

584. (c.) The foregoing discussions are introductory to the consideration of any specific tax or group of taxes, or existing tax system, respecting which we may inquire how far it answers the requirements of equitable contribution, or, on the other hand, if we abandon the rule of equity altogether—as did Mr. McCulloch—how far it secures to the state the needed revenue, with a minimum of irritation to the public mind, with a minimum of expense and loss in collection, and with a minimum disturbance to trade and industry.

## XVI.

## THE PRINCIPLES OF TAXATION.

585. *Inadequacy of the Literature of Taxation.*—According to an eminent German financier, Hoffmann, it would be difficult to find, in the whole realm of political economy, a subject more generally misconceived, more disfigured by false views, more degraded by a partial study, than Taxation. “If,” adds M. de Parieu, author of the ablest French work on the subject, “this proposition appeared true in a country where the problem of instruction in administration has for a long time been studied, it is probably still more so in France, where the practice is even further separated from the science of administration.”

586. The body of English literature in finance is extremely unsatisfactory.\* Adam Smith, indeed, gave to taxation about one-fourth of his *Wealth of Nations*; but his treatment shows little grasp of the subject, at any point; while his ignorance of the law of rent goes far to vitiate his general views. Ricardo dealt with taxation, at great length; and as a study of the

\* I have been severely blamed for using language even stronger than this, in former editions of this work. I dare say my statements were too sweeping. Mr. Newmarch's papers on public debts and Mr. Gladstone's Budget speeches are never to be mentioned without honor. Mr. Robert Giffen, Prof. Cliffe Leslie, Mr. Inglis Palgrave, and Prof. Thorold Rogers have made important contributions to many questions touching local or imperial taxation.

propagation of an economic impulse from object to object, and from class to class, his discussion is masterly. But Ricardo's underlying assumption of perfect competition has necessarily resulted in conclusions which are widely inconsistent with the facts of industrial society. J. R. McCulloch discussed taxation and the funding system in a distinct treatise, which is not without value. Later English contributions to finance have, with few exceptions, either been trivial in character or have been confined to single phases of the general subject. No great, comprehensive English work on Taxation exists.

587. Perhaps we shall get as good an idea of the inconsequence of the English literature in this department, as can be obtained in any other way, by referring to Adam Smith's maxims respecting taxation. Dr. Smith proposed four maxims,\* or principles, “which,” says Mr. Mill, “having been generally concurred in by subsequent writers, may be said to have become classical.” A vast deal of importance has been assigned by English economists to these maxims. They have been quoted over and over again, as if they contained truths of great moment; yet if one examines them, he finds them, at the best, trivial; while the first and most famous of these can not be subjected to the slightest test without going all to pieces.

588. *The Social Dividend Theory of Taxation.*—“The subjects of every state,” says Dr. Smith, “ought to contribute

\* “I. The subjects of every state ought to contribute towards the support of the government as nearly as possible in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.

“II. The tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.

“III. Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it.

“IV. Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state.”



towards the support of the government as nearly as possible in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state."

This maxim, though it sounds fairly, will not bear examination. What mean those last words, "under the protection of the state"? They are either irrelevant, or else they mean that the protection enjoyed affords the measure of the duty to contribute. But the doctrine that the members of the community ought to contribute in proportion to the benefits they derive from the protection of the state, or according as the services performed in their behalf cost less or cost more to the state, involves the grossest practical absurdities. Those who derive the greatest benefit from the protection of the state are the poor and the weak—women and children and the aged; the infirm, the ignorant, the indigent.

Even as among the well-to-do and wealthy classes of the community, does the protection enjoyed furnish a measure of the duty to contribute? If so, the richer the subject or citizen is, the less, proportionally, should he pay. A man who buys protection in large quantities should get it at wholesale prices, like the man who buys flour and meat by the car-load. Moreover, it costs the state less to collect a given amount from one taxpayer than from many.

Returning to the maxim of Dr. Smith, I ask, does it put forward ability to contribute, or protection enjoyed, as affording the true basis of taxation? Which? If both, on what principles and by what means are the two to be combined in practice?

