



## **THE POWER TO TAX: A LECTURE OF HAYEK**

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### **Abstract**

*This article describes the argumentative structure of Hayek on the relationship between power to tax and redistribution. It is observed throughout its work giving special attention to two works: The Constitution of Liberty (1959) and Law, Legislation and Liberty, vol3; The Political Order of Free People (1979). Hayek describes one of the arguments most complete information about progressive tax systems (progressive tax), PT. According to the author the history of the tax progressive system, works against such a tax model and deploys a variety of arguments in his favourite spot by critics: liberal democracy.*

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**JEL classification:** E60, E62, E64, O23, B1, B2, E6

### **1. Introduction**

Tax policy and taxation is geared towards the creation of mandatory conditions for individuals and organizations, imposed by a government to obtain resources to finance spending on public goods and services and to control the volume of private spending in the economy. In each case, tax policy has been classified in different ways. On the one hand direct taxes (taxes on income or wealth), on the other indirect taxes are taxes on transactions especially the expense (tax on value added tax and excise).

The progressive tax system and progressive taxation in general relates to a situation in which the proportion of income earned through taxation (tax rate) increases with income and purchasing power. Most tax systems in the world are progressive in nature. His achievement is accomplished



through a system of increasing marginal tax rates as income increases<sup>1</sup>. It is possible to have a progressive tax expense in which the tax rates with increases in consumption expenditures. In this field are expanding as differences we observe in this article<sup>2</sup>.

If tax policy is complex redistribution also has problems (Estrada, 2010a). Both systems contain aspects for the study and scope of the tax system. In the case of redistribution is related to a process of altering the distribution of income or wealth exists in society. The redistribution can result from a deliberate policy of income among individuals or may be an effect "accidental" economic policy. It is generally possible to distinguish between monetary redistribution in which individuals were detracts or given money, and redistribution in kind, by which individuals are provided goods and services free or at subsidized rates.

This article describes the argumentative structure of Hayek on the relationship between tax policy and redistribution. It is observed throughout its work giving special attention to two works: *The Constitution of Liberty* (1959) and *Law, Legislation and Liberty, vol3, The Political Order of Free People*, University of Chicago Press, Chicago (1979). Hayek describes one of the arguments most complete information about PT progressive tax systems (progressive tax). According to the author the history of the tax system works against such a tax model and deploys a variety of arguments in his favourite spot by critics: liberal democracy.

The article is divided into two parts. The first describes the critique of Hayek PT progressive tax systems (Hayek, 1959: 1979) from their conception of social order and fiscal rationality. Hayek envisions a reflection on a key principle in liberal democracies: majority rule<sup>3</sup>. Furthermore extends comments on the moral influence tax decisions. The second is aimed at analysis reception Hayek Brennan constitutional economics/Buchanan (1980). In the interpretation of tax policy has decisively if governments reflect a tyrant or a benevolent Leviathan State.

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<sup>1</sup> Diversification of tax systems is a constant in economic history. Among the most prominent types are: Ad Valorem tax, poll tax, inflation tax, luxury tax, Pigovian tax, corporation tax, inheritance tax, specific tax, proportional tax, regressive tax, excise tax, tax on capital expenditure tax, Wealth tax, tax on business traffic, value added tax (VAT) tax on carbon emissions, income tax, purchase tax, Income Taxes capital, taxes on imports, payroll tax, sales tax, tax on excess wages, transfer tax, tax unit, import taxes and excise. For a detailed discussion: *Macmillan Dictionary of Modern Economics*, David W. Pearce, Macmillan Press Ltd. 1992.

