

# Causes and Consequences of the Inflation Tax<sup>i</sup>

## **Abstract:**

While ethical implications of direct taxation systems have recently received renewed attention, a more veiled scheme remains unnoticed: the inflation tax. We overview the causes of inflation, and assess its consequences. Salient wealth redistributions are a defining feature of inflation, as savers and fixed income individuals see a relative wealth reduction. While evasion of this tax is difficult in many instances due to the primacy of money in a monetary economy, the tax codes of most developed countries allow avoidance techniques to be employed. We analyze the ways that inflation taxes may be avoided in an attempt to preserve personal wealth, as well as the consequences of such practices.

# Causes and Consequences of the Inflation Tax

## Introduction

Much recent literature focuses on the ethics of direct taxation (Joel Slemrod 2007; Bagus *et al.* 2011; Robert W. McGee 2012c). Whether income and consumption taxes are coercively imposed on both consumers and producers has long been contested. Being this as it may, taxes can be, and often are, remitted to the government voluntarily as if they were not reliant on their coercive imposition. In this case we are led to believe that there is no difference between taxation and voluntarily donations of money to the government –both will result in spending that is consistent with taxpayers’ desires. The curiosity that arises is that *if* people did not donate money voluntarily to the government, neither coercion nor taxation would be necessary.<sup>ii</sup>

However, the degree of “voluntariness” of the governing process implementing taxation cannot affect the core nature of the problem (Robert McGee 1994). Even if we assume the legitimacy of a democratically elected government (as in Allen Buchanan 2002) or question this legitimacy (as in Hans Hermann Hoppe 2006 and Thomas DiLorenzo 2009), the issue of coercively redistributing resources remains. Complicating this matter is that political arrangements proposing to redistribute resources among a society in accord with all individuals’ preference scales are, by-and-large, imperfect processes.

Evading tax payments is an attempt to halt the redistribution of resources to use them for ends more highly valued than the ones imposed by government means (Lickert 1966, Lundsteldt and Spicer 1976, Becker and Spicer 1980). If we take as a base assumption that an individual knows his desired ends better than a third party (including a centralized government), we can see that evading taxes is but one way that an individual can increase his welfare given his available

means.<sup>iv</sup>

In contrast to voluntary payments, taxation severs the link between the receiver of goods and services and the provider of the payment necessary for their acquisition (Murray Rothbard 2009: 1149-1253). Voluntary trade relies on an individual's preference scale to determine how much he is willing to renunciate to obtain a specific good. The means to pay for a good or service is intimately related to the subjective value that the purchaser places on the item in question. Taxation severs this value-link. As a tax veils the preferences and values placed on goods, the question of how to best allocate goods according to these preferences and values must be answered. This has led some to deem taxation as an inefficient disruptor of the process of economic calculation (Philipp Bagus *et al* 2011).

While effects from the system of direct taxation have been adequately addressed, there is a more obscure, if ubiquitous, form of taxation affecting all market participants. The inflation tax – that loss of purchasing power savers suffer as a result of inflationary monetary policies – is another means of government finance. The government acquires resources in both cases of taxation. Under direct taxation schemes the government directly acquires money from the public. The government uses this money to fund its expenditures and purchase goods and services from the public. With the inflation tax, the government uses its monopoly on the supply of money to create new money or to receive newly created money from a legally privileged banking system.<sup>v</sup> The government can buy resources from the public with the new money, thus bidding up prices and imposing an implicit cost on the public. Resources are transferred from the public to the government in a similar manner to direct taxation.<sup>vi</sup> In both cases the public has command over fewer resources and the government over more.

## **Inflation Tax – Veiled and Costly**

Although the inflation tax has a storied history among economists, focus on its legitimacy has been insignificant (Zoran Balac 2008).<sup>vii</sup> Writing in the late 16<sup>th</sup> century, the Spanish scholastic Juan de Mariana outlined the coercive nature of the inflation tax (Huerta de Soto 1999: 6). David Hume's monetary writings in the 18<sup>th</sup> century assessed unit changes of the monetary stock as valuational changes that affect the unit value of other individuals' money holdings (Hume 1970).

