TAXES
The Case for Reform
BY ANTHONY CARTER

IT WAS A British Chancellor of the Exchequer, Selwyn Lloyd, who, when introducing a tax he knew would be unpopular, acknowledged that 'all taxes are odious.'[1] This may seem a truism, but the remark deserves study, for it is true in two different senses and the distinction between them is significant. It is true, first, in the superficial sense that no one enjoys paying taxes. No one likes to have something taken away from him, even for a pupose of which he approves. The payment of taxes is always a nuisance.

There is, however, a more profound meaning to the statement that all taxes are odious. It is that the majority of taxes throughout history have been regarded as onerous, arbitrary, and harmful in their effects. Such feelings are understandably prevalent in the nineteen-seventies, for the extensive role played by the state in the life of modern nations has resulted in levels of taxation far higher than those of the past. A biting tax bites harder; an unjust tax is more unjust, a depressive tax more depressive. The innate tendency of any tax becomes more marked as the level of the tax increases.

The principal taxes that hold sway today are those on incomes (wages, interest, and profits); on wealth (possessed, acquired, or transferred); and on spending (sales and value added taxes, customs and excise duties). Let us look at the properties and consequences of some of these taxes.

A graduated tax on incomes is usually accepted as embodying an inherent principle of fairness: 'from each according to his ability,' with the corollary 'to each according to his needs,' is the axiom not only explicitly of the Marxist but implicitly of most of the industrialized countries of the world. The ability to pay principle is engendered by a social condition in which there is a growing gulf between the rich and the poor and a recognition that this must be changed.

The effect of income taxes is to blunt the incentive to seek higher incomes. This is not much felt when rates of tax are low but becomes more potent as rates of tax rise. It ceases to be worth while not only to work hard, to shoulder responsibility, to learn skills and undergo technical or professional training, but also to innovate, to take risks, and to exploit opportunities. The worker and the entrepreneur alike are penalized if they improve their performance, and the investor is penalized for putting his capital into productive enterprises rather than consuming it.

Business profits are similarly affected. In a healthy competitive economy profit is the measure of success. The reward for proficiency in reducing costs and expanding output and sales is a higher return, which the tax system proceeds vigorously to cut back.

Taxes on wealth have many of the same defects, for the accumulation of wealth is one of the spurs to economic action. A case can be made for the prohibition of inherited wealth, but equally a case can be made for the freedom of a man to devise his property as he wishes. *There is too much emphasis on the size of the fortune and too little on the means by which it was obtained. Even wealth transmitted through generations had to be won at some time. The relevant question is how it was won—by contributing to the economic well-being of society or by living on the contributions of others.*

One of the commonest forms of tax on wealth is that on real property, levied either on the capital value of the premises or on their actual or imputed annual value. It is characteristic of such taxes that the finer the building, or the more it is improved, the higher the tax imposed on it; the shoddier the building, or the more it is allowed to decay, the lower the tax imposed on it. Best of all is an empty site, for to have no building is to pay no tax at all. The window tax in England is rightly held up to ridicule, but countless modern property taxes operate in exactly the same way.

Taxes on spending fall on goods and services and make those goods and services dearer. They are like an additional cost of production, artificially raising prices and decreasing the standard of living. Customs duties reduce the competitive advantage of goods imported from abroad and afford protection to home suppliers of those goods. This protection boosts employment in industries less efficient than their overseas competitors and thereby impedes the flow of labour to industries which, if the goods were freely imported, would be supplying the exports with which to pay for them.

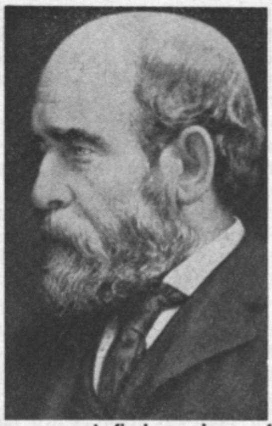
To sum up, it can be said that taxes on incomes discourage effort, that taxes on wealth discourage saving, that taxes on property discourage development, and that taxes on spending discourage production. Thus virtually all contemporary taxes are negative and detrimental. This may lead many to concur, reluctantly and despairingly, with the statement that all taxes are odious. Must it be so? Must every tax hamper social virtues and foster social vices? It there no hope of a good tax, one that is odious to those who pay it but so formulated that its consequences are positive and beneficial?

