

## **Why is it Necessary to Cut Taxes Now.**

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*“Pennies do not come from heaven. They have to be earned here on earth.” “Pennies do not come from heaven. They have to be earned here on earth.”*

Margaret Thatcher

In the current difficult situation, it is especially important for Georgia to choose a pragmatic way and not to be overwhelmed by emotions - this applies to health care measures as well as economic policy.

I can't put myself on the healthcare specialty, however, I have previously stated how important mass testing is to restart entrepreneurial activities; I would also like to point out that it was necessary for the government to use the accumulated pension funds (part of the state contributions) immediately to purchase services from the private sector of the healthcare - to prepare private clinics to fight Koronavirus, to encourage and support private initiatives in this area. What we don't see yet, I hope they know better.

As for the economic, entrepreneurial direction, I think it raises even more difficult tasks. Almost everyone believes that, as in the case of healthcare, the role of the state here is (also) special. This idea (actually emotion) is reinforced by three important factors: 1. People believe that the government exists precisely to solve economic problems (moreover, to manage the economy). 2. The government, together with the National (Central) Bank, has more resources than the private sector. 3. The government knows better how to spend this money.

Different people use different variations of economic policy, some supporting government subsidies, some relying on the central bank's monetary machine. These versions involve saving businesses and artificially maintaining economic activity, which is expected to cause money to be wasted. impoverishment of the people and accumulation of public debt, which the population itself will have to pay.

### **Alternatives.**

There is only one alternative that responds less to emotions, although from an economic point of view it seems much more realistic. Before presenting this alternative, let's look at what government intervention means. It is believed that the government has much more money than the private sector. There are at least two factors behind this illusion:

1. In the hands of the private sector there are far more resources, just in an uncertain situation its participants do not want to take extra risks. This automatically indicates the high risk of financial injections by the government in such a situation - it simply means that the private

sector, including banks, will not be able to help with more cautious actions, and the government will help with its careless adventurous steps.

2. The illusion is that the government has money - we have to pay that money, either now or in the future - to cover the debt. Moreover, in the face of economic downturn, taxes will inevitably pay off - and so will budget revenues. At the same time, the government's use of central bank reserves will further weaken the Lari's very weak immunity. People may not have the guts to do this if the Lari were not the only legal means of payment. But in the current situation, the depreciation of the Lari is the only way for the state to earn money quickly, even though it will raise prices and impoverish the population.

### **Injecting money into the economy.**

The government's injection of money into the economy is not new for either Georgia or the world. The negative experience of such models is well known - the damage is still to be borne by the population - today or tomorrow. Since the late 1980s, Sweden (even) has also severely hampered the growth of the public sector. Even now, during the Coronavirus crisis, Sweden has become an example for everyone due to limited state intervention and pragmatic action. Any state injection is payable to the population, regardless of the stage at which a particular individual pays it. This means that if state revenues are generated mainly by large taxpayers, they will inevitably reimburse these tax costs from the population from the prices of the products. The government has no money of its own, we pay it.

When the Lari depreciates, the state artificially lowers its value for two purposes: 1. Part of the value of the money depreciated by the increase in the money supply in circulation is transferred to the government's accounts. 2. The state budget, which depends on imports, directly increases revenues at the expense of VAT and excise tax incomes (paid at the border crossing) if the locally circulated currency is depreciated. Clearly, in both cases, it is at the expense of the individuals and families.

### **Government participation in credit activities.**

Calls on the government to participate in bank loan programs can also be heard, either by guaranteeing credit resources, or by issuing subsidies and/or loans. Such calls to and actions of a government are not new and are part of a misconception. Banks in Georgia obviously have enough resources to lend to any business now, they just don't want to risk it, not only because of their investors and the regulation, but also because of competition and the risk of losing business. Clearly, if the government injects such credit resources or guarantees loans, this risk disappears nowhere - on the contrary, here it grows - as its source - the taxpayer has less control over the situation and competitors no longer pose a threat. In this case, the banks will receive resources that could be disposed to finance riskier projects more freely than in another case. That is, as a result of state intervention, credit risk increases and does not decrease. Losses incurred as a result of this risk should be covered either at the expense of the state (or taxpayers) or at the expense of other clients - by lending them loans or reducing the benefits of deposits.