More recently, Hülsmann (2008) and Howden (2010a) have delved into the history of relations between monetary economics and ethics. It is, however unfortunate, not too surprising that there has been a general neglect for attention heeded to ethical implications of the inflation tax. As Hülsmann (2008: 87) explains:

Economists are reluctant to dwell on the moral dimensions of social facts, and rightly so, because moral questions are outside their customary purview. But one does not need to be a moral philosopher to know that certain incomes are illegitimate; that they derive from a violation of the fundamental rule of society.<sup>viii</sup>

Monetary economists are especially well suited for analyzing the inflation tax as they understand the process by which it originates and later propagates throughout the economy. A background in this knowledge is essential prior to assessing the methods to and legitimacy of evading such a tax.

The inflation tax propagates through two different ways – one at its inception, and one ongoing. We must first assess the process through which a fiat money guaranteed by legal tender status replaces the existing commodity money in circulation. This is typically achieved with

force or threat thereof (Rothbard 2008). When Franklin Roosevelt signed executive order 6102 on April 5<sup>th</sup> 1933, U.S. citizens were effectively “forbidden [from] the Hoarding of Gold Coin, Gold Bullion and Gold Certificates.” Violators were treated under the “Trading with the Enemy” Act of 1917 (later amended in 1933) and subject to a fine of up to \$10,000 or ten years in prison, or both.<sup>ix</sup> While this act effectively forbid domestic citizens from using gold as money, it was not until Richard Nixon unilaterally “closed the gold window” on August 15<sup>th</sup> 1971 that foreign governments were barred from redeeming U.S. dollars into gold bullion. The U.S. dollar had officially been transferred to a fiat standard under the coercive threat of fines and imprisonment. **It is under the security of legal tender laws that the inflation tax becomes coercive in a similar manner to direct taxes. As an individual is obliged to use the preferred money unit by law, he is unable to easily (or legally, in some cases) avoid incurring the effects of inflation.**

Legal tender status guarantees the continued existence of a fiat money (Frank Chodorov 1954: 42-43). The advantage of a guaranteed demand is created by making a currency acceptable in the settlement of all public and private debts. Even if the legal tender status is only applicable to public debts, the induced demand for the money for the payment of taxes (which are, after all, the only other certainty after death) creates a desire for private agents to accept the money in settlement of private debts as well. This gives the fiat currency, although not officially imposed onto the market, a competitive advantage over its potential rivals. “Gresham’s law”, named after the 16<sup>th</sup> century English financier of the same name, sets in. Namely, good money is driven out of the market as it is artificially undervalued relative to the newly guaranteed bad (or coercively imposed) money.

A monopoly monetary system imposing inflation and its associated tax may be regarded as illegitimate (Walter Block 1991, Rothbard 1998, and Hoppe 2006 assess the legitimacy of

imposed orders). If the expropriation of a favored money has occurred, such as occurred in America in 1933 and 1971, actions to evade this expropriation must also be supported. While 1933 and 1971 represent two clear examples of this monetary expropriation, an ongoing tax via inflation achieves the same effect. The inflation tax, while redistributing purchasing power from the public to the monetary authority, leads to three main results.

First, there is a redistribution implicit in any process that changes the money supply. Newly created money is injected into the economy at specific places and spreads slowly to individuals' cash balances, bidding up prices (Richard Cantillon 1959). Depending on the preferences of the first receivers of money, relative prices will change as some prices rise faster than others. There is a redistribution from the last receivers of the new money to the first receivers. Those individuals who receive the new money units last will see their costs rise faster than their incomes compared to those who receive the new money first and see their incomes rise faster than their costs. The inflation tax allows the government and the first recipients of government spending to profit at the expense of late receivers of the newly created money.<sup>x</sup>

A second cost is imposed on a group of specific market participants – savers – who forgo consumption in the present in hopes that their savings can grow to satisfy a greater future level of expenditure. Their plans are frustrated as inflation erodes the future purchasing power of their savings. Those on fixed incomes, typically pensioners or the unemployed, are likewise hurt.<sup>xi</sup> As their budget is constrained by accumulated savings, the only way to increase future purchasing power is through healthy investment returns. Inflation reduces real profits (i.e., those reckoned in terms of purchasing power), thus disturbing their ability to consume at a predefined level. The inflation tax promotes consumption as an additional cost on savings makes this activity relatively less attractive.<sup>xii</sup>

