

JUSTICE, FEDERAL SPENDING, TAX REVENUE, AND DEFICITS

Edward J. O’Boyle, PhD
Senior Research Associate
Mayo Research Institute
www.mayoresearch.org
edoboyle737@gmail.com

Years ago while he was still a U.S. senator representing the State of Louisiana, Russell Long (2014) gave us these words to express how he saw his responsibility in writing the tax code. “Don’t tax you; don’t tax me; tax that fellow behind the tree.” Understandably taxpayers today see their responsibility in complying with the tax code in these words. “Pay what you must, avoid what you can.”

The present federal income tax code is problematic for two main reasons. First, it is so complex that many taxpayers are forced to hire a specialist to prepare their tax returns. Second, large numbers of households do not pay any taxes. In 2020 the numbers were roughly 61 percent due mainly to pandemic-related factors and the availability of refundable tax credits to millions of households (Watson 2021).

Complexity is inevitable because the code is under continual revision in Congress by taxpayers – individuals and organizations -- pleading for new ways to reduce their taxable income. When they are successful, tax revenues tend to decline. With more than one-half of tax filers with no skin in the game, many will be supportive of added spending that benefits them directly – “it’s free” -- or will not stand in the way of additional expenditures which do not accrue to their personal advantage.

In fiscal year 2019 federal revenue according to the St. Louis Federal Reserve Bank amounted to \$3.5 trillion of which \$1.7 trillion came from individual income taxes and \$230 billion from corporate taxes. At the same time federal expenditures totaled \$4.4 trillion resulting in a deficit of \$984 billion which required the U.S. Treasury to sell more government securities. In 2019 the public debt averaged more than \$69,000 per person in America (Flynn 2019). Even though more recent data are available, Mayo Research Institute (MRI) uses data for 2019 because they do not reflect the economic lockdown triggered by fears of the spread of Covid-19.

Democrats insist on dealing with the deficit by raising taxes. Republicans counter that the imbalance should be addressed by reducing expenditures. Taxpaying individuals and corporations resist the Democrats' efforts to raise taxes. Those with no skin in the game resist Republicans' efforts to reduce expenditures because those expenditures contribute directly to their personal well-being. Today, President Biden argues that "the rich are not paying their fair share of taxes". The more radical members of the Democrat Party persist in the same argument with the harsher language of "tax the rich". Both Biden and radicals use language that divides America along class lines. People without money and property are pitted against those who do. In essence, this is the old Marxist rhetoric that seeks to divide and conquer, replacing self-governance with authoritarian rule and a class-less society.

MAKING SENSE OUT OF TAXES: APPLYING DISTRIBUTIVE AND CONTRIBUTIVE JUSTICE

The Scriptures admonish us to "render to Caesar the things that are Caesar's and to God the things that are God's." What then do we owe Caesar? Do we owe him more when he is a just and compassionate leader, less when he is a cruel and inhuman tyrant? Do we owe anything at all to a tyrant? These questions must be addressed in terms of justice because justice is the principle that requires us to render to others that which is *owed*.

Three principles of justice apply to economic affairs: commutative justice, distributive justice, and contributive justice. Social justice depends on the faithful practice of all three. However, commutative justice which relates to what one economic agent owes another in a routine transaction, for example between a buyer and seller or worker and employer, is not relevant to the question as to how much is owed to Caesar. Only distributive justice and contributive justice apply. Taken together they help make sense out of the current tax muddle by reminding us as to (a) how we the people acting together and instructed by distributive justice ought to construct a tax code and (b) what each one of us acting individually and informed by contributive justice owe the government in terms of taxes and why we ought to pay what we owe.

Under distributive justice we the people acting through our elected representatives have an obligation to construct a tax code that distributes the benefits and burdens of citizenship/residency in some *equal fashion* among everyone who is a citizen/resident in the United States. Tax reform would change those benefits and burdens and presumably would make the code better reflect the financial circumstances of taxpayers.

Contributive justice requires taxpayers to comply with the tax code when its provisions properly reflect their financial circumstances. They have a duty to pay their taxes when as citizens/residents they receive benefits from the government such as national security, flood control, and air travel safety, and the code is reasonable. That duty is eroded when the benefits are not widely shared or the code is not reasonable as, for instance, in the extreme circumstances wherein the rich are able

to use shelters to avoid paying any income tax whatsoever or persons of lesser means avoid paying taxes by dealing in cash and being careful not to keep or sign receipts for certain transactions or to make a deposit or withdrawal from a bank account except when absolutely necessary.

Tax evasion is the intentional effort to not pay the taxes owed as prescribed in the tax code. It represents a direct violation of contributive justice because when evasion is successful other citizens/residents are forced to make up the difference either in the form of reduced spending, higher taxes, or increased public indebtedness. Tax avoidance is an entirely different matter. Avoidance means arranging one's income in a way which conforms to the tax code but reduces the amount of taxes owed.