OF ALL taxes the most widespread are those on incomes. Without them the rich grow richer and the poor grow poorer, an intolerable situation which has very little to do with the initiative of individuals and much to do with what look like inexorable laws of nature. The ethical basis of taxes on income is the assumption that the gulf between rich and poor is natural and should be corrected by the redistribution af wealth. That gulf certainly exists: shorn of a redistributive mechanism the tendencies towards an inequitable distribution of wealth reassert themselves. *This does not prove that those tendencies are natural and inevitable. An alternative explanation is that an equitable distribution of wealth would occur naturally but that somehow the natural forces are interfered with and distorted.*

The gap between rich and poor is, after all, a very curious phenomenon. One would expect some men to be richer than others; one would not expect, unless conditioned to it, that there would be a very small rich class and a very large very poor class. What is even more curious is that as societies progress—as labour becomes more skilful and specialized, as machines are invented and technology evolves, as the power to create wealth is multiplied many times over—the lot of the poor is barely improved. On the contrary, the gap between rich and poor grows more pronounced. The rich get richer; the poor, relatively if not absolutely, get poorer.

To explore the hypothesis that this outcome, far from being natural, is fundamentally unnatural is to head for new horizons which challenge the whole functior

'Did you ever think what a strange thing it is that men cannot find employment? Adam had no difficulty in finding employment, neither had Robinson Crusoe; the finding of employment was the last thing that troubled them. If men cannot find an employer, why cannot they employ themselves? Simply because they are shut out from the element on which human labour can alone be exerted. Men are compelled to compete with each other for the wages of an employer, because they have been robbed of the natural opportunities of employing themselves; because they cannot find a piece of God's world on which to work without paying some other human creature for the privilege.'—HENRY GEORGE.



of redistributive taxation. If the gulf between rich and poor is not natural it behoves us not to accept it and react to it but rather to search for the cause of it and bend our energies to the removal of that cause. If taxation could play a part in this we should be well pleased.

One of the foremost proponents of this alternative thinking was the nineteenth century American economist and philosopher Henry George who in 1879 published *Progress And Poverty*. George was perplexed as to why in an age of plenty there was so much deprivation. He set out to analyse this paradox and identify the reasons for it, and having done so to propose a remedy. His remedy was to abolish all taxes except that on the value of land!

We ask how such a change could possibly achieve so much. A tax on land values—that is, a tax falling on the market value of all land irrespective of its state of development—is practicable, has much to commend it, and has on occasion been adopted; but how radically could a single tax on land values alter the distribution of wealth, how much revenue would it yield, and what is the ethical justification for taxing citizens with land and not those without?

As we shall see later, George was convinced that a tax on land values was the best method of taxation even when judged purely as a tax, but his primary aim in urging it was to transform the social attitude to land, which had come to be treated like a commodity when it was entirely different in at least three crucial ways. First, unlike most commodities, land was fixed in supply. Second, land was not produced by human agency but was in the manner of a gift to mankind. Third, man could not live without access to land which was an indispensable factor in all production.

Land in the classical economic definition embraced all the resources of nature, not only the surface of the earth but the air above it and the contents of the ground beneath it. It was ownership of land in this sense—ownership of nature—which conferred on a few men the power to grow rich, for as land was essential to human life the rent that could be demanded for its use absorbed all wealth in excess of the minimum return required by labour and capital. This remained true as production rose, so with every economic advance made by society rent increased but wages and interest stayed broadly constant. Those with land grew rich through no effort of their own while those without land were as poor as before.

The title to land was of dubious origin, frequently gained by appropriation or conquest. The justification for private property is that wealth produced belongs to those who produce it. If a fisherman makes a net, it is his; if he fish the oceans with it, the catch is his; if he lend the net to another to fish the oceans, what that other willingly gives him in exchange is his. Where land is freely available, labour earns its full reward and capital earns a fair return but no more. The same justification cannot be applied to ownership of land, and the fact that the title may be bought with a man's savings does not of itself give it moral validity since the identical argument could be invoked to support slavery.

