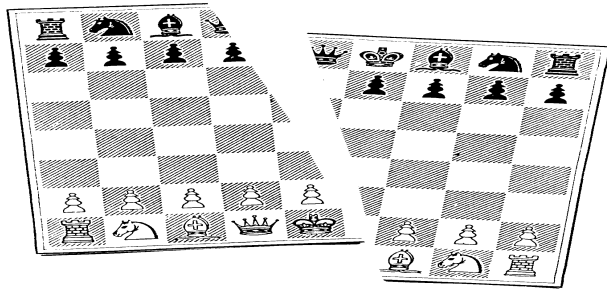


TAXATION VERSUS THE MARKET PROCESS



BARRY MACLEOD-CULLINANE

The resignation of its leader has prompted the Labour Party to embark upon a frenzy of recriminations as to who or what was to blame for its fourth consecutive election defeat. Central to this witch-hunt is the issue of taxation. Proposals to raise taxes are seen as the key factor in Labour's failure to wrest power from a Tory government presiding over an economy wracked by unemployment and recession.

Interviewed earlier this year, Mr Kinnock, in outlining Labour's tax proposals to be implemented upon election victory, claimed only 12% of earners, on "well over 30,000 a year", would be hit by a rise to 50% for the top rate of income tax.¹ A thorough misunderstanding of the market process is betrayed by his mistaken belief that the proposed tax hike would not affect the other 88% of earners.

This article's purpose is not to quibble figures which, as will become apparent, are often meaningless but to analyze the mechanics of State intervention, and to investigate the consequences of its disruptive influence upon individual choice, plan formation and action.

EXPECTATIONS, ACTION AND PLAN REVISION

The analogy of a chess game is used to illustrate an individual's decision-making process, first in an unhampered market economy.

Individuals speculate about the future: they form expectations and make plans to secure their desires. By trying to 'read' his opponent's likely responses and by projecting changes in the mutually supporting relationships of his and his opponent's pieces, and in the antagonistic relationships between them, Player (A) considers how best to attain victory.

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FOR LIFE, LIBERTY AND PROPERTY

Player (B) must re-appraise his contingency plans in the light of Player (A)'s move, discarding those 'plans' made irrelevant by time and human action, and select that move now considered most likely to secure his eventual victory.

The dynamic creation of new opportunities in chess requires continuous activity, ending only when victory for one, or stalemate for both, is achieved.

Unlike chess, and the Neo-Classical world of static equilibrium, where all activities have run their course, so beloved in mainstream economic textbooks, the market process is unending: no conclusion nor a solution set of mathematical equations exists. The passage of time, proving previously held expectations erroneous, necessitates constant plan revision and adaptation of actions.

COST, CHOICE AND SUBJECTIVE VALUE²

A chess player often faces a situation in which, whatever his move, he stands to lose at least one piece. His choice, of what to "sacrifice", may enable him to gain a strategic position or to capture a more valuable enemy piece, or it could be due to his opponent's superior play.

As the idea of "sacrifice" demonstrates, "cost" is a subjective evaluation, by the decision-maker, of expected benefits from alternatives foregone by his act of choice. Moreover, "cost" cannot be articulated to others: no objective measurement unit exists for the subjective, personal and ephemeral experience of anticipation that composes cost.

In 'sacrificing' a knight for a rook, Player (A) demonstrates that he considers the rook's capture more valuable than retention of his knight. Value is not inherent, but arises from the relationship between the observed and the mind of the observer: a player evaluates a piece's worth to the extent to which it relates to the achievement of his plans. A relationship eloquently described by the common expression that: "beauty is in the eye of the beholder".

Scientifically, all that can be said about a particular action chosen is that the economic agent preferred its anticipated outcome to alternatives considered, and rejected, at the moment of choice. Questionnaires reveal only that some individuals preferred to answer questions than to walk on by: they do little to dispel uncertainty about future choices.

MONEY, PRICES AND PROFITS

Pursuit of profit, and avoidance of loss, provide criteria for evaluating, and choosing between, alternatives. Afterwards, by comparing the outcome experienced with that expected, to determine whether his choice proved profitable, the individual can learn from experience to better anticipate events.

Whereas the chessplayer is akin to Robinson Crusoe, in being one against the environment in his efforts to survive and win, the economic agent in the market process engages in widespread social co-operation.

'Prices', emerging spontaneously in trade as individuals pursue satisfaction of their needs within a framework of private property-rights, represent unintended, but beneficial, results of voluntary human interaction. The entrepreneurial 'discovery' of money, the most marketable good, enables the specific knowledge of time and place (possessed by some) to be transmitted to all through fluctuations in the money price.

Reflecting increased scarcity, price rises encourage more prudent ownership, whereas falling prices of some goods prompt their substitution for expensive goods. Thus losses

shift resources to more capable owners, whilst profits permit further acquisitions.

TREASURY AS MINISTRY OF MISINFORMATION

With Labour's proposed Chancellor, Mr John Smith, recast as Player (A) and realisation that the chess pieces on the chessboard symbolize individuals interacting in the market economy, the tax-hike's effects can be examined. The Shadow Chancellor's opponent, Player (B), is the individual who must evaluate State actions.

