CHAPTER IV

RELATIONS OF IMPERIAL TO LOCAL TAXATION

§ 1. EVERY modern State finds itself in need of a continually increasing income for the performance of new non-remunerative work, and for the enlargement and improvement of existing public services. Comparatively little of this new or enlarged work is directly and specifically productive of wealth upon which the cost of the State service can be charged. Though public health, education, defence and industrial regulations may be considered conducive to the improved economic productivity of the nation, this economic gain is not the sole or even the main object of the State, nor is it so certain, immediate and measurable as to furnish a specific revenue for the performance of the public service, as in the case of the Post Office Services. The cost of most of these services must therefore be defrayed out of the general income of the State. That income must be obtained either from the profitable exploitation of State properties and monopolies, or by general taxation. Where, as in some countries, State ownership of lands, forests, mines, railways, banks and other lucrative resources, enables the public revenue to be enriched by receiving rents and profits which elsewhere are left in private hands, subsidies from these sources may be applied to help to bear the cost of non-remunerative services. But even in these cases it appears that the rents and profits thus taken by the State are in effect taxes upon the income of citizens, in the shape of surcharges on their purchase of the goods or services delivered to them by the State. For, when the State administers a productive and remunerative service of which it has a monopoly, it can either supply the goods or service at cost price to the community, or it can levy an arbitrary toll, working its public monopoly on business lines as would a private owner. If, in order to defray the cost of other specific services, or to improve the general revenue, the State pursues the latter policy, its action ought clearly to be recognized as a method of taxation. The determination of State policy is not, however, as a rule, guided by mere or immediate considerations of finance. Low railway rates may be given in order to promote health and amenities by helping to relieve the congestion of population in cities; a drink or tobacco monopoly may impose high prices and earn a high profit primarily for public order and hygiene or in order to check excessive consumption of luxuries. A well-administered State will certainly use its economic monopolies to achieve other serviceable objects than the provision of revenue. The desirability of providing cheap food, fuel, travel, carriage, insurance or credit, will, in many cases, disable the State from reaping a large direct revenue out of the economic services it owns or controls. To encourage or discourage certain habits of consumption may be deemed more truly profitable for a State, in relation both to its higher purposes and to the future economic productivity of the nation, than to exploit these monopolies for present purpose of maximum public revenue. Upon the whole, the tendency of a modern progressive State will be to use its increasing economic control to supply sound goods and services at cost price in all cases except where health, public order, or some other clearly defined advantage accrues from restricting or regulating the supply of the goods or services controlled. We cannot, therefore, hold it likely that our post-war State, however greatly it extends its ownership or control of specific industries or services, will utilize the power of monopoly thus obtained to any large extent as a source of public revenue. In other words, the great bulk of the increasing revenue the modern State demands must come out of ordinary taxation.

§ 2. Hence the demand for a thorough exploration of the taxability, or ability to pay, contained in the various elements of income possessed by members of the community For all taxes, direct or indirect, upon whomsoever levied, are in the last resort deductions from the monetary and real incomes of individuals, transfers of their spending-power to the State. Death duties are taxes upon the parts of annual incomes which, not being spent, have accumulated, and can bear a second or special tax when they pass by death. Now those parts of income which are necessary to support the producers of that income in the output of their productive energy, have no taxable capacity. For any attempt to touch them would react in a reduction of the productive capacity of the nation, the source of the wealth from which all future taxes must be raised. Again, in a community where provision is made by individual saving for large increases in future production, in order to provide for the needs of an anticipated increase of population or a rising standard of consumption, a similar immunity from taxation must attach to the minimum interest necessary to evoke the required amount of that individual saving. The items of income needed to defray these costs of production have no true taxable capacity, and any tax which seeks or tends to assail them is *ipso facto* a bad tax. It follows that all surplus incomes over and above these costs possess taxable capacity in various degrees. Economic rents and all such portions of interest, profits, salaries, and other income as represent the operation of monopoly, scarcity, or some stroke of economic force or luck, some exploitation of a favourable opportunity, are the only proper objects of taxation. Not being due to any laborious effort or sacrifice on the part of their private recipient, their removal does not diminish his productivity, except in so far as their expenditure has been so embedded in a class or personal standard of living that a too sudden or violent attack upon it might cause an injurious failure to adapt himself at once to a lower standard. Apart from this consideration we find in these economic surpluses an absolute ability to pay. But the application to the practical problems of taxation of the distinction between costs with no capacity and surplus with absolute capacity to pay is full of difficulty. For, in the operations of industry and the emergence of personal income, it is seldom possible to distinguish accurately between costs and surplus, or to measure them. Even in the case of rents of land the part attributable to natural scarcity or situation or fertility is difficult to separate from the part attributable to improvements due to skill, enterprise and the investment of capital. In most other cases surplus is even more closely linked up with some legitimate payments for ability and saving. These considerations, though not invalidating the distinction between costs and surplus in respect to taxability, point to the inadvisability of basing any taxing-system upon the separate measurement of surplus elements in income. The practical basis of sound taxation is found in the presumption that the proportionate taxable capacity of individual incomes varies directly with their size, *i.e.* the larger the income, the larger the proportion of taxable surplus it contains.