In a republic the tax code is a product of the deliberations of the legislature. It depends, therefore, on legislators being well-informed about the facts of the financial circumstances of taxpayers and the role of distributive and contributive justice. Even then there will be complaints from some that taxes are too high and from others that they are too low. As annoying as they may be, complaints help the legislature become more vigilant about what taxpayers owe Caesar.

A tax code which regardless of before-tax income maintains everyone at the same level of after-tax income may give the appearance of equality but it actually treats citizens/residents differently. Equality of outcome has been achieved by means of inequality of treatment. Those who are poor are released from paying taxes. Everyone else is required to pay whatever taxes it takes to reduce them to the same level of after-tax income for all and to pay for the guaranteed annual income program that raises the incomes of the poor to the same income for all.

Under such a code, everyone is entitled to the basic necessities but no one is entitled to anything more. In addition to violating the principle of distributive justice by treating citizens/residents differently, the code disconnects the tax system from the principle of contributive justice that links the tax burden to the benefits received and replaces it with a system in which the greater one's income, the greater one's ability to pay, and the greater one's obligation of pay even more. It changes the tax code into a scheme for redistributing income.

When it comes to constructing a budget, the representatives of the people have two duties: to see (a) that all spending is based on the needs of present and future generations, not their wants, and (b) that current tax revenue is sufficient to pay for every bit of that spending so that the current generation does not pass along to future generations the cost of providing benefits that the current generation avoids by running a deficit and selling government securities which future generations have to redeem. There is no justice when the government's budgeting process forces future generations to pay for the benefits it makes available to the current generation. Deficit-financed benefits represent ill-gotten gains for the current generation taken from future generations by imposing on them taxes without their consent.

When expenditures exceed revenues in a crisis such as a pandemic-induced economic contraction a *temporary* surcharge may be imposed. For reasons which we have just indicated, a budget deficit should be the exception, not the rule.

THREE REMEDIES

Mayo Research Institute has three tax-related remedies to help preserve our constitutional republic by defeating the forces that promote class warfare. The first is a flat-tax on income; the second is a national sales tax; the third is the elimination of the refundable tax credit. Both the flat tax and the sale tax have been advocated many times in the past by different individuals and organizations. The refundable tax credit is a relatively new provision of the tax code and to our knowledge has garnered little support for its removal from the code.

The present tax code is much too long and complicated for the ordinary taxpayer to understand fully. *The Standard Federal Tax Reporter*, for instance, publishes 18 volumes on the federal income tax law, regulations, and annotations in the code. No doubt, simplification would be helpful to the ordinary taxpayer. On the other hand, it likely would be harmful to those who currently operate or work for income tax preparation establishments.

Flat Tax Remedy. A flat tax on income to replace the present progressive tax would greatly simplify tax preparation for the ordinary tax filer especially if the flat tax were to eliminate the vast assortment of provisions of the present code that exclude income from taxation. Just one rate for everyone, with the rich still paying far more in taxes than persons with lower incomes. Even persons in poverty pay the same rate on their cash income, which is reasonable because it would not touch their benefits in kind: Medicaid, SNAP, housing, in addition to refundable credits. Furthermore, it means that even the poor have skin in the game. Treating everyone the same conforms to the demands of distributive justice and has the additional beneficial effect of reducing class warfare.

Such a no-exemptions flat tax would reduce the pay-for-play incentive which is a regular phenomenon between persons with money and influence willing to financially support members of Congress for a favor that will reduce their bottom-line taxes owed. Moreover, the higher marginal tax rates of the progressive income tax rests on the “stick-it-to-them” argument that the government is justified in treating taxpayers with higher incomes differently than others with lower incomes just because they have more money. It is a violation of distributive justice.

A flat tax may have the additional beneficial macroeconomic effect of reducing the size of the underground economy, which has been estimated for 2018 at between \$2.25 trillion and 2.46 trillion (Johnston 2019), if the flat tax is perceived by the general public as being a better, more equitable scheme than the present income tax code. Specifically, if it increases the amount of

wages and salaries paid that previously were not reported, that outcome would raise the amount owed and paid in taxes and may help reduce deficit spending.

Sales Tax Remedy. Implementing a national sales tax is not as radical as it sounds. The federal government for years has imposed a tax on motor vehicle fuel. Presently the price of fuel at the pump includes at federal tax of 18.4 cents per gasoline. The proceeds are earmarked for the highway trust fund. MRI's second tax-related remedy imposes a national sales tax with exemptions for prescription drugs and other expensive goods and services critically needed by persons and families. As with the flat income tax, a national sales tax treats everyone the same. On any specific item for sale, the same tax is paid by rich and poor. Additionally, it helps assure that everyone, rich or poor alike, is contributing to the support of government which provides across-the-board benefits such as national defense, law enforcement, economic and weather information, and flood control to rich and poor alike.

