PROPORTIONALITY, JUSTICE, AND THE VALUE-ADDED TAX

Charles W. Baird

This paper has two purposes: to establish that the most frequently proposed form of value-added tax is really a proportional income tax rather than, as it is popularly seen, an inflationary, regressive sales tax; and to propose that this value-added tax be adopted as an alternative to all existing federal personal and corporate income, as well as federal employment and excise, taxes. Of course, to make such a proposal in light of the government's propensity to simply add any new tax on top of existing taxes is risky. Nevertheless, the nature of the value-added tax and the argument that it is superior to existing taxes stand apart from the danger that the government will merely add it on to present taxes. I don't believe we should refrain from identifying a superior taxing plan merely because politicians might treat it as a supplement rather than an alternative.

Proportionality and Justice

Since the time of the ancient Greek philosophers proportionality has been a generally accepted and frequently employed principle of justice. Proportionality is deeply ingrained in the Western mind as a first approximation to justice. When, for example, some authority deems it necessary for each member of a group to use less of something, the solution that seems automatically to come to mind is that each person should cut back by the same percentage.

Politicians and the press all agreed that justice during the recent California drought consisted in every household's reducing water consumption by the same percentage. The *San Francisco Chronicle's* telephone poll indicated that such a solution was very popular with the public at large. Even the Department of Energy, an organization concerned more with coercion than justice, sells its gasoline allocation rules to the public by stressing that each oil company must cut each of its retailers back by the same percentage. Indeed, it appears that most journalists and politicians hold proportionality to be the best way of putting the principle of equal treatment before the law into effect in just about every area *except taxation.*

For a while some economists attempted to excuse the failure to employ the principle of proportionality in taxation by claiming that a progressive tax imposes on each person an "equal sacrifice." But "equal sacrifice" is not operational, because utility cannot be measured in any way that permits one person's sacrifice to be compared with another's. Moreover, the assumption of declining marginal utility of income is not sufficient to justify progressive taxation, even in principle. Even if, for every person, the marginal utility of income declined, it could well be that a *proportional* tax would result in "equal sacrifice." Declining marginal utility of income by itself merely implies that a person with higher income must be taxed by a larger *absolute* amount than a person with a lower income if both are to suffer "equal sacrifice."

In taxation, proportionality is the only known way to make the principle of equal treatment before the law operational. In the words of J. R. McCulloch in the *Edinburgh Review* in 1833, "The moment you abandon the cardinal principle of exacting from all individuals the same proportion of their income or of their property, you are at sea without a rudder or compass, and there is no amount of injustice and folly you may not commit."[1] If taxing one person's income at 50 percent and another person's income at 14 percent is considered just, why is it not just to tax the higher income at 60 percent or 70 percent? What makes one rate on the higher income fair, but not another rate? What is the operational principle? There simply is *no* operational principle. The different rates charged on different incomes are wholly arbitrary. As F. A. Hayek puts it, ". . .all arguments in support of progression can be used to support any degree of progression. . . . Unlike proportionality, progression provides no principle which tells us what the relative burden of dif-

[1] J. R. McCulloch, "On the Complaints and Proposals Regarding Taxation," *Edinburgh Review* 57 (1833): 164.

ferent persons ought to be. It is no more than a rejection of proportionality in favor of discrimination against the wealthy without any criterion for limiting the extent of this discrimination."[2]

A proportional tax is, therefore, morally superior to a progressive tax. Of course, all taxes involve coercion, and coercion is, to most people, a bad – something they would prefer to have less of rather than more of (ignoring the costs of getting rid of it). Minimal-state libertarians, such as Mises and Hayek, argue that at least protective and judicial services are best obtained collectively through government and paid for by taxation. Coercion is a bad, but the optimal amount of coercion is not zero. Whatever the merits of the points made in the debate between the anarchists and the minarchists, taxation will be with us for a long time to come. It is useful, therefore, to seek out those forms of taxation that are morally superior to existing forms of taxation, to describe how they would work, and to advocate their adoption.

