizes) in order to buy an electric saw. Thus, he will be able to consume more and capitalize more. He was able to increase his future consumption only by restricting his present consumption. This is the way it is with any family, person, or country.

As for hitting hardest those with fewer resources, let's take the example of a 2% tax on all consumption. How much will a person who earns Q180 a year and, therefore, consumes Q180 have to pay? He will pay Q3.60 in a year, or 30 cents a month. Is that too much to ask of a citizen?

That 2% would produce some 4 or 5 times more fiscal revenue (see note 3) than an income tax. The state might capitalize in part through investment in infrastructure, but without *negatively affecting private capitalization*; in addition to and not instead of, without taxing every citizen's private life and creating political weapons.

In conclusion, we can say:

a) Fiscally speaking, progressive taxation does not produce important fiscal revenue because the higher rates fall on a small minority. In effect, it applies low rates to a wide taxpayer base (nonexistent in a poor country), which has the same effect as a tax on consumption.

b) Economically speaking, income tax is levied on the accumulation of capital and, thus, restricts production and consumption. This, in turn, restricts mid-term fiscal revenue (see note 4).

c) As far as labor is concerned, taxing income available for investment restricts the number of jobs and their corresponding salaries.

d) Socially, we have a typical case of the gradual destruction of democracy. Democracy is accepted and justified because it supposedly guarantees equal rights before the law (not economic equality), with no discrimination as to race, religion, poverty, or wealth, etc. With income tax, the dispossessed majority forces a minority to pay a tax higher than one it accepts for itself. For me, it points to the degree of democracy's decadence in the U.S. and England, which is reaching expropriatory extremes.

Let's look at the unequal ownership of wealth and the supposedly inherent redistributive aspect of income tax. Envy towards those who have more is the only reason I can come up with for redistribution: I am sure I would have more, if it weren't for those who have more than I. However, I believe it is neither healthy nor fair to impoverish the poor even more, just so we won't have any rich people (see note 5).

Note 1
Education itself can be seen as a consequence of capitalization, because capitalization liberates people from having to employ all their time to produce what they need just to subsist. What opportunity for education will someone have if he has to work all day and even force his children to work simply to survive? As long as that person, family, or country cannot produce the bare

minimum, it is illusory to imagine having enough time left over every day to study, discuss education, pay teachers, maintain schools, universities, laboratories, etc. Education is necessary to increase productivity, but one must recognize that even productivity is preceded by capitalization.

It is no coincidence that countries with more cultural opportunities are those where productivity is higher.

How many hectares can a doctor of economics plow with oxen instead of a Q3,000 tractor?

Note 2
The theory that the state should own production assets has serious practical drawbacks. The most important is that state ownership removes the incentive for many persons whose greater ingenuity, initiative, entrepreneurship, organization, etc. serve society. It is true that there are other incentives, but it is equally true that this one in particular is eliminated.

(Whether a communist state is desirable or not, is not the topic of this essay.)

Note 3
It is important to note that in countries where income tax produces important fiscal revenue, there is a large tax base, a sizeable middle class. In such countries, there is already a high standard of living. The lion's share of this fiscal revenue represents a sacrifice of income available for consumption. It has the same effect on the consumer as a consumer tax, but at an extremely high cost in bureaucratic management. For example, in the U.S., 80% of fiscal revenue from income tax comes from the 20% minimum rate. The income tax rates above 50% don't even produce 1%. Fiscally, the progression is insignificant. Politically, it's a different story.

Note 4
A country's "tax factory" is its total production. To restrict capitalization of the very "factory" that produces the taxes reminds us of the man who receives an inheritance, then spends his life consuming all his income and capital, without reinvesting in new machines, maintenance, etc. When he dies he leaves his children penniless.

Note 5
Although the following point is beyond the scope of this essay, as well as debatable, it is important to touch upon it, at least superficially.

The theory that supports coercive redistributions (imposed by the majority on the minority) is based on a mistaken assumption: that the income or wealth of some is born of sacrifice by others, that the wealth of some causes the poverty of others. This concept presupposes a fixed amount of income or wealth in the world, which is clearly not the case. The belief is that an exchange will always result in one party gaining at the expense of the other, rather than what really occurs: that both parties have to benefit in order for a free exchange to take place. Mistaken concepts as to how wealth is produced and distributed have distorted understanding to such a generalized degree that it prevents the adoption of sane principles of justice, because we don't understand that the wealthy are not wealthy because the poor are poor. Rather, the wealthy are wealthy because the poor are less poor.

It is also important to mention that there is no such thing as idle money. Admittedly and unfortunately, some capital will flee, but that's a horse of a different color (although the topic always merits consideration). In general, those with income beyond their consumer needs who do not invest it directly, deposit it in banks. At the same time, the banks lend it to be invested in the areas of highest demand. The owner of the money conserves his property in the sense that he can withdraw it. The borrowers use it principally to produce in ways that carry little risk of it being lost or consumed. In other words, it is put to use for society.

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