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Principles of Taxation for Emerging Economies: Lessons from the U.S. Experience

Robert W. McGee

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Principles of Taxation for Emerging Economies: Lessons from the U.S. Experience

Robert W. McGee*

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*Robert W. McGee is a professor at the W. Paul Stillman School of Business, Seton Hall University in South Orange, New Jersey, and is an adviser on tax and trade policy to several governments. He has authored or edited more than 30 books and monographs and has written more than 300 articles and reviews for a variety of scholarly and professional journals. The author would like to thank John Tortora and Vivian Lugo for providing research assistance for this article.
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I. Introduction

All governments need money in order to pay for operations, and they obtain funds through a number of means. Emerging economies are in a unique, perhaps enviable position because they have not built up large, burdensome tax collecting bureaucracies. The tax systems in Western democracies, on the other hand, have become increasingly complex, inefficient, and difficult to manage. For example, tax laws in the United States are passed, later amended, and then amended again. Tax laws often become obscure because the government continually passes new, complex laws. Since laws are easier to pass than to repeal, the volume and complexity of these laws grow each year to the point where the whole tax system is in danger of collapsing on itself.

Emerging economies do not face these problems. They do not have to dismantle old systems of taxation before constructing new systems, but can instead start without the burden of complex, inefficient, and obscure tax laws. They have the opportunity to study existing tax systems, selecting methods that work and disregarding methods that do not. They can learn from the mistakes of Western democracies and can construct tax systems that are simple, efficient, and more equitable.

Constructing a tax system involves more than simply economic engineering, but also involves the development and implementation of philosophical positions. For instance, one revenue raising method may be “better” than another, but not “fairer.” When speaking of “better” or “fairer” tax systems, one leaves the realm of value-free economic analysis and enters the realm of philosophy because value judgments are required to answer questions involving these terms.

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1. See Emese P. Fátyó, Structural Changes in Eastern European Countries -- Case of Hungary, 33 ARTHA VINANA 345, 345 (1991). These countries have built up other systems, however, that require structural changes. Id.
2. This obscurity occurs in many of the tax laws in the United States and other Western democracies. I will say more about this point later.
3. It can be argued that no public finance system based on coercion can be completely equitable because such systems take property without the owners’ consent.
4. Commentators over the years have debated whether economics is a value-free science. See LUDWIG VON MISES, HUMAN ACTION 882-85 (1966). If one’s goal is simply to go from point A to point B, a policy is good if it achieves the goal and bad if it does not. However, simply because an economist states that a policy is good or bad does not mean that the economist forms a value judgment. Instead, the economist only considers whether or not the policy measures up to its stated goal. Value judgments arise only when one asks whether the policy’s goal is worthy in the first place. At this point, the discussion leaves the realm of economics and enters the realm of philosophy.
Moreover, in developing systems of revenue collection, one necessarily utilizes methods that involve more than common notions of taxation. In a sense, all taxation is coercive—some would say theft—because it involves the taking of property without an owner’s consent. Not all methods of raising revenue, however, are coercive. User fees and lotteries, for example, provide governments with a noncoercive means for collecting revenue. These forms are not taxes in a strict sense because they voluntarily transfer funds from individuals to government.

This Article will review tax systems now being used in Western democracies, evaluating their strengths and weaknesses in an attempt to determine the type of tax system that an emerging economy should adopt. This Article does not apply particular systems of taxation to particular emerging economies, but rather recommends systems and principles that all emerging economies can follow when creating a system of revenue collection. Indeed, many of the developed Western countries could beneficially apply the principles developed here, although they would have difficulty doing so because of the entrenched bureaucracies they have built up over the years. Part II of this Article examines attributes common to the means governments utilize to raise revenue, identifying the attributes that are desirable and those that are not. Part III evaluates the major forms of raising revenue, setting forth the advantages and disadvantages inherent in each form. Part IV discusses the need to limit taxation and government spending and examines methods lawmakers can utilize to limit government taxation. Finally, Part V suggests basic principles of taxation upon which an emerging economy can base its system of revenue collection.

II. Attributes of Taxation

Forms of taxation—more properly, systems of public finance—can have many attributes. Tax systems may be based on coercion or voluntary exchange. They may charge high or low rates. They may be based on the ability to pay principle or the cost-benefit principle. Rates may be uniform—the same rate for everyone—or discriminatory. The

6. If taxation is theft, one might legitimately ask whether tax evasion is unethical. Pope John Paul II has stated that tax evasion is a sin, but others disagree. If tax evasion is ethical, should we punish attorneys and accountants who advocate tax evasion because they encourage an action that is ethical? See Robert W. McGee, Is Tax Evasion Unethical, KAN. L. REV. (forthcoming).
7. See infra pp. 83-84.
system may be easy or difficult to administer. Taxes may be hidden or
visible. Taxes may be easy or difficult to collect. Collections may go
into a general fund, or may be earmarked for specific uses. Collections
may produce a steady cash flow or a sporadic, unpredictable cash flow.

The system chosen may produce minor or major distortions to the
economy. The system chosen will inevitably affect competitiveness and
economic growth. Rules may be simple or complex, clear or vague.
They may be stable over time, or may change frequently. The tax base
chosen may be wide or narrow. The system may result in major or
minor effects on behavior and incentives and social harmony. The
system may have high or low administrative costs. Finally, the revenue
raised from a specific tax may at times amount to less than the
administrative costs of collection.

These attributes are not mutually exclusive. Indeed, they coexist in
the tax systems of all Western democracies. This section discusses these
attributes, attempting at times to determine the attributes that are
desirable and those that are undesirable.

A. Voluntary or Coercive

One goal in a liberal democracy is to maximize individual liberty
and minimize the amount of state encroachment on that liberty. One can
apply this philosophy to the means governments use to raise revenue. A
government can raise revenue either through coercion, or through
voluntary exchange. Income, property, and estate and gift taxes.

8. In the United States, one defines the term "liberal" quite differently from how one defines
the term in Europe. In the United States, one might loosely define a liberal as someone who wants
government to interfere with the economy, but not with personal issues. In contrast, conservatives
want government to regulate personal conduct, but not the economy. Authoritarians want
government to regulate both the economy and personal conduct. On the other hand, libertarians do
not want government to regulate anything. Libertarians want to limit government action to the
defense of life, liberty, and property. Liberals advocate protectionism, tariffs, quotas, and wage and
price controls. Conservatives are against these policies. Liberals would repeal sex legislation for
consenting adults, while conservatives would advocate laws prohibiting homosexual conduct, nude
dancing, and so forth. For more on the classification of the political spectrum, contact Advocates

Thomas Jefferson, in his first inaugural address, gave perhaps the best definition of liberal
democracy in the European and nineteenth century American sense of the term. See THE WORLD'S
GREAT SPEECHES 259 (Lewis Copeland ed., 1942). He defined a liberal government as "a wise and
frugal government, which shall restrain men from injuring one another, shall leave them otherwise
free to regulate their own pursuits of industry and improvement, and shall not take from the mouth
of labor the bread it has earned. This is the sum of good government." Id. at 261.

9. See infra pp. 64-69.
10. See infra pp. 69-70.
11. See infra pp. 78-79.
for example, are coercive forms of taxation because individuals cannot choose whether or not to pay. They must pay or face possible punishment. Voluntary forms of revenue raising include lotteries and user fees.\(^\text{12}\) In these forms, the element of coercion is absent.

Some would argue that taxation is not really coercive, reasoning that at some point, voters consented to be taxed. A number of flaws, however, exist in this line of reasoning. First, the voters who consented to be taxed did so in the past. With individual income taxes in the United States, for example, they gave their consent in 1913.\(^\text{13}\) Many of the people who gave consent are now deceased, and others who were alive and of voting age at that time did not give their consent.

Second, it is a fundamental principle of both common law and basic justice that one person cannot be held for the contract of another. Accordingly, even if one views consenting to be taxed as a contract between citizens and the state, this contract is null and void in regard to those who did not consent. Taxation is not noncoercive simply because some voters agreed to be taxed in the past. Thomas Jefferson, in a letter to John Wayles Eppes, elaborated on this point when he wrote, "We may consider each generation as a distinct nation, with a right, by the will of its majority, to bind themselves, but none to bind the succeeding generation, more than the inhabitants of another country."\(^\text{14}\) In a letter to James Madison, Jefferson went further, stating:

> The question Whether one generation of men has a right to bind another, seems never to have been started either on this or our side of the water. Yet it is a question of such consequences as not only to merit decision, but place also, among the fundamental principles of every government . . . no such obligation can be transmitted . . .
>
> the earth belongs . . . to the living . . . 15

Jefferson determined the average life expectancy in his time to be fifty-five years of age.\(^\text{16}\) He reasoned that, because the majority of twenty-one year-olds who belonged to a particular generation would be dead nineteen years after entering into a social contract with the state, the

\(^{12}\) See infra pp. 83-84.

\(^{13}\) In 1913, Congress passed the Sixteenth Amendment to the U.S. Constitution. See U.S. CONST. amend. XVI. This Amendment made income taxation constitutional. See id. Before that time, the government raised needed money through excise taxes and tariffs.


\(^{15}\) Letter from Thomas Jefferson to James Madison (Sept. 6, 1878), in THOMAS JEFFERSON: WRITINGS 959, 959 (1984).

\(^{16}\) Id. at 960.
contract became null and void after nineteen years. This rule applied to constitutions, public debt, and all laws. Every law and constitution expired naturally at the end of that time. Accordingly, a government enforcing a law or constitution beyond nineteen years did so by force, not by right. Following this line of reasoning, one could philosophically argue that laws passed by majorities—or even by unanimous vote—expire after some period of time because one generation cannot bind another.

Another problem regarding the obligation of citizens to the state involves the concept of majoritarianism. Under majoritarianism, if 51% of a population vote in a law, the other 49% must obey the law whether or not they want to do so. Although a basic weakness of democracy, majoritarianism is endured so that democracy can function. It is a pragmatic compromise. If unanimous consent were required for all laws, governments would not be able to pass laws. Simply because a majority passes a law, however, does not mean that the law is noncoercive. In many instances, a large minority disapproves of the law. Furthermore, in representational rather than direct democracies, representatives sometimes pass a law not supported by the majority of citizens. Thus, government is force, regardless of how many individuals voted in favor of a particular law.

Majoritarianism is also associated with the concept of a social contract, the view that a group of people have somehow entered into a contract with the state and that they can bind the entire population. The population gives up a part of its freedom in exchange for certain benefits that the state can provide. Some social contract theorists, such as Hobbes, would argue that individuals give up all their rights in exchange for protection from the state. Others, such as Locke, would

17. Letter from Thomas Jefferson to John Wayles Eppes, supra note 14, at 1281.
19. Thomas Jefferson, in his first inaugural address, made the following point: "Though the will of the majority is in all cases to prevail, that will, to be rightful, must be reasonable; that the minority possess their equal rights, which equal laws must protect, and to violate which would be oppression." The World's Great Speeches, supra note 8, at 260.
20. An advantage of democracy over dictatorship is that, under a dictatorship, one person tyrannizes the other 99.99% of a country's population, while under a democracy, at worst, 51% tyrannize the other 49% of a country's population. See Herbert Spencer, Social Statics 189 (1970). Others might characterize the difference between democracy and dictatorship as the number of feet on one's throat.
22. Id.
argue that individuals give up only some of their rights, and that the individual can reclaim these rights if the state fails to do its job.24

Some commentators would go further asserting that social contracts do not exist, and even if they did, they would not bind anyone who did not agree to their terms. For example, Spooner states that

[t]he Constitution has no inherent authority or obligation. It has no authority or obligation at all, unless as a contract between man and man. And it does not so much as even purport to be a contract between persons now existing. It purports, at most, to be only a contract between persons living eighty years ago. And it can be supposed to have been a contract then only between persons who had already come to years of discretion, so as to be competent to make reasonable and obligatory contracts. Furthermore, we know, historically, that only a small portion even of the people then existing were consulted on the subject, or asked, or permitted to express either their consent or dissent in any formal manner. Those persons, if any, who did give their consent formally, are all dead now. Most of them have been dead forty, fifty, sixty or seventy years. And the Constitution, so far as it was their contract, died with them. They had no natural power or right to make it obligatory upon their children. It is not only plainly impossible, in the nature of things, that they could bind their posterity, but they did not even attempt to bind them. That is to say, the instrument does not purport to be an agreement between any body but “the people” then existing; nor does it, either expressly or impliedly, assert any right, power, or disposition, on their part, to bind anybody but themselves.25

Thus, those arguing that taxation is not coercive because “the people” consented to it stand on shaky ground philosophically. Taxation is coercive whenever it takes people’s property without obtaining their explicit consent.

Some arguing in favor of coercive forms of taxation assert that a government cannot raise the funds it needs through voluntary means. They contend that coercion is necessary for the state to function. While impossible to fully explore this issue within the confines of this Article, a few points should be raised. First, this line of reasoning is pragmatic

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24. See John Locke, Two Treatises of Government (Peter Laslett ed., student ed. 1988). The United States Declaration of Independence reflects Locke’s view that people can replace a government that fails to protect basic rights with one that protects these rights. See The Declaration of Independence (U.S. 1776).

25. Lysander Spooner, No Treason: The Constitution of No Authority 11 (Ralph Myles ed., 2d ed. 1980). Spooner refers to the U.S. Constitution, which was adopted approximately eighty years before he wrote this essay. See U.S. Const.
rather than philosophical or ethical. It basically states that government must use coercion simply because it is the only way to raise needed funds. It does not address considerations of fairness, equity, and property rights.

Moreover, even if one concedes that governments require some level of coercion to raise funds, governments should minimize the amount of coercion utilized. In a free society that attempts to maximize individual choice, lawmakers should reduce coercive taxation wherever possible. For example, lawmakers can reduce the role of government in society by allowing the private sector to perform many of the tasks carried out by government. A government that provides less services needs less revenue to operate. While minimizing the role and size of government is a worthy goal, accomplishing this goal is far from easy. Despite the size of government, the tax system can be used to reduce coercion if voluntary means of raising revenue are used first and coercive methods are only used to satisfy revenue shortages.

Therefore, in a society that values freedom and private property, voluntary forms of revenue raising are superior to coercive forms. If one views government as the people's servant rather than master, lawmakers must minimize coercion and maximize voluntary exchange. Accordingly, forms of revenue raising that do not depend on coercion are preferable to forms of revenue raising that rely on coercion. Where government must provide services, it should first attempt to raise revenue using noncoercive methods. Only where noncoercive means fail to collect adequate revenue should governments employ coercive methods of taxation. Moreover, tax laws that expire after some period of time are preferable to tax laws that remain on the books until repealed. Approval for any law declines with time as a portion of the citizenry dies and new citizens are born. While this requirement would not solve the consent problem completely, it would at least be a move in the right direction.

B. High or Low Rates

A tax system may impose high or low tax rates. High tax rates are a major disincentive to production, savings, and wealth accumulation. For example, a painter in the 90% tax bracket offered a commission

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26. The private sector can perform most governmental functions more efficiently and with less cost, as numerous studies have shown. See James T. Bennett & Manuel H. Johnson, Better Government at Half the Price (1981); Randall Fitzgerald, When Government Goes Private (1988); Robert W. Poole, Jr., Cutting Back City Hall (1980).

27. Marginal tax rates in the United States and countries such as England have reached 90%.
to paint a portrait for $20,000 only keeps $2,000 if she accepts the work. In effect, she has the option of working for below market price or not working at all. 28 In this situation, she will often decide not to work, and no one will ever paint the portrait. On the other hand, if she paints the portrait, she may not declare the income on the commission. In this situation, the high tax rate increases the amount of tax evasion in the economy and decreases respect for the law. 29

High tax rates affect many areas in an economy. For example, high rates in the area of estate taxes discourage savings and investment. When government confiscates 90% of one’s assets at death, one has incentive to immediately spend income when earned, rather than leaving it for heirs. As a result, capital accumulation and, consequently, economic growth and the standard of living decline. Of course, one can give income and assets to children and grandchildren before death. However, this option is not attractive when the government takes a large portion of the gift through a gift tax.

A number of studies have concluded that, while high tax rates retard economic growth, low rates encourage it. 30 When government takes money out of the private sector, individuals cannot invest in business expansion, cannot save, and cannot spend on consumption items. Raising taxes simply redistributes previously created wealth. Thus, if one desires to maximize economic growth, one must, among other things, minimize taxes through lower tax rates.