Computation of Value Added

A firm's "value added" is its gross receipts from sales minus its purchases of intermediate goods, services, and supplies from other firms and the depreciation of its plant and equipment. Figure 1 is an income statement typical of many corporate and noncorporate firms.

FIGURE 1
INCOME STATEMENT

Cost of Producing and Selling Goods and Services Sold	Sales of Goods and Services
Wages and salaries	Sales to:
Rent	Households
Interest	Other firms
*Raw materials	Governments
*Supplies	Foreigners
*Goods in process	
*Services	
Depreciation	

Net revenue

[2]F. A. Hayek, *The Constitution of Liberty* (Chicago: University of Chicago Press, 1960), p. 313.

The right-hand side of the statement shows the total dollar value of sales—gross receipts. The left-hand side above the dotted line shows all the dollar costs that were incurred in order to produce and sell the goods and services that the firm offers. All noncapital actual expenditures that firms make can be placed into one of the categories listed. The difference between the right-hand side and the left-hand side above the dotted line is net revenue. When net revenue is added to the left-hand side, the two sides balance.

Raw materials, supplies, goods in process (goods purchased from other firms to which something further must be done before they are ready for sale to their ultimate users), services (electricity, natural gas, janitorial services performed by others, etc.) are all purchased from other firms. Such purchases are called intermediate goods.

Durable plant and equipment (buildings, machines, typewriters, tools, etc.) are also purchased from other firms, but they are not used up in the process of production during the accounting period the income statement represents (usually a year). Durable goods that are partly used up (and in a sense become embodied in whatever finished product the firm is producing) are said to depreciate.

When Firm A subtracts its purchases of nondurable goods and services (the starred items on the left-hand side of the statement) together with depreciation from its gross receipts, the sum of money left is paid as income to households. Wages and salaries are income to households. Rents paid by Firm A directly to households owning resources, such as land and buildings, used by Firm A constitute income to such households. Similarly, interest paid by Firm A directly to households for the use of the households' financial capital (e.g., interest paid directly to households that have bought Firm A's bonds) constitutes income to such households. The net revenue of Firm A, if Firm A is not a corporation, is income to the owners of Firm A. If Firm A is a corporation, a portion of its net revenue—dividends—is direct income to its owners, and the remainder—retained earnings—is also income to its owners. Dividends retained by a corporation can be considered savings from the point of view of stockholders. The corporation saves a portion of the stockholders' income for them and reinvests it in the firm.

Value added (defined as gross receipts from all sales, including sales to government, minus purchases of intermediate goods and services *from other firms* and depreciation) exactly equals all of the incomes that *households* receive because the resources they own (e.g., labor, land, buildings, and loan funds) are used in the productive process. The value added accumulated by all of the firms in the

private sector during a year is the same as the total amount of income originating in the private sector during that year. *A tax assessed on that value added is a tax assessed on income.* Such a tax is often called an income-based value-added tax.

To know what Firm A may deduct from its gross receipts in order to determine its value added and, therefore, its tax base, it is necessary to distinguish payments to households from payments to other firms. As I stated above, interest payments on bonds purchased by households are direct income payments to such households. These payments are exactly like wages and salaries paid to employees and are not deductible. On the other hand, interest payments made to a bank on an outstanding loan, or on bonds purchased by the bank, are payments for intermediate services from another firm and are deductible. Similarly, rents paid directly to households for the use of land and buildings the households own would not be deductible, but rents paid to business firms that own such resources would be.