<sup>2</sup> One of the most celebrated works in defense of progressive tax imposed has been the work of Edwin R. A. Seligman: *Progressive Taxation in Theory and Practice*, 1894. Seligman developed the history of progressive taxation and assessment of theory from Wagner socialists, Paine, Guicciardini, Marshall, Licht, the theory of profit which contrasts proportionality and progressivity, the theory of utility costs and their subsequent decay. Based on a broad portfolio of thinkers: Hobbes, Pufendorf, Turgot, Proudhon, Sartorius, Braun, Seligman identifies advocate line through the proportional tax benefit. And then question it from the beginning of social and economic philosophy Gandillot, Bentham, Robespierre, Vauthier. The most salient components of the work of Seligman, however, are in the third part of this work where an application of principle to power progressive tax in the United States and Spain. (la traducción al español: *El impuesto progresivo en la teoría y en la práctica*, Trad. I. Victor Paret, Madrid, 1913 [en la Biblioteca de la Universidad Externado de Colombia, Clasificado: 336.293. S 464 i, ej.1])

(Spanish translation: The progressive tax in theory and in practice, Trad. I. Victor Paret, Madrid, 1913 [in the University Library Externado de Colombia, Rated: 336,293. S 464, ej.1]).

<sup>3</sup> A comparative work between the tax structure and electoral rules that significantly extends Hayek to differentiate relevant aspects of the author's position with regard to conventional economic tradition



In summary, this article describes Hayek's position on taxation and subsequent developments. In the context Hayek defends controversial extended arguments on proportional tax system. If a majority rule corrects deviations from political power must also limit the progressive taxation conditions. According to Hayek the progressive tax system (PT) violates a principle of constitutional law by creating more obligations between those who work for the growth of the economy, in this sense, the progressive tax system operates counter to principles of democratic justice.

This version of Hayek's criticism since the economy expanded constitutional Brennan/Buchanan (1980). The argument is that the potential addition of a tax collecting duties commensurate with a broad base (eg VAT) always tends to be greater than that of a highly progressive tax on a more or less comparable. This argument suggests that a shift to more restrictive constitutional guarantees of uniformity of the tax rate may be undesirable. The argument rather indicates that in some cases, equal tax treatment can be guaranteed at the expense of more stringent safeguards against the absolute limits of income (Estrada, 2010b).

Our goal is working on two units as separate arguments. The Hayek hypothesis rule within a liberal market economy extended to matters of liberal political economy (close to Robert Nozick). The critical version of Brennan/Buchanan controverts arguments of political liberalism from a Hobbesian political economy (other than John Rawls). If Leviathan is at risk of being domesticated responsibility in fiscal matters of constitutional theory is to impose limits. The main achievement of this article is to detail both units showing how the second argument complements the first. And as the first argument (Hayek); is still relevant in the contemporary tax debate, when we can analyze the second (Brennan/Buchanan).

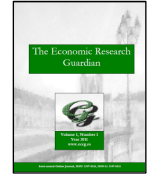
## **2. Hayek's argument against the progressive tax system**

One of the central hypothesis focuses on Hayek's assessment of the political economy<sup>4</sup> that has given rise to a progressive tax system PT<sup>5</sup>. This system is for the author against the spirit of open and

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<sup>4</sup> Friedrich Hayek's work is a real paradigm in almost all areas uncovered by the contemporary economic theory, whether in a higher level of scale: monetary problems, financial systems, foreign trade, pricing system and so on, down to a micro level: psychology rational preferences, markets, labor system, consumerism, etc.. Samuelson recently led a tribute applauded by the international scientific community: "Personal report, A few remembrances of Friedrich von Hayek (1899–1992)", *Journal of Economic Behavior & Organization* 69(2009) 1-4; Andrew Farrant, Edward McPhail, "Hayek, Samuelson, and the logic of the mixed economy?", Tatiana Damjanovic, David Ulph/*European Economic Review*, Sep. 2009. Hayek contrasts between Adam Smith, Daniel B. Klein., Smith –Hayek: Economist: From Character to identity", Institute of Economic Affairs 2007. Further: G. R. Steele, Friedrich A. Hayek, "The Complete Economist", *Institute of Economic Affairs* 2008, pp. 67-69. Dos estudios biográficos Bruce Caldwell, *Hayek's Challenge: An Intellectual Biography of F. A. Hayek*, Chicago, IL: University of Chicago Press, 2003, pp. 500; Alan Ebenstein, *Hayek's Journey: The Mind of Friedrich Hayek* (London: Palgrave Macmillan, pp. 288.

