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# THE ECONOMIC JOURNAL

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## EQUITY AND ECONOMY IN TAXATION <sup>1</sup>

WE professional economists will always have a kindly feeling towards the Local Taxation Commission of 1897-1901. The Commissioners set us an examination paper, and though, as Adam Smith would have said in his hasty way, "they endeavour to degrade" our answers "by the humiliating appellation" of *Memoranda* (which Professor Edgeworth has reduced to the still more undignified *Mem.*) we were pleased to be noticed. It is easy to laugh at the *Memoranda*. Nobody enjoyed the joke more than the examinees. Staid professors felt their youth renewed as they conned over the paper, and wondered which questions they could "do." The more ribald found a wicked joy in the thought that as no class list was to be brought out, it was not necessary to conciliate the examiners by careful concealment of the fact that the form of some of their questions showed their entire ignorance of the subject. But the result of the experiment has been very valuable. Though we cannot suppose that any of the commissioners read the whole of the answers, we may conjecture that each of them looked at the answers to the questions which he himself proposed, and it is probably owing partly to this fact, that the litter of reports so resolutely avoids many quagmires in some of which the personages who framed the reference to the Commission, and perhaps some of the Commissioners themselves, were floundering at the beginning of the inquiry. Whatever benefit the Commission may have derived from the *Memoranda*, it is certain that more than one economist is

<sup>1</sup> Read before the Scottish Society of Economists, October 11, 1901.  
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ready to acknowledge his obligations to the Commission for compelling him to deal with the questions actually asked by the practical man, and giving him the opportunity of comparing his attempt with that of his colleagues.

The Commission has produced enough of its final report to show its position in regard to the principles of taxation, and now our turn has come to criticise it, and to get what profit we can from it.

Like some other commissions and committees of recent years, the present Commission has been unfortunate in the terms of its reference. Our Governments are never content to give a commission a free hand; they always endeavour, as far as possible, to tie it up to the particular answer which they themselves favour, and when their attempt to do this has been slightly modified to meet the objections of the front Opposition bench, it is seldom improved. The Opposition has its own distorted view as well as the Government, and the end of the consultation is that two leading questions are put to the Commission, and the truth is, so far as possible, excluded from the terms of reference.

It would have been easy to ask the Commissioners "to inquire into the present system under which taxation is raised for local purposes," and to suggest any improvements therein which might seem desirable. Instead of this, they were asked "to inquire into the present system under which taxation is raised for local purposes, and to report whether all kinds of real and personal property contribute equitably to such taxation, and, if not, what alterations in the law are desirable in order to secure that result." This clearly implies that it is an axiom of equity that all kinds of property should contribute to taxation raised for local purposes, since we can scarcely suppose the framers of the reference to have admitted in their minds the possibility of an "equitable contribution" being *nil*. It also probably implies that it is equitable that persons should not contribute to taxation raised for local purposes except in respect of property, *i.e.*, that earnings of personal exertion should not be taxed for local purposes. Further, it says nothing whatever about economy, except so far as economical considerations may be obscurely implied in the word "desirable."

Equity is put in the first place, and economy, if considered at all, is to come in afterwards as a sort of practical difficulty in the way of the complete adoption of equitable principles.

Though the Commissioners, both of the majority and the minorities, have shown no slavish adherence to the letter of their commission, they have almost all been strongly influenced by the

mode of stating the question adopted in the reference, and it is to this malign influence, in great part at any rate, that we must ascribe the fact that their reports, though careful and able, are scarcely luminous. They throw little light on the main question, because the Commissioners fail to distinguish clearly between considerations of economy and considerations of equity, and to put the two in their right place.

They have all, with the possible exception of Judge O'Connor, adopted two entirely different maxims of taxation for local and national taxation. In an ideal world, they seem to think, national taxation would be distributed over the taxpayers in proportion to their ability to pay, while local taxation would be distributed over the taxpayers of each locality in proportion to the benefit derived by them from the expenditure. But, and this is of course a very important proviso, in such a world the services performed by governmental agency would divide themselves sharply into two classes, one of which would be clearly national, and the other local, national services being those from which benefit arises to the nation at large, and local services being those from which benefit arises to the persons interested in the locality. They imagine themselves to be precluded from advising a division of services, and a frank recognition of the two great maxims of national taxation according to ability, and local taxation according to benefit, not so much by the fact that the various services do not actually divide themselves into the two classes, as by certain administrative difficulties, such as the stupidity and Chinese conservatism of a central bureaucracy on the one hand, and the irresponsibility of local committees administering national funds on the other.