The households that receive the payments that Firm A cannot deduct would not have to file any tax returns regarding those payments with the Internal Revenue Service. However, business firms that receive the payments that Firm A *does* deduct would have to file tax returns regarding such payments. The payments would constitute part of such firms' gross receipts and, therefore, would enter into those firms' calculations of their own values added.[3]

Illustrations of Incidence of the Tax

To show how the value-added tax will work, I will propose an economy with no taxes and no government expenditures and then impose a 20 percent value-added tax and an equivalent amount of government expenditure. I will assume that the government administers the tax by requiring each firm to compute its value added and then pay 20 percent of that amount directly to the Internal Revenue Ser-

[3] A self-employed person working out of his home presents a definitional problem. If Firm A hires such a person to do a marketability study on a proposed new product, are the payments to the person deductible? Payments to regular employees are not deductible; why should payments to a temporary employee be different? To deal with this problem it is necessary to have some operational definition of a firm. A self-employed lawyer, doctor, or engineer is considered a firm for tax purposes. Such a person must file federal tax Form C reporting "profit (or loss) from a business or profession." Under the proposed value-added tax substitute for the current income tax, the same implicit definition of a firm could be used. For purposes of the value-added tax, those who previously had to file Form C would be considered firms. Such self-employed individuals would have to file value-added statements and pay value-added taxes directly. Payments made to such self-employed individuals by Firm A would be deductible in the determination of Firm A's value added.

vice. An alternative way to administer the tax – the invoice meth-od – will be discussed in a later section.

If firms must compute their value added and pay 20 percent of that amount directly to the IRS, they could do one of two things in order to maintain their pre-tax revenue. They could reduce their nominal payments to suppliers of factors by the amount of the taxes, or they could attempt to recoup the taxes through raising prices. Let's consider these alternatives in that order.

Suppose that without any tax of any kind and no government expenditures, the net revenue of Firm A is $500, calculated in the following way:

Gross Receipts	$4,500
Less intermediate goods and depreciation	– 1,500
Less factor payments to nonowners (wages and salaries, rent, interest)	– 2,500
Net Revenue	$ 500

Firm A's value added would be $3,000 – its net revenue plus its factor payments to nonowners. Since net revenue is directly or indirectly income to owners, value added is simply the sum of the incomes generated by this firm.

The $1,500 in intermediate products purchased by Firm A is the sum of the value added by the various other firms involved in the production of those intermediate products. (For example, if Firm A is a refiner and its intermediate product purchases are crude oil, the amount it pays for the crude oil is the sum of the value added by the firms that owned the well and the value added by the firms that transported the crude oil to the refinery.)

Suppose that a 20 percent value-added tax is imposed on all firms at all stages of production and that the government spends the proceeds of the tax purchasing goods and services from private firms. Firm A's tax liability would be $600 (20 percent of $3,000). The tax liability of other firms emerging out of transactions with Firm A would be $300 (20 percent of $1,500). When the government spends the $900 in taxes received from Firm A and its suppliers of intermediate goods by purchasing government goods from other private firms, some resources will be redirected toward the production of government goods and away from the production of private goods. For example, suppose the $900 was spent purchasing government goods from Firm B. Firm B's net revenue could be calculated as

follows (in each case using 20 percent of the corresponding original figures for Firm A):

Gross Receipts	$900
Less intermediate goods	− 300
Less factor payments to nonowners	− 500
Net Revenue	$100

Since $900 was taken away from production and sales of $4,500 worth of private goods produced by Firm A, Firm A's net revenue could be calculated as follows (using 80 percent of the corresponding original figures in each case):

Gross Receipts	$3,600
Less intermediate goods	− 1,200
Less factor payments to nonowners	− 2,000
Net Revenue	$ 400

The tax liabilities of the firms involved in the depicted expenditures would then be as follows:

Firm A	$480 (20% of $2,400)
Firm A's suppliers of intermediate goods	$240 (20% of $1,200)
Firm B	$120 (20% of $600)
Firm B's suppliers of intermediate goods	$60 (20% of $300)

The total tax collected would be $900, and the indicated flow of expenditures and receipts could be maintained indefinitely.

