On Money, Wealth, & Taxes

David J. Bean

David J. Bean is a member of the Long Beach Civil War Roundtable, a retired aerospace engineer and a free-lance writer.

The following discussion could probably be titled "Econ. 101" and may seem elementary at first. But the subject of taxes has been so obscured by our politicians and others that it is necessary to restate some basic definitions and principals in order to understand what has evolved into the greatest bureaucratic mess and the most misunderstood system of our times: our tax system.

Money

Most people think of money as wealth, but money is not wealth: it is a substitute for goods or services. It is a lien on wealth. It is a promise that the holder can obtain goods or services by trading money. Money can be printed and is worthless without some backing (such as from Government) to insure the ability to trade it for goods or services.

Wealth

Wealth from a national standpoint is the total production of salable goods and services produced by that nation. The production of wealth requires capital, labor, and facility. Capital is the surplus wealth that has been saved or inherited. It is required to start any business, whether a one-person operation or a large dot-com company. Labor is also a strict requirement. When a worker produces a useful product or service, he is producing wealth and receives money in return so that he can procure other necessary forms of wealth. The miner in Colorado, the General Motors worker and the hot dog vendor are all producing wealth. Even the clerk at the bank is producing wealth, since he is selling his services to the bank.

Taxes

Taxes are the wealth taken from the people to pay for the services provided by the government. Taxes reduce the amount of surplus capital available for investment in new or established businesses. Almost every family in the U.S. pays at least some taxes: income taxes, sales taxes, Social Security taxes, property taxes, estate taxes, gasoline taxes, liquor taxes, etc. What most people do not understand is that any tax on a wealth-producing activity is passed along as a cost of that production and is ultimately paid by the consumer of that production effort. This fact results in the conclusion that productive people only pay income taxes (and other wage-related taxes) when they function as consumers! Ultimately, consumers pay almost all wage-related taxes, whether they are producers or non-producers.

When a product or service is consumed, the consumer of that product or service pays for all the costs that went into producing that product or service. And once that product or service is consumed, those costs can no longer be passed on. A good portion of those accumulated costs must include all of the taxes paid by all of the producers who ever had anything to do with producing that product or service.

Another way of looking at it is to consider a worker's paycheck at the end of the week. His pay stub will show that part of his pay went toward income taxes and other wage related taxes plus other deductions. He never sees this money; it is basically an accounting entry. But all of his pay, including the tax and benefits part, goes into the cost of the product or service he is working on and is passed on to the ultimate consumer of that good or service. The gross number on his paycheck means absolutely nothing to him; it is just a number.

When a person pays his gardener for cutting his lawn, that service is consumed and the gardener, in calculating his costs and charges must allocate part of the payment he receives from his customer to what he must net in wages and part toward his taxes. Assuming that the only source of income for the gardener is his customers, it can be seen that when the gardener pays his taxes, the money had to come from the money that he received from his customers; he has only acted as a conduit. Thus, his customers ultimately pay all of his taxes.

The gardener in turn, when he buys a loaf of bread and consumes it, indirectly pays a portion of the grocer's taxes and the baker's taxes, and the taxes of the farmer who grew the wheat, etc. When the gardener functions as a consumer and consumes a product or service himself, he personally pays all of the passed-along taxes associated with the production of that product or service. This is true for all producers. When a person is acting as a producer, he becomes a conduit for taxes- since in reality all of his wages, taxes and other benefits are passed on to the ultimate consumer.

In the same sense, all viable businesses do not pay taxes; they only act as collection agencies for the government. Even the one-man hot dog vendor who is both a businessman and a consumer can pass all of his business expenses on to his customers in the price of his hot dogs. If the only source of income he has is from his customers, it must follow that his customers wind up paying all of the hot dog vendor's costs and those costs include his business taxes as well as his income and other taxes.

On the other hand, when the vendor functions as a consumer and buys a car from General Motors, all the income taxes paid by the people who produced that car are included in the price of the car since all of their costs must go into the product and are passed along to the consumer. That includes income taxes paid by the people who mined the ore to make the steel and the machinist who worked the lathe and the salesman who sold the car. Those people in turn pay the accumulated income taxes on any product or service they consume. But as long as they are acting as producers, their wage related taxes are being passed on to the ultimate consumer.

What about non-producers? Everyone is a consumer and therefore non-producers pay the accumulated taxes on any product or service they consume. This includes retired people, people on welfare, or anyone no longer engaged in some kind of production. From a personal standpoint it makes no difference to any of these people that their personal income taxes cannot be passed on; it just means their net income is reduced and their own income taxes do not add to producer prices.

The unfortunate part of the current tax system is that the reality of the system is hidden from the general public. Most people do not realize how heavily they are being taxed or who really pays the taxes. They are only dimly aware of how grossly inefficient the present system is. In addition, contrary to the normal belief that higher taxes curb inflation, the present system results in some price inflation since taxes associated with production wind up in the price of produced goods or services. Of course higher taxes and higher prices can curb business and, after time, lower demand, and that can finally lower prices. And when a higher tax rate is set a wage earner immediately experiences a loss of spendable income and that lowers demand but also prompts the worker to seek higher wages, which ultimately shows up in higher inflation.

But taxes also distort business activity figures. Whatever the total gross business is for a company, the company must show a profit on that gross figure. The fact that the figure includes all kinds of taxes doesn't matter: the company still must show a profit on the gross figure.

The progressive income tax also contributes to the growing gap between the rich and poor because the more tax that is taken from the top producers, the more raises in income they will insist upon. Does anyone imagine that the top ball players worry about anything except what they will net?

Thus, the present tax system is a big ponzi scheme. When Joe Lunchbox says "tax the big corporations, don't tax me," he obviously doesn't realize that he and other consumers wind up paying all the taxes anyway. It would be much more honest and simpler for everyone if we eliminated all taxes on producers and substituted some kind of sales tax. This would be more honest because a sales tax is truly a consumption tax. The mechanism is in place in most states to collect such a tax and the IRS could essentially be eliminated.

How much would this sales tax have to be? Well, currently the Federal Government is spending just over twenty percent of the gross domestic product. With the improved efficiency likely to result from this type of change, a fifteen percent sales tax would probably generate the required amount.

Of course this begs the question of how much of our national income do we want to devote to the public sector. And any discussion on the fairness of how taxes are collected must also consider how the tax money is distributed. One thing is clear: there is no "hidden hand" to guide resources between public and private uses. Today government is regarded by many as being responsible for correcting inequalities in the distribution of income. While there is some consensus that income and wealth should not be distributed "too unequally," there is no consensus as to what the minimum of equality ought to be. Still, there can be no doubt from the above analysis that the present system of tax collection is a complicated fraud and only provides virtually unlimited opportunities for politicians to reward allies and punish dissidents. Surely we can do better. *Ω*