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The Crisis in Public Finance: *No Ways or Means*

PUBLIC finance is beset with the dilemma of meeting two objectives that may not be attainable. On the one hand, there is the prescription that any public financing scheme must be fair. Though there may be considerable divergence of opinion on what this means, there is some consensus that it must be considered in any financing proposal. The second objective is that the plan must be feasible. Contemplation of feasibility can range from simplistic administrative or enforcement concerns to more remote indirect impacts on the economy.

The problems faced in public finance are significantly different from those confronting non-governmental organizations. Private enterprises must obtain their funds via the voluntary transactions of the marketplace. Consumers are not required to purchase, or pay for, goods and services they may not want. Such is not the case when the government is involved as a participant in the transaction.

Fairness in private finance is achieved by virtue of the fact that all transactions are voluntary. Any would-be participant serves as the sole arbiter of the fairness of any bargain he may choose to make. In the non-voluntary transactions involving the government, the government serves as the arbiter of the fairness. The conformity of actual transactions with the great differences in perception regarding fairness must, unavoidably, be worse when one must judge for all (as in

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government enterprise) than when each may judge for himself (as in private enterprise).

In private enterprise the decision as to feasibility is rendered simply and swiftly. The marketplace is a strict disciplinarian in such practical matters. Unfeasible ideas never get off the ground, or quickly crash if they do. The marketplace performs this function continuously. The private enterprise, relying upon investors and customers for its resources, obtains a steady flow of information regarding the feasibility of its actual or intended plans.

Public enterprise does not have access to the same convenient feedback from the marketplace. Government produced goods and services are not really marketed to consumers. Often the purchase decision is involuntary, at least from the perspective of the consumer. Instead, purchase behavior must be simulated, assumed, or arbitrarily determined by some government employee.

Under such a handicap, it is extremely difficult for public enterprise to evaluate the feasibility of any plan. Isolated from the necessary information to specifically identify those goods or services which can be feasibly supplied, government must rely upon more remote indicators of viability. In place of product sales or company profits as measures of feasibility, the public financier must grapple with political resistance to a proposed tax or analyze the more widespread economic impacts of the government's coercive intervention into a particular sphere of business activity. The severance of the transaction in which the service is provided from that in which the revenue is collected makes any such analysis that much harder.

Unfair Means

The issue of fairness in public finance revolves around the answer to the question: Who *should* pay for whatever service is contemplated? Three separate approaches have been traditionally brought to bear upon this issue. First, it is often asserted that those who benefit from a government service ought to pay for its provision. Second, it may be argued that the burden of payment ought to be related directly to the costs incurred to serve a particular user of the service. Finally, some maintain that payment should be based upon the ability to pay.

The first and second approaches generally lead to financing schemes based upon "users funds," such as the highway users fund. The attempt is to draw revenues from those who use and benefit from the service rendered.

The ability-to-pay approach abandons any attempt to link consumption with payment. Instead, it

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is asserted that services ought to be dispersed on the basis of need, while receipts ought to be drawn from individuals according to their ability to pay. Since the major forms of revenue generation—income, sales, and property taxes—employed by the government are already structured along ability-to-pay lines, reliance upon this approach suggests that government services be financed out of a "general fund."

Each of these three approaches to public finance presents some problems. From a practical standpoint there is an immense difficulty in ascertaining just how much benefit is involved in any one user's enjoyment of public services. Private enterprise cannot serve as a model here because private firms do not concern themselves with attempts to estimate the benefits enjoyed by specific customers. If enough customers perceive sufficient benefit in purchasing a firm's products or services for the firm to meet its profit goals, then the product or service will continue to be provided. "Enough" and "sufficient," imprecise as they are, can be tolerated in non-governmental enterprises because they are disciplined by external market forces. On the other hand, such imprecision presents the government with horrendous problems because its goals are essentially undisciplined by any outside market forces.

While there can be more precision in the determination of costs incurred to meet a general specification of services or products supplied, the allocation of these costs to individual users may prove troublesome. It is true, of course, that private enterprises are also faced with cost allocation problems. These are, however, primarily bookkeeping problems since the price of the service or product is determined by the marketplace. Knowledge or estimates of price and volume allow a private firm to work backward to determine how much cost can be covered by anticipated revenues.

Unfortunately, this process does not work in reverse. That is, knowledge of production costs will not tell us at what price and in what volume the final product will sell. All too often, public agencies become entrapped in a cycle of ever-increasing deficits by trying to price the services they provide on the basis of the costs incurred.

How Measure Demand?

Ability to pay is easier to measure than either benefit or cost. It is evidenced in tangible property or income and sales transactions. However, regardless of the ease of measurement here, we are completely severed from any information that would indicate the demand for the services to be provided.

As bad as pricing schemes based

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upon estimated benefits or costs are, a system in which there is no price is much worse. Consequently, determining the amount of resources to be expended for whatever level of service is an entirely artificial process. We can have no objective idea of what degree of effort is necessary. Instead, completely arbitrary decisions must be made. Of course, there will be no way to tell whether these decisions will even come close to meeting genuine needs. The prospects for a balance of supply and demand under these circumstances are rather remote.