**589. Taxation According to Ability.**—But if we take the last six words as merely a half-conscious recognition of the social-dividend theory of taxation, and throw them aside, we shall still find this much-quoted maxim far from satisfactory: "The subjects of every state ought to contribute towards the support of the government as nearly as possible in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy."

But is the ability of two persons to contribute necessarily in

proportion to their respective revenues? Take the case of the head of a family having an income of \$500 a year, of which \$400 is absolutely essential to the maintenance of himself and wife and children in health and strength to labor. Is the ability of such a person, who has only \$100 which could possibly be taken for public uses, one half as great as that of another head of a family similarly situated in all respects except that his income amounts to \$1000, and who has therefore \$600 which could conceivably be brought under contribution? Manifestly not.

We shall, then, still further improve Dr. Smith's maxim if we cut away all after the first clause: "The subjects of every state ought to contribute towards the support of the government as nearly as possible in proportion to their respective abilities." The maxim as it stands is unexceptionable, but does not shed much light on the difficult question of assessment.

**590. The Leave-them-as-you-find-them Rule of Taxation.**—The best statement I have met of the principle of contribution based on ability is contained in an article in the *Edinburgh Review* of 1833: "No tax is a just tax unless it leaves individuals in the same relative condition in which it finds them." What does the precept, which we may call the leave-them-as-you-find-them rule of taxation, demand? In seeking an answer to this question, let us inquire, historically, what bases have been taken for assessment. Leaving out Rent-Bearing Land, whose fiscal relations have been sufficiently dwelt upon, we note four:

1. Contribution has been exacted on the basis of Realized Wealth, commonly spoken of as Capital.
2. On the basis of Annual Income, or Revenue.
3. On the basis of Faculty, or native and acquired power of production.
4. On the basis of Expenditure, or the individual consumption of wealth.

These are the four historical bases of taxation. Let us see how far each in turn answers the requirement of the *Edinburgh Reviewer's* maxim that the tax ought to leave the mem-



bers of the community in the same relative condition in which it finds them.

And, first, of Realized Wealth. Wealth is accumulated by savings out of revenue. If, then, wealth alone is to be taxed, it is saving, not production, which contributes to the support of the state. Economically there can not be a moment's doubt that for government thus to draw its revenue from only that part of the produced wealth of the community which is reserved from immediate expenditure, must be prejudicial. The question also arises, where is the political or social justice of such a rule of contribution? *If my income belongs to me, to spend for my own comfort and gratification, without any deduction for the uses of the state, why should I lose my right to any part of it because I save it?* To tax realized wealth is to punish men for not consuming their earnings as they receive them. Yet it is eminently for the public interest that men should save of their means to increase the capital of the country.

**591. Revenue as the Basis of Taxation.**—Turning to Revenue, it would seem, on the first thought, that we had reached a rule of equitable contribution. Yet the rule of contribution according to revenue is subject to grave impeachment.

Here are two men of equal natural powers. One is active, energetic, industrious; he toils early and late and realizes a considerable revenue, on a portion of which the state lays its hand. The other lets his natural powers run to waste; trifles with life, lounges, hunts, fishes, gambles, and is content with a bare and mean subsistence. *Was his duty to contribute to the support of the state different in kind or degree from that of the other? If not, how has his idleness, shiftlessness, worthlessness, forfeited the state's right to a contribution from him in proportion to his abilities?*

We must, I think, conclude that, while to tax wealth instead of revenue is to put a premium upon self-indulgence in the expenditure of wealth for present enjoyment, to tax revenue instead of faculty is to put a premium upon self-indulgence in the form of indolence, the waste of opportunities, and the abuse of natural powers.

**592. Expenditure as the Basis of Taxation.**—Passing for the moment by our third title, we find that the fourth basis taken for taxation has been Expenditure. This must not be confounded with taxes on consumption, as constituting a part of a tax system in which taxes on realized wealth, taxes on revenue, taxes on faculty, one or all of these, also appear. Nor do we speak here of taxes on expenditure imposed in practical despair of an equitable distribution of the burdens of government. We are now concerned with expenditure only as the single basis of taxation, in the interest of political equity.