A relationship also exists between economic efficiency and the tax rate. When rates are high, businesses lose less from a bad investment or more at times. In some instances, rates have exceeded 100%. For example, an individual in the 93% bracket pays more than 100% in taxes when a government assesses a 10% surcharge.


29. The subject of tax evasion presents interesting ethical and philosophical questions. If taxation is theft, no ethical duty exists to pay taxes in the same way no ethical duty exists to turn over your property to a thief. Taxation is similar to theft because in both cases someone takes an individual’s property without consent. However, differences between the two exist. With theft, a robber only steals from an individual once. With taxation, the government continually takes an individual’s property. Moreover, taxation is arguably more akin to slavery because government lives off the fruit of an individual’s continual labor.

The Roman Catholic Church recently issued its first new catechism since 1566. See Sins, Ancient and Modern, ECONOMIST, Nov. 21, 1992, at 50; New Rules for an Old Faith, NEWSWEEK, Nov. 30, 1992, at 71. This catechism lists tax evasion as a sin. Nevertheless, theologians over the centuries have repeatedly said that, at least in some situations, no moral duty exists to pay taxes. See REV. MARTIN T. CROWE, THE MORAL OBLIGATION OF PAYING JUST TAXES (Catholic University of America Studies in Sacred Theology, No. 84 (1944)) (representing one of the most comprehensive treatises on the ethics of tax evasion).

PRINCIPLES OF TAXATION FOR EMERGING ECONOMIES

decision because they can deduct the loss on their tax return. As a result, businesses tend to be less careful about making investments. Furthermore, when high rates combine with a complex tax system, as occurred in the United States before the enactment of the 1986 Tax Reform Act, tax shelters—investments that make no economic sense, but good tax sense—become more prevalent. For example, under a tax shelter scheme that has a 5-to-1 write-off, every $100 investment results in a $500 tax deduction. If the tax rate is 50%, an investor can reduce his taxes by $250 (50% of $500). Consequently, the initial loss ultimately results in a return larger than returns attainable from most legitimate investments that create real economic wealth.

While taxpayers prefer low rates, governments prefer high rates because they are able to collect more revenue utilizing them. Nevertheless, although higher revenue collection may occur over a certain range of rates, it does not occur in all cases. When rates are too high, people change their behavior, and the total revenue generated may actually decline. If the marginal individual income tax rate rises to 100%, for example, individuals do not work at second jobs and refuse to work overtime despite receiving premium pay. In addition, substantial incentive exists not to report income and evade taxes. When the rate is only 90%, the same behavior occurs to a lesser degree. In contrast, when the top rate is 5%, people have incentive to work harder and longer because they are able to keep most earned income. However, a state has difficulty collecting the revenue it needs to pay expenses using a 5% top rate. Accordingly, a government must find the optimum rate between 0% and 100% that maximizes tax collection.

While a relationship exists between tax rates and the amount of taxes collected, a number of problems arise with the “optimum tax rate” approach. First, determining the optimum rate is impossible. Individuals have different preferences that continually change. Some continue to work when government taxes 95% of their income, while others do not. Some work for a few extra hours, while others work longer. Their preferences are not known and cannot be easily measured. Therefore, determining an optimal tax rate involves almost pure


guesswork. Second, one must question whether a government should attempt to extract the maximum amount of taxes from its citizens. If government is the people's servant rather than master, it should not extract the maximum from taxpayers, but should instead provide the most services with the least confiscation of property.

Some have argued that raising tax rates can beneficially affect an economy when the economy is nearing full employment and becoming "overheated." Keynes and others have argued that governments can use fiscal policy—raising taxes—to reduce overheating and ease inflationary pressures. Those supporting this view believe that either excess demand or increasing costs cause inflation. Economists call these two causes "demand-pull" and "cost-push." However, studies over the years have discredited the belief that excess demand or increasing costs cause inflation. Unemployment and inflation can exist at the same time. Substantial evidence suggests that an increase in the quantity of money, not excess employment or low tax rates, causes inflation, a general increase in the price level. Accordingly, those who argue that high tax rates are proper when used to stimulate economic growth or cool an overheated economy stand on shaky ground.

Consequently, low tax rates are preferable to high rates. Low rates result in less distortion to the economy because government takes less


34. At least one economist has stated that "[t]axes are needed not to provide governments with money but to take money away from the public." Richard M. Bird, Tax Policy & Economic Development 4 (1992). This statement seems a bit extreme, even for a Keynesian.

35. For an exposition of this view, see any economic textbook, e.g., LIndert & Kindelberger, International Economics (7th ed. 1982).


38. Under the monetarist view or quantity theory, an increase in the supply of money causes inflation. Under the Keynesian view, excess employment or low tax rates cause inflation. The monetarist view is not new. It has existed for hundreds of years and provides a better explanation for the cause of inflation than other theories. Milton Friedman is one of its strongest modern exponents. See Milton Friedman, A Program for Monetary Stability (1960); Milton Friedman, Essays in Positive Economics (1953); Hans F. Sennholz, Age of Inflation (1979).
money from producers and redistributes less to tax consumers. Moreover, individuals do not squander resources on tax shelters that make little economic sense. Low rates also aid in economic growth because more money is available for investment. Finally, low rates are more equitable than high rates because they involve less confiscation of personal property.

C. Ability To Pay or Cost-Benefit

Two basic and diametrically opposed views of taxation exist: the ability to pay approach and the cost-benefit approach. Under the ability to pay approach, the state is a master who extracts tribute from its subjects on the basis of how much they are able to pay. The state is also a benevolent father figure distributing tax benefits on the basis of need. As Karl Marx wrote, "[f]rom each according to his abilities; to each according to his needs." In contrast, under the cost-benefit approach, the state is the people’s servant. Government provides services to taxpayers, and in return, taxpayers pay for the services. Those benefiting most from services pay the most. Those not using a particular government service do not pay for it.

The ability to pay principle involves exploitation. The government exploits producers, the wealth creators, and redistributes a portion of their income to wealth consumers, those who use various government programs. It is a parasitical system. The cost-benefit principle, on the other hand, attempts to match costs with benefits. Again, those utilizing government services pay for them, and those not using services do not pay.

Problems with both approaches exist. Because one cannot objectively determine someone’s ability to pay, one must arbitrarily decide. Furthermore, one cannot determine the benefit an individual receives from available government services, even when only few people want them, because bureaucratic fiat determines the price of such services, not voluntary exchange.

The U.S. government, for example, would not have punished Leona Helmsley for tax evasion if its tax system was based on the cost-benefit principle. See United States v. Helmsley, 941 F.2d 71 (2d Cir. 1991). The taxes she paid—more than $100 million—far exceeded the benefit she received. In fact, under a cost-benefit system, she would have been entitled to a refund. Nevertheless, because she paid several million dollars less than she "owed" under the ability to pay system and because she used illegal means to prevent the government from assessing the "proper" taxes owed, the government convicted her for tax evasion and sentenced her to prison. See id.

Ross Perot, during a televised presidential debate in October 1992, announced that he has paid a total of $1 billion in taxes in his life time. See The 92 Vote: The 2nd Presidential Debate (ABC television broadcast, Oct. 15, 1992), available in LEXIS, Nexis Library, SCRIPT File. Even if the government provided Perot with a large home, free clothing, and three meals a day, it could not

39. Karl Marx, Critique of the Gotha Program, in THE GREAT THOUGHTS 274, 274 (George Seldes ed., 1985). The original wording was "Jeder nach seinen Fähigkeiten, jedem nach seinen Bedürfnissen." Id. Louis Blanc, the French socialist, essentially used the same words in 1848. Id.

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Accordingly, a tax based on the cost-benefit principle is fairer and, all other things being equal, preferable to a tax based on the ability to pay principle.\textsuperscript{42}

\textbf{D. Uniform or Discriminatory Rates}

A tax system can be structured to have either uniform or discriminatory rates. Three basic options exist. First, governments can utilize a graduated system, a system that takes a larger percentage in taxes from some groups than others. For example, a graduated personal income tax takes a larger percentage of marginal income from those who earn more and a smaller percentage from those who earn less. Such a system might take 10\% of taxable income between $0 and $10,000; 15\% of taxable income between $10,001 and $20,000; 25\% of taxable income between $20,001 and $35,000; and 40\% of taxable income over $35,000. This system can be complex, with ten or more different rates based on income level, or it can be relatively simple, with just two or three rates.

The second option is a tax that has uniform rates. An example of a uniform tax is the flat rate income tax.\textsuperscript{43} Under this system, everyone pays the same rate. If the rate is 10\%, someone with $10,000 in taxable income pays $1,000, and someone with $1,000,000 in taxable income pays $100,000. Accordingly, although every person pays the same tax rate, the wealthy pay more taxes than the poor.

The third option is a tax that charges everyone the same amount, such as a poll or head tax.\textsuperscript{44} For example, if the total cost of providing government services in a particular community is $1,000,000 and 10,000 people live in the community, every individual pays a $100 tax.

A graduated system of taxation is less desirable than a system charging uniform rates or a system charging each taxpayer the same amount for several reasons. First, a graduated system is based on the ability to pay principle rather than the cost-benefit principle because it

\textsuperscript{42} However, it should be pointed out that, under both the ability to pay and cost-benefit principles, government predominantly uses force or threats of force to raise taxes. Accordingly, both entail significant defects. Nevertheless, in choosing between a tax based on the cost-benefit or ability to pay principle, a tax based on the cost-benefit principle is preferable. It at least attempts to match costs and benefits equitably.

\textsuperscript{43} See ROBERT E. HALL & ALVIN RABUSHKA, THE FLAT TAX (1985). Because no tax is neutral, any change in tax policy benefits some and hurts others. See Murray N. Rothbard, The Case Against the Flat Tax, in THE FREE MARKET READER 342 (Llewellyn H. Rockwell, Jr., ed., 1988) (discussing this point as applied to the flat tax).

discriminates against those who earn more. The more one earns, the
more the government takes in taxes. Graduated tax systems are also
more complex than the other systems. As will be discussed below,
simple tax collection systems are preferable to complex tax collection
systems.45 Finally, a number of utilitarian reasons exist for not
utilizing a graduated income tax.46 Most importantly, a graduated tax
system destroys the incentive of the most productive people in an
economy by penalizing them for being productive. Because these are
primarily the people in an economy who save, invest, and create jobs,
a graduated tax retards economic growth by reducing the amount of
capital available for investment.

A tax that charges uniform rates has several advantages over a tax
charging graduated rates. First, while the wealthy admittedly pay more
taxes under a flat tax rate, the tax is at least somewhat more equitable.47
Government does not single out individuals who earn more by forcing
them to pay higher tax rates as their income increases. Second, a flat tax
rate does not penalize the more productive individuals in an economy to
the same extent as a graduated tax. Accordingly, it affects incentives and
capital formation to a lesser extent. Finally, a flat tax rate may decrease
class tension. When all individuals pay the same tax rate, the wealthy
are less likely to complain that they must pay for those unwilling to
work.

A tax charging individuals the same amount is the most equitable of
the three options. This form of tax is based on the cost-benefit principle.
Assuming all benefit equally from government services, everyone should
pay the same amount without regard to income. Otherwise, free riders
and parasites take advantage of the system. This system of taxation is
also the closest approximation to a market system. For example, if one
purchases a loaf of bread in a store, the cashier does not ask what one's
income is before quoting a price for the bread. The price one pays is not

45. See infra pp. 51-53.
46. See WALTER J. BLUM & HARRY KALVEN, JR., THE UNEASY CASE FOR PROGRESSIVE
TAXATION (1953); F.A. Hayek, The Case Against Progressive Income Taxes, FREEMAN, Dec. 28,
1953, at 229.
47. One might argue that the wealthy should pay more than the poor because they have more
property to protect, and one function of government is protecting property. Although seemingly
reasonable, upon close examination, many problems arise in this line of reasoning. For example,
little or no relationship exists between the cost of protecting property and the amount of property
to be protected. Protecting 100 acres of land worth $10,000 may cost more than protecting a bank
vault containing $100 million. See MURRAY N. ROTHBARD, POWER AND MARKET: GOVERNMENT
AND THE ECONOMY 115 (1970). Nevertheless, a flat tax is at least somewhat equitable, whereas a
graduated tax is based on exploitation.
based on a percentage of one's income. The price is the same for all, regardless of income level.

However, the poll tax is not neutral because some people benefit from government services more than others. Furthermore, if everyone received $100 worth of services in exchange for a $100 poll tax, the poll tax itself would be unnecessary. Lawmakers could eliminate the middleman (government) by abolishing the poll tax and allowing individuals to pay for services directly.

Moreover, although a poll tax may be the fairest of the three options, governments have historically had difficulty imposing a poll tax. This difficulty arises because the poll tax is a direct and visible tax, not a hidden one. Thus, people know exactly what they pay in taxes. When a tax is hidden, people are less likely to protest because they do not know exactly what they pay. For example, Margaret Thatcher, Britain's former Prime Minister, triggered vehement public reaction after attempting to impose a poll tax. Those who would have had to pay more under the poll tax protested loudly and, at times, violently. Apparently, irreconcilable conflict exists between fairness and feasibility when implementing a poll tax, especially if some, such as the poor, unemployed, or retired, cannot afford to pay it.

E. Ease of Administration

A tax may be easy or difficult to administer. Needless to say, a tax that is easy to administer is preferable to one that is difficult to administer. While this point might seem obvious, many Western democracies presently impose taxes that are difficult to administer. Complexities have crept into their systems, making tax administration more difficult than it needs to be.

Emerging economies should understand the need for ease of administration and avoid similar problems in constructing their own tax systems. They should not blindly follow the advice of Western tax experts. These very experts are responsible for constructing the overly complex systems that now burden many Western democracies. For example, the Polish government has called upon the U.S. Internal Revenue Service to give advice to Polish economists and tax collectors about the intricacies of the U.S. tax system. To many who are familiar with the needless complexity and unfairness of the U.S. tax

48. See infra pp. 45-46.
system, the thought of the Internal Revenue Service giving advice triggers responses ranging from hilarity to worry, fear and disgust.

F. Visibility

A tax can be visible or hidden. Which possibility is better? That depends on the goals a government pursues. If a government’s goal is to raise maximum revenue with minimum protest, a hidden tax is preferable. An example of a hidden tax is the value added tax. The value added tax is hidden because the people who ultimately pay it, consumers, do not know what amount they pay for the actual product and what amount they pay in taxes. As a result, consumers tend to blame the manufacturer or seller of the product for a high price, when in fact, a significant portion of the price constitutes a tax. Excise taxes on alcohol, tobacco, and gasoline are other examples of hidden taxes. Although the tax may be stated on a receipt, package, or gas pump, consumers, for the most part, ignore this information.

If a government’s goal is to restrain taxation or allow taxpayers to know what they pay for government services, a visible tax is preferable. An example of a visible tax is a user fee. If people have to pay $4 to enter a national park, they immediately know the cost of that particular government service. In contrast, when admission is free, the real cost is hidden. Someone has to pay for maintenance of the park, for the salaries of park employees, and so forth. If government funds these costs through general tax revenues, the general population subsidizes those who use the park for free.

Some taxes are partly visible and partly hidden. For example, in the United States, the government collects personal income taxes by having employers take taxes directly from employee paychecks before an employee even receives his pay. The tax taken is disclosed on an employee’s pay stub, but employees do not feel the full “bite” of the tax because they never actually possess the money taken. The tax would be more visible if employers did not take it from employee paychecks. Employees could pocket their full paycheck and then pay the government the amount owed at a later date. Such a requirement would place more pressure on politicians to keep taxes low because taxpayers would have a better feel for the taxes they actually pay. On the other hand, it would

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50. A value added tax is a tax assessed on a product at each stage of production. For example, if raw materials costing $1 million go in one factory and exit as a semi-finished product worth $3 million, the value added tax will be assessed on the $2 million increase in value. The tax will also be assessed as the product exits other factories on the way to becoming finished.
also increase collection problems because not everyone would voluntarily pay the tax as required.

From a strictly moral or ethical point of view, a visible tax is preferable. Disclosure should be as full and complete as possible. Disclosure is required on corporate financial statements so that investors have information about the stocks they purchase. Product labeling laws force manufacturers to disclose the contents in a package. The law requires bankers to reveal interest charges on the loans they make. In the same manner, people should know what they pay to the government in taxes. When they do not, people are unable to make intelligent decisions at the voting booth.

**G. Ease of Collection**

Governments should utilize taxes that are easy to collect. A government imposing a tax that is difficult to collect must budget large sums of money for tax administration and enforcement. As a result, the tax system becomes inefficient.