<sup>5</sup> Although the chapter we discuss Hayek develops a detailed history of the SFP, the latest developments and relying on econometric models can already be axiomatic in: Tatiana Damjanovic, David Ulph "Tax progressivity, income distribution and taxation-compliance", *European Economic Review*, Sep. 2009.



liberal society because higher tax rates imposed by the higher rents<sup>6</sup>. It establishes a bias on economic wealth and affects the incentives of working age. Hayek's position in this chapter is openly polemical. This is recognized:

For many reasons I would like to skip this chapter. The dialectical contradiction criteria used so widespread, it will necessarily have to offend many. Even those who have followed me this far, reasonable considering all of my posture, probably think my views on radical tax system is clearly also not possible to implement them<sup>7</sup>.

Problems are closely related to the area of taxation and the tax structure but mechanisms significantly affect a wide range of fields related to equality and freedom. This is the central premise of the arguments presented and the reasons why your thoughts have scope to our time. The act of generating wealth is linked to a fundamental concept designed to identify individual freedoms. Hayek notes that fiscal problems are partly to its foundations in moral philosophy practiced by society<sup>8</sup>.

The contradictory nature of PT progressive tax system with respect to a proportionate tax system is also reflected in the imbalances that promotes and freedoms denied (Nicolò De Vecchi, *Hayek and the General Theory*, 2006, Wenli Li and Pierre-Daniel Sarte, *Progressive Taxation and Long-Run Growth*, 2004). While a proportional tax burden seems to better fit the criteria of political equality, the SFP impairs the basic incentives of competition in the markets and wealth is subordinated to the democratic vote of majority. Tax Saving subject to trends and changes introduced by the legislature. One objective of Hayek is oriented to identify with classical liberalism illegitimate transfers of political power<sup>9</sup>.

Recall that the progressive tax system is one of the fundamental methods of income redistribution (N. Gregory Mankiw and Matthew Weinzierl, "The Optimal Taxation of Height: A Case Study of Utilitarian Income Redistribution", 2009, Nicolas and Patrick Pintus Dromel, "Are Progressive Income Taxes Stabilizing? 2008). So your exposure Hayek critique means to attack one core of prejudices inherited on tax matters. The rise of progressive taxation had its early origins in invoking fraudulent false pretences; Hayek mentions his defence in Marx and Engels and their opponents in the economic history of liberalism<sup>10</sup>:

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<sup>6</sup> The concept of *Open Society* is a legacy of Karl R. Popper political debate during the period after World War II. We know from the same notes that Hayek was estimated by the philosopher of Vienna. Popper's arrival at the London School of Economics was achieved through the good offices of the economist. Some authors observed significant differences on this concept, see for example: Naomi Moldofsky: "Open Society: Hayek vs. Popper?", *Economic Affairs*, april-june 1985.

<sup>7</sup> Friedrich A. Hayek, *Los Fundamentos de la Libertad*, Octava Edición, Unión Editorial, Madrid, 2008, p. 407, and 408.

<sup>8</sup> Hayek's relations with the classical tradition are unavoidable, particularly with the *Theory of Moral Sentiments* by Adam Smith. See op., Daniel B. Klein, "The Smith-Hayek. Economist: From Character to Identity ", p. 4; Amos Witztum, "Smith's theory of actions and the moral significance of unintended", *The European Journal of the History of Economic Thought*, 15(3): 401-432, September 2008.

<sup>9</sup> *The Fatal Conceit: The Errors of Socialism* (The Collected Works of Friedrich August Hayek, Volume I) Routledge y Chicago University Press, 1988; Hayek, Friedrich A., *Principios de un orden social liberal*, Unión Editorial, S. A. Madrid, 2001.