Third, savers and investors are disconnected from each other. Inflation is generally defined as an increase in the money supply (Rothbard 2008: 43-44; 2009: 809, 913; Mises 1971: 239-241, 272 and *in passim*). This increased money supply often coincides with a credit expansion of the banking system. As the central bank and private banking sectors often purchase government bonds, the monetary base multiplies when banks expand credit upon a base of the newly created reserves. This credit expansion may distort interest rates and lead to more investments than there have been real savings. As successful long-term investments can only be undertaken consistent with real savings, a boom-bust cycle may set in if investment exceeds real savings.<sup>xiii</sup>

While these three negative results of inflation are well known, their causes deserve quick mention. As inflation is defined as any increase in the money supply, its effects stems from two fundamental sources.

First, a centralized agency may create money *ex nihilo* if it has a monopoly over the issuance of money. This is typically the case today with national central banks with this monopoly power endowed by their respective governments. Backed by legal tender laws ensuring the acceptance of their notes, these banks can augment the money supply with an assurance that there will be an assured demand.

Second, a fractional-reserve banking system can increase the money supply endogenously (Bagus and Howden 2010; 2012b). By allowing banks to hold only a portion (or fraction) of their demand deposits as reserves, a greater amount of deposits are issued than currency exists to cover.

Before delving into the effective means to reduce the overall burden of the inflation tax on society, we must comment on a method of evasion that serves to merely redistribute its

burden. Individuals reducing their savings rates in favor of increased consumption expenditures can mitigate the burden of the inflation tax.<sup>xiv</sup> As inflation cannot reduce the purchasing power of something that is not there, no inflationary loss can directly ensue. While this avoids the first-order effects of the tax, it misses a more salient point. A second-order reduction of purchasing power results in part due to the increase in consumption expenditures. As more money is dedicated towards the purchase of consumer goods, their prices are bid up accordingly. At this higher price level, the existing pool of savings will be able to purchase only a reduced amount of goods. The result is that a secondary inflationary effect will still detriment savers.

No progressive tax can be considered neutral in the sense that it benefits or harms all individuals equally (Hayek 1960: 314). Likewise, an evasion of the inflation tax by increasing consumption expenditures will benefit those who initially spend, while those who prefer to continue savings will see continual erosion in their purchasing power (Bagus and Howden 2011; 2012c fn4). Not only is the inflation tax itself highly unequal and redistributive, but its evasion can also exacerbate these results. Inflation thus has the same result as a general tax (Maurice Allais 1993: 331) and its evasion places a secondary tax on those unknowing of its presence or reacting less quickly to it. The burden of the inflation tax shifts from those who spend faster and in increased amounts onto those who spend more slowly or in smaller increments.

Not all affected individuals can feel the effects of this evasion equally. It may be obvious that depending on one's role in the inflationary process – as either the creators of inflation or innocent bystanders –the benefits and detriments will be asymmetrical (Mises 1998: 412).

Lower-income individuals typically bear a larger portion of the inflation tax than their higher-income counterparts (Andrés Erosa and Gustavo Ventura 2002). Wealthier individuals are usually better situated to avoid any tax as they tend to have both the knowledge and resources to

do so. They may invest a larger portion of their earnings (as a percentage) in higher earning assets, thus retaining the ability to save in the face of a general decline of purchasing power. Lower-income individuals can pursue similar strategies, to the extent that index funds or inflation-indexed bonds are available. Yet because they have a smaller portion of their income available for investment purposes they will have an offsetting larger portion of their income negatively affected through inflation on the prices of goods there are purchasing. While financial products exist to minimize the effects of inflation on one's investments, it is difficult (if not impossible) to employ a similar strategy to protect one from the increasing prices of their consumables.

Tax accountants are well noted for their ability to aid the wealthy in evading more direct taxation schemes. In the same sense, savvy financial planners are able to direct clients' savings into plans that offer competitive inflation-adjusted returns, thus better evading any inflationary effects on their wealth. Knowledge of wealth management is generally higher among the wealthy than the lower-income portion of society. This leads to a greater awareness of the existence of inflationary losses of purchasing power, as well as increased attention towards mitigating its effects. Finally, wealthy individuals are usually among the earlier receivers of an increased money supply (whether for investment purposes or through purchases of investment firms that gain early access to the funds).<sup>xvi</sup> As a result they are better situated to take advantage of the increased money supply prior to any upward pressure on the general price level (which they will invoke through their spending).