A tax-hike, by altering an individual's circumstances, is like a thrown stone disturbing a still pond. Each person's capacity to anticipate, choose, and act implies plan revision in the shifting informational milieu, though these spreading ripples remain largely imperceptible to stone throwers on the bank or in No. 11 Downing Street.

Arguments that "State spending creates jobs and benefits the whole economy" are simply fallacious. Tax monies are resources, taken coercively from other parts of the economy, whose beneficial receipt must be concentrated: when £100 is taken from everyone and then returned, no-one's original position improves.

Like the slowly spreading mound created by pouring honey onto a flat tray, the effects of government spending last even after the flow is turned off. Its influence, through the price-mechanism, causes malinvestments by drawing resources to sectors experiencing net tax gains from those suffering net tax losses.

Without further State intervention to (temporarily) maintain them, malinvestments are liquidated as individuals revise their expectations with events; whilst automatic wealth transfers, or 'social security', following liquidations, perpetuate the distortion of information, choices and actions.

ANARCHY OR HIERARCHY?

Repeatedly, Neil Kinnock has declared that his tax increases would not disrupt the smooth intermeshing of individuals' plans and actions, but would affect only high income earners.³ The implication being that the Chancellor would intervene to 'correct' the unwanted outcomes of his previous intervention. Let us examine the mechanics of such 'corrective' intervention.

A single chess player can move all his pieces, i.e. those within his 'span of control', thereby readjusting all his mutually supporting relationships in response to changes wrought by his opponent's actions.

The Chancellor, trying to prevent tax-hikes from affecting other earners, soon encounters a physical limit beyond which it becomes impossible to re-write the changed text. Individual freewill quickly exceeds his 'span of control', his ability to directly coordinate and simultaneously readjust all the actions of taxpayers.

Even this misses the point. Over time the Treasury's hierarchical structure of intervention collapses into market anarchy, the polycentric organisational process formed by the horizontal interrelationships of many individuals. Indeed, markets, black or otherwise, sustain economies in spite of increasing irrationality caused by State intervention.

ETHICS AND ECONOMICS

If human action is 'right' from the actor's perspective, how can decisions by recipients of State monies and favours be condemned as 'wrong'? Issues of moral philosophy, such as

the inviolability of property rights (embodying individual rights), falling outside *wertfrei* - value-free - economic study limit economists to establishing the (harmful) effects of State violation of property titles.

Politicians, gripped by visions that 'public works reduce unemployment', are, instead, trapped by reality: marginal firms go bust; prospective enterprises are still-born in entrepreneurs' minds, and the next recessionary episode of the government induced trade cycle liquidates malinvestments.

Whereas the State only transfers wealth and jobs, the market creates them. Speculators investing in new factories are indistinguishable from playboys buying new sports-cars: each creates demand for more employees.

The costs of coerced transfer payments, whether UB40s or State-granted monopoly franchises, are comprised of all anticipated benefits, from the taxpayers' perspective, now forcibly foregone. Higher taxes, by penalizing entrepreneurs, replace queens with bishops, resurrect the 'British Disease' manifested in (capital) flight to tax havens, whilst State benefits raise pawns to knights.

An owner always uses his property in what he considers its most productive capacity. But when one group utilizes the State's coercive powers to enhance its own well-being at the expense of others, incentives for initial acquisition, trade, and capital formation will be reduced, as will economic prosperity.

Calls for rapid and widespread, privatisation in Eastern Europe vehemently reject this 'caretaker' mentality, yet in divorcing ownership and control of property the Welfare State heralds the returning economic Dark Ages.

SEEN AND UNSEEN

Frederic Bastiat, the Nineteenth Century French political-economist, in his famous essay "What is Seen and What is Unseen", summarized, for would-be statesmen, the questionable wisdom behind tax increases and public works. For,

[I]n the economic sphere an act, a habit, an institution, a law produces not only one effect, but a series of effects. Of these effects, the first is immediate; It appears simultaneously with its cause; it is seen. The other effects emerge only subsequently; they are not seen; we are fortunate if we foresee them.

There is only one difference between a bad economist and a good one: the bad economist confines himself to the visible effect; the good economist takes into account both the effect that can be seen and those that must be foreseen.⁴

The truth of Bastiat's observation cannot be evaded by the Labour Party and its leaders if Labour is to ever project itself as capable of forming a credible and responsible government.

NOTES

1. BBC Radio 4's "The World This Weekend", 05/01/92, as reported in *The Daily Telegraph*, 06/01/92, p.1.
2. On these ideas see Jack Wiseman, *Cost, Choice and Political Economy*, Edward Elgar, London, 1989; and James M. Buchanan, *Cost and Choice: An Inquiry in Economic Theory*, Markham, Chicago, 1969.
3. Ibid, Neil Kinnock, on TV-AM, Sunday 22/03/92, and throughout the election campaign.
4. Frederic Bastiat, "What Is Seen and What Is Unseen", in *Selected Essays on Political Economy*, George B. de Huszar, ed., Foundation For Economic Education, Irvington-on Hudson, New York, 1975, p. 1.