

# Libertarian “Taxation”

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## Summary

Libertarians favor a strictly limited minimal state. Funding any state is problematic as most forms of taxation violate the Non-aggression principle and are the equivalent of robbery. A small amount of aggression by taxation can be accepted so long as the minimal state can effect a reduction in aggression (by helping secure citizens' rights) that is greater than that added by the taxation (a net reduction of aggression). The following revenue sources are listed in the order they should be employed. The first three are consistent with libertarian principle, but likely cannot provide sufficient revenue. The remaining two violate libertarian principle and their use must be minimized and strictly limited.

1. Usage Fees – Toll roads and bridges are examples and a fuel or mileage tax could be a reasonable approximation.
2. Land Value Tax – All land is appraised as unimproved land and taxed a rate not higher than half the prime interest rate. (Improvements are never taxed.) Other similarly valuable and limited natural resources (e.g., the electromagnetic spectrum and the number of geosynchronous earth orbits) can be taxed in the same way.
3. Severance Tax – Non-renewable natural resources (oil, gold, uranium etc.) are taxed at a rate not to exceed 24% of the initial sales price to be paid by the first seller of the resource.
4. Import Duties and Imposts – A low and uniform tax (not to exceed 6%) would be imposed.
5. Sales Tax – A tax not to exceed 9% is collected as a part of the sale to the end user or consumer of most goods and services. The only exceptions are food, clothing, medical costs and most education costs.

One potential revenue stream that entirely passes libertarian muster has not been included on the list: the “environmental impact fee.” The ways in which people can infringe upon each other's equal rights through the environment are extremely complex, varied and difficult to define in advance. Often, determining who has harmed whom and by how much requires much expert analysis and careful deliberation. Worse, things change with time, circumstances and technology. There is just no reasonable way to turn this kind of mess into a revenue stream that comes anywhere close to the definition of a “good” tax. It would have to be left to the politicians to devise and endlessly amend a thicket of laws. If a limited minimal state is ever to be achieved, this is precisely the sort of thing that absolutely must be kept out of the hands of crappy politicians. Adjudication on a case-by-case basis in the courts is by far the better choice for such issues.

## Introduction

The essential core of the libertarian philosophy can be very simply stated as “live and let live.” People must be free to do whatever they like so long as they do not adversely and materially interfere with anyone else's equal liberty to do likewise.

Also at the heart of libertarianism is the fact that each person completely owns himself or herself. It follows that each person owns his or her labor and the product thereof. No person or group of

people has any claim on another person or the fruits of another person's labor. On the flip side of that coin, each individual is responsible for himself and for his actions.

Force itself is neither good nor evil, but can be used for either. Defending a person against aggression or collecting a just debt that is delinquent is consistent with libertarian principle; force used for murder or robbery obviously violates libertarian principle. The use of force or coercion on people is the antithesis of liberty; they either are forced to do what they do not wish to do or are prevented by force from doing things they do wish to do. Clearly, force and coercion must be minimized and carefully restricted to good uses consistent with libertarian principle.

Most libertarians believe that some sort of limited power structure (usually called a government) is necessary to secure a basic set of individual "rights." This necessarily is a highly dangerous entity since governments are nothing but pure force (normally projected through "laws" and law enforcement), and they inherently have an inexorable tendency to expand their powers until they are out of control. Even if a way can be found to keep such governments under control, they do require resources to operate. These resources are usually confiscated through taxation. Whammo!! Fundamental libertarian principle is blatantly violated: the government is going to employ force to steal the fruits of people's labor. Libertarians advocate completely voluntary interactions, so voluntary payments to the government for value received would be the only acceptable funding approach; the well-known economic free rider problem unfortunately renders this a generally unworkable alternative.

