Can Taxation Be Constructive?

By Hon. Frank A. W. Lucas, Q.C.

The present set-up of our social and political organisation presupposes some form of government body to conduct its public affairs and to provide such services as the public opinion of the time thinks can be better supplied by it than by private enterprise. To do all that, a revenue is required, and this is normally derived from taxation. When such an instrument is placed in the hands of public bodies, it behooves us to look into the way it is, and should, or should not, be used. It is easy to name instances where taxation has destroyed useful things.

In England in the last century windows were taxed. Many were then bricked up. That was bad for the health and the comfort of the people. In the Middle East, a sultan placed a tax on date trees. They were cut down. The food supply suffered and the country became more arid. In South Africa, wheels have been taxed. The poor whites and blacks who depended on ox-drawn wagons or carts removed the wheels. That was hard on the oxen and bad for the country. Sleds tore up the surface of the earth and greatly increased the peril of erosion. Those are spectacular examples of the destructive power of taxation. The outward and visible signs of destruction caused by some other taxes are not so obvious, but it, nonetheless, occurs.

In some instances the effects of taxation may be even more dangerous for the community than the mere destruction of commodities. Income tax furnishes an example of this. That tax is justified on the basis of the ability of the possessor of an income to pay it. We are nowhere told where the state got the right to act as a Robin Hood or highwayman and to demand a share of his income. This is the assumption behind the basis of the ability to pay. A private individual is not normally entitled in business to demand, in return for what he gives, more than its value. On what moral grounds is the state entitled to claim from the taxpayer more than the value of the service it renders to him of the benefit it confers on him? Income tax bears no relationship whatever to such services or benefits.

But much worse is involved. The amount payable by the taxpayer depends on how much he can hide from the tax gatherer. It places a premium on his dishonesty. The moral degeneration it causes to the character of the people is incalculable. It destroys integrity as a respect for truth and law. A very high rate of taxation tends to kill initiative, and makes those who must pay it likely to slacken in their efforts and their work. After a certain stage is reached, the taxpayer is virtually working, without payment, for the Government. In any event, the more he works the more he must pay.

So, too, with customs tariffs. Here the intention is to destroy foreign trade. If we had been logical, we should have welcomed the damage the German submarines tried to do to prevent our carrying on such trade. Tariffs place in the way of every traveller the temptation to try to smuggle goods into the country. In effect we treat those goods as evils and the person bringing them in as a criminal. Customs tariffs breed unfriendliness between nations and they have been an important factor in causing wars.

Heavy trading licences tend to destroy competition. They keep a small man from entering business and so help to establish monopolies. A tax on improvements tends to restrict building and is a substantial obstacle in the way of meeting the housing shortage. One might go on like that through the whole gamut of taxation as now levied.

Taxation and the Cost of Living

Another serious evil that flows from our present system of taxation is its effect in raising the cost of living. That is obvious with customs tariffs and sale and purchase taxes. At first sight, it is not so obvious with the income tax, but it is, nonetheless, true with it also. The rate at which anyone will lend money must be high enough to include the tax and leave at the same time an attractive rate of interest. Similarly, the merchant will fix his price for the commodity he sells to include enough to give him the required income after he has paid the tax.

The effect of taxation on the cost of living might in the face of the visibly abounding prosperity in the United States seem to be of little account. That, however, overlooks the interests of people with a fixed income, the value of the purchasing power of which declines with each rise, and, in particular, it overlooks the plight of those who are living on or near the poverty line. The figures contained in a recent report of the economic study group of Congress reveal that about 20 per cent of the people of the United States are living in that condition. For such people every increase in the cost of living represents a nightmare. Their poverty also makes for a poor market for the produce of the farmers, who are, thus, left with unsold surpluses.

Apart from the seriousness and hardship so caused, there is danger to the State in the discontent that flows from poverty because it provides a fertile field for the spread of Communism and subversive action. Leaders of the totalitarian States of this century came to power through playing on the discontent and poverty of the masses in their countries.

The perils from our system of taxation are therefore serious and urgent, and that is true not only for the United States but for the whole Western world.