I am not sure that four or five years ago, when the Commission was appointed, I should not have been content with some such doctrine. I should not be surprised if some one alleged that I taught it myself. But four or five years make a difference, and now the doctrine seems open to very serious objections.

1. Payment according to ability does not so completely govern national finance as the Commissioners seem to suppose. The principle of payment according to cost of services rendered, is often applied, and, owing to the requirements of economy, quite properly applied, to national services. We do not propose to pay the expenses of the Post Office by an income tax or death duties proportioned to the ability of the taxpayer, but according to the number of letters and parcels he sends. There is, too, in the chief European countries, a very large revenue derived from taxes on

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alcoholic liquors. Will any one pretend to believe that this taxation is maintained out of respect for the principle of payment according to ability? When did the habitual drunkard become so capable of bearing taxation? There are few forms of expenditure which form a less trustworthy criterion of ability than expenditure on alcohol. We all know very well that the drink taxes exist because, in addition to bringing in a large revenue, they are supposed to limit, to some extent, the consumption of a commodity in which people are prone to indulge to excess.

2. The idea that national and local services can be sharply divided, and the former governed by one maxim of taxation, and the latter by another, is insular and unhistorical. It would not enter into the mind of a German, an American, or even an Englishman or Scotchman who really regarded himself as a citizen of a great empire. The distinction the Commissioners have in their minds is not the distinction between Germany and Bavaria, the United States and Pennsylvania, Canada and Ontario, the British Empire and India, but merely the distinction between England and its urban and rural districts. They do not even seem to have thought about the subdivision of the counties into districts and the rural districts into parishes. When we remember that nations and localities are of various sizes, and think of the enormous changes that have taken place in the frame of government in historical times, we see how unlikely it is that one maxim is exclusively applicable to national, and another to "local" areas.

3. It seems to be admitted that the theory cannot be applied without causing administrative inefficiency. Such a theory is to be at once condemned. To lay down principles and then say they are subject to qualifications and exceptions, was a common practice in the 19th century, but I hope it will not be so in the 20th. There is no more untrue saying than that every rule has its exceptions; a rule with exceptions is no rule at all, but only an inaccurate generalisation. A theory of taxation which cannot be applied is a bad theory.

The object of every good legislature and every good Chancellor of the Exchequer is to raise the money required for government purposes, whether central or local, with as little aggregate suffering as possible. Any one may call this popularity-hunting if he likes, but there is nothing wrong in such popularity-hunting if the populace is not deceived. A government which imposes a tax the bad effects of which are difficult for the populace to follow, in preference to a really less harmful tax of which the bad effects would be more easily recognised, is to be condemned, but when

the effects of the taxes are equally plain to the uninstructed, the most popular will be the best. This does not of course mean that the best tax is that which would get most votes in a compulsory plebiscite: popularity must be weighed as well as counted, and the intense dislike of one man will weigh as much as the tepid liking of three or four; in practical politics it is perfectly well recognised that it is more dangerous to offend 100,000 voters deeply than to offend 1,000,000 slightly. Nor does it exclude consideration of remote as well as immediate effects. Considered in its immediate effects, the kind of income tax described by Professor Edgeworth in one of his fascinating studies,<sup>1</sup> which would simply remove the superfluity of the very richest persons, reducing say every one with more than £50,000 a year to that sum, would be productive of least aggregate suffering. It would make a given income go furthest. But the given income would not remain. The persons with more than £50,000 a year would not continue to have more than £50,000 a year, at any rate within the purview of the state, and next year the limit might have to be reduced to £40,000 a year, and so on till the interference with the productive force of the community far more than counter-balanced the economic saving secured by making the given income go furthest. Consideration of remote effects is not to be treated as if it were consideration of "practical difficulties" interfering with the full adoption of correct theory. Remote are to be considered along with immediate effects, and given an equal place.

The principle of payment according to ability, when applied to payments for certain services which cannot be divided up and sold retail to the consumers, but are performed for the community in a lump, is in thorough accordance with the principle of least aggregate suffering, inasmuch as taxation according to ability practically means taxation which takes the least essential and useful part of the income of the community, so far as that can be done without interfering with production. The various interpretations which we find put on the phrase are due to the different degrees in which people think it safe to approach the system already described, in which the whole burden is thrown on the higher incomes.