§ 3. But the fact that the income, which in its acquisition is an individual income, is, in its expenditure, as a rule, a family income, has an important bearing upon the tax-policy. For it requires us, in considering the 'cost' part of an income, to take into account the size of the dependent family. Admitted already in the system of allowances for wife and other dependents, this principle must be fully incorporated in our taxing-policy so as to recognize that, as regards all low or moderate incomes, taxability varies inversely with the number of those dependent on the income. The income-tax, thus amended and graduated smoothly so as to avoid the irritation, injustice, and evasions, due to sudden jumps, curved more steeply on the higher grades in accordance with our general law of taxability, would remain the chief instrument for the collection of State revenue. It would be supplemented, as now, by the death duties, graduated still more steeply in the higher estates, by which would pass to the public purse large portions of surplus, accumulated sometimes through several generations, which had not been adequately tapped by any annual income-tax. A higher taxation of the larger annual incomes would, of course, in time slow down the accumulation of large estates, diminishing the proportionate, though not necessarily the absolute, contributions of death duties to the revenue.

§ 4. An intelligent interpretation of this taxing-policy condemns all taxes on commodities and other indirect taxation as vexatious and costly methods, injurious alike in their assessments and collection, their shifting and their incidence. Indirect taxes are occasionally defensible on other grounds than those of revenue, as instruments for checking the wasteful production and consumption of certain articles of luxury involving injury to health, morals or social order. Import duties, excise and licences, may be utilized for these purposes, bringing incidental revenue. But ordinary import duties, general or discriminative, are incapable of bringing any net gain to the national revenue. Ultimately falling upon the incomes of the people in the importing country, by raising prices and reducing the real value of their money incomes they inflict heavy damage. Costing much in expenses of collection, directing much of the capital and labour of the nation into less productive channels than they would otherwise have taken, and weakening the stimulus to the discovery and application of improved technique, they reduce the aggregate yield of wealth and so the 'surplus' from which State revenue can properly be derived. The rare cases in which the foreigner can be made to pay (*i.e.* when the import tax falls on foreign surplus incomes) are so precarious and incalculable as to make them rightly negligible in a taxing-policy. Import duties (unaccompanied by excise) are only defensible, if at all, for other purposes than revenue, for example, as a weapon in an international campaign against 'sweating.'

Such is the normal policy by which a progressive State should levy taxes, in order to supply itself with revenue. In order to meet the abnormal financial situation produced by the war, we have examined the practicability, economic and political, of two proposals for a capital levy, one of large dimensions confined in its incidence to capital values made during the war period, the other of a general kind, though of smaller dimensions. We came to the conclusion that, though it would not be practicable to add to the improved and more productive income-tax a capital levy as a normal or repeated instrument of revenue, these objections are overborne by the special considerations of the war-emergency. In other words, such a special levy as is here proposed would not have the damaging reactions upon future savings, productivity and taxable yield which its opponents allege against it. Nor do the undoubted difficulties of valuation and collection preclude its use.

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§ 5. To this general summary of the theory and policy of taxation I desire to add the following important implication. If this policy be consistently adopted and developed as the instrument for State revenue, the long delayed adjustment between national and local finance becomes extremely urgent.

The services financed by local government may be conveniently grouped under two heads. First come those productive enterprises such as supply water, gas, and electricity, tram service, etc., to private citizens, for which specific payments are made by them either in the shape of a separate rate or by retail payments for each unit of supply. These are ordinary business transactions with which imperial finance has no proper connexion except so far as the State may be required to sanction the raising of loans for capital expenditure. The revenue thus raised is not tax revenue. Attempts have frequently been made in theory and in practice to distinguish among the numerous other services locally administered certain ones as being of distinctively national value from others of merely or mainly local value. Among the former are commonly placed such services as Education, Public Health, and Poor Relief; among the latter such material arrangements and improvements as the making and repair of streets, their cleaning and lighting, and the provision of parks, libraries, museums, etc. But a little reflection shows that the alleged distinction between services of national and services of local benefit cannot be maintained. In all alike the primary benefit is confined to the local inhabitants: in all these local benefits alike the nation participates. For in modern times there is nowhere to be found such municipal self-sufficiency as prevailed in the medieval city, and survived in some measure up to railway days. Commerce, communications, mobility of population have conspired to destroy the old localism.