In George's view, those who believe in private ownership of land as well as of wealth produced are as mistaken as those (more common in our day than in his) who, noticing the evils of concentrated land ownership, regard all private property as theft and would have the state expropriate it. The truth as George saw it was neither of these extremes but lay in the two principles which are the foundation of his philosophy: that all men should have equal rights to the use of land; and that every man should have a right to the product of his own labour.

THE NECESSITY for land has been recognized in many of the less developed countries, but the response is all too often to divide and reallocate the land, a policy which may ease the problem but does not penetrate to the heart of it. An acre of inhospitable agricultural land might be equivalent to a square metre of valuable land in the centre of a city, and reallocation can at best be a very imprecise way of securing equality for as soon as the pattern of values or the population changes the apportionment is out of date. George rejected the nationalization of land on the grounds that it would substitute a public for a private monopoly, and concluded that the best answer was to tax the rent or value of land. This would enable private possession of land to be maintained but would require the occupier of every site to pay the community for the privilege of its exclusive use. The amount of the payment would match exactly the extent of the privilege as reflected in the site's market value.

We can now understand how George saw land values as an instrument of social justice, and, further, how he was impelled to propound the simultaneous abolition of all other taxes. The tax on land values established equal rights to the use of land. Taxes on labour and capital eroded the right of a man to the product of his labour. The inescapable inference was that the tax on land must fully replace the taxes on labour and capital.

In George's day the expenditure of the state was nowhere as great as it is today. It is salutary to remember that one of the objections to his proposal was that it would endow the state with surplus funds which might not know how to spend wisely. No country knows how much a complete tax on land values would yield. It would not be anything like enough to finance current levels of public expenditure, but this may be one more sign that public expenditure is too high. If George's analysis is sound, his solution to the problem of poverty would eradicate it at source and so render costly social welfare payments superfluous. In due time much of the apparatus of the welfare state could be dismantled, and with two major exceptions this might enable the needs of government to be financed by the land value tax. The exceptions are, first, that some countries have amassed a large national debt the servicing of which the land value tax could hardly be expected to meet, and, secondly, that in the modern world nearly all countries are obliged to spend large sums on defence. A tax on land values can never be a single tax in a world where the members of the human family continue to fight one another. It is an ideal capable of fulfilment only in a world of peace.

IT IS NOT, however, necessary to believe in the land value tax as a single tax to observe its intrinsic merits, and we will now examine some of these.

The maxims of taxation listed by Adam Smith[2] are that taxation should bear equally, that the tax which each individual is to pay should be certain and not arbitrary, that every tax should be levied in a manner most convenient for the contributor to pay it, and that a tax should take from the people as little as possible over and above what it brings into the public treasury. These maxims may be styled those of equality, certainty, convenience, and cheapness.

Henry George was conversant with the maxims of Adam Smith and adapted them to his own use, chiefly by elevating to independent status the maxim that a tax should not hinder production. This promotion is scarcely surprising in view of the great rise in productive capacity that had taken place in the century since publication of the *The Wealth Of Nations*. George's canons[3] were that a tax should bear as lightly as possible on production, that it should be easily and cheaply collected and fall as directly as possible on those intended to pay it, that it should be certain, and that it should bear equally so as to give no citizen an advantage or disadvantage compared with others.

Incentive to production

Many of George's arguments sound familiar to us today, 100 years after he enunciated them. He contends that taxation which lessens the reward of the producer necessarily lessens the incentive to production; that taxation which decreases the earnings of the labourer or the returns of the capitalist renders the one less industrious and intelligent and the other less disposed to save and invest; and that taxation which falls on the processes of production interposes an artificial obstacle to the production of wealth. This checking of production is 'characteristic of most of the taxes by which the revenues of modern governments are raised.'