<sup>10</sup> The historical line of argument followed by Hayek ranging from fiscal policy in Renaissance Italy, the French Revolution until the period after World War II, reviewing a voluminous tradition from Florence (Italy) during the second half of the sixteenth century, compares regions fundamental geopolitical Europe and America: Britain, Germany, United States, reviewing outstanding authors of classical liberal tradition: John Stuart Mill, Edgeworth, Wieser, Marx and Engels.



Among many arguments in support of this thesis and that still survive in the textbooks of Public Finance, was imposed which ultimately gave more scientific appearance of progressive rate tax. The basis of this dialectic is none other than the diminishing marginal utility of the successive acts of consumption. Despite or perhaps because of its abstract nature, this theory has gained support scientifically predicament to what until then had been and was admitted on the basis of arbitrary assumptions<sup>11</sup>.

In the controversy Hayek defines the historical and methodological conditions gave way to the imposition of the PT<sup>12</sup>. A lesson based on false assumptions and describes how the harsh polemics on the value and usefulness undermined the premises PT support. Furthermore the difficulties to quantify or compare the utility felt by different subjects. Similarly Hayek accuses weaknesses on the concept of value for tax analysis methods. The defence as a criterion to justify a burden on redistributive means, according to Hayek: "a serious mistake"<sup>13</sup>.

The criticism of the author breaks down the opposing arguments in the field of political economy: tax progression did not benefit the poorest; the profit fell to class better equipped and the lower strata of the middle classes, "who supplied the largest number of voters"<sup>14</sup>. Hayek stresses how different interest groups may push the tax changes. The economic policies depend on interests external to the economy itself. A determination of income decreasing productive are limited for ideological reasons<sup>15</sup>. Hayek emphasizes the political nature of the progressive tax system in order to highlight responsibilities<sup>16</sup>.

Contrasting upon revenue derived from the progressive tax system, Hayek supports that revenues are minimal when compared with negative effects on production and incomes increased volume<sup>17</sup>.

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<sup>11</sup> Friedrich A. Hayek, Op. Cit., 411.

<sup>12</sup> Domenic Antonio Faust, Italian economic historian, interprets the fiscal tradition with criteria different from those of Friedrich A. Hayek. In the Italian tradition of public finance the issue of redistributing wealth and reducing inequalities through the SFP does not follow a strictly utilitarian ethics applied to tax problems. These utilitarian principles are abandoned in the historical context of the Italian fiscal power. This argument is due, according to Faust, the egalitarian nature of political tradition in Italy. The maximalist approach of individual utility is unknown to this tradition, Italians, according to Faust, seem closer to the criteria of justice as fairness in John Rawls. See: "The Italian theories of progressive taxation", *Euro. J. History of Economic Thought* 15:2 293-315 June 2008.

<sup>13</sup> Until today that is controversial SFP cannot solve the basic problems of tax reform. It is assumed that an increase in personal allowances helps the tax system becomes more progressive. This assumption takes into account that fiscal responsibility is never equal to zero. But what happens if we generalize? ie, we get those with zero personal income taxes paid. Well, would change completely our conception of the PT. There will be difficulties in analyzing the emissions rights and related income tax deductions and credits. We will have a very different record on the books of accounts. This shows that the tax burden becomes more progressive as far as performance-enhancing. We have no other choice. An extension to this argument: Michael Keen, Harry Papapanagos and Anthony Shorrocks, "Tax Reform and Progressivity", *The Economic Journal*, 110 (January), 50-68

<sup>14</sup> Friedrich Hayek, Op. Cit. Ibid., pp. 414, and 415.

<sup>15</sup> Rivalries in the economic tradition go by the dichotomy between scientific theories versus ideology. The issue is not easily resolved. In previous work I have reviewed the controversies and disputes in the economic debate. In especial the arguments presented by Daly/Bhagwathi about the advantages of free trade (Estrada, 2006).