We cannot therefore deal with municipal finance by merely asking and answering the question *cui bono*? For local and national benefits interpenetrate and are indistinguishable. And yet it is undeniable that the citizens of Birmingham or Bradford have a far keener and stronger interest in their streets or trams, or schools, than has the rest of the nation, and that in virtue of this special interest there devolves in them an important or even a predominant part in their administration and finance. Evidently the chief direct control of their paving, lighting, care of local poor, must be vested in the local authorities, who alone can know the detailed circumstances. But it is equally evident that the wider national interest carries a duty of supervisory control, and that these two controls must both be represented in finance. The municipality cannot be allowed to determine or to administer an expensive policy for which it has no financial responsibility. It is equally clear that, if the State is to require conformity to a national standard of efficiency on the part of local administrators, it must be prepared to assist in the finance. With the development of the national standard this policy of national supervision, advice, and finances must continually assume greater prominence, and an increasing part of the required expenditure will devolve upon the State. This consideration gives great importance to the invention of the Grant in Aid as the instrument of national and local corporation in municipal services. Mr Sidney Webb has given the following account of the objects which this invention is designed to serve.

"Grants in Aid are necessary, in the first case, to prevent an extreme inequality of burden between one district and another. To leave each Local Authority to pay for its own sanitation, its own schools, its own roads and bridges, its own sick and infirm and its own aged poor, would mean that some districts would have to incur a rate in the pound ten or even twenty times as great as others." But the achievement of the object depends, as Mr Webb shows, upon the proper allocation of Grants in Aid. "The way actually to aggravate this inequality, and to transform the Grant in Aid from a beneficent to a maleficent force is to make it vary in proportion to the rateable value of each district, which is actually how several of the Grants in Aid have been allocated, thus giving to the richer districts which have least administration to pay for, and the greatest means, more than to the poorer districts, which have most administration to pay for and the least means." [1]

The second object achievable by Grants in Aid is that " They are needed to give weight to the suggestions, criticism and authoritative instructions by which the Central Authority seeks to secure greater efficiency and economy of administration." Thirdly, "They furnish the only practicable method, consistent with local autonomy, of bringing to bear upon local administration the wisdom of experience, superiority of knowledge, and breadth of view which, as compared with the administrators of any small town, a central executive department cannot fail to acquire, for the carrying into effect the general policy which Parliament has prescribed." "The fourth reason for Grants in Aid is that only by this means can we hope to enforce on all Local Authorities that 'National Minimum'

[1] "Grants in Aid," ch. ii. (Longmans.)

of efficiency in local services which we now see to be indispensable in the national interest."

§ 6. The funds contributed by the State as Grants in Aid to local services must, of course, in accordance with the analysis of the incidence of national taxation adopted here be derived from the general body of surplus or taxable income. But what is the fund upon which Local Authorities can properly draw for their contribution to the maintenance of local services for which specific payments are not taken? Do the local benefits derived from these services take a definitely economic shape in measurable terms of improved income for any class of citizens? If they do, then there emerges a body of wealth due to public expenditure upon which a rate may equitably and economically be levied to defray that expenditure in whole or part. Now it is certain that clean, well paved, and well lighted streets, open spaces, and other local utilities and amenities, helping to draw into the town some population from the country, or from neighbouring, but worse-equipped towns, increase the ground value and the annual rental which landowners can claim. Is this the only taxable surplus created by public expenditure upon these utilities and amenities? Some say yes, arguing that any other benefits, whether economic or not, which such public services render to business and professional men and to private residents, are charged up against these primary beneficiaries in higher rents. Though house-owners or lease-owners, as distinct from ground landlords, will get some gain out of the situation, the whole advantage will, they urge, eventually pass into the pockets of the landowners. Shopkeepers may begin to benefit because the town made healthy and agreeable by the public policy, has drawn well-to-do residents. But shop rents will soon go up, the owners of the property taking the gain. So with the advantage which the general growth of population and of demand will bring to other business and professional men, it will in every case enable the landlord to raise his rent.