These effects are in stark contrast to the different groups affected by direct taxation schemes, whereby high-income individuals are more highly affected (Michael Allingham and Agnar Sandmo 1972; Hazlitt 1978: 41; Charles Clotfelter 1983). Greater cash outflows for "big

ticket” items (i.e., houses, cars, luxuries, etc.) imply that these individuals pay a larger portion of consumption taxes.

While direct taxation operates under the pretense of helping lower-income individuals through redistribution effects, the inflation tax is constrained under no such mandate. In fact, it is unclear *who*, exactly, the inflation tax is supposed to benefit. Detrimental consequences fall most heavily on those shoulders that are generally regarded as the most in need of help – the lower income brackets of society. More egregiously, these detrimental consequences are felt, to some degree or another, by all *market* actors; purchasing power losses cannot be evaded. The only group to benefit from this process is the ultimate producer of money – the government’s monetary authority, a monetary institution endowed with a state-granted monopoly privilege over the nation’s money supply, or a bank permitted to operate with only fractional reserves.

### **Three methods of evasion**

Evasion of taxes has long been supported if it is proven that these taxes are coercive and disruptive in nature. However, little explicit support for the evasion of the inflation tax exists, likely a result of its veiled nature. However, given the complexities of money’s role in the economy, there are three ways that this evasion can be achieved. Money has three primary functions – it acts as a medium of exchange, a store of value and a unit of account. Each of these roles can be used to evade the inflation tax and thus preserve the purchasing power of savings, as well as allow for increased ease of economic calculation through steady prices. Money’s three roles also allow for three distinct means that we may use to evade the inflation tax without merely redistributing the burden as in the case of shifting savings into consumption expenditure.

The first method to evade the inflation tax is via money’s unit of account function. The

unit of account is that good that we commonly define prices in. Goods are priced in dollars in the United States; in the Eurozone, prices are expressed in terms of euros. Inflation adds costs to producers as the real value of the money they receive in exchange from their goods declines. As a result, they must continually change prices to reflect this change, an outcome commonly referred to as a “menu cost.” Alternatively, consumers must make more frequent withdrawals of their money as it loses value, leading economists to assign the term “shoe leather costs” to reflect the expenses from making additional withdrawals. Most importantly, monetary calculation (accounting) requires a currency that is not subject to violent fluctuations in purchasing power (Mises 1998: 424-26). When the crucial tool of monetary calculation loses its value, economic planning is severely hampered. Without a reliable unit of account, planning errors – both financial and production-based – increase.

These costs can be avoided easily by denominating goods, services and contracts in a good other than the one issued by the central monetary authority. **Defining prices in a commodity (such as gold), or a composite bundle of commodities, can bring stability to prices not available under most imposed fiat money regimes. The benefits of such an option are more pronounced on longer-dated loan contracts, as the effects of inflation compound over time. As an example of how this alternative would operate, consider a simple mortgage transaction. In today’s world, an individual borrows \$150,000 today to purchase a house, and must pay this off over the ensuing 30 years. The bank is at great risk, as it must estimate what the rate of inflation will be over those 30 years, lest it lose through being repaid in less valuable money units than it originally reckoned. Now consider that the mortgage could be denominated in a commodity of more-or-less stable value, e.g., gold. If gold was selling at \$1,500/oz. when the mortgage was contracted, this would imply that 100 oz. of gold were borrowed. The homeowner will need to pay the bank the**

equivalent value of these 100 oz. of gold over the next 30 years, thus protecting the bank from any inflation eroding the value of the money unit.

In extreme cases like the German hyperinflation of 1923, people started to calculate in gold marks or dollars instead of the legal tender “Reichsmark” in order to evade this effect of the inflation tax (Wilhelm Röpke 1937: 103-04). In more subdued cases of inflation – ones where the rate is *merely* high but sustained – countries often experience a shift toward the use of foreign currency to serve money’s three roles (Carmen M. Reinhart and Kenneth S. Rogoff 2009: 191).