Before the tax was imposed, total factor payments arising out of transactions with Firm A were $4,500: Direct factor payments to nonowners by Firm A were $2,500, factor payments made by firms involved in the provision of intermediate products to Firm A were $1,500, and factor payments to owners of Firm A were $500. After the tax is imposed, the government expenditures made, and the redirection of resources completed, total after-tax factor payments come to $3,600. The components of total after-tax income are:

Source	Gross Income	Tax	After-Tax Income
Direct income paid by Firm A to nonowners	$2,000	$400	$1,600
Income of Firm A's owners	400	80	320

Source	Gross Income	Tax	After-Tax Income
Firm A's suppliers of intermediate goods	1,200	240	960
Direct income paid by Firm B to nonowners	500	100	400
Income of Firm B's owners	100	20	80
Firm B's suppliers of intermediate goods	300	60	240
	Total after-tax income		$3,600

The numbers above illustrate only one possible outcome of the imposition of the tax and government expenditures. In the example firms responded to the imposition of the tax by cutting all factor payments—direct and indirect—to owners as well as to nonowners. The tax is unambiguously a proportional tax on incomes earned. All factors that used to work are still working. The only difference is that after the tax and expenditures some resources are employed producing government goods rather than private goods. Total expenditures haven't changed, and the average money price level hasn't changed. All factors together have lower real incomes—$3,600 instead of $4,500. (The consumption of the $900 of government goods is not counted as income.)

It is frequently asserted that the imposition of a value-added tax would result in firms attempting to recoup the tax by raising prices. Firms would not reduce nominal factor payments, it is alleged; they would pass the tax on to buyers. For that reason a value-added tax must be regarded to be a sales tax, and it is inflationary to boot.

But even if the value-added tax were a form of sales tax, which it isn't, it couldn't be inflationary. In the absence of ratifying increases of the money stock, any exogenous increase in the average money price must result in decreased real expenditures. Decreased real expenditures would cause production cutbacks and layoffs until the average money price returned to its original level. The sum of the new base price and the tax add-on would, on average, have to equal the price that existed before the imposition of the tax. Since it is the base price that is actually available to sellers for use, nominal factor payments would have to be lowered, and the end result would be as it is in the example above.

Suppose, however, that ratifying increases of the money stock did occur. In the face of a 20 percent tax, prices would have to be increased by 25 percent in order that the after-tax factor payments could be unchanged. That is, if the tax is to be recouped through

raising prices, and since the tax would be based on the new prices charged, total dollar expenditures would have to amount to $5,625 (125 percent of the original $4,500). The tax yield on $5,625 would be $1,125, so the composition of spending would be $1,125 on government goods (produced, as before, by Firm B) and $4,500 on private goods (produced, as before, by Firm A). The net revenue calculations for the two firms would be:

	Firm A	Firm B
Gross receipts	$ 4,500	$ 1,125
Less intermediate goods	– 1,500	– 375
Less nonowner factor payments	– 2,500	– 625
Net revenue	$ 500	$ 125

The tax liabilities of firms A and B would be:

Firm A	$600 (20% of $3,000)
Firm A's suppliers of intermediate goods	$300 (20% of $1,500)
Firm B	$150 (20% of $ 750)
Firm B's suppliers of intermediate goods	$ 75 (20% of $ 375)

The total tax collected would be $1,125, and, again, the indicated flow of expenditures and receipts could be maintained indefinitely.

Just as before, the tax is collected by assessing each firm on the basis of its value added, and the firms pay the tax out of funds that in the absence of the tax, but at the now higher prices, would have been used to make factor payments. The distribution of the tax burden is:

	Gross Income	Tax	After-Tax Income
Direct income paid by Firm A to nonowners	$2,500	$500	$2,000
Income of Firm A's owners	500	100	400
Firm A's suppliers of intermediate goods	1,500	300	1,200
Direct income paid by Firm B to nonowners	625	125	500
Income of Firm B's owners	125	25	100

	Gross Income	Tax	After-Tax Income
Firm B's suppliers of intermediate goods	375	75	300
Total after-tax income			$4,500

The price index relative to the previous example is 1.25. Real after-tax income paid to factors, therefore, equals $4,500/1.25, or $3,600—exactly what it was in the first example. Even though sellers recouped the tax through higher prices, the actual burden of the tax shows up as decreased real income. Again, *the value-added tax is a proportional income tax.*

The Invoice Method

The main reason why most people fail to recognize that the value-added tax is a proportional income tax is the way it is administered in many European countries. In the examples given here, the tax was collected by direct assessment on all private firms. Each firm, it was assumed, calculated its value added by subtracting its purchases of intermediate goods and depreciation from its gross receipts, reported the result to the tax collector, and was assessed 20 percent of the result in taxes. The firm paid the tax out of funds that otherwise would have been factor payments—both direct and indirect, and to owners and nonowners.