"It is generally allowed," wrote Sir William Petty, two hundred years ago, "that men should contribute to the public charge but according to the share and interest they have in the public peace; that is, according to their estate or riches.

"Now, there are two sorts of riches, one actual and the other potential. A man is actually and truly rich according to what he eateth, drinketh, weareth, or in any other way really and actually enjoyeth. Others are but potentially and imaginatively rich, who, though they have power over much, make little use of it, these being *rather stewards and exchangers for the other sort than owners for themselves.*

"Concluding, therefore, that every man ought to contribute according to what he taketh to himself and actually enjoyeth, the first thing to be done is," etc., etc.

Arthur Young seems to have had the same view. After saying that every individual should contribute in proportion to his ability, he added in a note: "By ability must not be understood either capital or income, but that superlucration, as Davenant called it, which melts into consumption."

In this view, so far as any one possesses wealth in forms available for the future production of wealth, he is regarded as a trustee or guardian, in that respect and to that extent, of the public interests. Just this is said by Young—taxes "can reach with propriety the expenses of his living only. If they touch any other part of his expenditure, they deprive him of *those tools that are working the business of the state.*"

**593. Fallacy of this Doctrine.**—I do not see but that, if



capital, or revenue in excess of personal expenditure, is to be exempted from taxation, on the plea that it has not yet become the subject of individual and exclusive appropriation, and is, therefore, presumably held and used in a way which primarily benefits society, the state has the right to inquire whether the use made or proposed to be made of wealth is such as will, in fact, benefit society, and benefit society, moreover, in the highest degree of which it is capable.

The citizen says to the state, "You must not tax this wealth because I have not yet appropriated it exclusively to myself. Indeed, I am going to use it for the benefit of society." The state rejoins: "Yes, but of that we must satisfy ourselves. We must be the judge whether your use of your wealth will benefit society. Pay your taxes, and you can do with your wealth as you like. Claim exemption on the ground of public service, and you rightfully come under state supervision and control."

The fallacy of the theory we are considering lies in the failure to recognize the fact that the selfish and exclusive appropriation and enjoyment of wealth are inseparable from its possession. The pride of ownership, the social distinction which attends great possessions, the power which wealth confers, are additional to the merely sensual enjoyment to be derived from personal expenditure. Would I resent the interference of the government, or of my neighbors, in the management of my property, upon the ground that it was not being used in the best way? What is that resentment but the proof of a personal appropriation, an exclusive appropriation, of that wealth? My resentment would spring out of the deeply seated feeling that my management of my own property is my right: and that he who should deprive me of it would take from me what is as truly mine as the right to eat, drink, wear, or otherwise consume and enjoy any portion of it; that, short of absolute mental incapacity, it is my prerogative to control my own estate, even though not to the highest advantage of the community, or even of myself: though not wisely or well. In other words, I am not a trustee, but a proprietor.

**594. The Dangerous Nature of this Doctrine.**—This doctrine of the Trusteeship of Capital is not more irrational than it is socially dangerous. It is held by men who are fierce in denouncing graded taxation as confiscation; yet it is, in its very essence, communistic. If the owner of wealth is but a trustee; if "his tools are working the business of the state," then the real beneficiary may enter and dispossess the trustee if any substantial reason for dissatisfaction as to the management of the property exists; the state may take the tools into its own hands and "work its business" for itself.

**595. Faculty as the Basis of Taxation.**—I reach, then, the conclusion that Faculty, the power of production, constitutes the only theoretically just basis of contribution; that men are bound to serve the state in the degree in which they have the ability to serve themselves.

I think we shall more clearly see Faculty to be the true natural basis of taxation if we contemplate a primitive community, where occupations are few, industries simple, realized wealth at a minimum, the members of the society nearly on a level, the wants of the state limited. Suppose, now, a work of general concern, perhaps of vital importance, requires to be constructed: a dyke against inundation, or a road, with occasional bridges, for communication with neighboring settlements. What would be the rule of contribution? Why, that all able-bodied persons should turn out and each man work according to his faculties, in the exact way in which he could be most useful.