Refundable Tax Credit Remedy. The third income-related remedy calls for the elimination of the refundable tax credit. This type of tax credit is one of the more important reasons why so many tax filers pay no federal income tax. Assume, for a moment, a household owes taxes of \$650 and holds a tax credit of \$1000 on a new electric vehicle it has purchased. A refundable tax credit would reduce its tax obligation to zero and issue them a check for \$350 -- the difference between \$1000 and \$650. A nonrefundable tax credit would reduce its tax obligation to zero but not cut and send them a check for \$350. Eliminating the refundable tax credit would have the beneficial effects of helping to manage the government deficit by reducing spending and of reminding all Americans that they have a duty to contribute to the support of their government. "It's free" is not really free because someone else is paying for it.

Personal income in 2019 was \$21.690 trillion; consumption expenditures amounted to \$14.533 trillion (Flynn 2019). A very rough estimate of the static revenue yield¹ from a simple flat tax of 15 percent on income without any exemptions would be \$3.3 trillion. Similarly, a crude estimate of the static revenue yield from a 10 percent national sales tax would be \$1.4 trillion. The combined yield of \$4.7 trillion which would cover the amount of government expenditure in 2019 of \$4.4 trillion (Flynn 2019) without running a deficit.

MRI has no recommendation for a specific rate for the flat income tax or for the national sales tax. Reaching agreement on those tax rates rightly belongs with Congress. However, minimally the two taxes taken together, along with the elimination of the refundable tax credit, ought to help

¹ Static tax yield refers to an estimate based on the premise that the change in the tax does not change human behavior. In our example, changing to a 15 percent flat tax does not change the personal income estimate that flat tax rate is applied against. Neither does introducing the 10 percent national sales tax change the estimated personal consumption expenditures against which the sales rate is applied. Dynamic tax yield refers to an estimate based on the premise that the tax in fact changes human behavior. The problem with dynamic analysis is that it is difficult to model behavior because human behavior is not entirely known and predictable.

reduce the federal deficit and nudge Congress away from the corrupting influence of the pay-for-play scheme. Insisting that everyone, whether rich or poor, has skin in the game should help undermine the appeal to further divide America along class lines and thereby further protect our constitutional republic.

CONCLUSIONS

In the republican form of government, which rests on the principle that the people are able and willing to govern themselves, the day-to-day responsibility to govern is assigned to representatives whom they elect to carry out their directives. The representatives of the people carry out the directives of the people by constructing a tax code that complies with the demands of distributive justice and contributive justice which makes for a tax return which is simple to fill out and file, and by seeing that the code is applied as written to all citizens/residents without fail.

Further, the people's representatives are duty bound to see to it that all spending is based on the needs of present and future generations, not their wants, and that current tax revenue is sufficient to pay in full for that spending. Deficit-financed benefits that are not available to future generations represent ill-gotten gains for the current generation which are taken by imposing without their consent taxes on future generations to redeem the government bonds needed to cover the cost of those benefits.

A 15 percent income tax with no exemptions and a 10 percent national sales tax appear to yield sufficient revenue to fully cover the \$4.4 trillion government expenditures without incurring a deficit.

The citizen/resident has no right to be completely exempt from paying taxes unless s/he has been excluded from the government benefits that other citizens/residents routinely receive. Everyone must have skin in the game as the price for preserving self-governance. Extending the right to vote to more and more persons who pay no taxes, all the while expecting persons of means to shoulder nearly all of the tax growing tax burden, is a formula for destroying a republican form of government.

Government has no right to tax its citizens/residents without their consent. That axiom was an essential demand of the founding fathers of our constitutional republic and today continues to give meaning to self-governance. Government runs afoul of that axiom whenever it imposes the cost of providing benefits to the current generation on future generations through deficit-financing, and whenever it imposes greater tax burdens on some citizens/residents to cover the cost of "pay-for-play" schemes that allow privileged taxpayers to shelter some of their income from taxes. The more we depart from that axiom, the greater the threat to self-governance.

REFERENCES

Flynn, Crystal (2019). “Where Federal Revenue Comes From and How It’s Spent,” St. Louis Federal Bank, November 27.

Johnston, Matthew (2019). “How Big Is America’s Underground Economy?” *Investopedia*, November 9, updated June 28, 2020.

Long, Russell (2014). “Don’t Tax You. Don’t Tax Me. Tax That Fellow Behind the Tree,” *Quote Investigator*, April 4.

Watson, Garrett (2021). “Covid-19 Tax Relief Added to Increasing Share of Households Paying No Income Tax,” *Tax Foundation*, August 20.