In many European countries the so-called invoice method is used to collect the tax. The invoice method works in the following way. Consider three firms in a given chain of production. Without taxes, Firm I produces an intermediate product that is sold to Firm II for $500. Firm II further processes the intermediate product and sells the resulting product to Firm III for $1,100. Firm III then finishes the product into its final form and sells it to a final customer—one who does not further change the nature of the product but uses it as a consumption item or a tool. The final user of the product pays Firm III, we will assume, $1,500. Each of the three firms, we will suppose, has $25 of depreciation. The value added by each firm, and thus the total income payments generated by each firm, together with tax liability (assuming a 20 percent tax rate) is as follows:

	Firm I	Firm II	Firm III
(A) Gross receipts (without tax)	$500	$1,100	$1,500
(B) Depreciation	25	25	25

	Firm I	Firm II	Firm III
(C) Purchase of intermediate products	0	500	1,100
Value added (A – B – C)	475	575	375
Tax liability (20% of value added or incomes generated)	95	115	75

The actual collection of the tax is based on invoices received and issued by the firms. Each firm is assessed 20 percent of its gross receipts as a value-added tax, but it is given a tax credit for value-added taxes paid to other firms and for 20 percent of depreciation. In our example, assuming that the firms attempt to recoup the tax by raising prices and that sufficient new money to allow the resulting increased dollar expenditures is created, it works out as follows: Firm I gives Firm II an invoice that shows that the base price of the product sold was $500 and that 20 percent of that base price was added on for the value-added tax. Firm II, in other words, actually pays $600 to Firm I. Firm II gives an invoice to Firm III showing the base price of the product sold to Firm III was $1,100 and that $220 was added on (20 percent of $1,100) for the value-added tax. Firm III therefore pays $1,320 to Firm II. Firm III gives an invoice to the final user of the finished product showing that the base price charged was $1,500 but that $300 (20 percent of $1,500) was added on for the value-added tax. The final consumer pays $1,800.

When the time comes to pay the taxes to the government, the following calculations and payments are made by each firm:

	Firm I	Firm II	Firm III
Gross tax (20% of gross receipts from base prices)	$100	$220	$300
Credit for VAT paid on invoices	0	100	220
Credit for 20% of depreciation	5	5	5
Net tax liability	95	115	75

Note that the tax actually paid to the government by each firm exactly equals 20 percent of its value added, which is exactly the same as 20 percent of the incomes generated by the productive activity of each firm. The factor payments generated are the same in nominal terms as they were before; but with the higher prices, real after-tax incomes are lower by the amount of the tax. This is the same situation as that depicted in the second illustration in the

previous section, except that nominal prices (base prices plus the tax) are 20 percent, rather than 25 percent, higher than without the tax because with the invoice method the tax is assessed on base-price revenues rather than gross receipts from base prices plus the tax. Real after-tax factor payments are the same in both cases.

The tax falls on people in their roles as suppliers of factors of production; but when firms attempt to recoup the taxes through higher prices (assuming the necessary additional money is created), nominal factor payments are what they were before the tax. The lower real income shows up as higher money prices, and thus people come to think of the tax as a sales tax. When the invoice method is used to collect the tax, the sales tax illusion is reinforced because final buyers receive invoices with the tax explicitly added on to the base prices. They are really paying an income tax without having to file any forms, but it looks like a sales tax.