<sup>16</sup> Those who recognize the argumentative structure of modern law, particularly in the context of German-legal tradition that goes back to Kant can be seen that Hayek proposes to enter the opposite field in order to play the cards (arguments) of their adversaries. An original episode Kant succeeds in writing the run to the *Critique of Pure Reason*.

<sup>17</sup> But the impact of fiscal shocks not only had macroeconomic consequences, the work of Burnside/Eichenbaum/Fisherc, "Fiscal shocks and their consequences" investigates labour shocks arising from fiscal policy in the U.S. after the Second World War. These fiscal shocks were associated with overall increases in private consumption". The authors



Record the highest income tends to reproduce a broken string on those who generate more and better income opportunities. Redistributing the wealth suggests the market entry of a hand visible and clearly skewed to make decisions that affect everyone. One of the conflicting evidence of the PT is comparative studies that Hayek is among the United States, Britain, France and Prussia. Based on the work of G. Shirra Findlay and L. Rosta, in 1943 (Table 1):

Table 1 - Rent and percentage absorbed taxation

Rent (L)	Percentage absorbed taxation
100	18
150	16
200	15
250	14
300	12
350	11
500	14
1000	19
2.000	24
2.500	25
5.000	33
10.000	41
20.000	50
50.000	58

Source: G. Findlay Shirras y L. Rostas, *The Burden of British Taxation*, Cambridge University Press, 1943. En Hayek (416).

In his commentary Hayek observes that:

The studies agree that, in general, middle-income taxpayers, who provide the largest number of voters, were the least punished, while the minimum income, on par with the highest incomes, burdened with an overall proportion much heavier<sup>18</sup>.

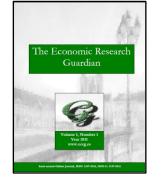
The data reflect the case of Britain, where in 1936 - 1937, total tax burden of families with two children was 18 percent for those whose annual income stood at 100 pounds and decreased gradually to a minimum of 11 percent for 350 pounds, to rise again to 19 percent with only 1000 pounds. Hayek, to demonstrate that "the most needy are not the biggest benefit, but the classes that constitute the majority in voting, and also that everything that was obtained by the progression could have achieved tax burden of middle income earners as intensely as they do with the poorest groups<sup>19</sup>.

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describe and apply a methodology to assess whether the neoclassical models could account for the consequences of a fiscal policy shock. See, *Journal of Economic Theory* 115 (2004) 89-117.

<sup>18</sup> Ibid., pp. 416, and 417.

<sup>19</sup> An update that shows the tax and investment behaviour in the U.S. during the last period: Douglas G. Steigerwald and Charles Stuart, "Econometric Estimation of Foresight: Tax Policy and Investment in the United States", *The Review of*



### 3. Majority rule

Since modern democracies have established their power in ideals of equality and majority shareholder. A majority election manifesto the chosen conditions of governance and political power reflects their decisions, Hayek uses the same principles to contest the democratic system failures in the mechanisms of its implementation. In the case of this progressive tax "means an open invitation to discrimination, and, worse, the majority to discriminate against a minority, so the assumption is purely arbitrary judicial desire" (Timothy Besley and Torsten Persson, "The Origins of State Capacity: Property Rights, Taxation, and Politics," *American Economic Review* 2009, 99:4, 1218-1244).

In line with the absurd, Hayek becomes the democratic virtues of the majority in a dangerous environment for the generation of economic policies: "The most for the simple fact of being, is considered the power to impose the sacrifices she rejects minority is to violate a principle of greater importance than the democratic principle itself, since it involves going against the very logic of democracy". The plot unfolds to a high of majorities to show how to sacrifice a liberal principle<sup>20</sup>. Converting a political achievement in fiscal policy approach represents a departure from the same democratic principles<sup>21</sup>. Hayek notes that the structural scope of a progressive tax system can get to a deterioration of the structure of the economy and production systems (Lombardo/Sutherland 2004)<sup>22</sup>. The overall economic balance derived from the progressive tax is less than its achievements. One of these negative effects is investments. A fiscal policy that overloads the tax liability tends to limit the risks taken by investors. Private capital are unattractive place their money with regulatory and fiscal obstacles to earnings. The extension of the PT regressive effect on poor countries is greater poverty and inequality<sup>23</sup>.