In regard to a community thus for the time engaged, we note two things: first, no man would be held to be exempt because he took no interest in the work; he would not be allowed to escape contribution because he was willing to relinquish his share of the benefits to be derived, preferring to get a miserable subsistence for himself by hunting or fishing; secondly, between those working, a higher order of faculties, greater muscular power, or superior skill would make no distinction as to the time for which the individuals of the community should severally remain at work.

**596. The Ideal Tax.**—This is the ideal tax. It is the form



of contribution to which all primitive communities instinctively resort. It is the tax which, but for purely practical difficulties, would afford a perfectly satisfactory measure of the obligation of every citizen to contribute to the sustentation and defense of the state. Any mode of taxation which departs in essence from this involves a greater or smaller sacrifice of the equities of contribution; and any mode of taxation which departs from this in form is almost certain to involve a greater or smaller departure in essence.

And it deserves to be noted that the largest tax of modern times, even in the most highly organized societies of Europe, the obligation of compulsory military service, is assessed and collected on precisely this principle.

**597. The Faculty Tax Impracticable.**—But while the tax on Faculty is the ideal tax, it has usually been deemed impracticable, as the sole tax, in a complicated condition of industrial society. As occupations multiply and the forms of production become diversified, the state can not to advantage call upon each member, by turns, to serve in person for a definite portion of each day or of the year. Hence modern statesmanship has invented taxes on expenditure, on revenue, on capital, not as theoretically just, but with a view to reduce the aggregate burden on the community, and to save production and trade from vexation and obstruction.

**598. We recur to the Tax on Revenue.**—The politicians of the existing order, as we have seen, shrink from the effort involved in levying the public contributions entirely, or even chiefly, according to faculty. Next in point of political equity comes the tax on incomes, or the revenues of individuals. That tax, as we now contemplate it, is a tax on the revenues of all classes, with exception only of the amount requisite for the maintenance of the laborer and his family, after the simplest possible manner, in health and strength to labor. It is not a compensatory tax, constituting a part of a system in which realized wealth and various forms of expenditure are also brought under contribution, but the sole tax imposed by the state.

**599. Exemption of the Actual Necessaries of Life.**—It has been said that from such an income tax the necessary cost

of subsistence must be exempted. Mr. D. A. Wells has, indeed, laid down two propositions: first, that "any income tax which permits of any exemption whatever is a graduated income tax;" and, secondly, that "a graduated income tax to the extent of its discrimination is an act of confiscation." But the exemption of a certain minimum annual revenue is a matter of sheer necessity, whether the state will or no. Economically speaking, it is not possible to tax an income of this class. A man in the receipt of such an income can not contribute to the expenses of government. Should the state, with one hand, take any thing from such a person as a taxpayer, it must, with the other, give it back to him as a pauper.

Conceding the exemption, on purely economic grounds, of the amount required for the maintenance of the laborer's family, one of the most vital questions in finance arises immediately thereupon, to wit: shall the excess above the minimum, shall the superfluity of revenue, which may be spent or saved at the will of the owner, be taxed at a uniform rate, or at rates rising with the increase of income?

**600. The Question of Progressive Taxation.**—The question of progressive taxation has always been one of great interest while the fiscal policy of states rested with the wealthy and well-to-do classes. It is certain to acquire vastly greater importance as political power passes more and more into the hands of the class of small incomes.

Upon the question of the equity of progressive taxation writers on finance are divided. One party holds that any recognition of this principle is sheer confiscation: the other admits that progressive taxation may be carried to a certain point without injury either to the sense of political justice or to the instincts of industry and frugality, some even holding with J. B. Say that "taxation can not be equitable unless its ratio is progressive." Both parties agree that there is great danger that, under popular impulse, progressive taxation may be carried so far as not only to violate all the equities of contribution but seriously to shock the habits of acquiring and saving property.