Second, the store of value is that good that we use to preserve the future purchasing power of our savings. It is also the monetary function most affected by the inflation tax. As the future purchasing power of savings is reduced, a wealth transfer from savers to consumers occurs. Fortunately, it is also the easiest function to use to evade such a tax. Savings can be, and often are, held in an inflation hedge – a countercyclical asset that increases in value as the purchasing power of the monetary unit decreases to evade this tax (houses and gold spring to mind quickly, but examples abound).

We require a store of value that allows us to maintain the value of our production until that moment comes when we desire to spend the proceeds. We typically prefer a monetary unit that retains its value over time, i.e., acts as a good store of value, to one that does not. In the modern economy, the store of value function has already been separated from the legal tender money in order to evade the inflation tax. Different goods have replaced legal tender money to preserve wealth and retain an individual’s purchasing power. By reducing cash holdings to a minimum, an individual substitutes savings away from cash and into a good that acts as a more optimal store of value. Again, gold may serve as the medium that we save our earnings in. Historically gold has preserved its purchasing power extremely well, allowing it to purchase a

similar amount of goods today as several hundred years ago. As we will see in conjunction with the next method, people may also start to exchange this store of wealth directly in some transactions, instead of using a currency that suffers from purchasing power losses.

Last, those old dingy notes in our wallet or the change jingling in our pockets embody the medium of exchange function. Medium of exchange is that good that we renunciate to a seller when we make a purchase. This is where the most evident effects of the inflation tax result. As a central bank generally directly controls the supply of the medium of exchange, its purchasing power is potentially subject to large variation. Every good economist knows that “a dollar today is worth more than a dollar tomorrow.” While we always prefer the certainty of a dollar sooner than later, it is also worth more as the general tendency under a monopolized currency is to inflate the currency’s value away, thus reducing the value of a dollar tomorrow. We call the profit earned from such an action seigniorage, and it represents that amount of taxation taken from savers and given to the money-issuing authority. This function is more difficult to evade, as it requires using a medium of exchange different from the one being inflated.

A good is chosen, or evolves, as money to eliminate the “double coincidence of wants problem” (Carl Menger 1892). In short, money allows us to trade easily with partners who do not directly desire what we have to offer. Money serves as an intermediary, greasing the wheels of commerce and trade. Abandoning the general medium of exchange in favor of another good requires that both parties agree upon the alternate good. This may prove difficult in practice.

In a spontaneous process of trial and error, the avoidance of the inflation tax may lead to the selection of a money that better fulfills its three functions. Inflation tax evasion thereby fulfills a crucial social function benefitting third parties: it may lead to a more stable and sound medium of exchange, reduce the risk of business cycles, foster savings, and facilitate economic

calculation and growth. An individual will only be motivated to avoid the inflation tax when the perceived benefits outweigh the costs. As the ultimate cure for the inflation tax is to rid the monetary system of inflation this realization helps to explain why so much ire is directed at direct taxation (and so many resources expended avoiding it) while so little is afforded to the inflation tax. Using the rate of price inflation as a proxy for the inflation tax, we can see that in most Western countries it has been low (around 3%) and stable for several decades. The corresponding gains from efforts aimed at circumventing “paying” such a tax are relatively low compared to those that can be gained by avoiding or evading direct taxes.

A functioning monetary system is the basis for an extended division of labor and a complex society in need of sophisticated economic calculation and long-term planning (Mises 1998: 230-32). When money stops to fulfill its functions sufficiently due to the inflation tax, tax evasion is one solution to the problem. Inflation tax evasion may improve the foundation of the monetary system and help to preserve it. For anyone who wants to maintain civilization based on the division of labor, long-term planning, savings and economic calculation, inflation tax evasion is not only ethically justified, it may also become a moral duty (Hülsmann 2003: 57; also Howden 2008).

### **Legal Complications**

In each of the three cases listed above, there are no legal complications to evading the inflation tax.<sup>xvii</sup> In most Western countries, the only law relevant to money’s use is a legal tender law.

This generally forces a merchant to accept a specified money in payment, but allows each of the aforementioned options to remain open. Individuals can denominate contracts in different goods, accept goods other than “money” to settle debts, and even pay in a non-money good (provided

the other party of the transaction accepts it). Thus, there is no insurmountable legal barrier involved in evading the inflation tax by using a nonmonetary good for each of money's three functions.

