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**A CAPITAL LEVY AND A LEVY ON  
WAR WEALTH**

## THE WORLD OF TO-DAY

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THE WORLD OF TO-DAY

A CAPITAL LEVY AND A  
LEVY ON WAR WEALTH

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# A CAPITAL LEVY AND A LEVY ON WAR WEALTH

## CHAPTER I

### INTRODUCTION

THE great war, which has shattered empires, desolated millions of homes, and sown the seeds of famine over enormous areas, has also, as a minor incident in its course, revolutionized fiscal conditions in nearly all the great states of the world. The scale of Government finance has been so changed that the problems it presents are different, not merely in degree, but in kind from what they were before the war. A brief study of the present position may usefully introduce our inquiry.

In the course of the war there has grown up a luxuriant and most confusing entanglement of inter-governmental indebtedness. Germany is confronted with a huge and hitherto undefined mass of foreign obligations under the head of reparations. Russia and Italy are heavily indebted to France, the United Kingdom and the United States, France to the United Kingdom and the United States, the United Kingdom to the United States. Considerable parts of this entanglement of indebtedness do, indeed, on paper at least, cancel out. England, on balance, is a creditor and not a debtor, and so also, if the German indemnity is reckoned in, is France. But how far it is reasonable for any country to count what it is owed by

others at full value among its assets, when interest payments are likely to begin, how long they are likely to be maintained, when, if ever, the capital obligations will be discharged, are questions not easy to answer. The path of prudence for any Government at the present time is to treat the money it itself owes abroad as a binding obligation, but not to bank too heavily on other Governments acting on the same view.

The gross capital obligations of the British Government were on March 31 last 7,880 million pounds. Of this sum 1,280 millions was external debt, about two-thirds of it being due to the Government of the United States. In addition to this, there was probably some comparatively small debt to foreign subscribers to British war loans. On the other side, the British Government nominally held claims on the Governments of Russia, Italy, France and minor allies to 1,730 million pounds, on British colonies and dependencies to 140 millions, and on Germany to a sum hitherto undefined. Other war assets, principally surplus stores, etc., are estimated at 700 millions. In view of the doubtful character of some of our foreign government debts, it would not be safe to reckon the real value of our war assets altogether at more than, say, 1,700 millions. Our net effective debt, therefore, we may reasonably put at from 6,000 to 6,500 millions, of which substantially the whole is debt to British citizens. In 1913 the corresponding debt was about 700 millions. During the war, therefore, it has multiplied itself about nine times. Owing to the higher rates of interest at which it has been contracted, the *annual* charge necessary to finance it is, in terms of money, nearly fifteen times as large as the corresponding charge before the war; when allowance is made for the diminished value of money, it is some six or seven times.



as large. These figures are set down here merely to indicate the general drift of the change that has taken place during the last six years.

Besides the great growth in national debts for which the war has been responsible, it has also led everywhere to great changes in the distribution of wealth. These have been brought about in two ways. First, the great war demand for certain things and the great shortage, caused by the war, of other things have enabled people who were in a position to make and sell these things to reap—in spite of excess profit duties and legal maximum prices—an abnormally large reward; while people engaged in occupations, the demand for whose services the war cut down, have been correspondingly impoverished. Thus, shipbuilders have grown fat while solicitors have languished. Secondly, the credit and currency expansion, by the help of which the war was financed, has raised prices everywhere. This has meant that people whose incomes are fixed in terms of money, the holders of debenture stock and the occupants of salaried posts with stipends derived from endowments—like some university professors!—have found their real income greatly reduced in comparison with holders of ordinary stock and people in a position to demand a rise of pay corresponding with the enhanced cost of living. The growth of debt and the shock to distribution have everywhere raised in men's minds two questions: should a great effort be made to cut down the debt by swift repayment; and should the state demand from those to whom the war has brought fortunes a special contribution to its needs? Positive answers to these questions lead respectively to a levy on capital (or, more exactly, to some species of single levy, of which a levy on capital is a particular example) and to a levy on war wealth.

Germany, Austria, and Italy have all enacted laws to provide, in various forms and in varying degrees of stringency, for the assessment and collection of a capital levy. In Italy provision has also been made for a separate levy on war wealth. The same issues are now in debate in this country. The Labour Party has incorporated in its programme a proposal for a capital levy. The Government recently set up a select committee to study the question of a war wealth levy. Both issues are, therefore, politically live. Plainly, if anything is to be done as regards either of them, it were best done quickly. Delay adds to the difficulties and prolongs the period of uncertainty. Persons interested in these matters should, therefore, study them now. The purpose of this booklet is to help them in this. I have not concealed my own view as to what the right policy is, but I have endeavoured to write in a scientific spirit, setting out both sides fairly and not as a partisan.

## CHAPTER II

### A CAPITAL LEVY

#### I.—THE PROBLEM

THE existence of an effective national debt of, say, 6,000 million pounds at 5% means that, as long as none of the principal is repaid, 300 million pounds will have to be raised every year to provide the interest. But nobody proposes that the principal of 6,000 millions shall be left outstanding as a debt for ever. A large national debt weakens the financial position of a state and makes it difficult for it to raise money to meet any emergency with which it may be confronted. Consequently, it has always been the policy of prudent Governments in time of peace steadily to reduce debt. When the British debt, in the years before the war, stood at the comparatively low figure of 700 million pounds, there was no dispute about this. Every year more revenue was raised than was needed for current expenditure and the payment of debt interest, and the balance was devoted, through the agency of a 'sinking fund,' to reducing the principal of the debt. There can be no question that a policy at least as strict as this must be followed now. In addition to revenue for interest payment, further revenue must be raised for the repayment of principal. This means that at first we should require, say, 350 millions annually, and then, as the debt is gradually paid off, a smaller annual amount. It is with this 'orthodox' financial policy that