The taxation problem alone is sufficient cause for some libertarians to eschew a minimal state solution (although power growing out of control is a far more serious danger in every respect). For those unalterably opposed to any state for reasons other than taxation, the following discussion will be of academic interest only. But before ruling out a minimal state *because of* the taxation issue, some further thought may be warranted. It might be possible to generate revenues using ways that are consistent with libertarian philosophy, or at least not grievously at variance with it. If resources must be extracted from the private economy, careful consideration should also be given to minimizing the damage done to the private sector. All taxes (as well as subsidies) cause distortions of the free market. In addition to the little problem of theft, this is yet another reason why taxes should be kept very low.

### Usage Fees

Usage fees are an entirely libertarian means for raising revenues in some limited cases where:

- The government is legitimately providing public goods or services (that cannot reasonably be provided privately).
- Each consumer's usage of a good or service can be measured and charged for in proportion to its cost.
- Consumers' access to the goods or services can be denied unless paid for (no free rider problem).
- Fees collected are utilized to pay the cost of each good or service.
- Per normal free market operation, prices generally would adjust so that the quantity supplied equals the quantity consumed (so some profits might possibly be realized).

Toll bridges are an obvious example of a usage fee and a fuel tax could be a pretty reasonable approximation of one.

The largest single legitimate government public good (and cost) is the common defense. It is also the poster child for the free rider problem. Defending the nation defends everybody and there is no reasonable way to deny this benefit to somebody who does not wish to pay his or her share.

Obviously, usage fees should be applied wherever feasible, but it is also clear that they could not cover the entire cost of government. So, another acceptable means of raising significant revenue is needed.

### Land Value Tax

There is a reasonable candidate; it is called a Land Value Tax. LVT characteristics are simple to state:

- All land is valued as *unimproved* land (improvements should never be taxed).
- A percentage of the unimproved land value is collected as an annual tax.

Unfortunately, LVT raises more hackles than not. The gut reaction is, “It’s *my* land; why should I have to pay what is in essence rent on property that I own?” Such an attitude is entirely understandable, but often stands in the way of a more rational analysis. A deeper examination will reveal that LVT has significant economic benefits that other forms of taxation lack, as well as (surprise!) being consistent with libertarian philosophy.

Suppose you work very hard for a number of years saving up to buy a cool \$100,000 yacht. When you pay for it, the yacht becomes your personal property. Clearly, the yacht is nothing but the fruit of your own labor. You earned it. You have (or certainly should have) what is known as allodial title to it. That means you alone have total ownership and control over the property; certainly, no one can charge you rent for it. Ah, but the government has instituted a 1% personal property tax and it costs you \$1,000 each year up front just to own the thing. In essence, you have to rent your own property! Short of murder, this is perhaps the worst affront to libertarianism imaginable. With an income or consumption tax, at least you only pay once per dollar of income or expenditure, but this abomination keeps coming back year after year. You’re forced to run on a treadmill just to stand still.

Instead, suppose you had spent your hard-earned \$100,000 on a beautiful 100-acre plot of land in the mountains. You owe a \$1,000 LVT each year. How is that any different? It is different because land is a very different kind of property than a yacht in some very fundamental and important ways.

In order to gain allodial (absolute) title to anything, you have to either create it yourself entirely as the product of your labor, or buy it from a seller who has an allodial title that can be transferred to you as a result of the purchase. The yacht manufacturer had allodial title to the yacht because they manufactured it from scratch. Did the previous owner of the 100 acres have an allodial title? It turns out that the answer has to be no.

It has been a long time since any land was created from scratch and, so far as we know, no person or group of people has yet created any land. Pre-existing land is not the fruit of any person’s labor. Therefore, the very first possessor of the land could not have had an allodial title. Therefore, no one in the ensuing long chain of transfers could have had one either.

Note that there is a basically fixed amount of land that was present before people showed up. Libertarians certainly would agree that, when people came along, each should have an equal

opportunity to use the land and no one should interfere with another's equal ability to do so. There is no problem as long as there are only a few people and lots of unused land. In fact, since the supply greatly exceeds the demand, it would be impossible to charge anything if you wanted to sell or rent land.