Another negative characteristics attributed to Hayek PT relates to limitations into economic development. Setting limits on income and income as the only reward specific act counter to productivity and growth. The author believes that progressive taxation punishes injured and "own resources who manage their own risk. The message for investors and entrepreneurs is contradictory: the tax punishes entrepreneurship and business initiative as both industrial:

The progressive taxation in general, favours corporations at the expense of individual savings and, above all, strengthens the position of existing firms to the detriment of new entrants (p.424).

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*Economics and Statistics*, by the President and Fellows of Harvard College and the Massachusetts Institute of Technology, 1997, pp. 32-40.

<sup>20</sup> In almost all his writings the means used by Hayek against the principle of majority is held in a technique or mechanism of argument that stresses the qualities and differences. In particular, this message Hayek has been shared in the liberal tradition from Stuart Mill to Popper, including less radical liberals like Isaiah Berlin and Norberto Bobbio.

<sup>21</sup> In the language of G. H. von Wright is transfer semantics (logic) illegitimate. The deviation in this case leads to changes in a different order to the phenomena that gave it its origin.

<sup>22</sup> Giovanni Lombardo, Alan Sutherland: "Monetary and fiscal interactions in open economies", *Journal of Macroeconomics* 26(2004), pp. 319-347.

<sup>23</sup> Observations with recent applications are available at: Iraj Hashi a, Jan Mladek, "Fiscal and Regulatory Impediments to the Entry of New Firms in Five Transition Economies", *Journal of East-West Business*, vol. 6(2), 2000, pp. 59-94.



This value judgment about the progressive tax system has, according to Hayek, social consequences unavoidable because progressive taxation leads to a paradoxical effect: perpetuates inequalities. Contrary to eliminate the unequal economic relations, progressive taxation, PT, provides inertial terms because denying opportunities for social mobility and economic advancement (Piketty/Saenz, 2006)<sup>24</sup> the tendency to introduce progressive taxation is to encourage feelings of envy among those who observe the fortunes and wealth beyond (Buchanan/Tullock, 1962, John Rawls. 1971; Robert Nozick, 1974)<sup>25</sup>.

The progressive tax system contains a variant moral opposite of democratic equality predicates<sup>26</sup>. The author posits limits to allow governments to provide fiscal instruments in order to correct deviations in the distribution of wealth. The moral alternative, however, incorporates a planned political principle of equality makes it difficult to observe the differences relevant to competition in a market system.

In countries where the income tax regime has introduced higher rates, the egalitarian desire embodied preventing anyone can have incomes above certain limit<sup>27</sup>.

The problem is to Hayek in how the tax burden can affect the total revenue. Something the author contests identified as such economic behaviour Britain after the First World War<sup>28</sup>. So we set limits on the increase in income is part of a moral prejudice. With this logic Hayek believes that poor countries will lower the maximum allowable income and therefore "more difficult it is to achieve income residents in wealthier countries worldwide considered moderates"<sup>29</sup>.

Hayek rejects populism as a policy for spending<sup>30</sup>. The issue is the moral justification when a majority fixed income and the maximum possible error affecting "who believe they are benefiting the masses as well. The distinction that strikes tributary to the rich to benefit the poor far from providing the output to a problem of equity in the distribution of wealth creates more risk and more fiscal imbalances. The effects are contradictory: economic growth retardation and difficulties in obtaining higher quality of income. The moral prejudice is not a reasonable defence:

It is unfair to pretend that the majority is allowed to transfer, by discrimination, taxation in the minority, that a service can remunerated differently depending on who the service provider and an

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<sup>24</sup> Piketty/Saenz, "The Evolution of Top Incomes: A Historical and International Perspective", *AEA Papers and Proceedings*, May. 2006, pp. 200 – 205.