When the services performed by the state are of such a character that it is possible to measure, at any rate approximately, how much each consumer has had, and the consumers are able to pay, it is in accordance with the principle of least aggregate suffering to make each person pay according to the cost of the

<sup>1</sup> ECONOMIC JOURNAL, vol. vii. (December, 1897), pp. 550-571.



service rendered to him, because this plan proportions production to demand, as may be seen if we follow out its working.

Whenever the state takes money or services compulsorily and provides in return other goods or services, it is obviously liable to fall into the mistake of asking too much and giving too little. What it provides may not be worth what the taxpayers have paid for it. A most effectual way of preventing such mistakes is for the state only to ask for the money when it supplies the goods or performs the service, and not to insist on any one taking the goods or the service. For example, if the state collected by general taxation money to pay for carrying parcels by post, and then performed the service of carrying parcels gratis in unlimited quantities for every one, a great many too many parcels would be sent by post, and the marginal value of the service rendered would fall to almost *nil*, and the total value would be much less than the cost. To avoid this, the state, instead of collecting the cost of working the parcel post by general taxation, collects it by a charge on the number and weight of parcels despatched by each person, and no one sends a parcel by post unless he regards the service as worth the money. The demand at the prescribed price determines how much of the service shall be performed.

This is the simplest case: more complicated examples are those in which a particular industry is taxed for some expenditure which is for the benefit of the industry. The principle of payment according to cost of service rendered is economical in such a case, because if the industry received special benefit from the state without paying for it, the consumers of the commodity or service would acquire it below cost price at the expense of the taxpayers, and the probability would be that the benefit to them would not equal the loss to the taxpayers. But if the industry be saddled with the special expenditure (*e.g.*, shipping with the cost of lights) the produce will be adjusted accordingly, and there will be no chance of an uneconomical amount being produced.

Another example of the economical character of payment according to cost of service is to be seen in the existence of local taxation. The governing body of a great area is certain to make mistakes and spend money on objects which are not worth it, if it tries, for example, to supply street maintenance, cleansing and lighting, drainage and water supply, removal of house refuse, parks, and the thousand other conveniences which modern civilisation calls for. It could not of course provide these things *ad libitum*, and the imposing of limits would mean the

assumption of the right to determine where increase of population was to be located, and what industries were to be carried on. Blackpool might want many additional attractions, but the Chancellor of the Exchequer or President of the Local Government Board might not approve of Blackpool, and might prefer to spend the national money at St. Andrews or North Berwick. Manchester and the cotton trade might want a Ship Canal, but the President of the Board of Trade might feel a tender interest in hardware and be member for Birmingham. To work such a system economically would require almost as much skill and wisdom as to work the whole country on a communistic basis, and a great deal more virtue, inasmuch as the deflecting force of private interest would still have full sway. Hence it is economical to create or to maintain in every great country small subdivisions each of which is independent for such purposes, and may spend much or little as it chooses, thus taxing itself (in the aggregate) according to the cost of the service rendered.

Even when the state must insist on a certain minimum of service being provided, as in the case of poor relief and police, it is economical to adopt the principle of payment according to cost of service as between different localities, in order to secure efficient management by local persons.

Thus both the principle of payment according to ability and the principle of payment according to benefit, or rather cost of service rendered, have their place in securing economy in the means of raising revenue.

But they do not furnish by themselves a complete guide to economical finance, and it often happens that a considerable portion of the total revenue of the state can be most economically raised by methods which are not suggested by them. There are two important examples of this truth.

One is the taxation of the luxuries which, if indulged in to excess, are harmful. By taxing alcoholic liquor the state manages to divert into its coffers at any rate some money which would have been spent in excessive drinking. So far as it does this it only deprives its subjects of a portion of income which, instead of being essential or even useful to them, would have been positively harmful. This is clearly a most economical kind of taxation: even if the money obtained by it is simply wasted by the state, there is no loss, and if it is spent on any good purpose there must be a gain.

The other important example is to be found in the fact that when small areas are to be taxed at different rates, it is most



economical to tax immovable property only. No intelligent person can read the report or reports of the Local Taxation Commission and the evidence taken before it without being struck by the almost entire absence of objection from the economic side to the English and Scotch system of local taxation in regard to its main principle, the taxation of immovable property alone. That principle is immensely strong. It was not adopted by newspapers, politicians, and Houses of Parliament to win the next election, nor even by a chance decision of the law courts. It was adopted gradually by the common sense of the people nearly all over the country, and when the courts refused to sanction it, it was forced on a reluctant Parliament which has never yet definitely ratified it.