Not only is the public enterprise isolated from information regarding price and quantity, but struggles with these problems may appear relatively simple in comparison with the need to determine the product mix that should be offered.

Typically, consumer needs, wants, and means are greatly diversified. The demand is for variety. Variety is what private enterprise must provide. The multiplicity of firms *facilitates* the fulfillment of these needs. The absence of the power to compel purchase *forces* private firms to cater to these needs.

In contrast, the government has the power to compel payment for such services or products it may choose to provide. This is not to say that the government will necessarily abuse this power by enforcing the consumption of frivolous or inappropriate services. However, it is inevitable that at least some people will be compelled to finance services which they deem frivolous or inappropriate.

A sincere desire to minimize the instances in which compulsory levies will be perceived to be expended in an unjustified fashion usually results in a policy of standardized service geared to meet the minimum requirements. Some critics have characterized this as a process of catering to the lowest common denominator. Deficient as such a process may be in terms of some notion of an "ideal" resolution of varied needs and wants, it is, nonetheless, the best alternative, given the constraints under which the public agency must operate.

Can Might Make Right?

Our examination of the conditions pertinent to public finance would seem to indicate that there is no way in which fairness can be assured. To the contrary, any public funding scheme is bound to be unfair. The involuntary nature of all transactions in which the government is a participant insures this.

Whether one takes an approach based upon the "users" theory and attempts to equate taxes with some element of service rendered, or whether one adopts the redistributionist logic of "ability to pay," the fact remains, some individuals will

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be made to pay for services they neither want nor even receive. Only governmental sovereignty prevents this *modus operandi* from being classified as criminal.

Fairness to the consumer is stymied in both key aspects of the product or service exchange. Whatever approach is used to determine price, he will have no option but to pay. Meanwhile, the quality and quantity in which the product or service is dished out will be decided by methods other than individual consumer choice.

Since attainment of universal fairness is not possible, the next best course open to the government is to minimize unfairness. This it has generally attempted to do in a number of ways. Almost without exception, the initial imposition of levies based upon ability to pay has started with low rates. Unfortunately, these have escalated to a point where the search for alternative revenue sources has become a widespread phenomenon at all levels of government.

The motivation behind the search for alternative revenue sources may stem from an uncertainty of conviction as to the justice of the "ability-to-pay" principle—that it must stop short of its logical conclusion to reduce everyone to an equality of wealth or income. Further taxes, it is felt, must be justified on some sort of "services rendered" basis. Despite the well-documented problems with both the benefits received and costs incurred approaches to public finance, there is a general consensus that reliance upon such methods is less unfair than any other option that includes continued government involvement in the provision of products or services.

Another motive inspiring the quest for new revenue sources is the belief that the supply of resources available under the ability-to-pay scheme may be "tapped-out." This "tapped-out" concept may relate to an estimate of the economic or the political infeasibility of heavier taxes for the general fund. The law of diminishing returns is a well-established principle. It is inescapable that, at some point, continued hikes in the burdens imposed on those able to pay will produce lower revenues. It is also inevitable that as increasingly larger numbers of people are discovered to be capable of paying larger and larger amounts, the balance of political power is bound to shift. Political resistance to public financing demands cannot help but increase, as the appetite for larger servings of public revenue can only be satisfied by placing more taxpayers on the menu.

Infeasible Ways

Since the payment of taxes is normally an involuntary activity,

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the pragmatic issue of public finance is essentially a question of "who can be made to pay" and "how much he can be made to pay." This issue can be considered from two angles.

First, there are certain economic considerations. Who has how much? What is the cost of taking various amounts from him? What are the economic consequences of various levels of taxation?

Second, there are several political considerations. What is the capacity of the targeted taxpayers to resist the government's taxes? Are the targets ignorant and powerless? Or are they well informed and powerful? The answer to these questions will determine the extent to which the identity of who will be taxed will have to be disguised.

To date, the government has not made much progress in dealing with the economic implications of public financing activities. "Who has how much?" has been given devoted attention. The records of incomes, sales, and property are voluminous. The government effort in this area has been substantial. The cost of enforcing the taxes has been given some attention, but the effort has been inconsistent and marked by a measure of indifference. The economic consequences of various levels of taxation have been largely ignored. As a result, total public revenues are increasing, but not as fast as the costs of collecting them. Meanwhile the impact of taxation on the economic health of the society is subject to a great deal of speculation, most of it suspecting the worst.

It has long been acknowledged that, at some point, the total burden of taxation would become "excessive." Objectively, this means that the next hike in the rate of the tax would actually produce lower public revenues. There has been no actual proof of what rate turns the tide. Therefore, a prudent course might restrict the government's taxation activities to the absolute minimum. Instead, government actions have continually increased taxes.

Whether the government's toll of the productive output has reached or passed the point of diminishing returns is a matter of serious concern. Recent public discussion of this problem and the fairly substantial argument over whether a cut in tax rates would increase government revenues, would seem to indicate, in an informal way, that we may be at or near a point of diminishing returns. At the very least, it is established that a substantial number of people are convinced that such a point has been passed.

