



Fallacies about Public Finance

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FALLACIES ABOUT PUBLIC FINANCE

In these notes, an affirmative statement is a fallacy, whether the statement is assertive or descriptive. Where a correct statement is made, it is in parens ().

A. Fallacies about Tax Justice

1. Tax policy is a trade-off between equity and efficiency.
 - a. We must choose between efficiency and equity; inefficiency is the price of egalitarianism. (With landowner subsidies they have it backwards. Allocation and efficiency are sacrificed to promote distributive INequity.)
 - b. Studiously ignoring available means to achieve equity and efficiency (or growth) jointly.
2. Large-group equity
 - a. Taxing poor people in rich countries to help rich people in poor countries, or regions: interregional equity.
 - b. Taxing poor people on good land to help rich people owning poor (developmental) land.
 - c. Taxing poor people in rich cities to help rich farmers. "Parity for farmers."
 - d. Help all widows because some are poor and worthy.
3. Profits are unearned, nonfunctional, surplus value. (Truth: bad profits stigmatize good ones; good profits camouflage bad ones. Solution: distinguish good and bad profits, eliminate or tax away the bad ones.)
4. Only win-win exchanges can be shown to raise human welfare. Both parties gain. Otherwise, you cannot justify changing anything because someone may be hurt, and interpersonal comparisons are impossible.

At the same time, you can justify keeping things they way they are, because the burden of proof is on change.
5. Analyzing economic concentration in terms of averages, ignoring dispersion.
6. Taxes are justified philosophically either by ability-to-pay, or benefits-received.
7. Ability-to-pay is synonymous with liquidity.
8. All taxes are "in personam," meaning the taxable entity or unit is always some person.
9. Public schooling is a "pro-natalist" service which is unfair to childless people and a subsidy to parents with large families. Pro-natalist policies are unfair to everyone, for Malthusian reasons.

10. It is all right to use public domain without paying a market rent, but it is entirely different, and unethical, to sell that privilege for money.

11. Since purchasing power is wrongly distributed, consumer sovereignty leads to a wrong result. Therefore, we should abandon the price system and substitute a rationing system.

12. Regression fallacy

a. Horizontal and vertical equity are needed -- each defined in terms of income.

b. The property tax is regressive.

c. An energy tax is regressive.

d. ALL taxes and charges other than income tax are regressive. All taxes are judged by how much they resemble the personal income tax, as idealized.

13. Anyone exporting an input (e.g. water) from a source area must compensate all those who were receiving, or might receive, positive externalities (either technological or pecuniary), from its use in the source area. Likewise, anyone importing the input to a target area must compensate all those who receive, or might receive, negative externalities from its use there.

At the same time, those receiving benefits from the move, either in the source or the target area, are receiving what is rightfully theirs as an appurtenance of their property, and have every right to keep it all.

15. The income of football quarterbacks is mostly unearned because they were born big and athletic, and have no alternative use worth much. Therefore, we should levy a high tax on persons whom the IRS identifies as having these qualities.

16. The value of government to a resident of a country is in proportion to the income he earns there.

B. Overall incentive effects

1. The "income effect of taxation" means that income taxes cause you to work harder.

2. Lower interest rates cause you to save more, because most people have a target retirement income they must have, regardless of how much they must save to get it.

3. It doesn't matter how you pay taxes, but only how much. A tax is a burden on enterprise and production in any case, and

will drive business away (even though all taxes are shifted forward to consumers).

C. Tax incidence, shifting, allocative effects

1. There are too few resources used in monopolized industries, and too many in competitive industries. To redress the balance, we should tax competitive industries more, and monopolies less.

2. The best economic use of a resource is that yielding the owner the highest return after taxes.

3. All taxes are shifted forward, because prices are determined by cost of production, and taxes are a cost.

4. All taxes suppress, destroy and distort incentives, and therefore reduce output. Heavy taxes are always a disincentive to economic activity, growth, and development.

5. TANSTAAFL.

(a. Doubling the welfare of A by dropping B by 1%, etc.)

(b. Sharing public goods.)

6. The effect of higher taxes is to lower private investors' rates of return after taxes.

7. Excise taxes of any kind drive buyers and sellers away from the taxed activity, and thus cause a misallocation of resources. (Not if the taxed activity is harmful and has no buyer, e.g. pollution.)