He would be a rash man indeed who would attack it on economic grounds. The first purpose of a tax is to bring in money, and no tax brings in money more easily than a rate on immovable property. It is cheaply collected, it is easily moved up and down without disturbance to trade, and it is as "certain" in the great majority of cases as any tax can be. The only allegation against its economy is that it discourages building and other investment of capital in creatable but immovable property. This of course is true. Every tax discourages some kind of production, because the aim of taxation is to divert a portion of the productive force of the community from producing what individuals desire as individuals to producing something else which they desire in their corporate capacity, and of course a tax on a particular kind of property will discourage the production of that kind more than the production of other kinds, though it is quite wrong to assume that it will only discourage that kind. If houses are more taxed it does not follow that householders will endeavour to recover the whole of the tax by reducing their standard of house accommodation. They may doubtless meet part of the tax by saving in other directions.

But even of the special discouragement to this kind of investment which does take place, it would be rash to conclude without inquiry that it is altogether uneconomic in its action. The major part of the local taxation of to-day is for what may be called public works, and so far as buildings are taxed for these, the discouragement is very like the discouragement which is caused by the necessary expenditure on foundations. Where the expenses of public works are great owing to natural causes or even inefficient management, it is just as right economically that building should be discouraged as where foundations are expensive

owing to the nature of the soil or the incompetence of builders.

The discouragement argument is consequently only valid to a very small extent, and is practically unimportant in this country, except perhaps in some parishes with abnormal school rates. The small economic disadvantage involved is not for a moment to be compared with the enormous disadvantages of other kinds of local taxation with their train of perjury and evasion. No writer on taxes ought to be allowed to ignore the history of English local rates or of the American property tax.

So far we have dealt with economy only, but the principle of least aggregate suffering by no means excludes considerations of equity. A feeling of injustice is a form of suffering which is often acute, and may too lead indirectly, by the disturbance it causes, to more material forms of suffering. But economy must be put in the first place. The first thing to do is to find economical means of raising money. The next to inquire if there is any ethical objection. No individual even of the most rectitudinous type inquires primarily how he can make money equitably. He only tries to make it without injustice, and this is all the state need do. The search for an equitable system of taxation in the abstract is as unpractical as the search for an equitable distribution of wealth. It can only be reasonably conducted by one of those 18th century persons who believe that the existing distribution of wealth is equitable. We of the 20th century are quite content to treat the existing distribution of wealth as a historical fact and to admit that wealth, like the rain, falls on the just and the unjust. All we want to know is what proposals to alter it are equitable and inequitable. Just in the same way we ought to accept our system of taxation as it has come down to us, without pestering ourselves with questions as to whether it would be equitable or inequitable to establish such a system in a new planet, if we happened to be allowed to be the creators of one. All we want to know is whether equity would be promoted by certain alterations in the system.

Here we find in popular discussion considerable complaint that the taxation which is supposed to be more or less in accordance with the principle of ability or cost of service rendered is not more exactly so, but this is rather a matter of detail. We also find pretty general acquiescence in the justice or injustice of the drink taxes, though they are obviously unfair to the people who have a taste for alcohol. But curiously enough one of the

strongest features of English finance from an economical point of view, the exclusive taxation of immovable property, is violently attacked as inequitable. The majority report of the Commission (in a chapter from which Lord Balfour of Burleigh and Lord Blair Balfour dissent) itself speaks of the growth of the amount raised by local authorities having "accentuated the inequality and inequity of the means by which so large a proportion of that revenue is raised." Beyond a suggestion that something of the kind "has been admitted by the great majority of those who have closely studied the subject of Local Finance, and who are entitled to be regarded as authorities on the question," no shadow of an attempt at proof of inequity is to be found in the report. It would be interesting to know who the close students mentioned by the Commissioners are. It is so easy to have such people on your side if you rule out all who are not entitled to be regarded as authorities!

The idea of the Commissioners seems to be that the fact that the great bulk of local taxation is raised from a particular kind of property, namely immovable property, is by itself a proof of inequity, which they seem to confuse with inequality, though they use both words. This notion is entirely erroneous.