But this extreme position attributed to landowners by many single-taxers is not seriously tenable. It rests on the assumption that the local land is strictly limited in amount, and belongs to a single landowner, and that business men and residents have no option of transferring their business and homes to other local areas. Now this assumption is invalid. Even in the case when all the town area is owned by one man, his power to take by rack-renting the whole economic benefits of municipal expenditure is limited by several considerations. The first and most obvious, of course, is the existence of leases which secure to tenants during the remainder of their tenancy the whole or part of the economic benefits. But apart from this, the monopoly of town land is qualified by the policy of most municipalities in enlarging the effective town area, for residential and for many business purposes, by cheap and rapid transport to outside belts of land, often accompanied by enlargement of the municipal area. This increased supply of land accompanied by development of building sites in suburban areas can operate as an effective restraint upon the raising of rents either by ground landlords or lessors of town buildings. This power of businesses to go outside the town area is an important and growing check upon town landlords, which may be made extremely effective when not only cheap transport but cheap electric power for industrial uses is obtainable. Further, although the inconvenience and loss incurred by moving a place of business or a residence from one town to another, or even from one part of the same town to another part, is a real source of economic strength to landlords, the existence of other neighbouring towns, pursuing a similar progressive policy of municipal development, furnishes a powerful element of competition for persons not tied down closely to a single central town area. These are real checks upon the power of a monopolist landlord to secure for himself the full economic value of municipal improvements. While, then, it is undeniable that a large part of such gains from monopoly expenditure fall to the landowner and leaseholders (during the period of the lease) it is equally the case that industrialists, tradesmen, professional men, and other occupants, are partakers to a considerable extent of these gains. So far as the benefits from such municipal expenditure are non-economic gains, such as health, intelligence, and recreation, they produce no fund capable of bearing a rate. But when the benefits accrue in real and monetary income, there is clearly a valid case for rating this income, so far as it can be ascertained or reasonably presumed, for the support of the local expenditure to which it owes its origin.

§ 7. The existing rating system which confines its demands to income from real property, land and its 'improvements,' can only be defended, on the ground that other municipally made income is too elusive to reach although it certainly exists and has ability to pay. It cannot seriously be maintained that the rental of business premises or a house is any reliable index of the possession of these economic gains from municipal expenditure on the part of the occupier. There is no complete solution of the problem of how to secure for locally administrative services the economic surpluses created by those services. For, as we recognize, in no respect is a town or other local unit so compact and separate an economic area that outside factors do not enter into every aspect of its economic life. Though an increase of town land values is evidently due in part to local expenditure in its influence upon the population and prosperity of the town, these very elements of population and prosperity are largely affected by other general outside factors which may be termed national, and which in their turn are influenced by still wider tendencies. Still more is this true of benefits which accrue to other citizens from the civic expenditure. Traders, professional men and workers in a progressive well-administered city will all enjoy certain advantages realized in concrete terms of real income or increased earning power. Part is due to the local good government. But how much it is impossible to gauge.

A revised taxing-system must have regard to these difficulties. It will, I think, do well to discriminate between the increases of land values due to local administration and other economic gains. So large a part do local improvements play in the former case as to justify a special contribution from this source. This could take shape in a special local tax on land values so assessed as to stimulate landowners to put their land to its most productive use. Since, however, it cannot be presumed that land values or even their annual increments are wholly or even chiefly attributable to local expenditure, the interest of the State in this form of surplus value must be duly safeguarded by a strict limitation of this rating power upon land values.

On the other hand, it is clearly desirable that Local Authorities should have incomes at their own disposal, derived from local sources, and put to local beneficial uses. A local income-tax, or a sur-tax on local incomes, sometimes suggested, is quite impracticable. If such a tax were confined to persons residing in the local area, evidently many of the richest business people would escape, having their domicile outside. Moreover, an increasing number of the larger and more lucrative businesses are not confined within one local area, either for their operation or their market, and in such cases it would be impossible to earmark any proportion of the income as earned in one locality. How could a railway, a bank, a branch shop, or even a local firm of lawyers, stock brokers or dealers, be assessed for income earned within any single municipal area? There is clearly no such relation between an income area and an area of local administration as to give validity to any such proposal.