But what happens when the supply of unused land dwindles? Too bad, it could be argued, those who jumped on the opportunity while it was available are those who "most deserve" the land and probably will be the ones who will put it to the best productive use. Productive use of land benefits everyone and becomes even more important when supplies are limited. But what about those of us who were born long after substantially all land was spoken for? It isn't that we late comers failed to "carpe diem," others already controlled all the commonly available land before we gained first consciousness. Clearly, every person must use at least some land upon which to simply exist and to labor. It could be argued that we certainly can still own or rent land, but it's really not quite the same; now we have to pay for it with our labor instead of enjoying free use. Also, notice that land has acquired a value since demand has exceeded the limited supply; land can now be sold or rented.

We have already agreed that each person should have equal opportunity to use the land. There is no such thing as a "right" as it is commonly thought of and interminably debated.<sup>1</sup> The concept of "rights" is an invention of the human mind and a "right" exists in practice only to the extent that some power structure exists sufficient to secure what has been defined as a right from those who would deny it. It would seem quite validly libertarian to define and secure a right that guarantees equal benefit from the fixed amount of land that is commonly available to all. To do so might require an adjustment to the way we view land "ownership."

The price paid for land could be considered a bond that the possessor will be a good steward of the land. The LVT is a fee or a rent that is paid to everybody who does not own the land in return for them agreeing that the possessor shall have what is approximately the equivalent of allodial title to it for the time period that s/he possesses it and the rent is paid. (If we have a state, minimal or not, the title will likely have to be downgraded slightly from allodial to fee simple title.) If/when force is required to collect delinquent LVT, it would be considered collection of a just debt rather than theft.

So, we have now blown a number of paragraphs trying to make people feel better about paying an LVT. Whether or not this attempt has been wholly successful, we will move on to examining the economic characteristics of LVT.

In order to discuss the economics of LVT, we need to think of the value of land in terms of the free market rent it would fetch. This is because assessing an LVT will affect the price for which the land can be sold. The price is determined by capitalizing the rent. That is, the price equals the amount of capital that would be required to generate an amount of interest equal to the rent. By example, if a parcel of land can be rented for \$900 per year and the current interest rate is 3%, the price of the land would be \$30,000 (3% of \$30,000 yields \$900 of interest per year). But if the owner of this land is liable for \$300 per year in taxes, the net rent left for the owner will be only \$600. Thus, the price for which it can be sold will be only \$20,000 (capitalizing the \$600 at 3%). Clearly, it could be disruptive to collect too high a percentage of the land rent as a tax. Prices would collapse and some land might even remain unutilized; very bad.

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<sup>1</sup> Minet, Roy (2009) *There Is No Such Thing As A Right*, Unpublished article.

However, setting LVT at the proper rate actually can produce some significant economic benefits. Holding land out of productive use would be discouraged while investing in improvements would be encouraged (rather than discouraged as is the case with conventional property taxes). The proper rate is much debated. It is not illogical to say that the possessor owes the entire rent. What might be a more reasonable and appropriate rate would be to collect approximately the price of the land over a lifetime of use, say 70 years. This would be a rate of 1.43% of the land price per year (or 14.3 mils). This rate translates to collecting just under a third of the land rent as taxes, again based on a 3% interest rate.

There are about 2 billion acres of land in the United States. Some is in downtown Manhattan and valued at millions of dollars per acre while much of it is in vast expanses valued at \$50 or \$100 per acre. Guestimating an average value of \$1,000 per acre and applying a 1.43% LVT rate would yield in the neighborhood of 30 billion dollars per year of revenue. Unfortunately, the defense budget is presently more than \$500 billion. Even cutting defense by 90% to \$50 billion leaves us a bit short of revenue and, of course, there is more to fund than defense (e.g., state and local budgets). Some economists advocate higher LVT rates and some claim that revenues could be much higher. However, limiting LVT to a “reasonable” rate and making a rough estimate suggests that we still will need additional sources of revenue.

So far, we have only considered “conventional” land. There is a fixed amount of land that existed prior to the arrival of people and which can neither be created nor destroyed. But there are some other resources that meet these same criteria; the electromagnetic spectrum and the number of geosynchronous earth orbits for satellites are good examples. An LVT can be applied in the same way to these resources.