Certain taxes are easier to collect because taxpayers are less inclined to resist paying the tax. For instance, low taxes are generally easier to collect than high taxes because individuals are more willing to pay low taxes. Other taxes are easier to collect because taxpayers are unable to avoid paying. Corporate and individual income taxes withheld by employers, for example, are easy to collect because employers collect the taxes before income reaches the hands of employees. Employers then turn the proceeds over to the government.

**H. General Fund or Earmarked**

Governments place taxes into a general fund or earmark them. Taxes placed into a general fund are used for a variety of purposes, while earmarked taxes may be set aside for particular purposes. Governments generally place income taxes, for example, in a general fund. Governments often use gasoline taxes, on the other hand, for the

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51. I do not advocate the use of labeling laws, but merely provide labeling laws as an example. Free speech advocates would quickly point out that forcing companies to disclose the contents of their products violates a company's right to free speech, or the right to refrain from speech. In cases where pharmaceutical companies must reveal the contents of their drug, a possibility also exists that their property rights are being violated because they have a property right in the products they produce.

52. I do not advocate such a means of collection, but merely point out that this approach makes tax collection easier. The fact that this collection approach makes the tax less visible—and therefore less honest—overrides that fact that automatic withholding makes the tax easier to collect.
particular purpose of maintaining highways. Some presently advocate using a portion of cigarette taxes for cancer research.

Whether revenues from a particular tax are placed into the general fund or earmarked for special purposes depends on a number of factors. For instance, the general population may be more willing to accept a tax increase if it is earmarked for a widely accepted purpose. Lottery proceeds used for education are one example. Social Security taxes set aside for taxpayers' retirement are another. Moreover, earmarking tax dollars serves as a good control device to insure that a government actually spends money for its intended purpose. It reduces the possibility that a government will squander money on pork barrel projects.

However, earmarking cannot be used for every government expenditure. Dumping taxes into a common pot gives the government more flexibility to shift spending to needed areas. Accordingly, some balance should exist between the two.

I. Predictability of Flow

Taxes can produce steady, predictable flows of revenue or sporadic, unpredictable flows. Income tax collection, for example, provides a steady and somewhat predictable flow of revenue, although collection can drop during recessions. Lottery revenues, in contrast, can be sporadic and unpredictable. If people unexpectedly stop purchasing lottery tickets, the revenue collected falls.

Taxes that produce steady, predictable flows of revenue are preferable to taxes that produce sporadic, unpredictable flows, all other things being equal. A government relying on sporadic and unpredictable revenue flows may encounter shortages in funds and, thus, has more difficulty operating.


54. The U.S. government does not actually set aside Social Security taxes collected for a taxpayer's retirement. The Social Security Trust Fund is not a true trust fund because those working presently pay into the system and retirees presently draw from it.

55. However, all other things are not equal, and therefore some taxes, although producing sporadic, unpredictable flows of revenue, may be preferable to taxes producing steady, predictable flows. For instance, an income tax is not preferable to a lottery. An income tax involves coercion and the weakening of property rights, whereas a lottery does not.

56. Although resulting in less predictable revenue flows, voluntary forms of revenue, such as lotteries, are preferable in other respects. These forms are more equitable because they rely on voluntary exchange instead of coercion.
J. Economic Distortion

From an economic perspective, the best tax is neutral. A neutral tax allows the market to operate as it would in the absence of taxation. It distorts the economy less, allocating economic resources efficiently by allowing them to gravitate to their most valued uses. A tax that diverts economic resources from their optimum use increases inefficiency and retards economic growth. However, a government must settle for a tax that is less than neutral because there is no such thing as a neutral tax.

High tax rates are generally less neutral than low rates. High rates cause more funds to shift into relatively inefficient paths and cause individuals and businesses to shift resources into areas that produce tax benefits rather than wealth. For example, in the United States, prior to the Tax Reform Act of 1986 (TRA), which lowered tax rates, taxpayers utilized tax shelters to shield income from high tax rates. After the TRA came into affect and tax rates dropped, taxpayers shifted money into taxable investments that produced wealth rather than tax deductions.

Changes in tax law can also significantly distort an economy, as the TRA adequately demonstrates. Many assert that the TRA caused the real estate industry in the United States to go into a depression. As one commentator noted, "In the Tax Reform Act of 1986 . . . legislators could not have done a better job of destroying [the real estate] market if they had consciously set out to do so." The TRA changed tax law in three principal areas that, taken together, deflated the real estate industry almost overnight. It eliminated the capital gains tax rate differential, eliminated the passive loss limitation rules, and lengthened the tax write-off period for real property. These changes destroyed the incentive to invest in real estate, as shown by the decline in housing starts every year since Congress enacted the TRA. From 1986 to 1990, housing starts as a whole declined by 36%, and multifamily housing starts declined by 71%. These decreases sent a ripple effect through the economy and thousands in the construction industry to unemployment lines.

57. VON MISES, supra note 4.
60. Id. at 1.
61. Id.
62. Id.
63. Id.
64. DESTROYING REAL ESTATE THROUGH THE TAX CODE, supra note 59, at 1.
65. The Institute for Policy Innovation estimates that the TRA has had the following effects on
The TRA has also adversely affected the savings and loan industry, which is presently in a highly depressed state. The law requires savings and loans (S&Ls) to invest a certain percentage of their assets into mortgages. After the real estate market depression resulting from the TRA's enactment, the value of these assets significantly declined, sending many S&Ls into technical insolvency. Even those S&Ls not becoming technically insolvent suffered a severely weakened balance sheet position. Further complicating matters, the government insurance fund established to protect investors from losing money in the event of an S&L bankruptcy presently does not have sufficient funds to cover resulting losses. Consequently, taxpayers have had to cover the difference.

As demonstrated by the enactment of the TRA, taxes have consequences. Because neutral taxes do not exist, policymakers should carefully consider these consequences before enacting a specific tax law.

K. Effect on Competitiveness and Economic Growth

Tax policy can negatively or positively affect competitiveness and economic growth. This effect is especially important to emerging economies because the transformation from a centrally planned economy to a market economy entails major shocks to an economic system. As a general rule, emerging economies have difficulty competing with more developed market economies because they do not make the products that developed economies want. In addition, the price is generally too high

the real estate market:

- The TRA reduced the value of commercial real estate by 17%.
- The value of home ownership fell by more than 9%.
- $35.6 billion of the estimated $150 billion S&L bailout cost is attributable to the TRA.
- The capital gains changes in the TRA reduced the value of commercial real estate by 9%.
- Rental costs increased 17.5% because of the TRA's impact on commercial real estate.
- Changes in the capital gains tax treatment, when combined with lower marginal tax rates, decreased the value of an owner-occupied home worth more than $150,000 by between 5% and 6.5%.
- The changes in the treatment of capital gains reduced the value of owner-occupied housing by about $125 billion.
- Approximately $21 billion of the $35.6 billion in S&L bailout costs caused by the TRA are due to the tax changes affecting capital gains and passive losses.


66. Id.
67. The present value of their liabilities rose above the market value of their assets.
68. Id.
or quality too low on the products they do make. Many emerging economies have skilled work forces willing to work at competitive wages, but the system does not allow them to use their skills and energy.\textsuperscript{69} Accordingly, emerging economies must adopt tax rules that foster economic competitiveness, rather than impeding it and that promote, rather than retard economic growth and development.\textsuperscript{70} Additionally, the tax system should encourage both foreign and domestic investment. An emerging economy can significantly relieve shocks resulting from the transformation to a market economy by knocking down trade barriers and importing modern technology. Governments should not penalize foreign companies for investing in the local country. Finally, domestic companies should not encounter domestic tax systems more burdensome than those of other countries.

A number of factors make a tax system more or less attractive to foreign investors. Most importantly, companies are more willing to invest in a country that has low tax rates rather than high ones. A number of studies have shown that, in addition to discouraging foreign investment, high tax rates retard economic growth.\textsuperscript{71} For example, one study concluded that tax increases President Bush signed into law in 1990 have retarded economic growth by 0.7\%, destroyed 400,000 jobs, caused the unemployment rate to increase by 0.45\%, and caused stock prices to drop by 15\%.\textsuperscript{72} It estimated that each 1.0\% increase in the federal tax burden leads to a 1.8\% reduction in economic growth.\textsuperscript{73} Another study of the U.S. tax system estimated that modifying payroll deductions; adopting neutral cost recovery; and eliminating capital gains taxation, the tax on corporate dividends, and the taxation and deductibility of interest would significantly improve the U.S. economy.\textsuperscript{74} Such changes would

\textsuperscript{69} Exceptions exist. Some of the skills acquired by retirees are of little or no use to a market economy. Moreover, in non-market economies, where jobs are guaranteed for life without regard to performance, living under generations of central planning often dampens the work ethic.


\textsuperscript{71} Reynolds, supra note 30.


\textsuperscript{73} Id.

\textsuperscript{74} ALDONA ROBBINS \& GARY ROBBINS, PROMOTING GROWTH THROUGH TAX POLICY (Institute for Policy Innovation Policy Report No. 115, 1992).
increase the economy’s growth rate by 1.1%; increase the gross domestic product by approximately $6.2 trillion dollars between 1992 and 2000; increase the standard of living by approximately 13% between 1992 and 2000; create approximately 4 million jobs between 1992 and 2000; and increase the stock of capital by $10.4 trillion between 1992 and 2000.75

In another study utilizing a model of the U.S. economy that took federal, state, and local taxes into account, researchers estimated that every dollar of extra revenue raised caused production to decline by $0.332.76

Finally, a World Bank study of twenty countries found that nations with lower tax rates had faster expansion in investment, productivity, employment, and government services and had larger growth rates.77

One need not refer to studies, however, to reach this conclusion. Common sense dictates that a government retards economic growth by taking a large portion of a company’s profits through taxes. The more money taken, the less available for investment. Furthermore, when tax rates are high, companies are less careful about how they spend money because whatever they buy is obtained at a large discount. For example, if the corporate tax rate is 60%, the after-tax cost of a $100 business lunch becomes $40 because the cost is deductible.78 If the tax rate is only 10%, however, the after-tax cost is $90. Accordingly, tax rates affect behavior. Low tax rates cause less waste and more efficiency because companies refrain from squandering money when they are unable to deduct large percentages of their costs.

The tax system should encourage capital accumulation. Ideally, it should not tax capital or capital gains. Nevertheless, if a capital or capital gains tax exists, it should have low rates because these taxes tend to retard economic growth.79

L. Complexity

A tax system should be governed by simple rather than complex rules. Simple rules make it easier for taxpayers to understand and, thus, comply with the law. Simple laws are also easier for the government to administer and require the use of fewer economic resources. For

75. Id.
76. James L. Paine, Unhappy Returns: The $600-Billion Tax Ripoff, 59 POL. REV. 18, 21 (1992). Paine points out that, using the 33.2% figure, production in the United States in 1990 was $315.6 billion lower than it otherwise would have been as a result of the tax system. Id.
78. For purposes of this example, we will ignore the fact that some business lunches are only 80% deductible, thus making the 3 martini lunch a 2.4 martini lunch for tax purposes.
79. Skousen, supra note 28, at 170-71.
example, complex rules might require a large corporation to employ 100 college graduates to ensure that the company complies with a tax law. If the tax system is less complex, perhaps ninety of these highly trained employees could be put to work performing activities that create wealth, rather than transferring it.

Many western democracies utilize unnecessarily complex rules to raise revenue. In the United States, for example, tax practitioners and taxpayers must sift through several sources to decipher tax laws. They may consult the Internal Revenue Code and Regulations, which consists of thousands of pages and numerous regulations. They may also consult volumes of tax cases decided in three different federal court systems, as well as Internal Revenue Service (IRS) publications and privately published tax treatises. Even then, answers are not always readily apparent. To make matters more unpredictable, the IRS sometimes issues a tax regulation retroactively. Accordingly, a tax rule issued in 1993 may take effect as of 1981.

Tax rules in the United States are so complex that even IRS agents do not fully understand tax laws. A General Accounting Office report found that IRS agents incorrectly assessed 44% of the penalties issued under the payroll tax rules. Furthermore, complexity is not limited to payroll tax rules. The IRS assessed a total of twenty-nine million penalties in 1990, many of which were later abated.

Emerging economies must avoid creating a quagmire of complex and uncertain regulations. First, any tax system adopted should have built-in safeguards to protect against unnecessary complexity. In Switzerland, for example, federal law limits the amount of words that lawmakers can put into a tax law. Second, emerging economies must

81. Taxpayers wanting to sue in federal courts have three options. They can initiate an action in the District Court, the Claims Court, or the Tax Court. These courts often decide similar or identical tax issues in different manners. Accordingly, a tax court’s stance on a particular issue may dictate where one initiates an action. From these courts, they can appeal to the Court of Appeals, and from there, to the Supreme Court.
83. Paine, supra note 76. The IRS assesses payroll tax penalties against one-third of all U.S. employers each year. Id.
84. Id. at 21-22.
PRINCIPLES OF TAXATION FOR EMERGING ECONOMIES

avoid proliferating rules and regulations. Constructing a tax code of less than fifty pages is not an overly complicated task. Third and finally, governments should only adopt prospective regulations in order to reduce a system's unfairness and increase its predictability.

M. Clarity

When writing tax laws and regulations, governments should utilize clear, easy to understand language as opposed to vague, obscure language. Written laws are easier to understand and, therefore, easier to comply with. They also reduce uncertainty, make planning easier, and reduce the need to hire high-priced specialists, which adds to compliance costs. Although seemingly an obvious point, laws in many Western countries are often vague, especially in the area of taxation.

Money magazine's yearly surveys illustrate the abundance of unclear tax laws in the United States. Since 1987, Money has asked fifty professional tax preparers to complete a federal tax return for a hypothetical family. Each year, the tax practitioners, who prepare these returns for a living, have incorrectly prepared the returns. In 1988, all fifty gave different answers to the same fact situation. The tax liability for the hypothetical family ranged from $7,202 to $11,881. In the 1989 study, the responses were more diverse. Again, the fifty tax practitioners gave fifty different answers. However, in this study tax liability ranged from $12,539 to $35,813. The 1990 study resulted in somewhat more uniform responses. The fifty practitioners again gave fifty different answers, but the Money judges decided that two

85. Courts may hold laws that are unclear and indecipherable void for vagueness. In other cases, courts may hold a law valid, even though the law is extremely vague or obscure. See Note, Due Process Requirements of Definiteness in Statutes, 62 HARV. L. REV. 77 (1948); Toni Kemmer, Note, The Lawson Decision: A Broaderening of the Vagueness Doctrine, 13 STETSON L. REV. 412 (1984) (discussing what distinguishes an obscure law from one that is void for vagueness); Jeffrey M. Evans, Recent Development, 56 WASH. L. REV. 131 (1980).

86. Each year, taxpayers in the United States fill out a tax return that discloses information regarding their income and deductible expenses. They must compute both taxable income and tax liability. Often, they hire a tax professional to complete the return because the rules are too complicated. The tax season generally runs from February 1 to April 15. On April 15, tax returns must be filed with the Internal Revenue Service, unless the IRS grants a taxpayer an extension.

87. Greg Anrig, Jr., Even Seasoned Pros Are Confused This Year, MONEY, Mar. 1988, at 134.
88. Id. at 135.
90. Id. at 111.
91. Id. at 110.
practitioners' answers were close enough to the correct answer to be considered error-free. Tax liabilities ranged from a low of $9,806 to a high of $21,216, with an average of $13,915. The correct answer was $12,038.

Errors again resulted in the next two Money surveys. In the 1991 survey, one practitioner actually determined the correct answer, $16,786. However, the incorrect responses varied widely, ranging from $6,807 to $73,247. In the 1992 survey, none of the practitioners gave the correct answer, even though the practitioners constituted the most experienced group ever participating in the survey. That year, Money magazine instituted a minimum experience requirement of five years. Regardless, answers ranged from $16,219 to $46,564, the correct response being $26,619.

In addition to showing the difficulty tax practitioners have in applying U.S. tax law, the Money surveys revealed the lack of a relationship between the fees charged by practitioners and the quality of performance. The fees charged and time spent varied widely. In the 1990 survey, for example, practitioners charged between $271 and $4,000 to prepare a return and spent from 4½ to over 50 hours to complete it. In the 1992 survey, practitioners charged between $520 and $4,500 and worked between 8 and 70 hours.