It is well known, for example, how banks are able to provide household loans to low-income families at the expense of high income ones - with low interest or sometimes without any interest. Banks also behave the same way when issuing loans to high-risk and low-risk projects on virtually equal terms.

More important is the quality of the projects that will be funded by loans from such a state. That being said, banks often refrain from financing high-risk projects because they believe these projects are of poor quality. Moreover, they really want to issue a loan, however, they realize how risky this case is. In this case, banks play an important positive role - financial expertise of credit projects. Compared to other roles of banks, this is in fact the most important and its neglect shakes the economy. However, this role is not part of its generosity, but is the result of accountability to customers, investors and the owners, and the competition that threatens it with the loss of customers, investors and owners. As a result, it is understandable why banks can rejoice in obtaining such easy resources. At the same time, we must not forget that this supposedly kind intention of the government is also to be financed by the population with the taxes paid.

Understandably, there is one big negative event that follows such programs - the corrupt cooperation between the state and the banking sector. The government will always try to get the banks operating for its own benefit, at the expense of its customers, and the banks will be ready to take part in many dubious activities of the government. Such a program should be implemented either quickly and without clear and complex rules, or the prolongation of its procedures will not bring any results. Consequently, if it (program of government participation in credit activities) is implemented, we will face a moral hazard situation, by wasting large sums of money and corrupting the business sector.

### **Government investments.**

It is also economically unpragmatic (now and always) government investment to increase production. No matter how beautiful and patriotic the name of such programs are, it is still a matter of public resources, the only source of which is taxes.

Banks may have more sophisticated ideas. For example, the issuance of such loans through more complex schemes. The government does not have (credit) resources, so the banks themselves lend this money to the government and then get it back in the form of credit resources. In this case, they will be able to make cheaper loans, and get the interest from the state debt or to finance it from the usual (at the expense of other) loans.

How much credit activity is expected to be easier in times of crisis - this question itself implies that, on the contrary, the crisis is precisely a complicated state of business activity. Everyone is trying to buy products of a certain nature and give up on others, while saving resources for a worse day. What crisis management policy means is that the government addresses the resources of the population in its own desired direction (of the anti-crisis plan) and artificially drives the savings. All the stories of crises and their coping end with the general impoverishment of the population.

Therefore, lending by banks at the expense of the state (taxpayers) is a very risky idea. Clearly, taking over this function by the government carries an even greater risk, it has neither the

knowledge nor the experience to do so. Its market action and investment solutions are similar to hand-wringing in a dark room.

For example, it may seem to many that investing in the food industry right now will definitely be successful, but they should keep in mind that investing is not a panacea, but rather productivity and competitiveness. If we let go of our emotions and misuse these hard-earned resources, we will be left with expensive and low-quality local products.

### **Support for local production.**

Here comes another misconception, the thoughts of which are covered by emotions. Many think that, especially in times of crisis, it is necessary to help local production, which will be developed and employ people. What is not seen (according to Frederick Bastia) is that in such conditions

1. Freedom of choice will be restricted to individuals, families.
2. Competition will be restricted and the population will receive lower quality but more expensive products.
3. These enterprises themselves will find themselves in an illusory economic world out of competition and will completely lose productivity and competitiveness.
4. Before this fantasy comes into play, many more will be thinking about making a profit in this field abroad, increasing productivity, improving others with new technologies, and so on. Even our better products can be expensive and the population (which is getting poorer as a result of the crisis) can still choose to import.