The legal setting of the tax's evasion has, however, little bearing on its legitimacy. One cannot resort to answering the question: "why is taxation morally permissible, while other types of compulsion are not?" with the answer: "because it is legal" (Bagus *et al* 2011). To do so falls prey to the *petitio principii* fallacy – namely, that one cannot base their argumentation on a conclusion, to do so results in a circular argument. One must, instead, evaluate the legality on either a normative or positive basis to achieve an assessment of legitimacy.

The legality of a process does not make it *ipso facto* just (Paul Groarke 2004). If it did, regimes such as slavery would have to be deemed just, provided that they exist confined to an accepting legal jurisdiction.<sup>xviii</sup> Legal tender laws, as they exist in much of the world today, make only some methods of evading the inflation tax illegal. This opens them up to greater ease at evasion in the face of the predefined illegitimacy. In fact, people have already started to use alternative currencies offered by companies such as e-gold or Bitcoin, effectively evading some of the costs of the inflation tax. Gradually the inflation tax may be evaded more and more by these and other market-based solutions.<sup>xix</sup>

## **Conclusion**

If the original basis of the inflation tax cannot be justified, evading (or avoiding) paying it cannot be considered ethically suspect. Money's three distinct roles – as medium of exchange, store of value and unit of account – allow for three methods to avoid paying such a tax.

Striking contracts in terms of a good other than the good being inflated allow the relevant

parties to avoid valuational changes due to inflation. Using an alternative good as a unit of account thusly allows an individual to ensure future cash flows retain their real value. Holding savings in the form of a good distinct from the inflated currency also allows one to avoid purchasing power losses. Investors often pursue this option today – knowingly or not – as individuals hold assets in goods that act as inflation hedges such as housing and gold.

There are however some practical problems to evading the inflation tax, especially concerning the medium of exchange function of money. People must accept the legal tender money for settlement of contracts, even though the contract is denominated in another good. When, for instance, a loan has been contracted in ounces of gold, the debtor has the right to pay the loan back in fiat dollars. This leads to a significant increase in legal uncertainty. Moreover, experiments to introduce alternative media of exchange encounter another difficulty due to the important network effects of money. As the government demands the legal tender money through its direct taxation and spends it later, it creates an important demand and use for the legal tender money. Due to the sheer size of the government in the economy and the network effects of media of exchange, it is difficult to introduce a competing medium of exchange in order to evade the inflation tax.

Although difficult to evade in practice, avoiding the inflation tax is far from impossible (Hülsmann 2008: 97-98). As in other walks of life, vigilance against unscrupulous individuals debasing or inflating a currency is necessary. A population aware of the circumstances surrounding inflation, and who properly regard it as a tax, will be more likely to search for alternatives to evade it. We have demonstrated that doing so is not only aids in aligning preferences to enhance welfare, but also raises no significant legal issues in most modern economies.

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<sup>i</sup> Acknowledgements to be added...

<sup>ii</sup> Kearly (1977) points out that it is a logical impossibility that the effects of taxation could be neutral. Only in those cases where the tax revenue extracted is identical to the amount that would have given voluntarily *and* it is used to fund projects that would also have been voluntarily supported could we imagine taxation as being equivalent to voluntary exchange. In light of the fact that an individual does not voluntarily give money to these specific programs, and instead remits it to the government shows us via demonstrated preference that the act of taxation implements different projects at different levels of funding than would have been voluntarily achieved.

<sup>iv</sup> An increasing body of literature assesses tax morale – the attitude towards tax compliance – plays a significant role in tax compliance. Benno Torgler (2007) explains countries with high degrees of tax compliance not in terms of penalties, but rather in the degree of psychologically induced morale. Lars Feld and Bruno Frey (2000) reckon that political participation correlates positively with morale, although the degree to which the correlation between the ends sought by taxpayers and those enacted by tax spenders has failed to garner much attention.

<sup>v</sup> Jesús Huerta de Soto (2006) explicates the invasions of legal norms practiced by the banking sector as a normal state of affairs. Bagus and David Howden (2009; 2012a) have elaborated on these points, furthering the arguments made for deposit banks to the arena of investment banks as well.