§ 8. What is required is some approximately sound way of getting a special contribution to local expenditure from persons whose incomes presumably contain elements due to such expenditure. Since this cannot be achieved by a residential income-tax, some other index of ability to pay must be recognized. The present basis of annual rental value of occupied buildings appears to me to be the best available index, provided certain important changes in assessment are made. In the first place, since it is locally made income we are seeking to tap, the same process of graduation as is applied for imperial income-tax is applicable here. The failure to carry even the slight and clumsy graduation adopted for rentals below £100 beyond that limit is a quite indefensible application of the taxing principle. But if housing accommodation is to be taken as an index of locally created income, the rating must have regard also to the general test of ability to bear furnished by the number of persons dependent on the housing accommodation. A ten-room house occupied by a family of nine must not be rated on the same terms as if the occupants were only three. The rating in the two cases need not be in the ratio of 3 to 1, for a large proportion of the accommodation of a house has small reference to the number of its occupants. Nor is it desirable to apply inducements to overcrowding or even to excessive economy on house room. But a considerable allowance in the rating system for number of occupants ought to be made.

If, as is sometimes pleaded, certain persons choose to spend a larger proportion of their income than others on a large showy house in an expensive neighbourhood they will doubtless be disproportionately rated. But this is a doubly serviceable result. For by operating as a deterrent against extravagant expenditure on housing, it economizes for the general body of citizens the aggregate supply of housing and tends to lower rents. Finally, if a sound and equitable rating is to be effected, the methods of assessment must be improved. This can only be achieved by entrusting the process of valuation to properly trained persons appointed by the Local Government Board, instead of to officials appointed by Local Authorities notoriously influenced in rating cases by personal interest. It is well-known that the assessment by Local Authorities, especially in rural districts, is often incompetent, slovenly and dishonest. The under-assessment of large properties belonging to members of the taxing authority, their friends and other persons of local influence, involving a higher general rate than should be necessary, is a frequent and notorious scandal.

If it were possible to discover and to measure with moderate accuracy the pecuniary gains derived by private citizens and local businesses from local services, it would be convenient and equitable to defray the cost of such services entirely by means of rates laid upon this publicly created surplus. But as a municipality or other local area tends to become less and less a self-sufficing unit for all economic and other purposes, it must become continually less possible to track down and measure such locally made gains. For this reason it will be necessary for the State continually to exercise a more rigorous supervision of local rating, so as to restrain the Local Authority from trenching upon taxable resources which are not properly local surpluses and which are needed for imperial purposes. This restriction will probably be accompanied by an increasing dependence upon Grants in Aid for important local services. This, however, need not be taken as self-evident. For just as a valid internationalism requires and stimulates distinctive qualities and capacities in its national constituents, so a valid nationalism should not aim at a too rigid standardization of local conditions, but should encourage local character to express itself in institutions and services administered and financed mainly or entirely from local resources. The art of municipal self-government is still immature and experimental, and financial policy should make allowance for freedom of growth, and for the utilization of the keener public spirit which breathes within the smaller areas of human fellowship. While, therefore, it is likely and reasonable that State control and State finance will figure more largely in certain spheres of local government, this is quite consistent with a wider local autonomy in other spheres, the larger aggregate of civic services affording scope for both tendencies. So intimately are the secret springs of economic prosperity associated with all services which constitute to human health, development, and happiness that it may be taken as a sound assumption that, though these services may be directed primarily to the attainment of non-economic objects, the higher standard of personal and collective humanity which they establish will yield as a necessary by-product such increase of wealth as will serve to defray the public expenditure those services involve, local equally with national. Such increments are in accordance with our general theory of taxation naturally adapted and designed for this public purpose.

§ 9. This brief consideration of the relations between Central and Local Government, in respect of the raising of revenue for public services, greatly strengthens the acceptance of our basic principle that taxing authorities find in surplus incomes the only funds with true ability to pay. Where there is a legitimate presumption that certain of these surplus values are directly traceable to benefits accruing from local public expenditure there is a strong *prima facie* ground for earmarking such values for contribution to the local revenue. Here is the case alike for local taxation of increments of land values within the locality and for a reformed general rating upon the present occupation basis. But the impossibility of ascribing any element of surplus income wholly to local public benefit, as distinguished from the operations of national policy or of *private* economic needs and opportunities, makes it improper for any local administration to rely wholly on its own rating powers for its income. For this would involve a continual danger of the locality poaching upon the legitimate resources of the State, the Local competing with the Central Government in its demands upon the same body of taxable wealth. Upon all surplus-income, except such as is presumably due to locally financed services, the State has a rightful lien for taxing purposes out of which to defray such costs of National Government as cannot conveniently be met from State-owned properties and monopolies, including under the term National Government such control of and participation in locally administered services as it helps to support by contributions from the national treasury in the shape of Loans, Subsidies or Grants in Aid.