<sup>25</sup> The theme of envy in the economic sphere corresponds to a venerable tradition dating back to classical Greek and Christian tradition; Dante and St. Thomas make up a portfolio of mortal sins, in Machiavelli expresses envy opposite behaviour to the moral virtues of civic life. Mandeville and Adam Smith made reference to jealousy and its effects on individual and collective experience. Envy is also subject in Descartes, Hobbes, Hume and Kant. The recovery of the classical tradition comes from the contemporary neocontractualism Buchanan/Rawls/Nozick.

<sup>26</sup> About moral sentiments in the economic field, Hayek has deployed a unique wisdom in the classical liberal tradition. See for instance his notes: *The Fatal Conceit: the Errors of Socialism*, (especially chapter V), Chicago University Press, 1988.

<sup>27</sup> Friedrich A. Hayek, *Los Fundamentos de la Libertad*, Octava Edición, Unión Editorial, Madrid, 2008, p. 426.

<sup>28</sup> Véase, pp. 414-416.

<sup>29</sup> Some of these biases are found Hayek in the history and the relations established with the mysterious world of trade and money. An initial contempt toward trade issues, that are often expressed in economic ignorance and suspicion of intellectuals toward money and finance the condemnation of the profit and contempt for business. An extension to these observations in: *The Fatal Conceit*, 1988, pp. 149-171.

<sup>30</sup> Véase: Hayek, 1976.





entire estate simply because you have an income other than their peers, is deprived of incentives and rewards provided by the act of others<sup>31</sup>.

The argument shows how Hayek moves between the arguments of their opponents. If a central predicate of liberalism is the defence of individual rights ergo, the protection of private initiative, the majority cannot impose taxes discrimination without disturbing the proceedings. Democracy can not punish the qualifications or distinctions to improve the supply in the markets. Taken to an extreme, what Hayek questions the answers are not tax inequality, but the mechanisms of punishment unjust to a minority that can be provided wealth.

The dominant role of government policy on the tax burden is a trend that affects the flawed economic system. Hayek defends the autonomy of markets as interventionist response to the excesses of governments to see how the progressive tax was creating an unspecified number of unique mechanisms that ended upset the policy own revenue<sup>32</sup>. The experience exposes us "how quickly the habit dulls the sense of justice and principle amounts to what in reality has no other basis than envy"<sup>33</sup>.

Monetary externalities eventually abysmal display gaps in society, above all when riches do not have reasonable linkages to production and employment generation<sup>34</sup>. In view of envy Hayek provides an impenetrable barrier to the distinctive growth potential that exceeds the average income. This is an inverted projection within the tax system that is as bad as those who risk making major advantages in the market. Hayek uses the *absurd* to put retaliatory tax liability just between advocates of progressive taxation:

To implement a fair tax system, is obliged to respect the following rule: the majority itself that set the total amount of the tax burden has to endure, in turn, the maximum rate of tax. There is no reason, however, who opposes most alluded to improve the lot of economically weaker minority share proportional reduction in pay<sup>35</sup>.

Hayek's argument seeks to defend a proportional tax burden and challenge the progressive taxation rate. His argument moves between dissociative technique (majority versus minority), and the mechanism of the differences (quantity versus quality). If the tax is political outcome of a decision by majority, its direct effect is that they meet the obligations. And being that the exit leads to resolve the position of the least advantaged, applies the same way the principle of proportional fairness.

The problem with Hayek is in the progressive model is perverse effect in time. Once started the trend seems to exceed the established limits. The defect does not result from the amount allocated or targeted tax discrimination, but of the nature of the progressive principle. He also stated in *The Road to Serfdom*:

...The close interdependence of all economic phenomena makes planning difficult to stop precisely at the desired point, and that, once beyond a certain limit obstructed the free market, the planner will be

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<sup>31</sup> Ibid. p. 427.