The Burden of Taxes

Every governmental ways and means proposal, then, is, of necessity, confronted with the question of its additional impact on the total tax

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burden. The fact that a particular tax proposal may be linked with a specific use for the funds generated does not insulate it from this total tax burden problem. Government imposed "users fees" are not market exchanges. The further removed these fees are from market exchanges, the greater the impact on the total tax burden.

The total burden, however, is not the only economic consequence of concern in public finance. The specific effects of each tax pose another problem. Tax rates or so-called users fees are not market prices. If the government's charge is less than the market price would have been, huge economic distortions may result. Demand for the underpriced product or service will be excessive. Demand for competing products will be suppressed. Greater supplies of ingredients to the underpriced item will be required. Each of these direct consequences will cause subsequent indirect consequences, creating a ripple effect of distortion throughout the economy. If the government's charge is more than the market price would have been, different, but equally serious, economic distortions would follow.

These distortions can lead to misallocation of resources and inefficiency. In effect, government taxes pollute the price system. The role of prices as feedback to the productive entities in the economy is thereby subverted. Wrong signals are given. Shortages and surpluses result. Resources are wasted. The rate of return on investment is reduced. Economic progress for all social groups is retarded.

This list of evil consequences may seem rather drastic. After all, how much devastation can be wrought by a few erroneous price signals? The degree of integration and sophistication that accompanies the advanced specialization of our high technology economy insures that the effects of even relatively minor transactions will spread throughout the economic system. Add to this the sensitivity of the price system as a continuous measurement device of the diverse wants, needs, hopes, ambitions, fears, greed, and other motivations of humanity, and you have a lever that can move the world.

Political Considerations

In contrast to the lack of attention given to the economic consequences of various public financing schemes, the political considerations of taxation have been handled with both dispatch and imagination. The growing proportion of total production being consumed by the government is evidence of the effort devoted to solving the political problems. Corporate America has been conscripted as the chief tax collector for both income and sales taxes, while the banking industry has been

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drafted to play a major role in collecting the property taxes on mortgaged real estate.

The capacity for tax resistance has been minimized by skillful placement of the collection point. The bulk of personal income taxes are *withheld*. Purchase transactions cannot be completed without payment of the sales tax. Property taxes are normally included in monthly mortgage payments. In most jurisdictions, seizure and sale of property for nonpayment of taxes is a simple and expeditious process.

While the historical record gives us every reason to assume that the government would be able to overcome the political resistance to increased taxation, there are several conflicting forces. On the one hand, most of the easy sources of funding have already been exercised, perhaps to exhaustion. On the other hand, the knowledge and will to resist further burdens seems to be on the rise.

The root of the public financing problem is that man-made law cannot abolish natural law. Enactment of government taxes can affect the distribution of economic goods, but legislative fiat cannot create economic goods. Instead, taxation unavoidably lowers the return on productive activity. Disregarding any disincentive effect, the reduction in the return, when compounded over time, must reduce the total pool of available resources *because a substantial potential quantity will never be created.* Resources which are not created cannot be diverted to government use. Even the most advanced political skills cannot alter this reality.

The Public Interest in Private Enterprise

Our examination of the dilemma of public finance would seem to indicate that in terms of equity, taxation is fundamentally unfair. The public enterprise is unable to determine what demand is, much less serve it. No bona fide exchange takes place. Individuals do not get what they pay for in any reasonable sense of the word. There is, in short, no defensible standard that is consistently employed in taxation other than convenience for the government.

Even convenience is unsustainable in the long run. The defenseless and the subservient have already been taxed, probably close to their capacity to pay. The strain on the economy's limited resources has become apparent. There is the very real possibility that any further attempt to raise revenues by increasing the tax rates will be counterproductive. Public enterprise has always been less feasible than private enterprise. The government must now face the prospect that this relative lack of feasibility is being replaced by an absolute infeasibil-

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ity, particularly with regard to the potential for additional revenue generation.

So, if public finance is both unfair and infeasible, what are the public policy implications? Expansion of the government's role must be ruled out. Replacement of public by private enterprise seems warranted.

The specific means for achieving the privatization of public enterprise must follow in the wake of a more widely spread recognition that such a step would be beneficial. The future viability of our economic system may well depend upon the speed with which such recognition takes place.

Another Anti-Inflation Circus

Hans F. Sennholz

EVERY U.S. President from the time of Franklin D. Roosevelt has been an "inflation fighter." Some denounced inflation as "public enemy number one," others even declared war on inflation.

And yet, since the first declaration of war by FDR, the American dollar has lost 80 per cent of its purchasing power and is losing more every day. Inflation is winning all the battles.

For almost 50 years of the anti-inflation war the U.S. government has pointed at several culpable parties. American business, especially big business, has taken the brunt of the blame. One President even used four-letter words to describe the greed of businessmen who raise prices. Some have taken potshots at physicians, attorneys, and other professionals, or pointed at labor unions. All presidents like to flail at speculators who hedge against the

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