Here is another important factor. Emotions can overwhelm us and start thinking about the so-called policy of protecting our own market or our own production - protectionism. This, as mentioned above, will be a big blow to Georgian consumers, especially low-income individuals and families. However, no less important is how it will affect Georgia's geopolitical positioning and the country's security. Without exception, all trading partners would believe that such an unfriendly move was taken against him - our country will lose the name of a conscientious and reliable partner. They are also expected to use trade and other harsh measures against us. Taking such steps will also be considered a violation of international trade rules, and ultimately the population and the country will suffer greatly.

### **Who pays the bills?**

It is also very important that the government generally tax mainly successful businesses - losers either have less or nothing to pay. Subsidies are funded at the expense of successful businesses. Failures also fail to take credit, and only rely on government programs or guarantees and loans, which again happens at the expense of success and the population. Therefore, the redistribution of resources from successful to unsuccessful businesses has a negative impact on the overall success of the economy. It will be easiest to understand just if you take the money from one successful supermarket and give it to a neighbor who is working poorly and has gone bankrupt. Every local customer knows about bankruptcy and thinks it is right - in fact, with his own choice, he gave preference to the first and bankrupted the second.

### **An alternative.**

What matters is what the alternative is. Here we can consider a private system based on healthcare competition - why not. The German experience of fighting the coronavirus is the result of decentralized, independent action by the public and private sectors.

However, if we do not miss the economic issues, we should consider the alternative of government intervention and solving economic problems through it.

This is a way to cut the taxes and the government spending. It must be said that taxes are not the only direct cost of doing business, it is also necessary to think about the radical reduction of state regulation of business. However, in this case, let's simplify and look at only part of the tax (obviously, when we see a reduction in taxes, we automatically mean government spending).

Cutting taxes will lead to two things - a change in the price structure of goods in the direction of reducing the share of taxes and a tendency to reduce the price itself. Evaluate the share of tax liabilities in the price under different levels of tax burden (tax burden - all visible taxes in the price of goods) - see the chart that describes the different modes:

	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
TAX 10%	LABOR				RESOURCES			INVEST	PROFIT	TAX
	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
TAX 15%	LABOR				RESOURCES			INVEST	PROF	TAX
	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
TAX 20%	LABOR				RESOURCES			INVEST	PROF	TAXES
	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
TAX 25%	LABOR				RESOURCES			INVEST	PROF	TAXES
	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
TAX 30%	LABOR				RESOURCES			INVEST	PROF	TAXES
	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
TAX 35%	LABOR				RESOURCES			INVEST	PROF	TAXES
	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
TAX 40%	LABOR				RESOURCES			INVEST	PROF	TAXES
	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
TAX 45%	LABOR				RESOURCES			INVEST	PROF	TAXES
	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
TAX 50%	LABOR				RESOURCES			INVEST	PROF	TAXES
	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
AVOID	OFFICIAL LABOR	HIDDEN L	OF. RESOURCES	H. RESOURCES	HIDDEN TAX	REAL PAID				

Chart. Share of Taxes in the price of a good. Gia Jandieri

The scheme clearly shows that in the event of an increase in the tax burden (i.e., the share of taxes in the price of goods), the entrepreneur has to reduce his other parts. That is, if taxes increase, the entrepreneur has to:

Reduce profits - and thus reduce its investment motivation

Reduce the level of investment - that is, refusal to expand and new technologies

Buy less resources - Use fewer and / or lower quality resources

Buy less labor - Less employment and / or lower wages

Finally, when the level of taxes becomes impossible - the emergence of the illegal part.

This happens when we try to move from a low tax situation to a high one. If we follow this scheme upwards, we will see that the release of resources from taxes - on the contrary, allows the growth of all other components. We must keep in mind that this scheme does not address the artificial creation of inflation by the government or any other gross interference that would affect the prices given in this scheme.