<sup>32</sup> The ingenious method of deductible expenses of representation, the companies had to implement the policy to avoid additional taxes, lawyers, etc. are examples of the cure worse than the disease. See Hayek, Ibid. p. 427.

<sup>33</sup> p. 428.

<sup>34</sup> These are deviations from the economy in societies affected by income from speculative capital. Or inequalities caused by the movement of money or criminal mafia.

<sup>35</sup> Ibid, p. 428.



forced to extend its interventions to covering everything. These economic considerations, that explain why it is impossible to stop the deliberate control exactly where you would like there, are greatly enhanced by certain political and social trends whose influence is felt increasingly extends under planning<sup>36</sup>.

The moral costs of progressive taxation exceed the relative advantages of its implementation. Hayek is inclined towards a principle that “marks a ceiling on direct taxes in relation to the entire tax burden”. A rule setting a maximum rate (marginal) direct tax equal to the percentage of national income that the State absorbed expenses. For example, if the tax burden diverts 25 per 100 of national income, direct taxes must not exceed 25 per 100 in individual income. If the security forces increase that percentage, just as it will increase the proportion allocated to these taxes. And will be reduced when the tax burden reduced.

This approach anticipates fiscal monetary conditions because it allows establishing mechanisms to limit government spending. Progressivity is not excluded, since those who pay the highest tax rates no longer pay certain indirect taxes, bringing its total contribution would be higher than the national average. Those who earn lower incomes will be required not only on indirect taxes paid. In these cases, however, progressivity affects only the amounts paid by indirect taxes, maintaining a proportional basis to the midline.

#### 4. Conclusions

Progressive taxation is a situation in which the proportion of income earned through taxation (tax rate) increases with income and purchasing power. A majority of countries in the world after World War II adopted the PT progressive tax system in response to demands for resolution of social inequalities. The reactions of their adversaries contain arguments that extend the debate on issues that are essential as demonstrated in Hayek (1959, 1979).

Hayek's position stands out because it helps to get a fuller picture of the history and issues arising from the fiscal power. The author notes that gaps SFP changes arising from taxation and tax policy principles of equality. This tense controversy of modern philosophy between equality and freedom, would determine the details of the tax burden in modern states.

In line with classical liberalism, Hayek defends as necessary distinctions between market and state. A liberal system of social order cannot impose restrictions on private initiative, nor to cap gains resulting from those who risk their capital in the market. The liberal defence of individual freedom encompasses respect to capital can encourage individuals. So a spontaneous market set its own balance without direct government intervention.

The progressive tax system sacrifices principles of democracy. Equality does not apply because of the discrimination that a majority imposed on a minority. Hayek's arguments are extremely controversial. The majority amount approving tax measures should logically bear higher tax burdens directly. But it's not what happens in reality. Because a minority of production that takes risks in the market, is

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<sup>36</sup> Friedrich A. Hayek, *The Road to Serfdom: Text and Documents— The Definitive Edition*, University of Chicago Press, 2007 (En español: *Camino de servidumbre*, Madrid, Alianza Editorial, 2006).



most affected by the PT. Discrimination policy involves inequalities perpetuated in time. The potential for mobility and economic and social dynamics in an open market are severely constrained.

Hayek has been proposed to demonstrate that the PT is rooted in a moral prejudice, envy. The difficulties that human beings have to accept their differences are reflected by means of wealth. Hayek's argument controvert pass a tax burden based on the value or merit. Envy is transferred to the field of economic interests to eliminate competition. Envy seriously affects the differences in income and production. The so-called moral hazard is a key instrument of markets, and envy in this case suggests avoiding it. Basically in the context of an allegedly democratic model of politics, F. A. Hayek has developed two different proposals for tax reform that may warrant further attention. As Hayek (1959, 1979), argues against escalation in the structures of the types of income tax.

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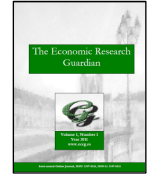
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