IRS employees seemingly do not perform their jobs better than practitioners. A 1987 General Accounting Office (GAO) study of the IRS telephone assistance program found that IRS employees responded incorrectly to 21% of questions asked by taxpayers calling for assistance. Moreover, based on a similar Money survey that asked easier questions than the GAO survey, the IRS accuracy rate declined. In the 1988 Money survey, IRS employees responded correctly to only

93. Id. at 91.
94. Id. at 90.
95. Id.
97. Id.
98. Id.
100. Id. at 89.
101. Id. at 88.
102. Topolnicki, supra note 92, at 90.
103. Tritch & Lohse, supra note 99, at 89.
55% of the questions.\textsuperscript{105} Another \textit{Money} test conducted the following year found that IRS employees responded correctly only 59% of the time.\textsuperscript{106} In later years, the percentage of correct answers increased. In 1990, IRS employees answered correctly 72% of the time.\textsuperscript{107} In 1991, IRS employees answered the questions correctly an astonishing 91% of the time.\textsuperscript{108} In 1992, IRS employees responded correctly 86% of the time.\textsuperscript{109} \textit{Money} attributed these increases to better training of the IRS personnel answering taxpayer inquiries.\textsuperscript{110}

If practitioners and IRS employees cannot correctly apply the law to common tax problems, taxpayers surely cannot expect to do better. Complication is completely unnecessary. A government can devise a simple tax system capable of collecting the same revenue that a complex tax system collects. Accordingly, emerging economies should resist adding complexity to their tax codes.

\textit{N. Stability}

Governments may enact tax rules that remain in effect for decades or change constantly. While replacing or improving bad laws is not undesirable in theory, governments often go beyond mere improvement and engage in unnecessary fine tuning. In the United States, for example, Congress has significantly modified tax laws almost every year since 1981. Few practitioners would argue that these changes have made tax laws easier to comprehend. In many cases, the laws have become more complex and obscure over time. Because tax laws significantly influence business decisions, frequently changing tax laws makes business planning extremely difficult.

Constant change also increases the costs of complying with tax laws because tax practitioners and businesses must spend time and money learning and adjusting to new rules. For example, one study estimated the cost of complying with the 1987 tax legislation in the United States to be $6.2 billion for 1988 alone.\textsuperscript{111} The same study estimated the cost

\begin{itemize}
\item \textsuperscript{105} Id. Actually, IRS employees may perform their jobs in a worse manner than practitioners. \textit{Money} asked each IRS employee only a few questions, while requiring practitioners to determine the answers to many questions in the process of finishing the tax return. \textit{Id.}
\item \textsuperscript{106} \textit{Meet Your Friendly IRS Helper \textemdash If You Dare}, \textit{MONEY}, Mar. 1989, at 112.
\item \textsuperscript{107} Denise M. Topolnicki et al., \textit{Surprise! The IRS Gets More Helpful}, \textit{MONEY}, Mar. 1990, at 97.
\item \textsuperscript{108} Miriam A. Leuchter et al., \textit{The IRS Aces This Year’s Money Telephone Exam}, \textit{MONEY}, Mar. 1991, at 100.
\item \textsuperscript{110} Leuchter, \textit{supra} note 108.
\end{itemize}
of complying with the 1989 changes to be $0.1 billion for 1989 and $5.6 billion for 1990. It estimated compliance costs for the 1990 Budget Accord to be $23.2 billion in 1991 and $10 billion in 1992. Governments must consider such compliance costs before enacting new tax legislation.

Furthermore, frequent tax law changes reduce foreign investment, especially in countries with emerging market economies. Convincing foreigners to invest in an economically unproven country is itself a difficult task. This task becomes more difficult when a country frequently changes its tax laws. Russia is one of several countries that illustrate this point. Russian tax laws are so uncertain and changing that even government officials do not always know what laws are in effect. Moreover, when they know what laws are in effect, they often do not know how to apply them. Such changing and uncertain tax liabilities scare away many potential foreign investors.

O. Tax Base Width

A tax system may have varying tax bases. For example, a system taxing salaries and wages has a wide base, although not as wide as one also taxing individual dividends and interest income. A system also taxing corporate income has an even wider base, although taxing corporate income results in double taxation because, in the final analysis, individuals owning corporation stock ultimately bear the burden of a corporate tax. A sales tax further expands the tax base by taxing consumption, whereas an income tax only taxes production. Adding an inheritance tax widens the tax base even further by taxing the dead.

Utilizing a wide tax base may have several advantages. First, a government that taxes a broad spectrum of its economy may be able to lower tax rates. For example, if a government wanted to raise X amount of money with a tax base that is Y wide, it might need a 20% rate. If the tax base expands to 2Y, the government may be able to raise the same amount of money with a 10% rate. Second, a government utilizing a wide base may be able to reduce its tax system's impact on behavior and incentives. When a government lowers tax rates by taxing more

112. Id.
113. Id.
114. Consumers may also bear some of the burden of a corporate tax, provided the corporation is able to pass on the tax in the form of higher prices. Stockholders also ultimately bear at least part of the tax because corporations use money otherwise available for paying dividends to pay taxes. A corporate tax also retards the corporation's growth rate. This consequence is reflected in a lower stock price.
sectors in its economy, people are more willing to work and invest because they pocket more of the money they make. Finally, a system incorporating a wide base may be more equitable. With a wider base, more individuals within an economy pay taxes. Workers, corporations, investors, and even the dead pay part of the total tax bill.\(^\text{115}\)

**P. Effect on Behavior and Incentives**

Another factor to consider when constructing any tax scheme is its effect on behavior and incentives. When an individual tax rate approaches 100\%, marginal income remains constant and, in some instances, even decreases. People have less incentive to work overtime and to work at second jobs. If taxpayers believe that they cannot keep the fruits of their labor, they will not work. Moreover, individuals will tend to spend, rather than save and invest. Those having money to invest will seek investments in countries with lower tax rates. Finally, taxpayers may view high rates as excessive and unfair and will, thus, be more likely to evade taxes.

Ideally, from a tax collector’s perspective, a tax should have both high rates and no adverse effect on incentives and behavior. In reality, however, no such tax exists. Instead, there is an inverse relationship between tax rates and taxpayer incentives to create wealth. Decisionmakers must consider this relationship when constructing or altering their tax system. If a government’s goal is to increase wealth, decisionmakers can reduce taxes. On the other hand, if a government’s goal is to increase revenue, decisionmakers should perhaps (but not necessarily) raise rates. Despite this inverse relationship, governments in the real world usually want to simultaneously increase both revenue and wealth. Accordingly, a government must strike a balance between raising revenue and economic growth.

**Q. Effect on Social Harmony**

A government should consider a tax law’s effect on social harmony before enacting a tax law. Tax laws can reduce social harmony within a country in several ways. First, a tax law can increase tension between the classes in society. The graduated income tax, for example, is divisive because it forces high income earners to pay what they perceive

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\(^{115}\) I do not advocate adopting such a system, but merely summarize arguments that others have made in favor of a wide tax base. Most taxes in such a system violate property rights, are coercive and retard economic growth. Such a system also increases complexity and shifts resources from wealth producing activities to wealth preserving activities.
as more than their "fair share." Those paying more in taxes feel that they are being exploited by those not working as hard or earning as much money. The graduated tax system further increases class tension by exacerbating the envy that lower income earners already have toward high income earners.

Second, a tax law can reduce social harmony by negatively affecting the economic conditions of a certain group within a country. For example, pension laws in the United States are so complex and the penalties so potentially large that many employers terminate their pension plans, rather than comply with the laws. Such decisions adversely affect hundreds of thousands of employees, many of whom truly need coverage. In the area of defined benefit pension plans, for instance, the law has been devastating. During the early 1980s, between 4,000 and 5,000 employers terminated their plans each year. In 1985, 12,000 employers terminated their plans. In 1989, employers canceled more than 16,000 pension plans, and the number of terminations may be increasing. Between October 1991 and September 1992, 19,390 employers filed termination applications with the IRS. If the IRS accepts these applications, pension and profit sharing plans covering 960,876 employees will be canceled. Because Social Security provides employees little in the form of a pension, these terminations will force employees to find other means to provide for retirement.

Taxes can also reduce social harmony within a country by reducing employment. When a government taxes, it takes money that individuals could otherwise invest and, thus, use to stimulate an economy and create jobs. For example, one study found that a 1% increase in the Colorado State sales tax destroyed as many as 75,000 jobs. Tax increases can also harmfully affect employment by increasing administrative costs to businesses. Productivity is reduced when employers utilize employees

117. Id. at 217, 221; ROBERT SHEAFFER, RESENTMENT AGAINST ACHIEVEMENT: UNDERSTANDING THE ASSAULT UPON ABILITY 177, 186 (1988).
119. Id.
120. Id.
122. Id.
123. Id.
to administer a tax law, rather than to produce wealth. For instance, one study estimated that a law requiring restaurants to collect and report employee income for Social Security purposes caused 72,000 job losses. 125

Finally, the methods a government uses to collect taxes can also decrease social harmony by straining a government's relationship with its people. For instance, in the United States, the IRS, which audits more than one million income tax returns each year, 126 sometimes harasses and verbally abuses taxpayers during an audit. In at least one instance, IRS abuse has driven a taxpayer to suicide. 127 Moreover, the IRS may utilize illegal methods to collect taxes that are not owed. 128 Such practices only increase existing tension between a government and its people.

A good tax collection system incorporates safeguards to minimize governmental abuse of power. At the very least, government officials should not have the authority to confiscate property until a legitimate court finds that a tax is owed. This safeguard does not exist in the United States, where the IRS can confiscate property without a court order and without a hearing of any kind. In addition, the government should have the burden of proving that a tax is owed. In the United States, this burden rests on the taxpayer. Furthermore, in cases where abuse has taken place, governments should fully compensate taxpayers for resulting losses. At present, the U.S. government rarely compensates a taxpayer for his full loss. For example, if the government seizes property worth $100,000 and sells it for $10,000 to satisfy a deficiency, the government will only give the taxpayer $10,000 for her loss, and only if a court determines that no tax was owed. Finally, government officials who abuse their power when collecting taxes should be subject to punishment in order to encourage adherence to the law. In the United States, IRS employees are generally immune from prosecution. Accordingly, they are not punished for assaulting and battering taxpayers, illegally confiscating assets, or harassing witnesses. A tax

125. Taxleads, DAILY TAX REP. (BNA), at H-2 (Mar. 9, 1992) (citing the Employee Policy Institute).
126. Paine, supra note 76, at 21.
127. See GEORGE HANSEN, TO HARASS OUR PEOPLE: THE IRS AND GOVERNMENT ABUSE OF POWER (1984). The decedent's wife then used the resulting life insurance proceeds to beat the IRS in court. Id.
system based on equity and fairness must provide safeguards against such abuses.\textsuperscript{129}

\textbf{R. Administrative Costs}

Governments can construct tax systems with high or low administrative costs. A gap always exists between the funds a tax collects for a program and the amount available for spending on that program because a government must spend some money to administer the tax. Governments can use funds most efficiently by minimizing the "deadweight loss" that its tax laws generate.

When measuring the administrative cost of a particular tax law or system, a government must consider more than governmental administrative costs. It must also take into account the costs taxpayers incur in complying with the tax law or system.\textsuperscript{130} In the United States, for example, a tax law's administrative costs fall predominantly on the private sector. In 1990, the IRS, Treasury Department, and Justice Department spent approximately $6 billion to administer tax laws.\textsuperscript{131} The private sector, on the other hand, spent over $618 billion in the same period.\textsuperscript{132} This amount represents approximately 65\% of the taxes collected in 1990.\textsuperscript{133} A study by the consulting firm of Arthur D. Little estimated that businesses and individuals spent 3.614 billion hours and 1.813 billion hours, respectively, complying with federal tax rules in 1985.\textsuperscript{134} If the average employee works 1,844 hours per year, complying only with federal tax laws would require 2.943 million people working full-time.\textsuperscript{135} Practically every man, woman, and child in a city the size of Chicago, the United States' third largest city, would have to work full-time all year to comply with federal tax laws.\textsuperscript{136} If these individuals charged $28.31 per hour,\textsuperscript{137} complying with federal tax laws in 1985 would have cost almost $154 billion, an amount

\begin{footnotesize}
\textsuperscript{129} It should be pointed out that the U.S. government could eliminate many IRS abuses by abolishing the individual income tax, or by replacing the present complex tax with a flat-rate tax.
\textsuperscript{131} Paine, supra note 76.
\textsuperscript{132} Id.
\textsuperscript{133} Id.
\textsuperscript{134} Paine, supra note 76, at 19.
\textsuperscript{135} Id.
\textsuperscript{136} The population of Chicago in 1988 was 2,977,520. See THE WORLD ALMANAC AND BOOK OF FACTS 1991 557 (1990).
\textsuperscript{137} This figure represents the combined hourly average wage for Arthur Andersen ($35.47) and IRS ($21.14) employees in 1985. Paine, supra note 76, at 19.
\end{footnotesize}
approximately equal to the gross national product of Belgium. 138 This amount excludes the cost of hiring professional assistance. In 1985, these costs equaled $5.8 billion. 139 Combined with the other $154 billion compliance cost, the total costs, $159.8 billion, amount to 24.43% of the tax revenues collected in 1985. 140

Other studies have also estimated the costs taxpayers incur to comply with various provisions of U.S. tax law. One pension actuary estimated that employers will spend over $4 billion in a five year period 141 to comply with employee benefit provisions in the Unemployment Compensation Amendment Act of 1992. 142 This amount constitutes more than twice the amount the government expects to raise from the law. 143 Another study estimated that employers will spend more than $59 billion for the five-year period ending in 1992 to comply with payroll tax rules in the United States. 144 Still another study estimated that taxpayers spent approximately 2 billion hours and $3 billion to fill out federal and state income tax returns in 1982. 145 Tax law changes since that time and inflation would push these costs to over $30 billion annually, assuming the average taxpayer expends time worth $12 to $15 an hour. 146 A General Accounting Office study estimated

138. THE WORLD ALMANAC AND BOOK OF FACTS 1991 690 (1990). Belgium's 1988 gross national product was $153 billion. Id. One should note that this study determined the $154 billion in compliance cost using 1985 dollars. Paine, supra note 76, at 19. If the study had used 1988 dollars, this figure would be slightly higher. This cost also does not include the cost of complying with state and local tax laws.

139. Id.

140. Id.


143. Withholding, supra note 141, at G-4. The actuary estimated compliance cost for a benefit plan to be approximately $1,500 and annual administrative costs to be approximately $1,000. Id. Because approximately 600,000 defined contribution plans and 100,000 defined benefit plans fall within the ambit of this law, the total start-up cost associated with complying would be approximately $1.05 billion. Id. The annual administrative cost would be $0.7 billion, amounting to $4.55 billion over the first five years. Id. The government expects to raise approximately $2.147 billion in revenue over the same period of time. Id. As a result, small employers, who are least able to pay such costs, might decide to terminate plans rather than incurring high compliance costs.


145. Slemrod & Sorum, supra, note 130, at 461.

146. For several reasons, this estimate is conservative. First, the more an individual makes, the more time he is likely to spend preparing a tax return. Thus, the $12 to $15 hourly estimate is somewhat low. Moreover, significantly more individuals pay taxes than paid in 1982. Therefore, more than two billion total taxpayer hours is presently required to file tax returns. Finally, tax laws have become more complicated since 1982. Consequently, taxpayers probably spend more time and more money for professional assistance in preparing returns.
that taxpayers spent 1.815 billion hours to complete the necessary tax return paperwork for fiscal year 1988, although that estimate may be low.\textsuperscript{147} Finally, a U.S. Office of Management and Budget report estimated that the Treasury Department spent 4.27 billion hours in response-time collecting information during the fiscal year 1989.\textsuperscript{148}

The level at which a government collects taxes can also affect administrative costs. In the United States, for example, local governments are often able to utilize a tax collected locally, such as a property tax, almost exclusively to pay for services. Local governments spend perhaps only 5\% to 15\% of the amount they collect on administration. State governments, on the other hand, spend perhaps 20\% to 30\% of the taxes they collect for administrative costs. The federal government incurs even higher administrative costs.\textsuperscript{149} In some federal programs, administrative costs far exceed the amount needed to provide government services. Therefore, it seems that as the distance between the collector and the proceeds recipient increases, the administrative charge increases.