<sup>vi</sup> Direct expropriation of goods and services may be regarded as a more immediate form of taxation where the monetary system is circumvented. In fact, there are three basic forms of expropriation of resources by the government, which vary in their degree of directness or openness. Expropriation is the most direct and open transfer of resources from the public to the government. Taxation via the coercive transfer of monetary units is less direct as the government uses the medium of exchange to acquire the resources it wants. Finally, the inflation tax is the most indirect form of transfer of resources to the government. By the creation of new monetary units, purchasing power transfers to the government, even though the public does not lose any nominal amount of monetary units.

<sup>vii</sup> Recent exceptions may be found in Jörg Guido Hülsmann (2008) and Bagus *et al* (2011).

<sup>viii</sup> It is debatable whether tax issues are in actuality moral issues. McGee (2012b) notes that morality can only exist when there is a choice. Given the compulsory nature of taxation paying or evading can be neither moral or immoral.

<sup>ix</sup> Indexed for inflation, the fine is equivalent to over \$165,000 today.

<sup>x</sup> Henry Hazlitt (1959: 278) discusses the loss in purchasing power for wage earners during inflationary periods and the subsequent redistribution effects.

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<sup>xi</sup> A negative opinion of the income tax may vary depending on one's demographic, as the effects felt are asymmetrical. David Boyd (2009) focuses on the differences between Generations X and Y concerning their ethical concerns. While these two closely related groups are shown to have drastically distinct ethical norms, the differences may become increasingly magnified as we focus on an even more distinct group – the elderly, as the example of the fixed-income group *par excellence* – and their attitudes towards the ethical concerns of inflation. McGee (2012a) finds that older citizens are more opposed to tax evasion than younger people, in a cross-sectional analysis of 12 countries.

<sup>xii</sup> The inflation tax leads to a tendency for consumption to increase in relation to savings. The final outcome of the consumption to savings ratio depends on the time preferences of the first receivers of the newly created money. When government expenditures are mainly on welfare programs and recipients with a relatively high time preference, the consumption to savings ratio is further increased.

<sup>xiii</sup> See, for example, Ludwig von Mises (1971; 1998), Hülsmann (1998), Rothbard (2000; 2009), Roger Garrison (2001), Bagus (2008), Friedrich Hayek (2008), Huerta de Soto (2009), Howden (2010b) for the relationship between the business cycle and inflationary monetary policies. Steven Horwitz (2003) argues that disrupted prices that cause business cycles are often neglected when assessing the costs of inflation, resulting in an understatement of the full economic cost of the practice.

<sup>xiv</sup> Inflation results in an artificially high level of “time preference” – the preference for present consumption over growth-enhancing savings (Hoppe 2006: 36; Hülsmann 2008). Savings can also be held in an asset class acting as an inflationary hedge to avoid purchasing power losses (gold is the classic example, but inflation-indexed bonds also abound today).

<sup>xv</sup> Governments can maximize their tax revenue by repressing financial innovation (Nouriel Roubini and Xavier Sala-i-Martin 1995). By reducing private financial alternatives, an increase in demand for government issued money results, with the result that an increase in inflation tax revenue (or seigniorage) will be obtained – one alternative to evading the inflation tax will be eliminated.

<sup>xvi</sup> Tax evasion is more correctly defined as the illegal concealment of taxable income. With this in mind, the methods described here may be more aptly called tax avoidance as they are, by and large, fully legal. See Jean Hindriks and Gareth Myles (2006: chap. 16) for this distinction.

<sup>xvii</sup> Even if legal rules are found valid by the court system of a given jurisdiction, there is still a question of one's moral duty to obey questionable laws. “Is the claim that a law is valid equivalent to the claim that it is morally valid and justifiable?” (Mark Tebbit 2000: 37).

<sup>xviii</sup> Until such a time that market-based solutions become readily available, the underground economy may continue to flourish to evade the inflation tax. Richard Cebula and Chris Paul (2000) assess the the United States, Howden (2011) assess the euro zone, and Torgler and Friedrich Schneider (2007) assess a cross-section of countries, finding a high correlation between the size of the underground economy and the size of the taxes prevailing. While much attention is paid to illegal activity that results in high direct taxation schemes, little attention has been previously afforded to inflation tax evasion that results in “black market” activity. In a similar vein, Marian Eabrasu (2012) notes the similarity between tax evasion and secession. Avoiding an income tax via an exit from the formal economy, or by renouncing the use of the legal tender currency in many ways amount to a secession from the monetary sphere.