The main advantage of the invoice method over the direct assessment method accrues to the tax collector: The invoice method makes tax evasion difficult. To evade the tax, the recipient of an invoice would want it to say that he paid more tax to the issuer of the invoice than he actually paid. On the other hand, if the issuer of the invoice is to be able to evade taxes the invoice must understate his gross receipts and, therefore, the amount of the tax collected from the recipient of the invoice. These two conflicting desires effectively deter evasion.

Saving and the Value-Added Tax

It is frequently asserted that savers can avoid the value-added tax, but since the tax is really a tax on income it should be obvious that such an assertion is incorrect. Especially when firms respond to the tax by cutting nominal factor payments rather than by raising prices, it is clear that savers and consumers alike have less real income because of the tax. When firms respond to the tax by raising prices, the fact that savers do not avoid the tax is more difficult to see. After all, in this case the lower real incomes show up through higher prices rather than lower nominal incomes. If some of the unchanged income is saved rather than spent on consumption goods, doesn't it escape taxation?

Final products are not only consumption goods; they are also investment goods (plant, equipment, machines, tools). If people use less of their incomes purchasing consumption goods—in other words, if people increase the amount of saving they do—that saving will be channeled into investment goods. Savers supply loanable funds to borrowers. When investment goods are purchased, the

value-added tax will be paid. Thus the borrowers will have to reduce the rates of return they offer to the savers. The savers do not avoid the tax.

Consider a person who earns $100,000 in income and spends only $40,000 on consumption goods, saving the other $60,000. A person saves by purchasing stocks, bonds, mortgages, and savings institution passbook credits. The saved money goes to people who spend it on housing, plant and equipment, and other investment goods. The sellers of those investment goods will charge those buyers the value-added tax on the purchases. The $60,000 does not escape taxation. The tax is paid out of the $60,000 when the investment goods are purchased. Nor does the saver himself escape the tax. The interest return he earns will be lower than it would be if there were no tax at all. The present value of the lost interest returns equals the value-added tax on the $60,000. In other words, the market value of the claim to that interest return will be reduced by the amount of the value-added tax on the $60,000. Suppose that in the absence of any tax the actual rate of return earned on investments was 10 percent. The saver would receive $6,000 per year interest income. When a 20 percent value added tax is imposed, only $48,000 of real investment goods could be purchased. If the real rate of return is still 10 percent, his interest income would be $4,800 per year. That $4,800 interest income represents an 8 percent rate of return on the $60,000 saving.

The Relative Price of Saving

All income taxes, including the income-based value-added tax, that do not exempt either interest on savings or income that is saved increase the price of saving relative to the price of consumption and so hamper saving and capital accumulation. To see this, imagine a taxless economy that generates a 10 percent rate of return on investment. One would have to earn $1.00 to purchase a $1.00 consumption good, and one would also have to earn $1.00 to purchase an annuity of 10 cents. The price of consumption relative to the price of a 10 percent annuity would be one-for-one. Now suppose that a 20 percent income tax is imposed. One would have to earn $1.25 to purchase a $1.00 consumption good. How much would one have to earn to purchase an after-tax annuity of 10 cents? The before-tax annuity would have to be 12.5 cents. The price of an asset that generated that annuity would be $1.25 (the rate of return on investments is still 10 percent), but in order to have $1.25 left over from earnings, one would have to earn $1.56. The price of a dollar's worth of consumption relative to the price of a 10 cent an-

nuity is no longer one-for-one. The price of the 10 cent annuity is 1.245 (1.56/1.25) times the price of a dollar's worth of consumption. The income tax has raised the relative price of saving and is thus biased against saving.

One way to remove the bias with an ordinary income tax is explicitly to exempt income that is saved. If that were done in the above example, the before-tax annuity that would have to be obtained in order to get an after-tax annuity of 10 cents would still be 12.5 cents (interest income is still taxed), but the amount that would have to be saved in order to buy an asset that would pay a 12.5 cent annuity would be only $1.25. Thus the price of a net 10 cent annuity would be 1.25/1.25 times the price of a dollar's worth of consumption. The exchange rate would be one-for-one, just as it was without the tax.