\textbf{S. Cost and Benefit}

Another factor a government should consider when constructing a tax scheme is the relative cost and benefit to the taxpayer. In doing so, a government should take into account more than easily traceable tax-related administrative costs. Administrative costs also cause ripple effects throughout an economy, and a government must consider these resulting indirect costs.\textsuperscript{150}

\textsuperscript{147} U.S. General Accounting Office, Paperwork Reduction: Little Real Burden Change in Recent Years (GAO/PEMD-89-19FS).
\textsuperscript{149} Some states resent paying taxes because they feel they are not getting their money's worth in federal government services. See, e.g., id. (describing New York's resentment). For example, Daniel Moynihan, a U.S. Senator from New York, asserts that New York State residents paid $838 more, per capita, to the federal government than they received in benefits. Taxes Paid Versus Federal Funds Received, \textit{Daily Tax Rep.} (BNA), at H-4 (Aug. 7, 1992). Over a fifteen year period, Moynihan believes that the federal government has "cheated" New Yorkers out of $136 billion. Id.
\textsuperscript{150} See Murray L. Weidenbaum & Robert DeFina, The Cost of Federal Regulation of Economic Activity (1978). These ripple effects are difficult to predict with any degree of accuracy because consumer behavior cannot be predicted. Nevertheless, administrative costs do cause resources to flow in directions different from those that they might otherwise take. For example, if a company must utilize an employee in an administrative compliance capacity, the company cannot also utilize that employee as an engineer. In the long run, demand for administrators will increase, and demand for engineers will decrease. This, in turn, will affect college curriculums. If engineers tend to vacation in Cleveland and administrators tend to vacation...
A government should also insure that a tax law actually increases, not decrease the revenue collected. While seemingly obvious, lawmakers sometimes overlook this consideration when formulating a tax law. Luxury tax laws in the United States provide a good example of such oversight.151 Congress recently enacted a law that places an excise tax on automobiles costing over $30,000 and on other high priced luxury goods, such as boats, airplanes, jewelry, and furs.152 The excise tax has stifled demand for luxury products, forcing many dealers out of business.153 Individuals who formerly paid taxes on income earned through the sale of luxury goods presently collect unemployment insurance or welfare. Consequently, the taxes lost as a result of this law have actually exceeded the taxes generated.154 Notwithstanding this loss, Congress has yet to repeal the tax law because of inertia. Many members of Congress also fear that, by repealing luxury taxes, they would appear to be coddling the rich. In fact, by not repealing these laws, they are destroying working class jobs.

III. Benefits and Disadvantages of the Various Forms of Taxation

Based on the attributes discussed in Part II, this section briefly discusses and evaluates major forms of raising revenue. The forms of taxation examined include the individual and corporate income tax; the property tax; the value added tax; retail consumption taxes; excise taxes; estate, inheritance, and gift taxes; social security taxes; tariffs; and printing money. This section also examines two forms of voluntary revenue raising, user fees and lotteries.

in Miami, the tourist industries in these two locations will also feel the ripple effects. There will also be more demand for air conditioning in Miami (and, consequently, electricity) and less demand for winter coats in Cleveland, which affects the textile industry in North Carolina. The ripple effects on any policy permeate the economy in many, often unpredictable ways.


153. It should be pointed out that this law protects the U.S. car manufacturing industry by increasing the cost on many foreign-made automobiles. The majority of cars sold in the United States costing more than $30,000 are made in foreign countries, although domestic manufacturers are increasingly entering the luxury car market. Thus, the tax law can be used to protect domestic producers at the expense of consumers, who would otherwise pay lower prices.

154. In addition, the law has probably had negative effects on health. Because luxury automobiles tend to be large, increasing the luxury tax will cause some consumers to substitute smaller, less safe automobiles for larger automobiles. Because large cars are better able to withstand an impact in an accident than are smaller cars, the number of fatal accidents may have increased as a result of the luxury tax. The number of auto fatalities caused by the luxury tax is difficult to estimate, but would be a good topic for further research.
A. The Individual Income Tax

The individual income tax is the principal form of taxation most Western countries use. As a general rule, taxes on individual income are undesirable because they dampen incentives to produce and take property without the owner’s consent. They also cause economic distortions by shifting resources as part of the redistribution process. Finally, individual income taxes are harder to collect than other forms of taxation, especially in emerging economies. A system that collects individual income taxes from worker salaries and wages only reaches income derived from the official sector of the economy. Those in the informal sector often escape the tax. Thus, where a large informal economy exists, individual income taxes often fail to tax large segments of the economy.

If an emerging economy chooses to utilize an individual income tax, it should choose the form that is most equitable and negatively impacts its economy to the least extent possible. First, an emerging economy should employ an individual income tax with low rates. High tax rates stifle economic growth more than low rates because they dampen incentives to work, invest, and accumulate wealth. Studies of the U.S. individual income tax system, for example, have estimated that the government loses between $0.24 and $0.47 in production for every $1 it collects in individual income taxes.

Second, it should use a flat rate individual income tax and not a graduated rate income tax. A number of problems exist with the concept of a progressive income tax. First, a progressive tax is based on the ability to pay principle and is, thus, less equitable than forms of taxation based on the cost-benefit principle. Moreover, the progressive income tax is based on the concept of redistribution, a concept that some regard as unethical. Progressive taxation also abuses the concept of redistribution because one cannot objectively compare the utilities of different individuals.

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156. Bird, supra note 34, at 15.
157. Some commentators advocate replacing the income tax with a value added or consumption tax. This article will discuss both alternatives below.
158. In a 1981 study, Jerry Hausman estimated the loss to be $0.287. Paine, supra note 76, at 20. In a 1984 study, Charles Stuart estimated the loss to be $0.244. Id. A 1987 study by Edgar Browning estimated the cost to be between $0.318 and $0.469. Id.
159. See Walter J. Blum & Harry Kalven, Jr., The Uneasy Case for Progressive Taxation (1953).
160. See Bertrand de Jouvenel, The Ethics of Redistribution (1989). Theorists have advocated using a progressive income tax to equalize utilities between individuals. However, as F.A. Hayek and others have asserted, one cannot objectively compare the utilities of different individuals. See, e.g., Murray N. Rothbard, Man, Economy and State 260-68 (1970); F.A. Hayek, The Case Against Progressive Income Taxes, Freeman, Dec. 28, 1953, at 229. Even if one
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majority rule. Under a progressive tax, the majority in a society, lower and middle income individuals, force a minority, upper income individuals, to pay more to the government than they receive back in benefits. Finally, the marginal utility theory dictates that taxes should be regressive rather than progressive. According to this theory, one needs more to encourage a wealthy man to produce than a poor man. Thus, if government desires to stimulate production and create wealth, it should give the wealthy lower rates because the wealthy tend to produce more than the poor.\textsuperscript{161}

In addition to conceptual problems, the progressive income tax negatively impacts an economy to a larger extent than a flat income tax. First, progressive taxes cause substantial administrative costs because they are generally complex rather than simple. Moreover, while all forms of income taxation negatively affect capital accumulation, progressive taxation adversely affects capital accumulation to a greater extent than a flat tax. A progressive tax takes more from those in the population more able and likely to invest. If a government wants to encourage savings and investment\textsuperscript{162} and the wealthy save and invest more than the poor, a tax system should not tax the wealthy more than the poor.

A flat-rate income tax avoids many of these problems\textsuperscript{163}. A flat-tax is more equitable because it is based on the cost-benefit principle rather than the ability to pay principle. Furthermore, a flat tax is generally a simple rather than complex form of taxation. Much of the complexity in the U.S. tax system arises because the system is progressive and attempts to affect behavior by granting deductions and tax credits for a plethora of activities. A simple, flat tax could perhaps eliminate the need for 99\% of the U.S. tax code\textsuperscript{164} and the administrative costs that result.

could do so, equalizing utilities is arguably not a legitimate goal or function of government. Isn’t providing services to its citizens the goal of government? Is taking a larger portion of someone’s property because they have more than others ethical? Does it make any difference whether the taker is a single individual, a group of individuals, or a government?

161. I do not advocate using regressive income tax rates, but only attempt to demonstrate that the marginal utility theory does not support the use of progressive rates.

162. Arguably, encouraging people to invest rather than consume is not a legitimate function of government because government should not tell people what to do with their money.

163. \textit{See} HALL & RABUSHKA, supra note 43 (advocating a flat tax).

164. The amount of the tax code that could be eliminated by adopting a flat tax depends on other changes Congress could make to the system. Congress could feasibly eliminate excise, estate, and gift taxes, as well as the corporate income tax by utilizing a flat tax system. Whether Congress would do so is another question.
Horizontal equity is another advantage of the flat tax. Under the present U.S. system, for example, a person earning $50,000 in wages might pay more in taxes than someone earning $50,000 from investments. A person owning a home might pay less than someone renting an apartment. The system's built-in incentives, deductions, and credits cause these discrepancies and distort an economy. Taxpayers make decisions solely to save money in taxes, resulting in the misallocation of resources. A flat tax eliminates these differences because it taxes a person only on the amount of income earned. The amount one pays is not influenced by where a person derives income, or how a person manages income. Thus, a flat tax does not distort the economy to the same extent as a progressive tax because it removes tax incentives from the system.

A flat tax also eliminates "bracket creep," the tendency of taxpayers to go into higher tax brackets because of inflation, because everyone pays the same rate. Finally, a flat tax eliminates a system's "marriage" tax penalty, in which single individuals and married individuals pay different tax rates.

B. The Corporate Income Tax

Like the individual income tax, the corporate income tax has several negative attributes that make it an undesirable form of taxation. First, the corporate tax is a hidden tax. Unlike individuals, corporations cannot vote, and thus, politicians encounter less resistance when they advocate raising the corporate tax. Nevertheless, only individuals ultimately pay taxes. Accordingly, the corporate tax is hidden because those who ultimately pay it do not know they are paying. In that sense, taxing corporations is dishonest. Assessing a tax on persons who cannot vote also seems unfair because they are being taxed without representation.

Second, the corporate income tax results in double taxation. For example, if a corporation has taxable income of $100 and has a 40% tax rate, those earning the same amount of income pay approximately the same in taxes.


168. When a corporation is able to pass on the tax in the form of higher prices, individuals paying for the corporation's products or services ultimately pay the tax. When a corporation cannot pass on the tax, individuals owning the corporation's stock receive a lower rate of return on their investment because the government siphons off a significant portion of the corporation's pretax profits. Either way, individuals ultimately pay the tax.
rate, it retains only $60 to reinvest or pay dividends. If the corporation pays $60 to an individual in the 40% tax bracket as a dividend, the individual pays a $24 tax and retains only $36. Thus, the government takes $64, or 64% of the corporation’s pre-tax income and gives the corporation’s owner only $36. Yet, the shareholder takes all the risk by making the investment. The government, on the other hand, skims two-thirds of the profit and does nothing to earn it.

Third, the corporate income tax is coercive rather than voluntary in nature. It is based on the ability to pay principle rather than the cost benefit principle. Fourth and finally, the corporate income tax can detrimentally affect economic growth and make businesses less competitive in world markets. Every dollar a government takes in taxes is not available for investment. For example, a 1981 Brookings Institution study of the U.S. corporate income tax estimated that the country lost $1.39 in production for each dollar raised by the corporate income tax. A 1989 National Bureau of Economic Research study estimated that production in the United States dropped between $0.84 and $1.51 for each dollar the government took in corporate income taxes. One economist estimated that the reduced efficiency caused by the U.S. corporate income tax cost the government up to half the revenue actually raised by the tax.

While all corporate income taxes are generally undesirable because they are coercive, are hidden, and retard economic growth, some corporate income taxes are less desirable than others. The U.S. corporate income tax provides an example of a less desirable tax. Taxes charged pursuant to the U.S. corporate income tax are not related to the benefits a corporation receives from government because the tax is progressive. Accordingly, corporations pay higher tax rates as their income increases, regardless of the benefits they receive from production.

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169. In the past, the situation in the United States was worse, with a top corporate rate of more than 50% and a top individual rate of more than 90%. In this situation, the high bracket shareholder receiving a dividend actually keeps approximately 5% of the corporation’s pre-tax income.


171. Paine, supra note 76, at 20.


government. Moreover, most corporations probably do not receive governmental services equal to the taxes they pay because the government tends to hinder business, rather than helping it. Finally, corporations that suffer losses do not even pay taxes, although they still receive government benefits.

The present U.S. corporate tax system also causes administrative difficulties in the private sector. The largest corporations must employ substantial personnel to keep records and compute tax liability. U.S. companies spend more than 500 million hours a year filling out corporate tax forms.\textsuperscript{174} If the average salary of the person filling out a form is $20 an hour, preparing these forms costs corporations $10 billion a year, and these costs constitute only a small percentage of the total cost of tax compliance.\textsuperscript{175}

Commentators also criticize the U.S. corporate income tax because it causes financial distortions to the U.S. economy.\textsuperscript{176} For example, the law favors noncorporate enterprises over corporations, encourages debt financing over equity financing, and favors retained earnings over paying dividends.\textsuperscript{177} Corporations can deduct interest payments, but cannot deduct dividend payments. They can avoid taxes at the shareholder level if they retain earnings, rather than paying dividends. Nevertheless, corporate income tax law may subject small, closely held corporations to an accumulated earnings tax if a corporation does not pay a dividend. A business entity can avoid this tax quagmire by doing business in the form of a partnership. However, doing so exposes partners to unlimited liability and makes raising capital more difficult.

This system encourages corporate executives to make decisions based on tax avoidance rather than sound business practices. As a result, executives allocate resources differently than they would in the absence of such incentives and sanctions. They allocate resources inefficiently and retard economic growth. At least one study has concluded that the corporate income tax is the least efficient major tax.\textsuperscript{178} A Treasury


\textsuperscript{175} A Coopers & Lybrand study of corporations with sales of $25 million or more found that the average company assigns 7.4 people to the state and local tax area and 9.3 people to the federal tax area. \textit{COOPERS & LYBRAND, STATE AND LOCAL TAXES: THE BURDEN GROWS 5} (1992).

\textsuperscript{176} Hallman & Haubrich, \textit{supra} note 174, at 2. These authors evaluated five proposals to reduce tax avoidance costs and financial distortions caused by the present corporate tax system. \textit{See id.}

\textsuperscript{177} Although this article primarily evaluates the U.S. corporate tax, many of the points raised apply to European corporate tax systems. \textit{See JOHN CHOWN, THE CORPORATION TAX -- A CLOSER LOOK} (1965) (evaluating European corporate tax systems).

\textsuperscript{178} \textit{See BALLENTINE, supra} note 173.
Department study concluded that integrating business and income taxes would shift capital to the corporate sector, reduce corporate borrowing, increase dividend payments, and increase the Gross Domestic Product by between $3 billion and $30 billion.\footnote{179}

Consequently, if lawmakers determine that a corporate tax is needed, they should adopt a tax with certain attributes. The system should utilize low rates, should be simple to understand and administer, and the law should not discourage investment, either by foreigners or domestic investors.

\section*{C. Property Taxation}

In the United States, local and state governments predominantly assess property taxes. Real and personal property taxes account for approximately 37\% of state and local government tax receipts\footnote{180} and are a major form of financing local government. Property taxation shares some of the attributes of income taxation. Both are coercive rather than voluntary, take property from owners without their consent, and cause economic distortion.\footnote{181} However, differences between the two also exist.

A significant difference is a property tax's competitive effect. Governments tend to provide services in a monopolistic manner because, in many instances, they alone provide certain services for a geographic area. As with any monopoly, costs tend to be higher and the quality of services lower where no competition exists. When consumers have no alternatives, governments have no incentive to improve the quality of service or cut costs. With the competitive tax effect, governments compete with each other for paying customers (residents who pay taxes). When citizens and businesses in one community determine that they can receive a better deal in another community, they move. This migration depletes the tax base of the community offering less desirable or more expensive services and encourages its bureaucrats to spend less tax dollars more wisely.\footnote{182} This competitive effect also occurs for other


\footnote{180. \textit{COOPERS & LYBRAND, \textit{supra} note 175, at 3. State and local governments obtain tax revenues from the following sources: real property taxes, 22\%; personal property taxes, 15\%; sales and use taxes, 16\%; corporate income taxes, 38\%; and capital-based franchise taxes, 9\%. \textit{Id.}}}

\footnote{181. \textit{See DICK NETZER ET AL., PROPERTY TAX REFORM (George E. Peterson ed., 1973) (suggesting ways to reform the property tax).}}

types of taxes, such as state, individual, and corporate income taxes. For instance, many individuals and businesses move from New York to New Jersey, which lies a short distance across the Hudson River, in order to take advantage of New Jersey’s lower tax rates. Avoiding federal taxes, in contrast, is much more difficult because individuals have the option of either paying the tax or moving to another country.\textsuperscript{183}

Of course, not everyone moves from one community to another in order to avoid high taxes. People sometimes move to a community with higher taxes when they believe that the government in that community provides better services. For example, parents in the United States may move to a new community in order to take advantage of high quality schools financed heavily by local property taxes.\textsuperscript{184}

A number of injustices involving the costs of public education arise from property taxes. Most significantly, all homeowners must pay the tax, even if they do not have children. In effect, they are forced to pay for the education of other people’s children. Moreover, those sending their children to private schools incur the additional expense of private school tuition. Furthermore, the cost of financing education through the property tax is hidden because those using the service often do not know how much it costs to educate their children. They do not realize that sending one child to school costs perhaps $6,000 or more per year because public education is “free.” Without knowing the true cost of the service, parents have little incentive to restrain educational spending.