If the Commissioners had to legislate for an island on which a number of persons with movable property had just arrived, and had to distribute the land among these persons, would they consider it grossly unequal and inequitable to say that the expenses of government were to be defrayed by rates on land and buildings? In our own country of course we have not to deal with a *tabula rasa*. We have had certain expenses paid by taxes on land and other immovable property for centuries, and the question is not whether it would be just or unjust to impose this unequal taxation in the beginning of things, but whether it would be just or unjust to alter it after it had been long established.<sup>1</sup> What can be more absurd than to assert that A, who has a thousand a year clear from

<sup>1</sup> The pretence that the burden of local taxation in this country is chiefly modern will not impose upon any one with any knowledge of history. The rural landowner has been complaining at least ever since he became able to write. Let us listen to Sir Thomas Culpeper: "It hath ever been the known grievance of this Kingdom, that all the hardships of the Commonwealth were born by Land: Our Land-lords only exposed to be Lords and Deputy Lieutenants, Sheriffes, Commanders in the Militia, Justices of the Peace, Jurymen, with divers other chargeable employments general and Parochial: Our Tenants to be Constables, Bosholders, Surveyours, Collectours, &c., Prest to the War, and charged even in Peace; Both of them in their degrees, obliged to Residence and Hospitality, subject to payment of Tithes, maintenance of the Poor, employment of Labourers at certain cost but uncertain Profit, Repaying of Churches, Mills, Bridges, Highwayes, Sewers, &c., Rarely portending to matters of much advantage."—*Necessity of abating Usury re-asserted*, 1670, p. 1.

land, is unjustly treated compared with B, who has a thousand a year from consols, because if the poor rate were taken off A's land and put on B's consols, A would have £1050 and B only £950? Possibly B sold the land to A and took up consols with the proceeds: why should the bargain be revised? Land has been far too extensively bought and sold subject to the burden of rates to make it just to take the burden off and impose it on other kinds of property. Rateable properties other than land have not only been bought and sold, but have for the most part actually been created or erected subject to the burden. Why should a man who has acquired land or buildings subject to the obligation of maintaining the poor claim that he should be relieved of the charge any more than that he should be relieved of a charge on it in favour of the late proprietor's maiden aunt? The old doctrine was *nullum tempus occurrit regi*; some of our modern would-be reformers have turned the maxim round and hold that no length of time can give the state a good title. From a claim that it is just that immovable property should be relieved from its special burden of rates it is but a little step to the demand that it should be relieved from its special burden of land tax. From the claim that it should be relieved of land tax, again, it is but a little step to the claim that crown land should be handed over to the present tenants free, gratis and for nothing. An ordinary landowner has inherited or bought his land subject to a long standing, well understood permanent charge known as the land tax. If it is just to present him with the charge at the expense of the taxpayers, it is difficult to see why it would not be just to present the crown lands to the persons who happen to occupy them. Equity certainly does not demand that the state should equalise its old demands in respect of different classes of property. By maintaining these old demands it inflicts no injustice on any one, inasmuch as it disappoints no legitimate expectations.

Maintenance of old unequal demands and the making of new ones are, of course, two different things, and it does not follow that because it would be unjust to the taxpayers to remit the present land tax, it would be just to impose a new tax of the same random character. While there would be no justice, but rather injustice, in releasing immovable property from the old charge for the relief of the poor, it would be quite unjust to levy the whole cost of the South African war from immovable property. Some people cannot be got to see the difference. Once unjust, they say, always unjust, and if it would be unjust to put a new special burden on a particular class of property, it must be un-

just to maintain an old burden. These people forget that private property is based on prescription. If they would have the state examine so carefully its title deeds and go back several centuries, let them do the same with regard to their own ancestral property, and if they find that their remote ancestor acquired the property by means of which they cannot approve, let them hand it over to the present occupiers.

The fact is, that in practice, equity in taxation is synonymous with conservatism. There might, of course, be taxes of such a character that no lapse of time would condone their original iniquity. A special tax, for example, on red-haired people, or people under 5 feet 6 inches high, could not be sanctified by any length of time. It would always be equitable to abolish such a tax. But we do not meet with many such personal taxes now: to find actual examples we have to go back to France before the Revolution. The only form in which they linger is that of unequal taxes on different commodities, which result in unequal burdening consumers of different tastes. These do not usually give rise to any very acute suffering.

The conclusion at which we arrive seems to be that economy plays, and should play, a much greater part, and equity a much smaller part, in schemes of taxation than is commonly supposed. Changes which are advocated as highly equitable, though perhaps not very economical, are to be regarded with the greatest suspicion. Equity is ordinarily so well satisfied by a policy of inaction, that desirable changes will usually be made with a view to economy rather than equity.

EDWIN CANNAN