### Severance Taxes

There are natural resources in the ground (oil, gold, uranium, gas, etc.). These were not created by the labor of people. Severance taxes on the depletion of such resources can be justified by the same reasoning that applies to land. As before, we need to limit this tax to some reasonable rate, say 25% of the sales amount to be paid by the extractor.

### Import Duties

Import duties and imposts might be considered next if additional revenues are necessary. Although difficult to imagine today, the young United States got along just fine for decades with just this as the primary source of funding for government operations. In the past, one could argue that these are voluntary taxes insofar as it is voluntary to buy imported goods; now, not so much, as nearly everything has some imported material and/or labor content. However, such fees should be uniform and low in the interest of free trade (say, a 6% maximum).

### Sales Tax

Although the mechanisms described thus far should come close to generating the revenues necessary to support a truly minimal state, it would be wise to provide for emergencies such as a major declared war which could legitimately require extraordinary short-term revenue. Unfortunately, we are fresh out of acceptable sources that offer even a fig leaf of libertarian justification. We will hold our noses and choose a broadly based sales tax on all goods and services sold to an end consumer. There should be no rebates, pre-bates, exclusions, other complexities or funny business. It is better to tax consumption than production, and we prefer a

simple tax that we can hope to keep politicians from converting to a tool for misguided socioeconomic engineering. Except for bona fide emergencies, the rate would be expected to be very low or zero. From a pragmatic standpoint, almost any tax can be tolerated if it is small enough. A three fourths vote should be required to increase the rate while a simple majority could lower it. A maximum rate limit (say, 9%) should also be imposed. Such a tax can be a powerful revenue generator if/as/when needed.

Although it really is not, some screech that a sales tax is “regressive.” Basic food, clothing and tuitions for education could be excepted from taxation to ameliorate said screeching.

### Conclusion

Revenue sources have been identified and listed in order of preference so that a minimal state could be largely funded in ways consistent with libertarian philosophy. A decidedly non-libertarian sales tax is proposed as a gap filler and short-term emergency revenue source, with a hard rate cap for safety.

Those who have considered this general problem in any depth probably will notice that one potential revenue stream that entirely passes libertarian muster has not been included on the list of “approved” sources. This would be the so-called environmental impact fee. It is the essence of libertarianism to expect those who have infringed upon the equal rights of others to pay restitution. Why has this potential revenue source been left off the list? The reason is that it sounds great on paper, but is awful in practice.

Perhaps the most important characteristic of a “good” tax is that it is clearly defined and simple enough for anyone to understand. It should be easy for taxpayers to know what they owe and when it is due. The tax should be hard to evade. The cost or overhead involved in calculating, collecting and enforcing the tax should be very low. It is also important to define the tax in some “permanent” way that will prevent politicians from tinkering with it for socioeconomic engineering purposes or to raise ever increasing amounts of revenue to support larger and larger government.

Many of the ways in which people can infringe upon each other’s equal rights are extremely complex, varied and difficult to define in advance. Often, determining who has harmed whom and by how much requires much expert analysis and careful deliberation. Worse, things change with time, circumstances and technology. There is just no reasonable way to turn this kind of mess into a revenue stream that comes anywhere close to the definition of a good tax. It would have to be left to the politicians to devise and endlessly amend a thicket of laws. If a limited minimal state is ever to be achieved, this is precisely the sort of thing that absolutely must be kept out of the hands of crappy politicians. Adjudication on a case-by-case basis in the courts is by far the better choice for such issues.

If we can move beyond the distasteful issue of funding a minimal state, we can then focus on the much more crucial problem of how to more effectively limit the state so that it cannot grow out of control. Our founding fathers made a creditable attempt with the US Constitution, but...

## **Appendix 1 – LVT Rate Relationships**

i = Interest rate as a decimal fraction

p = LVT rate as a decimal fraction of the land price

r = LVT rate as a decimal fraction of the land rent

$$r = \frac{p}{p + i}$$

$$p = \frac{ir}{1 - r}$$