Finally, even individuals who do not own homes ultimately pay the tax because landlords tack on the property tax to their monthly rental bill. Even when a landlord is unable to do so, a renter still ends up paying the cost of the tax. Landlords who cannot pass on property taxes must absorb these taxes themselves and, thus, have less money available to invest in other apartments. The absorption of costs restrains new housing and increases demand and cost. Landlords also have less to spend for providing essential lessor services, such as routine maintenance. In short, the tenant always pays.

\textbf{D. The Value Added Tax}

The value added tax (VAT), like most other forms of taxation, is coercive. It takes property without the owner’s consent. Nevertheless,

\textsuperscript{183} Actually, U.S. citizens must do more than move to another country to avoid paying U.S. individual income taxes. The United States is one of the few countries that taxes its citizens living outside national borders. Consequently, in addition to moving outside the country, an individual must give up his citizenship to avoid paying individual income taxes.

\textsuperscript{184} The real estate property tax finances a large portion of local school budgets.
if one believes that some takings are better than others, the VAT may be a viable alternative to the income tax. For years, commentators have advocated replacing the income tax with some form of VAT because the income tax discourages production and encourages consumption and leisure, while the VAT encourages thrift and enterprise.\textsuperscript{185} Certainly, if this is so, an emerging economy should consider utilizing a VAT.

Proponents of this tax also contend that the VAT offers several additional advantages over other forms of taxation. For example, proponents assert that the VAT is "neutral" because it charges a uniform rate over the whole consumption base. Thus, the tax system does not affect methods of production chosen, and producers can shift to more profitable methods of production without affecting their tax burden. No penalty results for being efficient.\textsuperscript{186} In contrast, under an income tax, the government penalizes companies that are more efficient and, thus, more profitable with higher income taxes. In addition, proponents contend that, unlike the income tax, a VAT does not subsidize waste. Businesses paying income taxes deduct costs and, thus, can reduce their taxable income. Under a VAT, no such deductions exist.

A definite advantage of utilizing a VAT is that governments can raise enormous amounts of revenue while keeping income tax rates relatively low because the tax base for a VAT is wider than the income tax base. The VAT tax base consists of an economy's total output of goods and services, as well as imports minus exports.\textsuperscript{187} A 3.5\% VAT, for instance, can raise as much revenue as a 34\% corporate

\textsuperscript{185} Murray L. Weidenbaum & Ernest S. Christian, Jr., The Allure of Value-Added Taxes: Examining the Pros and Cons 1 (1989). One must still question whether a tax system should encourage or discourage certain kinds of activity. Many favor using the VAT over the income tax because they believe government should encourage savings over consumption. Is influencing taxpayer behavior a legitimate function of government? If one views government as the servant and taxpayers as masters, one must question whether the servant (government) should really take interest in how his master (the taxpayer) uses his own money.

\textsuperscript{186} However, a study of several countries concludes that, in practice, the VAT is far from neutral in most cases. See Graham Bannock, VAT and Small Business: European Experience and Implications for North America 8 (1986). In fact, because all taxes affect economic growth, the VAT is not neutral. However, predicting where distortion will occur is not easy. While producers technically pay the tax, they can pass its cost on to consumers in the form of higher prices. If producers do not pass on the VAT, profit margins suffer, shareholders receive a lower return on their investment, and employment expands less rapidly. The VAT may also adversely affect some types of business more than others. Accordingly, one cannot truly state that a VAT is neutral.

\textsuperscript{187} Weidenbaum & Christian, supra note 185, at 4.
income tax.\textsuperscript{188} A 16\% VAT can raise as much as an individual income tax assessed at the U.S. rates of 15\% and 28\%.\textsuperscript{189}

Commentators in the United States have advocated employing a VAT to supplement the income tax because they believe that raising more funds through an income tax is not feasible.\textsuperscript{190} In one respect, these commentators are correct. If politicians raise income tax rates beyond a certain point, taxpayers may react by voting the politicians out of office. Politicians can avoid this consequence by using a VAT to raise additional revenue because the VAT is a hidden tax. Those who ultimately pay the VAT do not know how much they are paying.\textsuperscript{191} However, because the VAT conceals its true impact on a taxpayer’s wallet, it is an unethical and dishonest form of raising revenue.

Furthermore, the VAT’s revenue-raising aspect is a double-edged sword. Those advocating low taxes see the VAT as a threat because a government utilizing a VAT can easily raise revenue, or in other words, take wealth out of the private sector. They worry that “instituting a VAT or a retail sales tax would be as risky as turning over the wine cellar key to an alcoholic.”\textsuperscript{192} Moreover, at least one study has concluded that governments are unable to resist raising tax rates once a VAT is in place.\textsuperscript{193} A government’s propensity to raise taxes after employing a VAT may explain why OECD (Organization for Economic Cooperation and Development) countries with a VAT have much higher tax ratios\textsuperscript{194} than those without one.

Computing the correct VAT tax may also be a problem. Basically, a government assesses the tax on the value added to the product, the difference between the value of the product as it comes in the door and

\begin{itemize}
  \item \textsuperscript{188} Id.
  \item \textsuperscript{189} Id. The study involved making these comparisons utilizing the 1987 U.S. tax system. See id.
  \item \textsuperscript{190} CHARLES E. MCLURE, JR., THE VALUE-ADDED TAX: KEY TO DEFICIT REDUCTION? 175 (1987). See also CONGRESSIONAL BUDGET OFFICE, EFFECTS OF ADOPTING A VALUE-ADDED TAX (1992) (considering the relative merits of a VAT as an additional revenue source by comparing it to an income surtax on individuals and corporations). As stated by one commentator, "consumption taxes alone cannot achieve the ability to pay principle and accordingly could not entirely replace an income tax." ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, TAXING CONSUMPTION 32 (1988) [hereinafter TAXING CONSUMPTION]. However, as discussed, the ability to pay principle is not a legitimate principle of taxation.
  \item \textsuperscript{191} The question of who ultimately pays a VAT or other consumption tax remains, and economists have yet to agree on the answer. See David G. Raboy & Cliff Massa, Who Bears the Burden of Consumption Taxes?, in THE VALUE ADDED TAX: ORTHODOXY AND NEW THINKING 39 (Murray L. Weidenbaum et al. eds., 1989).
  \item \textsuperscript{192} MCLURE, supra note 190, at 176.
  \item \textsuperscript{193} BANNOCK, supra note 186.
  \item \textsuperscript{194} A tax ratio is the amount of tax collected as a percentage of taxable income.
\end{itemize}
the value as it goes out. In practice, however, the computation is not that simple. Policymakers tend to make certain items, such as food, exempt. Moreover, classification problems exist because policymakers often assess different rates for different products and services. Pressure also arises to exempt or charge lower rates to governmental units and nonprofit organizations. Producers engaged in both exempt and taxable activities would require apportionment, a process which could become quite complicated.

These and other complexities in the VAT cause significant administrative costs. Governments must employ thousands of bureaucrats to administer a VAT, and businesses must spend considerable time and resources keeping records and filing tax returns. Moreover, governments that use a VAT to supplement an income tax need two sets of bureaucrats to administer both the VAT and the income tax. Businesses paying both a VAT and an income tax must also employ additional individuals to comply with the increased burden caused by the tax laws. Without a VAT, these individuals could spend time creating wealth instead of shuffling papers.

The VAT also has other drawbacks. First, it is regressive because the working and lower middle classes, those least able to pay, give a higher percentage of their income in VAT taxes than those in higher income brackets. Governments can give some relief to these groups by exempting certain items, like food and medicine, but doing so makes the system more complex and difficult to administer. A study of European VAT systems found that the VAT is also regressive in another

195. The author discovered an easy way to evade the VAT at a McDonald's in Paris. The French government charges a VAT on food consumed on the premises, but not on food taken outside the restaurant. Accordingly, one can evade the VAT by telling the cashier that you will eat the food outside the restaurant and then sitting at a table after you have the food in-hand. Catching a VAT evader would require stationing hamburger police at every McDonald's.

196. For example, one would have trouble determining whether an anti-dandruff shampoo is a medicine and, thus, exempt, or a cosmetic and, therefore, taxable. French tax officials engaged in an extensive debate over this issue. See Weidenbaum & Christian, supra note 185, at 5.


199. In England, small businesses complained about the complexity of the British VAT. Prest, supra note 197, at 26. As a result, the British government simplified VAT tax forms. Id.

200. One can make the same argument for abolishing the income tax, which has become increasingly complex. However, a simple, easily administered VAT may be preferable to a complex, burdensome income tax. Regardless, a government should consider simplicity and ease of administration in choosing any form of taxation.

201. However, these individuals ignore the argument that taxes based on the cost-benefit principle are preferable to taxes based on the ability to pay principle.
manner. The cost of compliance and administration falls more heavily on small firms than on large ones. Emerging economies must consider these costs when employing a VAT because most economic growth in an emerging economy comes from small enterprises rather than large ones.

Second, the VAT adversely affects economic growth. For example, one study predicted that each 1% in a VAT would slow growth in the U.S. economy by 1% and would increase inflation by 1.5% to 2% during the initial adjustment period. Third and finally, like many taxes in an emerging economy, a VAT is not easy to collect. Employing a VAT will encourage enterprises to do business in the informal sector of the economy, and an emerging economy will consequently have difficulty collecting the VAT.

E. Retail Consumption Taxes

Governments can levy retail consumption taxes at the national, state, or local level. In the United States, most states levy a retail sales tax on the sale of products but not on services. The federal government does not presently assess a similar tax at the national level, although lawmakers have discussed instituting such a tax to supplement the federal income tax.

The sales tax has many positive attributes. First, unlike a VAT, the sales tax results in relatively low administrative costs. A government requires less bureaucracy and paper shuffling because it levies sales taxes only on the end user. Because it assesses the sales tax only at the final stage of production rather than at every stage as is done with a VAT, administering a national sales tax is less costly than administering a national VAT. Reduced administrative costs are especially prevalent in jurisdictions that already have a sales tax because the administrative mechanism is already in place.

Second, unlike a VAT, a sales tax, whether at the national, state, or local level, is visible. A taxpayer sees the amount he pays in taxes because the government assesses the tax on each purchase he or she makes. Accordingly, taxpayers are more likely to resist tax increases

202. See BANNOCK, supra note 186.
203. Id. at 24-25.
204. WEIDENBAUM & CHRISTIAN, supra note 185, at 10 (citing Joel L. Prakken, The Macroeconomics of Tax Reform, in THE CONSUMPTION TAX: A BETTER ALTERNATIVE? 117 (Charls E. Walker & Mark A. Bloomfield eds., 1987)).
205. TAXING CONSUMPTION, supra note 190, at 68-69.
206. Id. at 99-101.
because taxpayers see and feel the tax. Politicians are also less likely to raise the tax because their actions are immediately visible to the taxpayer.

Third, when a government assesses the tax at the state or local level, as is done in the United States, tax competition often occurs. When neighboring localities or states charge sales taxes, residents tend to shop in the locality assessing the lowest tax rate. For example, a Massachusetts resident living close to New Hampshire will shop in New Hampshire if the state charges no sales tax and Massachusetts charges a high sales tax. If New Jersey does not assess a sales tax on clothes and New York assesses a high sales tax on clothes, New York residents will shop for clothes in New Jersey, even if they must pay a few dollars in travel costs. Furthermore, New Jersey residents who work in New York will wait until they get home to buy clothes.

While most individuals do not spend more than a few hundred dollars at any one time, large out-of-state purchases can significantly reduce state tax revenues. For example, a New York resident purchasing a $10,000 fur coat in New Jersey might save hundreds of dollars in sales taxes. However, this is not the only money New York loses in tax revenue. New York furriers lose income from lost fur sales and, consequently, pay less income taxes to the New York government. Other businesses also lose income and pay less income taxes to New York. For example, those individuals purchasing furs may also decide to buy lunch or go to a movie while in New Jersey. As a result, New York restaurants and movie theaters also earn less income and pay less in income taxes. Finally, local businesses that lose income as a result of high sales taxes may move to the low tax state. Such a migration is increasingly occurring in New York, where high local and state sales taxes have driven many businesses into neighboring New Jersey. Thus, decreased tax revenue caused by tax competition, as well as the public's general resistance to higher taxes, combine to keep sales taxes low.

Another positive attribute of sales taxes is that they charge uniform rates. Each individual, regardless of the income he or she makes, pays the same tax on the purchase of an item. Accordingly, sales taxes do not enhance class tension because the wealthy do not pay a higher rate than

207. See Brown, supra note 182.

208. New York tax officials are so concerned about this phenomenon that they presently record automobile license plate numbers in New Jersey shopping malls to identify New York residents who shop in New Jersey. New York State law requires individuals purchasing out-of-state merchandise to pay a use tax equal to the difference between the tax they paid and the tax they would have paid had they purchased that item in New York. New York residents almost universally ignore this law.
the poor. However, individuals avoid sales taxes when they do not purchase items. Accordingly, because the wealthy tend to spend more than the poor, they pay more in sales taxes despite the uniformity in rates. Economists call these effects horizontal and vertical equity. Taxpayers are treated equally because they pay the same rate. Nevertheless, taxpayers who earn and, consequently, spend more money pay higher taxes.\footnote{Skousen, supra note 28, at 168.}

Taxing sales rather than income may also positively affect the savings rate. When a government taxes individuals only upon purchases, individuals tend to save, rather than consume. If savings increase relative to income, the funds available for investment increase. Consequently, lower interest rates, lower costs of capital, more investment, and, ultimately, increased economic growth and job creation result. This effect does not occur with an income tax because it taxes both savings and investment. Under an income tax, people are more likely to consume because their relative after-tax return on an investment is lower. Studies estimate that a 12\% to 15\% national sales tax in the United States would collect the same revenue now raised by the individual and corporate income tax.\footnote{Id. at 169.}

Other beneficial effects would also result by replacing the U.S. income tax with a national sales tax.\footnote{While this Article uses the United States as an example, the same effects would occur in any country utilizing an income tax.} First, this change would substantially reduce administrative costs. A sales tax is simpler and easier to assess than an income tax because individuals and businesses do not need to file a tax return to pay the tax. Accordingly, individuals and businesses could spend the hours previously used to fill out tax returns on more productive activities, such as creating wealth. Congress could almost entirely scrap the U.S. tax code, and consequently, the multitude of cases, revenue rulings, revenue procedures, and other IRS pronouncements would become irrelevant. Second, replacing the income tax with a sales tax would also significantly reduce government intrusion into an individual’s private life. The government would no longer need to audit tax returns for millions of individuals.\footnote{The IRS audits approximately one million tax returns a year, or slightly less than 1\% of the income tax returns filed in the United States.} This in turn would reduce official corruption and the arbitrary use of power.\footnote{See Burnham, supra note 128 (discussing IRS abuse).}

Despite these advantages, some criticize the sales tax, contending that it is regressive because the poor pay more of their income in sales

\begin{footnotes}
\item[209.] Skousen, supra note 28, at 168.
\item[210.] Id. at 169.
\item[211.] While this Article uses the United States as an example, the same effects would occur in any country utilizing an income tax.
\item[212.] The IRS audits approximately one million tax returns a year, or slightly less than 1\% of the income tax returns filed in the United States.
\item[213.] See Burnham, supra note 128 (discussing IRS abuse).
\end{footnotes}
taxes than the wealthy. This view assumes that the poor tend to spend a higher percentage of their income than the wealthy and that the wealthy tend to save more than the poor. Empirical evidence, however, suggests that the wealthy do not save a higher percentage of their income than the poor. One study found that savings, as a percentage of income, declined for seven of the eleven years examined. Another study concludes that savings, as a percentage of income, remain constant over time.