Only Two Alternative Sources of Revenue

The question then arises whether a scientific approach to taxation is not possible. Is there no form of constructive taxation, one that will promote sound prosperity in which all can share? If we were to apply scientific methods to our problem of taxation in the same way as we do to problems of mechanics or electronics, we ought to be able to provide government with its revenue without the evil effects which our present system brings about. A scientist would ask whether there is not some source of revenue which would bear a reasonable relationship to the benefits conferred by good government, which would be just in its incidence, easy and cheap to collect, difficult or impossible to evade, and one which would encourage and reward industry and thrift.
Ultimately there are only two sources from which state revenue can be obtained, the produce of labour and the rent of land. There are three, and only three, factors in the production of wealth: land, labour, capital. As capital is merely stored up labour for use in aiding production of wealth, the interest on it, that is, the return for its use, may, for our purpose, be taken as the produce of labour. In any event, a tax on interest goes into the cost of production and the cost of living.

The Economic Rent of Land

We have seen that every tax on the produce of labour enters into and raises the cost of living. Our scientist would then consider obtaining revenue for the state from the rent of land, excluding from it, as being the produce of labour, the value of any improvements on it. He would find that the landowner, as distinct from land-user, does not make the value of land. He contributes, as such, nothing to the production of wealth. Land yields nothing of itself. Labour must be applied to it before there can be any production from it. The only function, therefore, of the landowner is to receive the land rent. He does this without rendering any service to the community in return. His income from this source thus differs fundamentally from income from labour.

Having got so far, our scientist would ask what is the source of land rent. He would find that the value of land is created not by the landowner who receives the rent but by the presence, activities, and expenditure of the community. Not only is it so created, but it is maintained daily and hourly by its presence and activities. The owner may live abroad, but the land value will be there as long as the community is there. This point was strikingly illustrated recently in South Africa. Land which was fertile but where malaria prevailed has, as the result of a long campaign, been freed from disease. The Minister of Health announced that, owing to the successful campaign, the land now so freed has risen in value by £50 million. The taxpayer paid for the campaign; the landowner, though contributing nothing to it, gained that increase. To maintain that value, the campaign has to be continued to prevent the return of malaria. The land value is entirely free from taxation. What is true of that land is true of all land, though that is a more striking example than most.

What Constructive Taxation Would Do

Our scientist would find that, strangely enough, though that value is most fitted for taxation, it is left virtually untaxed. He would see that it is the one source from which revenue could be obtained without any of the evil effects which we have seen flow from the present system of taxation. Revenue derived from that source would not raise the cost of living. It would tend to reduce it by reducing rent. All economists are agreed that taxation on the value of land cannot be passed on but stays where it falls. It is easy to assess the value of land. We buy and sell land every day and have no difficulty in arriving at an agreed price. Such taxation cannot be evaded, as land cannot be hidden. There would, therefore, be nothing in it to demoralise or corrupt the character of the people. This tax would be easy and cheap to collect. It would be just because it would merely take for community purposes what the community created. There could be no better justification for a tax than that. It would be a payment directly proportionate to the value of services rendered and benefits conferred by the state.

An adequate amount of revenue could be obtained by the state in this way. In fact, government services would produce enough to pay for their cost. Many services produce far more land value than they cost. The South Africa example, of the anti-malaria campaign, is an instance in point. It must be remembered that the value of land includes all natural resources and potentialities inherent in it. This is recognised in South Africa, where the right to mine precious minerals and metals and oil is vested in the state. From this source the country receives a substantial revenue through rents and royalties. The value of such natural resources everywhere depends, as does any other kind of land value, on the activity and presence of a community which makes it possible for them to be worked and exploited.

A tax on the value of land is an incentive to the use of land of private enterprise, and, therefore, it encourages the development of such enterprise.

Thus, there is a form of constructive taxation. This form would destroy the speculative and monopolistic value in land, but leave the true value of it to provide a source of taxation free from the evil effects that follow from our present form of taxation. It would leave to the producer intact all the value of his produce. He, like every one else, would pay to the state only the value of the services he received from the occupation of the land he used.

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