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Tax-Cut Alchemy

by Jacob G. Hornberger

In the midst of massive increases in federal spending and an enormous budget deficit, President Bush has proposed a large reduction in federal taxes. How's that for political magic — lower taxes and more benefits? Unfortunately, however, it's not magic but instead a political and economic scam that public officials throughout history have used to fleece the people.

If there's a difference between the amount that is collected in taxes and the amount that is being spent, an important question arises: Where does the federal government get the money to fund the deficit?

The answer: It borrows it. The problem, however, is that that debt ultimately must be repaid, which then means ... higher taxes to raise the money to liquidate the debt.

However, tax increases are oftentimes unpopular and, in fact, historically have even led to tax revolts and rebellions. Thus, throughout history, to avoid the unpopularity resulting from the imposition of higher taxes, public officials have resorted to a time-honored method by which to liquidate their debts — an indirect form of taxation that enables them to loot the people secretly and surreptitiously.

Here's how the swindle worked in the olden days, when people used gold and silver coins, rather than paper money, as their medium of exchange. The process back then was called "clipping the coin."

The king would issue, say, an official gold coin containing one ounce of gold. The coin would circulate in the realm and everyone would use it in trade, on the assumption that it truly contained one ounce of gold.

To finance his operations, the king would collect certain amounts of gold coin in taxes. Given that the king's needs were infinite, that meant that he was always in need of more revenues (surprise, surprise). He knew, however, that at some point, additional taxes were dangerous because they often brought with them tax resistance, which was sometimes violent, among the citizenry.

Kings came up with a solution to the dilemma. When coins would come into the kingdom through taxation, the officials would shave a small bit of gold from around the edges. They would then melt the shavings and use them to create new one-ounce gold coins. Voilà! Additional money for the king to spend! And most people would never notice the difference.

Over time, however, some people would begin discovering the truth — that the king’s official one-ounce gold coins no longer weighed an ounce. Thus, the coins began trading at a discount in the marketplace. For example, suppose an item was priced at one ounce of gold and someone tried to purchase it using a gold coin that the king had shaved around the edges. The merchant would protect himself by requiring the customer to pay the one-ounce gold coin plus a bit more.

That would anger the king because he considered the merchant’s discounting an attack on his integrity, especially given that these were the official, government-certified coins of the realm. The king’s response would be to simply decree that all official coins, shaved or not, were to be accepted as “legal tender” at face value for all expenditures in the kingdom, both public and private.

The monetary scam was made much simpler with Guttenberg’s invention of the printing press in the 15th century. It enabled governments to outlaw the use of gold and silver coin as media of exchange in favor of using government promissory notes. While the notes promised to pay the bearer gold and silver coin, inevitably the government would print so much paper money that the king would have to decree the notes to be irredeemable, given that he lacked the gold and silver to pay off all the notes that had been printed. To ensure that people accepted his irredeemable notes at face value, the king would make them “legal tender.”

Today, the alchemy of tax cuts and increases in government spending is performed by the Federal Reserve System. Its operations, of course, are much more complicated than simply “clipping the coin” or spending vast amounts of recently printed paper money. But in the final analysis, that’s how government officials are able to spend more than what they collect in direct taxes. Hardly anyone is the wiser, and most everyone is grateful, and those in the private sector who raise their prices in response to the depreciating currency inevitably receive all the blame.

Is it any wonder that throughout history governments have maintained political control over monetary affairs? After all, what better way to fleece people than through political debasement of their currency?

Mr. Hornberger is founder and president of the Future of Freedom Foundation (www.fff.org), publisher of *Tethered Citizens: Time to Repeal the Welfare State* and *Your Money or Your Life: Why We Must Abolish the Income Tax*, both by Sheldon Richman.