In addition, those criticizing the sales tax for being regressive generally believe that taxes should be progressive, should take a higher percentage of income from the wealthy than from the poor. They support the ability to pay approach rather than the more equitable cost-benefit approach. Aside from being inequitable, any tax based on the concept of ability to pay exacerbates class conflict and reduces social harmony by pitting the classes against each other. Under a sales tax, the wealthy pay more than the poor in absolute terms because they spend more. The wealthy also receive more benefit from government because they have more property in need of protection. Accordingly, the sales tax operates in a more equitable manner.

F. Excise Taxes

Governments assess excise taxes on many items ranging from alcohol and tobacco products to gasoline, airline tickets, telephones, foreign insurance policies, and oil spills. While similar to a sales tax in many ways, the excise tax is more selective because it focuses on a single item or group of related items. Unlike a sales tax, which assesses the same rate on a broad range of items, an excise tax can charge different rates on different items.

Governments can utilize excise taxes to regulate certain activity. When policymakers want to punish an activity, such as smoking or alcoholic beverage consumption, the ability to vary the rate charged can be useful. Moreover, a government can limit the use of revenue it generates from a specific excise tax to the activity generating the revenue. For example, a government can earmark some excise taxes,

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215. Id. at 113.
216. ALVIN H. HANSEN, A GUIDE TO KEYNES 75 (1953).
218. If the purpose of government is to serve the people, a government arguably should not use the tax system to regulate private behavior by punishing certain activities. Moreover, a government that charges different rates on different products makes a system more complex.
such as gasoline taxes, for highway maintenance and repair, while using other excise taxes, such as tobacco taxes, for cancer research.

Excise taxes possess many negative attributes. They are coercive, violate property rights, distort various segments of an economy, and cause high administrative costs because of complexity. Moreover, certain excise taxes, such as those on alcohol, tobacco, and gasoline, encourage tax evasion and often feed organized crime. Finally, some criticize certain excise taxes such as those on alcohol and tobacco, arguing that the tax falls disproportionately on the poor because the poor spend larger percentages of their income on these products.

G. Estate, Inheritance, and Gift Taxes

Estate, inheritance, and gift taxes are forms of raising revenue that involve the taking of accumulated wealth. Governments levy estate taxes on the estate of a deceased person, inheritance taxes on those who receive the property of a deceased person, and gift taxes on the donor or donee of property transferred before death.

These forms of revenue raising entail considerable drawbacks. First, they are based on the ability to pay principle. Such taxes cannot be based on the cost-benefit principle because the deceased are incapable of deriving benefit from government. Second, these taxes effectively confiscate and reduce wealth, destroying incentive to work, save, and invest. Studies show that the right to inherit is closely linked to savings. For instance, one study suggests that as much as two-thirds of all capital accumulation results from inheritances. Thus, because

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219. Excise taxes reduce output of the taxed commodity and distort the allocation of resources. Income taxes also cause distortion, but in a different manner. Excise taxes generally cause more distortion on the segments of the economy they tax, while income taxes distort a broader tax base. Controversy exists as to which tax is more desirable. See generally Milton Friedman, The "Welfare" Effects of an Income Tax and an Excise Tax, 60 J. Pol. Econ. 25 (1952), reprinted in MILTON FRIEDMAN, ESSAYS IN POSITIVE ECONOMICS 100 (1953); Earl R. Rolph & George F. Break, The Welfare Aspects of Excise Taxes, 57 J. Pol. Econ. 46 (1949).

220. However, this reasoning is based on the "ability to pay" principle rather than the "cost benefit" principle. Moreover, the tobacco and alcohol industries use this argument to protest the imposition of such taxes, which decreases demand and, thus, profits. See Low-Income Individuals Pay Disproportionate Share of Wine Excise Taxes, Study Finds, 150 DAILY TAX REP. (BNA), at D-16 (Aug. 4, 1992).

221. Karl Marx advocated a 100% inheritance tax as a means of destroying capitalism because of its confiscatory effect. See KARL MARX & FRIEDRICH ENGELS, THE COMMUNIST MANIFESTO (1848), in 50 GREAT BOOKS OF THE WESTERN WORLD 413, 427, 429 (Robert M. Hutchins ed., 1952). Equalizing income is not a legitimate goal of government, see generally JOUVENEL, supra note 160, and I do not attempt to argue that it is.

PRINCIPLES OF TAXATION FOR EMERGING ECONOMIES

estate, inheritance, and gift taxes remove the incentive to accumulate wealth, save, and invest, wealth accumulation and, ultimately, economic growth suffer. Third, because many ways exist to avoid paying estate, inheritance, and gift taxes, they do not raise significant revenue. People either place accumulated wealth in areas where government cannot confiscate it, or refrain from saving and accumulating it in the first place. For example, individuals and businesses may take accumulated wealth outside of the country to avoid confiscation.

Emerging economies are least able to afford this dissipation of resources. Indeed, they should consider becoming tax havens, places where people send accumulated wealth to protect it from confiscation, in order to provide needed capital at little cost. The State of Florida, for example, attracts the accumulated wealth of many retirement-age people by not having an inheritance tax. Retirees move to Florida bringing lifetime savings and causing a small boom in the trust and wealth management industries. Accordingly, a government that abolishes these taxes would notice little change in the amount of revenue raised.

Finally, estate, inheritance, and gift tax laws, at least in the United States, are extremely complex. Even tax planners have difficulty shielding clients from tax liability, and courts have heard thousands of cases involving estate, inheritance, and gift taxes over the years. The resources spent administering these tax laws could be better utilized elsewhere.

H. Social Security

Emerging economies wanting to emulate social security systems in Western democracies should first study these systems. Social security is one of the worst investments a country or individual can make. The U.S. social security system illustrates this point well. The U.S. government established social security during the depression in the 1930s to ensure retirement income for individuals. At first, the program had little effect on working individuals because the government took only a small portion from workers' paychecks to finance the program. Employers paid an equal portion. The present-day system, in contrast,

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224. Some commentators even argue that these taxes are "voluntary" because only those not smart enough to plan for their death pay them. STIGLITZ, supra note 223, at 558.

225. Estate of Clayton v. Comm'r of Internal Revenue, 976 F.2d 1486 (5th Cir. 1992) serves as a good example of the complexity of just one estate tax provision.

has expanded to the point where combined employee and employer payments equal approximately 15% of an employee's salary. The amount taken will only increase over time.

A significant part of the problem is structural. The U.S. government does not place the money taken into a trust fund to accumulate until a person's retirement. The government instead takes money from those presently employed to support people who have retired. When those presently working retire, they will have to depend on younger generations for support because the money taken from their paychecks will have already been spent. Since people are having less children, living longer, and retiring earlier, the funds taken from the system will soon exceed the funds being put in. In time, the system will run out of money, and those who previously paid will have nothing for retirement.

The system is also structurally defective because it penalizes those who work beyond the retirement age. Those individuals lose their benefits when they earn over a certain amount. Consequently, the system forces many knowledgeable and productive people into retirement when they could be contributing to economic growth. Aside from structural defects, bureaucrats who control the system have consistently mismanaged it. Despite these problems, lawmakers are afraid to reform the system because they believe that retirees who fear having their benefits cut off or reduced will vote them out of office.

227. In some European systems, combined employer and employee payments constitute a larger percentage of an employee's salary. One individual estimates that, unless significant changes are made, the U.S. government may eventually have to take 40% to 50% of an employee's salary to meet social security obligations. See John C. Goodman, Private Alternatives to Social Security: The Experience of Other Countries, in SOCIAL SECURITY: PROSPECTS FOR REAL REFORM 103 (Peter J. Ferrara ed., 1985).

228. An ethical question exists because government confiscates an individual's property—wages—to pay for another individual's retirement. If government must confiscate an individual's property, it should set aside the property for that individual's retirement, rather than utilizing it for those who have already retired. Moreover, one must ask whether forcing citizens to save is a legitimate governmental function. Many have concluded that it is not. See, e.g., MILTON FRIEDMAN, CAPITALISM & FREEDOM 187-89 (1962).

229. In addition, intergenerational conflict will result as young people are forced to support the elderly. See GENERATIONAL ACCOUNTING: KNOWING WHO PAYS, AND WHEN, FOR WHAT WE SPEND (1992), reviewed in Susan Lee, Tax-System Troubles, WALL ST. J., Apr. 28, 1992, at A18.


An alternative to government involvement is the fully privatized social security system. Several benefits result from such a system. Most importantly, money taken from employee paychecks is set aside and invested. These funds are placed into an investment vehicle that grows over time, such as stocks, bonds, or mutual funds. Those contributing accumulate wealth and have property rights in the accumulation. The whole economy benefits because the capital available for borrowing and investment grows, reducing interest rates and making borrowing easier. In short, a privatized system fosters economic growth and creates jobs. A privatized system has a simple psychological benefit as well. Workers do not have to worry about supporting themselves upon retirement.

I. Tariffs

Prior to utilizing income taxes, the U.S. government primarily used tariffs to raise revenue. Presently, the government uses tariffs more to protect domestic industry from foreign competition than to raise revenue. The government would probably better serve the vast majority of the public by abolishing all tariffs.

A principal problem with tariffs is that they raise the price consumers must pay for imported products and, thus, decrease the standard of living. Various studies estimate that trade protectionism in the United States costs perhaps $65 to $80 billion a year. Protectionism also destroys more jobs than it creates and is, therefore, especially harmful to an emerging economy trying to expand employment. Finally, protectionism enhances tension between different groups. It pits consumers, who want low prices and high quality, against producers, who desire government protection from foreign competition. It also pits domestic industries against each other. For example, the steel industry may want tariffs to stem the flow of cheap foreign steel into the country.

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234. Under the present U.S. system, in contrast, the government does not pay money taken from a deceased worker’s pay over the years to the worker’s heirs. Moreover, because social security payments stop when a person dies, no wealth accumulation can result.

In contrast, the auto industry may not desire tariffs so that it can keep its own costs low by buying cheap foreign steel.236

J. Printing Money

Printing money is one of the easiest methods an emerging economy can use to raise revenue. It is also one of the most harmful.237 Most importantly, printing money leads to inflation, alters behavior, and causes distortion in the economy.238 The price mechanism, which acts as a signalling device for the communication of information, cannot adequately function when prices are continuously rising. Moreover, foreign investors hesitate to invest in countries with high inflation rates because inflation increases uncertainty. Finally, inflationary expectations cause people to spend, rather than to save and invest, and are thus especially counterproductive in an economy that needs growth. While some economists contend that a stable rate of inflation fosters sound economic decisionmaking,239 others argue that zero inflation,240 or even a gently declining price level,241 promotes better economic decisionmaking.

Economists have proposed indexing242 to neutralize the inflation tax, and several countries have tried this method with varying degrees of success.243 However, indexing does not stop inflation or the accompanying misallocation of economic resources because an increase in the supply of money causes inflation. Others have proposed privatizing the money supply as a long-term solution to inflation.244 Privatizing the money supply stops inflation dead in its tracks and takes away the governmental monopoly on money.245

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238. Using inflation to raise revenue is also a dishonest form of taxation because it raises revenue without corresponding legislation.
242. The consumer price index or some other index could be used for this purpose. If the index rises by 5% in a given year, the amount of taxable income in each tax bracket also goes up by 5%.
245. Space does not permit a full discussion of these effects. Nevertheless, a few points can be made. In most countries, money is a government monopoly. As is the case with all monopolies,
This solution is especially enticing for an emerging democracy whose currency is not recognized beyond its own borders. Privatization can fill the void that currently exists for a stable currency in some emerging economies. Privatizing the currency in a Western democracy, on the other hand, might prove more difficult because its currency might already be widely accepted beyond its borders. Accordingly, people will probably have little or no need to change the currency because they do not have problems using it.

K. User Fees

User fees are fees the government charges for using a government service or government property. Examples of user fees include governmental electric, gas, and water company charges; subway and bus fares; garbage collection fees; admission fees to public zoos, parks, and museums; turnpike tolls; and gasoline taxes. User fees are fairer than most forms of taxation because they link cost to benefit. Those actually using the service pay for it, while those not using the service do not pay.

A government can utilize user fees to finance many of the services historically paid for through general tax revenues, such as public education. In the United States, property owners and, to a lesser extent, income earners pay for public education whether or not they have children. When a government finances education through user fees, individuals with children alone pay for the costs of educating their children.

User fees could also be utilized to provide fire fighting services. In some U.S. communities, for example, residents subscribe to a local provider for fire protection. In the event of a fire, these residents call the fire prevention agency, which extinguishes the fire free of charge. Individuals who do not subscribe may also obtain protection, although they must pay a premium when they use the service. In many instances, these fire protection agencies provide services more efficiently and at a

the absence of competition results in higher prices and lower quality than would be the case under competitive conditions. Privatizing money—allowing private suppliers to supply it—enhances the quality of the money supply. In all likelihood, private money would be backed by some commodity (as it has been historically) that would reduce or eliminate the possibility of inflation.

246. See G.J. ROTH, A SELF-FINANCING ROAD SYSTEM (1966). Arguably, the government should not regulate these activities because the market—private companies—can provide these services at a lower cost and in a better manner. See POOLE, supra note 26; FITZGERALD, supra note 26; BENNETT & JOHNSON, supra note 26.

247. See FITZGERALD, supra note 26; E.S. SAVAS, PRIVATIZING THE PUBLIC SECTOR 95-96 (1982); POOLE, supra note 26.
lower cost than governmental fire fighters. Moreover, homeowners using this service often pay lower fire insurance premiums.

The legal system is another area that can operate on a user fee basis. For instance, in the United States, the American Arbitration Association and other groups settle disputes faster and cheaper than the government court system. Moreover, many advocate establishing competing private police forces to which consumers could subscribe as they now do for private fire protection. In fact, some police forces are already privatized. Many companies presently employ private security guards to protect company property.

L. Lotteries

In one sense, lotteries are the most desirable form of taxation because they entail no coercion. Government doesn’t confiscate property or force one individual to pay for another’s benefits. Moreover, lotteries are generally simple and easy to administer. Several states in the United States use lotteries to raise substantial revenue. For instance, Florida raises more than $2 billion a year utilizing a lottery. An emerging economy that limits spending and privatizes wherever possible may be able to eliminate coercive forms of taxation by raising revenue solely through lotteries and user fees.

M. Capital Gains Taxes

Governments assess capital gains taxes when certain assets are sold at a “profit.” For example, an individual or corporation that buys 100 shares of stock in 1975 for $1,000 and sells the stock in 1993 for $1,500, makes a $500 “profit” on the sale. If the capital gains tax is 30%, tax liability is $150 (30% of $500).

Capital gains taxes have many serious shortcomings. First, most capital gains taxes do not take inflation into account in determining whether a profit has been made. In the previous example, if the rate of inflation between 1975 and 1993 was 300% (a rate that is much lower than what has occurred in many emerging economies), the purchasing power of $1,000 in 1975 dollars is equivalent to $3,000 in 1993 dollars. Hence, the owner of the stock incurs a real loss of $1,500 upon sale of

248. See POOLE, supra note 26, at 51-61; FITZGERALD, supra note 26, at 93-119.
250. Some do not favor using lotteries to raise government revenue because lotteries involve gambling and are, thus, seen as immoral.
the stock. This amount equals the difference between $3,000 and the $1,500 received on the sale, both measured in 1993 dollars. Therefore, the stockholder must pay a capital gains tax on the $500 "profit," although a real loss of $1,500 actually occurred. This result is unfair because the taxpayer loses twice, once when he sells the stock at a real loss and again when he pays a tax on a gain that he never realized.

Second, high capital gains tax rates retard economic growth because money taken in a capital gains tax is not available for further investment, and investment leads to industrial expansion and job creation. For instance, industrial countries that generally have high economic growth rates, such as Germany, Japan, the Netherlands, and Italy, either exempt capital gains from taxation or have a very low capital gains tax rate. In contrast, industrial countries that generally have low rates of economic growth, such as Great Britain, Canada, and the United States, have high capital gains tax rates.  

Third, capital gains taxes create administrative costs in both the public and private sectors. Fourth and finally, other more desirable forms of taxation, such as the income tax or value added tax, can raise almost as much revenue as the capital gains tax. A study by the National Bureau of Economic Research, for instance, found that the U.S. government would realize slightly more revenue in the absence of a capital gains tax because of the Laffer Curve effect. Hence, to remain competitive and to enhance economic growth, an emerging democracy should not tax capital gains.

IV. The Need To Limit Taxation

Governments should eliminate taxation wherever possible. When a government taxes, individuals have less money to spend and, thus, have a lower standards of living. Moreover, higher taxes leave less money for savings and investment. If a government absorbs money otherwise available for savings and investment, businesses do not have the funds needed to invest and grow. Finally, decreasing the funds available for spending, savings, and investment causes interest rates to rise. Given these effects, governments should utilize revenue raising methods that limit taxation.