The most notable example of a tax that does not bear on production is that on the value of land. Whereas the labourer contributes his own capital (wealth derived from his own labour), the owner of land, the passive factor in production, contributes only what nature has given. The labourer and the capitalist produce; the land owner merely draws from their production. Land can be taxed up to its full market value without affecting the reward of labour or capital and without therefore weakening the impetus to production. Indeed, the reverse is the case. A tax on the value of land stimulates its more intensive use. In order to pay the tax, the owner of a site which is being under-utilized in relation to its market value, or which is being held vacant in the hope of an increase in its price, will be encouraged to put the site to better use or offer it to others who will do so. If labour is taxed, it will be less productive; if capital is taxed, it will be less productive; if land is taxed, it will be more productive. As George declares:

> **Tax manufactures, and the effect is to check manufacturing; tax improvements, and the effect is to lessen improvements; tax commerce, and the effect is to prevent exchange; tax capital, and the effect is to drive it away. But the whole value of land may be taken in taxation, and the only effect will be to stimulate industry, to open new opportunities to capital, and to increase the production of wealth.**

In short, almost alone among taxes the land value tax has a positive and creative effect, not a negative and destructive one.

It must be recalled here that George's proposal is for a tax on all land value irrespective of its current use. Taxes that fall only on certain categories of land when there is a change of use are occasioned by the change and become taxes on development rather than on land. Such travesties are as inhibiting as any other form of development tax.

On ease and cheapness of collection, George affirms that land cannot be hidden or carried off, its value can be readily ascertained, and collection of a tax would accordingly be much simpler than that of less straightforward taxes. Moreover, taxes on things of unfixed quantity raise prices by increasing the cost of production and checking the supply, being finally borne by the consumer; but a tax on land does not reduce the supply of land, cannot therefore raise its price, and must be borne directly by the persons on whom it falls, the owners of land. In point of fact, since more land would become available for use, the supply would actually be increased and the price would tend to fall. The tax would also have a direct impact by reducing the net income to be obtained from a site and correspondingly reducing its capitalized selling price.

On cartainty, George is concerned not only with the costs of uncertain taxes (evasion, prevention of evasion, bribery, litigation) but also with the effect on what in those days they called 'morals.' Our revenue laws, he said, 'suppress honesty and encourage fraud' and 'divorce the idea of law from the idea of justice.' These remarks are as pertinent now as when they were written. By contrast, the tax on land values possesses the highest degree of certainty because it would be simple and clear and be assessed and collected 'with a definiteness that partakes of the immovable and unconcealable character of the land itself.'

On certainty, George is concerned not only with the men of equal incomes should contribute equally to the expenses of the state if the income of one is derived from the exertion of his labour and the income of the other from the rent of land. Adam Smith's idea that all types of property may be taxed because they are enjoyed under the protection of the state is founded, asserts George, on the assumption that the enjoyment of property is made possible by the state, 'that there is a value created and maintained by the community, which is justly called upon to meet community expenses.' This is true only of the value of land, which arises with the formation of a community, increases with its growth, and if the community were suddenly dispersed would immediately disappear. George concludes:

'The most just tax'

> **The tax upon land values is, therefore, the most just and equal of all taxes. It falls only upon those who receive from society a peculiar and valuable benefit, and upon them in proportion to the benefit they receive. It is the taking by the community, for the use of the community, of that value which is the creation of the community. It is the application of the common property to common uses. When all rent is taken by taxation for the needs of the community, then will the equality ordained by nature be attained. No citizen will have an advantage over any other citizen save as is given by his industry, skill and intelligence; and each will obtain what he fairly earns. Then, but not till then, will labour get its full reward, and capital its natural return.**

This is a stirring vision, a vision of genuine equality of opportunity in which communal and individual rights are perfectly combined, in which social obligations and personal freedom complement each other, and in which the removal of barriers to the creation of material wealth liberates men for the realization of those faculties which transcend the material.

It is supposed that taxation must always be burdensome and repressive, but this is not so. There is a tax that is fitted for its purpose as other taxes are not, and for the proposition 'all taxes are odious' we must substitute 'all taxes are odious except one.' It is not odious because it is the right tax, and it is the right tax because ultimately it is not a tax at all but the collection by society of its own proper income.

REFERENCES

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