8. Investors may avoid risky ventures. Risky ventures may be very productive. Therefore, Congress should allow special tax concessions for risky ventures. Examples might be lower tax rates, partial exclusion of revenues from taxable income, capital gains treatment of asset sales, and expensing of investments.

9. The income tax is neutral because it takes a percentage of net income. The job that pays the most before taxes, also pays the most after. The investment that yields the most before taxes, also yields the most after.

D. Marginal-cost pricing matters

1. A street lamp is a pure public good.

2. National defense is a pure public good.

3. It is wrong to subsidize decreasing-cost operations, because that means taxing other industries and regions.

4. There is no way to identify the consumer surplus generated by natural monopolies like distributing water, extending city services, etc.

5. To finance a local public work like a toll bridge, you should charge high tolls when it is new and worth a lot, then less as it gets older, more crowded, and less desirable. When the bonds are retired, there is no excuse for charging any toll at all.

6. Regulatory fallacies: treated under Ind. Org. rather than Pub. Fnce.

7. Fallacy of consolidating accounts (abandoning marginal exactitude).

a. Letting diversified firm (the taxable unit) deduct costs of losers against gains of winners, when undiversified losers cannot do same. Cf. opposition to "safe-harbor leasing," ca. 1980.

8. Utilities are monopolies and should be taxed heavily in order to extract the monopoly rents for public use. This lets other taxes be lowered, and is thus a net gain to the people.

9. Use of the public streets and roads should always be free: it is a basic human right. This includes bridges, ferries, tunnels, elevators, etc. It is proper to pay for airplane rides and train service, however, because the flying and rolling stock is privately supplied.

People should not be charged for using streets because they do not consume them. Thus, streets are a kind of "public good," like telecasting, with no marginal cost of use.

E. Intertemporal matters

1. The income tax favors investments of shorter payout over longer, because with shorter payout the writeoff is faster, and has a higher present value.

2. An income tax taps all sources of consumer purchasing power.

3. Treating investing in durables as a current expense.

a. Failing to annualize, thereby overstating LMC.

b. Expensing exploration outlays, on grounds you are replacing reserves just used, barrel for barrel.

c. Writing off cost of tree-planting against stumpage.

4. "Fast write-off" of durable capital investments from taxable income has no net effect on tax liability, because you just have to pay tomorrow instead of today. Better pay up early, take your medicine like a man, and get it over with. You'll improve your character, and face the future with a clean slate.

5. When oil at the well-head is worth \$15/bbl, every barrel I pump from any well lowers the value of my total deposit by \$15. I should therefore be allowed to deduct \$15 from taxable income, as depletion.

6. There is no net income from mining because the resource is exhausted by use.

F. The property tax

1. A lump sum tax would have no marginal disincentive effect. That is, however, purely a theoretical construct with no real-life counterpart.

2. If the discount rate is 5%, a property tax of 5% will take the entire income, leaving nothing for the private owner.

3. The property tax is minor, because its rate is only 1% in California, while state income tax rates go up to 10% or so.

4. A property tax, applied to standing timber, will take more money over the growing period of a tree than the harvest value of the tree.

5. A property tax applied to rising, speculative land on the growing urban fringe makes the owners pay a higher share of their income in taxes than other property owners do.

G. Intergovernmental relations

1. Federal grants to local governments are like manna from heaven.

H. General; methodological

1. Confusing incidental with essential; connotation with denotation; myth with reality; etc.

2. Fallacy of identification (often meaning misidentification). Block phrases, generally.

a. Regressive local tax becomes "regressivepropertytax." In result, proposed policy does not

serve the ostensible end, e.g. shifting to sales tax to help poor people in poor regions.

3. Fallacy of exaggerated feedback

a. Raising tax rate lowers tax base so much it lowers tax take.

b. Letting imports into a country lowers price, lowers domestic output so much as to raise price (Ehrlich).

4. Fallacy of not recognizing preemption as consumption.

a. People should not be charged for using streets because they do not really "consume" them, i.e. break them into little pieces. This makes streets a kind of "public good," like telecasting, with no marginal cost of use. (See also under marginal cost pricing.)

b. Holding land is not consuming anything, because the land is not used up or impaired. Thus, land is a kind of public good: use by A does not preclude use by B.

5. Fallacy of not recognizing that adding entropy is consumption.

a. Only "consumptive" uses of water (diversions less return flows) deprive anyone else of its use.