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252. Skousen, supra note 28, at 170-71.
253. Paine, supra note ’76, at 20-21 (study conducted by Roger Gordon and Joel Slemrod in 1983).
A. Tax Limitation Methods

Many tax limitation methods have been proposed in the United States and other countries. The main methods proposed and/or tried are the balanced budget amendment, the line-item veto, supermajority requirements, referendums, sunset provisions, stating an upper limit in the constitution, and privatization. An emerging democracy should utilize the methods best suited for its particular situation.

1. Balanced Budget Amendment.—A balanced budget amendment added to a country’s constitution slows government growth. This option, however, is not always feasible. For example, the U.S. Congress has been unwilling to implement a balanced budget amendment, although most state constitutions already utilize this method of tax limitation. Additionally, countries lacking a written constitution, such as Great Britain, are also unable to employ a balanced budget amendment as a means of curbing government taxation.

2. Line-Item Veto.—The line-item veto acts as a spending restraint. In the case of the United States, Congress often combines several proposals into a single bill that the President must either sign or veto. Congressional members sometimes insert unpopular and otherwise unacceptable provisions into a piece of legislation. Although the bill may contain unacceptable provisions, the President must sign the bill if he wants other needed provisions to be implemented. The line-item veto would allow the President to reject specific proposals within a piece of legislation. Hence, the President could exercise spending restraint when Congress is unwilling or unable to do so.

3. Supermajority Requirement.—A supermajority requirement requires more than a 50.001% majority vote to pass a bill into law. Various supermajority vote proposals have been suggested in the United States, but none have passed perhaps because Congress does not want to give up some of its power. Establishing a supermajority requirement, at least for spending bills, may be feasible in an emerging democracy where political power is less secure.

As the percentage requirement increases, it becomes more difficult to raise taxes and to increase spending. Therefore, there are several options to choose from. For example, a constitution might require a two-thirds vote for passage of a spending bill and a three-fourths vote for raising taxes. Perhaps a simple majority would be required to reduce taxes or repeal a law. Any of these combinations could be added to a country’s constitution.
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4. **Referendum.**—A referendum submits to popular vote any measure that seeks to raise taxes. Because the voters themselves approve all tax increases, legislative representatives are unable to clandestinely raise taxes. Although a referendum requirement presents some administrative problems, it seems to restrain governmental power to tax and spend.

5. **Sunset Provisions.**—A sunset provision places a time limit on the validity of a law. Laws are easier to enact than to repeal. Sunset provisions that limit the applicability of a law to five years, for example, make it easier to repeal laws that are unpopular or no longer carry out their intended purpose.

6. **Stating an Upper Limit in the Constitution.**—An upper limit in a country’s constitution prohibits taxation above a certain percentage and, thus, limits government taxation. For example, a constitution can prohibit taxing more than 25% of an individual’s income. However, lawmakers may attempt to circumvent a constitutional provision by enacting other taxes, such as a VAT or sales tax. Accordingly, a government must carefully word a provision to eliminate such legislative maneuvers.

7. **Privatization.**—Privatization reduces the need for taxation. Empirical evidence suggests that the market can provide most services to the public at a lower cost than the government.254 The worldwide movement toward privatization of government services provides numerous examples of this phenomenon.255 Municipal solid waste disposal costs 61% to 71% more when done by government.256 Over the same time period and under similar conditions, 68% more U.S. government employees are needed to remove 21% of the amount of railroad track that private sector employees can clear away.257 Private companies charge 25% less to build a prison than the U.S. government

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254. Contact the Local Government Center, c/o Reason Foundation, 3415 South Sepulveda Boulevard, Suite 400, Los Angeles, CA 90034 USA, to obtain case studies that support this view.
256. SAVAS, supra note 247, at 93; see also Barbara J. Stevens, Solid Waste Management, in PRIVATIZATION FOR NEW YORK: COMPETING FOR A BETTER FUTURE 215 (1992) (Contracting out waste disposal to private companies saves between 22% and 30% in costs.).
257. FITZGERALD, supra note 26, at 17. Fitzgerald found that 77 private railroad employees could remove 344 miles of track in the same amount of time that it took 129 Amtrak employees to remove 71.8 miles of track. Id.
Moreover, they can do it in less than one year, compared to the five years needed by the government. A study of 121 cities in the Los Angeles County area found that contracting out street cleaning to the private sector saved an average of 43% in street cleaning costs. The cost savings in the following other areas are also substantial: 73% for janitorial services, 42% for refuse collection, 56% for traffic signal maintenance, 96% for asphalt overlay construction, 40% for grass maintenance, and 37% for street maintenance. Private fire companies respond quicker to fires and cost approximately half as much as government fire departments. Other examples include police protection, the legal system, emergency ambulance service, leisure and recreational services, transit systems, social services and health care, planning and zoning, public works, and city management.

In terms of total cost, perhaps the largest potential savings from privatization occurs in the area of education. Financing public education constitutes a major expenditure of government, especially in Western democracies, which have small government sectors. Moreover, privatizing education improves the quality of education provided. For example, a New York State study reached the following conclusion:

Although the goal of educational choice is to give our children a better education, [privatization] would also eliminate stultifying and expensive educational bureaucracies and may yield significant savings. While these are very difficult to estimate, some proponents reason as follows: Superior education is achieved in private schools

258. Id.
259. Id. Private companies are also able to operate prisons at less cost and to provide higher quality services. See CHARLES H. LOGAN, PRIVATE PRISONS (1990).
261. Id.
262. Id. at 122; FITZGERALD, supra note 26, at 72, 75-79.
263. POOLE, supra note 26, at 37-50.
264. Id. at 51-61.
265. Id. at 79-87.
266. Id. at 99-109.
267. Id. at 110-125.
268. POOLE, supra note 26, at 126-35.
269. Id. at 136-46.
270. Id. at 147-57.
271. Id. at 158-71.
272. As countries in the former Soviet bloc convert to market economies, they are rapidly changing their educational systems. See, e.g., EMESÉ P. FÁYNÉ, ENLARGEMENT OF EC: CASE OF AUSTRIA AND THE HUNGARIAN ATTITUDE 7-8 (1990) (presented at the Second Integration Symposium, Confederation of European Economic Associations, Lille, France).
where the per-pupil cost is less than half the cost in public schools. New York spent $7,338 per pupil in 1989. Therefore, if the national experience can be replicated in New York, per-pupil expenditures could be less than $3,700. Even if one inflates this figure by fifty percent, it still amounts to saving of $1,834 per student. For New York City alone, the savings could be $1.7 billion. For the entire state, with 2.57 million students, the saving could amount to as much as $4.7 billion.\textsuperscript{273}

A number of reasons for the lower cost exist, the primary reason being simply that different structures produce different results. The government has a near monopoly in providing education and, thus, provides services like a monopoly. The quality of service is low and the cost higher than what exists under competitive conditions.

Costs in providing public education have risen faster than inflation,\textsuperscript{274} yet student scores on standardized tests have declined.\textsuperscript{275} Between 1970 and 1990, the cost per pupil increased by 489\% , while inflation was 213\% — a real increase of 88\%.\textsuperscript{276} In some school districts, less than half of those on the payroll actually do any teaching.\textsuperscript{277} In contrast, at many private schools, more than 90\% of those on the payroll are teachers.\textsuperscript{278}

A New York City Comptroller study\textsuperscript{279} found that, while educating one severely handicapped student in a government school cost $6,196, it cost private schools under contract with the city government $4,730.\textsuperscript{280} The difference in cost equals a savings of $1,466, or 24\% using the government school cost as the base.\textsuperscript{281} A New York State Senate study determined the total cost in 1990 of educating one student in a public school to be $4,929, approximately twice the cost of educating a student in a Catholic school.\textsuperscript{282} The cost of educating a student in Boston rose from a little over $1,000 in 1971 to $4,000 in

\begin{thebibliography}{99}
\bibitem{274} POOLE, \textit{supra note 26}, at 173.
\bibitem{275} GOODMAN, \textit{supra note 260}, at 123. \textit{See also} Chubb & Moe, \textit{supra note 273}, at 109, 115-19.
\bibitem{276} Chubb & Moe, \textit{supra note 273}, at 111.
\bibitem{277} GOODMAN, \textit{supra note 260}, at 123.
\bibitem{278} POOLE, \textit{supra note 26}, at 179.
\bibitem{279} OFFICE OF THE COMPTROLLER, \textit{POLICY ANALYSIS OF THE COST AND FINANCING OF SPECIAL EDUCATION TO HANDICAPPED CHILDREN IN NEW YORK CITY} (1978), cited in SAVAS, \textit{supra note 247}, at 115, n.44.
\bibitem{280} SAVAS, \textit{supra note 247}, at 102.
\bibitem{281} \textit{Id}.
\bibitem{282} Chubb & Moe, \textit{supra note 273}, at 111.
\end{thebibliography}
1981, making Boston's school system the second most expensive large school system in the country. By 1985, although the per pupil cost had risen to approximately $5,400, Boston's high school seniors scored more than 200 points below average on the scholastic aptitude test. Accordingly, simply throwing money at the problem will not solve it. The problem rests not with insufficient funds, but is structural.

Lower cost structures prevail in the private sector at all levels of education. A New York State Department of Education study found that disadvantaged students in educational opportunity programs were graduated from private universities at a much lower cost ($18,570) than students at government-run universities ($103,061), although public funds were used for both types of programs. In other words, private universities provided education at 18% of what it cost for a government-run university to provide education.

Voucher systems are an increasingly popular solution to the problems of government-run schools. Educational vouchers shift the emphasis on providing education away from the government towards the individual, away from central planning to a consumer-driven market approach. In a traditional educational system, the government provides schools, and children attend the school closest to their home. They have no choice in the matter.

Under a voucher system, the government gives each child a ticket or voucher equal to a certain cash equivalent. The children then exchange the voucher for admission to the school of their choice. For example, if educating a high school student in a particular school district costs $5,000, that district gives each high school student a voucher entitling the child's parents to purchase $5,000 worth of education at the school of their choice. The school chosen turns the voucher into the school district in exchange for a $5,000 check. Parents desiring to send their child to a private school costing $6,000 give the voucher and pay for the remaining $1,000. If they find a school that charges only

283. FITZGERALD, supra note 26, at 139.
284. Id.
285. SAVAS, supra note 247, at 103.
286. Id.
287. Numerous books and articles exist concerning the various voucher systems that have been proposed and tried. See MILTON FRIEDMAN & ROSE FRIEDMAN, FREE TO CHOOSE: A PERSONAL STATEMENT 158 (1980); DAVID W. KIRKPATRICK, CHOICE IN SCHOOLING: A CASE FOR TUITION VOUCHERS (1990); ALAN MAYNARD, EXPERIMENT WITH CHOICE IN EDUCATION (1975); ARTHUR SELDON, THE RIDDLE OF THE VOUCHER (1986). Milton Friedman was one of the first to suggest vouchers as a solution to the state's education monopoly. See FRIEDMAN, supra note 228, at 85-107.
$4,500, they give the voucher and receive a $500 rebate, if permitted under a system's rules.

The voucher system breaks the government monopoly on providing education by giving educational consumers a choice. Parents are able to send their children to the school nearest to them, but are not required to do so. If they can find a better school willing to admit their child, the parents can upgrade the quality of their children's education at no cost by abandoning the school they deem to be of inferior quality. Schools are consequently forced to compete for students by providing better education. Schools providing inferior education lose students and face the possibility of closing.\(^{288}\)

Injecting market forces into education reduces educational costs by forcing schools to become more cost conscious. Incentives exist to cut costs and spend money efficiently as any business must do to survive. Numerous examples exist of costs being reduced by 20% to 50% after privatizing services previously provided by government. Given these examples, one could reasonably expect the cost of providing education to drop drastically after privatization. If privatization of education reduces costs by 30%, local government could pay only $3,500 per student, instead of $5,000. Reducing taxes would consequently be a real possibility.

While vouchers would significantly improve the educational system by breaking the government monopoly on education, reducing cost, and enhancing the quality of education, they are only a half-way solution, a form of market socialism. The basic issue still remains: by what right does government force some people to pay for the education of other people's children? Moreover, property rights are still being violated because the money used to provide for vouchers comes from taxes—the forcible taking of property without the owner's consent. Finally, with a voucher system, the government would still be involved in education. For instance, the possibility exists that, in order to be eligible to receive vouchers, a school would have to comply with certain government requirements. Such government involvement would defeat the whole purpose of vouchers.

A better approach, from a human rights perspective, would be to establish a user fee system through which parents pay for the education

\(^{288}\) The state of Vermont has used a voucher system for many years. See John McClaughry, *Who Says Vouchers Won't Work?*, REASON, Jan. 1984, at 24, cited in Goodman, *supra* note 260, at 124. As of 1984, 95 of Vermont's 246 towns did not have public schools and did not belong to high school districts. *Id.* These local governments instead used vouchers to contract out the service to private schools. *Id.*
V. Principles of Taxation for Emerging Economies

Unlike Western democracies, which have entrenched tax systems that lawmakers can change only piecemeal if at all, emerging economies are not saddled with inalterable tax systems. Accordingly, they have the rare opportunity to construct tax systems practically from scratch. They can adopt systems that raise revenue without the burdens of excess complexity and administrative cost and without the evils of coercion and inequity. Based on the principles previously examined in detail, emerging democracies should utilize the following general guideline in constructing a system of revenue collection:

- Noncoercive methods should be used first, and coercive methods should be utilized only as a last resort. In countries that do not need to support a large defense force and that have privatized wherever possible, there may be no need to resort to coercive forms of taxation. Lotteries and user fees—the only forms of noncoercive taxation—will be sufficient to raise the needed revenue. Aside from being equitable, these methods do not distort incentives, and consequently, economic growth is not stifled. Moreover, noncoercive taxation methods are the only tax methods that do not violate property rights.

- Where coercion is needed to raise the necessary revenue, some taxes are better than others. Emerging economies should never resort to a tax that is based on the ability to pay principle. Such forms of taxation are inherently unfair because they are based on exploitation. Taxes based on the cost-benefit principle at least have some degree of "rough justice" because some relationship exists between what people pay and what they receive in government benefits. Accordingly, a flat income tax is preferable to a graduated income tax. Furthermore, governments should impose a tax "cap," some maximum beyond which individuals are not taxed. Based on the cost-benefit principle, it is difficult to justify forcing an individual to pay $100 million in taxes because no individual can possibly receive $100 million in government benefits. Perhaps $10,000 or some other figure is more equitable.

- Where an emerging economy uses coercive taxation, it should keep rates as low as possible. Low rates are more equitable than high rates because they confiscate the least amount of property from an individual. In addition, low rates affect economic growth less negatively and distort an economy to a lesser extent than high rates.
Emerging economies should adopt simple rather than complex tax systems in order to reduce administrative costs. Emerging economies should thus avoid emulating the tax systems in most Western democracies because these systems are needlessly complex and cause high administrative costs.

Governments should utilize visible rather than hidden taxes so that taxpayers know what they pay for government services. Hidden taxes are dishonest and akin to thievery. Government officials should always keep in mind that they are elected to serve the public. Public officials who hide the true cost of government from those who pay are acting dishonestly, just as a bookkeeper who hides costs from an employer is acting dishonestly.

Where appropriate, emerging economies should earmark, rather than pour taxes into a general fund because earmarking insures that tax revenues are spent for their intended purposes.

Tax rules should be clear and easily understandable to the average taxpayer. Vague tax rules cause unnecessary confusion, increase administration costs, and generally increase disrespect for tax laws and government.

Emerging economies should avoid changing tax laws once they are established. Frequent modification increases complexity and resulting administrative costs, increases distortion to segments of an economy, and retards economic growth. When lawmakers take the time to construct a tax system based on sound tax principles, little or no need for frequent change will exist.

Emerging economies should only adopt tax systems that collect more than they cost to administer. While seemingly obvious, many Western democracies have yet to comprehend this basic point. Lawmakers should immediately repeal any tax that collects less than the costs of administration.

Tax laws should not continue indefinitely without the need for reenactment, but should have a fixed life. Experience has shown that passing a law is easier than repealing a law. Accordingly, a government that passes laws that expire after a fixed period of time insures that bad laws will be ultimately scrapped and will not remain in effect forever.

A country that adopts a tax system based on these principles will enhance its economic growth and minimize inequity. Confiscation of property violates basic human rights, and the tax systems advocated in this paper eliminate or minimize the amount of confiscation that must occur to raise the funds needed to pay for government services.