The corresponding way to remove the bias with an income-based value-added tax would be to exempt investment goods. If that were done, the purchase prices of the investment goods would not be raised to recoup the tax, so the amount of saving that must be done to purchase the assets would not be increased; but interest payments, along with other factor payments, would be reduced in real terms.

When investment goods are exempted from the value-added tax, the result is sometimes called the consumption-based value-added tax, but this is really a misnomer because the tax still falls on individuals in the form of lower real after-tax factor payments (income). When investment goods are not exempted, they are really taxed twice – directly when purchased and again when the interest returns they generate (part of factor payments) are taxed.[4]

To illustrate: When all goods are subject to the tax, and when the tax has been recouped through higher prices, what was a $1.00 consumption good before the tax will, after the tax, be a $1.25 consumption good. Similarly, what was a $1.00 investment good yielding an annuity of 10 cents will, after the tax, be a $1.25 investment good still yielding an annuity of 10 cents. However, the real value of the 10 cent annuity is 8 cents (10 cents/1.25). To get an annuity with a real value of 10 cents, the nominal annuity must be 12.5 cents. If, after the tax, a $1.25 asset yields a 10 cent annuity, it takes a $1.56 asset to yield a 12.5 cent annuity. Thus the price of a real 10 cent annuity is $1.56, while the price of a real $1.00 consumption good is only $1.25. If investment goods were exempt

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[4]Norman B. Ture, "Economics of the Value Added Tax," in *Value Added Tax: Two Views* (Washington, D.C.: American Enterprise Institute, 1973), pp. 81–86.

from the tax, it would take only $1.25 to purchase an asset that would yield a real annuity of 10 cents, so the imposition of the tax would not affect the relative price of saving.

Conclusion

That a proportional income tax is more just and efficient than a progressive income tax is well known. There seems to be little justice, to use an example from *The Constitution of Liberty*, when two lawyers performing exactly the same service (as indicated by the payments their clients are willing to make for the service) at the same time end up with different net payments merely because they have made different amounts of income elsewhere during the same accounting period. That is certainly not equal pay for equal work.[5] Moreover, progressive income taxation decreases the willingness of resource owners to supply their services, makes worse the distortion of the relative price of saving, and so reduces real economic growth. It seems that the substitution of the value-added tax for all other federal taxes, or even for just the existing federal personal income tax, is a policy proposal that all supporters of growth in the private sector relative to the government sector would support.

Perhaps Murray N. Rothbard would not support the proposal. In the second edition of *For a New Liberty* Rothbard warns libertarians against "right-wing opportunism":

> The major problem with the opportunists is that by confining themselves strictly to gradual and 'practical' programs, programs that stand a good chance of immediate adoption, they are in grave danger of completely losing sight of the ultimate objective, the libertarian goal. He who confines himself to calling for a two percent reduction in taxes helps to bury the ultimate goal of abolition of taxation altogether....
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> [T]he libertarian must never support any new tax or tax increase. For example, he must not, while advocating a large cut in income taxes, also call for its replacement by a sales or other form of tax. The reduction or, better, the abolition of a tax is always a noncontradictory reduction of State power and a significant step toward liberty; but its replacement by a new or increased tax elsewhere does just the opposite, for it signifies a new and additional imposition of the State on some other front. The imposition of a new or higher tax flatly contradicts and undercuts the libertarian goal itself.[6]

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[5]F. A. Hayek, *Constitution of Liberty*, p. 317.

[6]Murray N. Rothbard, *For a New Liberty*, rev. ed. (New York: Collier Books, 1978), pp. 299–300, 306.

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In my view, however, the advocacy of the substitution of the value-added tax for all other federal taxes, or even for the existing federal personal income tax alone, is not an example of "right-wing opportunism." The value-added tax is *not* a new or an additional tax. It is merely an income tax. My proposal, in either form, is at least a call for a *reduction of income taxes*. If, in addition to a reduction of the federal personal income tax, some other taxes, such as employment taxes and excise taxes, are abolished, then so much the better. The libertarian goal would not thereby be obscured.