One thing is clear, you can't have high taxes and high economic activity at the same time - the more resources a business has, the easier it is to expand, employ people and create and maintain competitiveness, and vice versa. Consequently, when we talk about the fact that a business needs more resources, we must first think about imposing less taxes on it. Otherwise, we force the entrepreneur to pay the tax first and then wait for how to get this money back from the government in the form of undeserved privileges.

It has also been said above that in fact successful businesses pay taxes and redistribute these resources through state mechanisms hardly if successful. It turns out that in this way productivity and efficiency are penalized and unproductiveness and inefficiency are encouraged. Therefore, it is better to leave these scarce resources to entrepreneurs so that they can make the best investment decisions in a competitive environment. This is all the more important in times of crisis - to give entrepreneurs innovation and creative ability the maximum opportunity to act and create wealth, instead of waiting for government privileges. It is also important that in such conditions, the entrepreneur will act to find out in which direction it is more profitable to invest now and what more the customer is asking and waiting for. The state will not be able to use him as an advisor and mentor in such a case, because on his advice, the entrepreneur will definitely lose the sense of competition and start a risky business.

Reducing taxes should be a necessary part of Coronavirus and its subsequent policies. Now the state budget itself will be depleted without re-starting business activities. Today, anyone who calculates the amount of tax revenue will be completely out of touch with reality - no one knows which business will survive in these conditions and what it will be capable to pay for. Entrepreneurs now have a lot of unpaid liabilities and there are already established and future liabilities on taxes, salaries, suppliers, and so on. Either they pay the state or they use this resource for action - there are no other options.

At the same time, if we look ahead, Post-Corona time will be in great competition in the world for investment resources - this has been the case before, but many did not understand it.

Therefore, Georgia urgently needs to create new additional advantages in order to attract investors. This should not be forgotten, given that the Lari is so volatile and there are many claims about the politicization of the judiciary (take any reality) and at the same time that everyone is competing for investments more than ever. What the government can easily change now to increase our nation's competitive advantage over existing problems is to cut taxes.

The reduction in taxes must be followed by a sharp reduction in government spending; Moreover, the state will have to reduce the expenses in any case - the reduction of the tax incomes is inevitable (if the US dollar does not become 5 GEL immediately). Obviously, we can no longer live in such a way, the salaries of the bureaucracy must be in line with the economy,

for example. Reducing taxes is also much easier to do than other alternatives - it will require nothing more than a declaration.

**There is another alternative.**

Other alternatives may include borrowing and / or receiving international assistance. When borrowing, we must take into account that now many nations' governments think and do calculations on such resources, and therefore - will become more costly. At the same time, taking this debt has its limits and its effectiveness - by trying to get today's illusory egg, we can easily break it and lose tomorrow's chicken for a long time.

We can be hopeful of getting aid, why not? - We do no harm to anyone. However, these aid resources are already in some kind of competition too; like in the case of loans, it also comes with preconditions (in some cases good) and at the same time we have done nothing (seriously bad or seriously good) to make us think we are in any privileged position. It is doubtful that the purpose of such resources is to meet the current or future demands of our economy. The more foolish it is to imagine it as our only hope and to see it as a reliable source of development. I would have thought about this issue at least a hundred or ten times instead of the government. I don't think it would be attractive for investors to invest money in a country that only hopes for foreign aid.

People with a sad and horrible experience of Soviet communism understand that the only source of wealth in the country is the entrepreneur, only he, motivated by profit, can come up with several solutions, adapt to any situation, attract the most modern ideas, both inside and outside the country, and mobilize and activate resources. All the others we act at his expense. The government does not have money, nor does it create anything, it must either take away our resources now or in the future and waste it to create the illusion.

That is why it is most realistic and pragmatic to reduce tax rates urgently and radically, leaving the private sector chances to act. We have to trust our entrepreneurs that they will offer us much better decisions, the government will need the courage to take the fiscal and political risks of such a decision, but it can calm itself down by not having any other choice.