the policy of a special levy has to be contrasted. That policy agrees with orthodox policy in refusing to allow the principal of the debt to remain outstanding permanently. It differs from it only as regards the period over which repayment should be spread. Whereas orthodox policy would repay a small fraction of the principal debt every year and would complete repayment in a period of, say, fifty years, the policy of a special levy would repay a very large fraction of the principal—if it were practicable, it would repay the whole—by a single tremendous effort. This is the fundamental issue, to which all questions of the form and method of a special levy, if it is decided to make one, are subordinate. Is it, on the whole, more to the national advantage to discharge a great slice of the debt by a single levy now, and so to do away with the obligation to pay interest on it in the future, or to repay the debt gradually and face large interest charges for a long term of years? This issue it is the business of the present chapter to examine. But, before that task is entered upon, it is desirable to clear out of the way a popular argument which rests on misunderstanding.

## II.—A FALSE ANALOGY

The problem to be faced, it is said, has an exact analogy in individual life. A man in debt to the extent of £6,000 borrowed at 5% has to choose between paying interest and reducing the principal of his debt slowly—orthodox finance—and paying off the whole debt at once—the policy of the special levy. It is impossible to decide which of these two courses would be more advantageous in any general or absolute sense. The right choice depends on the circumstances of the debtor. If, however, he has contracted the debt in resisting an attack by a

powerful neighbour, and if, in the course of the contest, his resources have been strained to breaking-point, the issue is not doubtful. He *must* repay gradually, for the simple reason that he *cannot* repay at once. The United Kingdom at the present time, the argument runs, is in exactly this position. The war has so impoverished us that the enormous payments which a special levy would involve are wholly out of the question. Staggering under the losses of the war, we have welcomed the offer of the United States to allow us to postpone for three years the payment of the *interest* on our American debt; to talk in these circumstances of wiping out great slices of principal is visionary nonsense. This reasoning sounds plausible. But it misses a vital distinction. Whereas the individual we have been imagining owes the whole of his debt to other people, the British nation, as was indicated in the preceding chapter, owes practically the whole of its (net) debt to itself. So far as it is indebted to foreigners, its position is analogous to that of our individual debtor. But, so far as it is indebted to British citizens, its position is quite different. To repay debt of this kind involves no drain on the resources of the community as a whole, because, though one part of the community transfers resources to another part, the community as a whole pays nothing. It follows that, whereas the impoverishment of an individual may make it impossible for him to pay off the principal of a debt due from him, and the impoverishment of a community may have the same effect on it so far as its debt is held by foreigners, this impoverishment cannot make impossible the repayment by the community of a debt held by its own members. This becomes obvious when we reflect that the community can, if it chooses, impose on each of its members a levy exactly equivalent to that

member's holding of State debt. Thus, the analogy between internally held national debt and debt due from individuals is not a valid one.

### III.—EFFECTS ON WORK AND SAVING

The direct effect of the imposition of a special levy to wipe out debt is to lessen the amount of revenue that is required, and, therefore, the rates of taxation which have to be imposed, in future years. At first glance it might, perhaps, be thought that the percentage reduction in rates of taxation would necessarily be equal to the percentage reduction in revenue raised. This, however, is not so. Under the British Income-tax Law the interest received by the holders of the national debt is itself counted as income assessable in the same way as all other income. If, therefore, national debt involving annually 300 millions of interest (we need not for the moment trouble about sinking fund) were paid off, the assessable income of the country in future years would be 300 millions less than it would have been otherwise. If, as is sometimes believed—though statistical data adequate to a satisfactory estimate are not available—the assessable income now is between 4 and 5 thousand millions, 300 millions will represent, perhaps, one-fifteenth of the whole. Therefore, after the debt had been wiped out, it would require rates of taxation fifteen-fourteenths as high as before to yield any given revenue; and the reduction in the aggregate amount of revenue needed by, say, one-third would involve a reduction in tax rates, not of one-third, but of two-sevenths. Of course, this is a very rough approximation. In the absence of data concerning the distribution of war loan among different income classes subject to different rates of tax no exact statistical statement can be made.

None the less, the consideration just set out shows that, other things being equal, the reduction in the *rates* of taxation which the repayment of the national debt through a special levy would make possible is slightly smaller than it might be thought to be at first sight. There is, however, also a consideration on the other side. It will be argued immediately that high rates of taxation tend to check production. If this is so, any given lowering in the rates must benefit production. This means that, in consequence of it, the amount of the country's real income will be increased, and, other things being equal, this increase is likely, as will be shown later, to be associated with an increase in money income also. It follows, therefore, that, if the amount of revenue to be raised by taxation is reduced by, say, one-third, the rates of taxation may be reduced by still more than one-third, and yet suffice to yield the reduced revenue now required. This consideration pulls the opposite way to that set out above. Which of them is the more important it is impossible to determine. It is, however, very unlikely that they will exactly balance, and, therefore, very unlikely that the percentage reduction in tax rates made possible by a cancellation of debt will be exactly equal to the percentage reduction in revenue required. But this is a secondary matter. For the present purpose it is enough to know that a substantial reduction in revenue required will make possible also a substantial lowering of tax rates.

It is generally agreed that, even though the income raised by taxation were all simply transferred within the country, being neither handed over to foreigners nor yet spent by Government in the production of goods or services, nevertheless, high rates of taxation would discourage work and saving, and so check national pro-

ductivity. When a man knows that out of every extra pound that he succeeds in making the Government will take 5s. 5d., he will tend to stop working a little sooner than he would do otherwise. When he knows that out of the yield of every pound that he puts by the Government will take 6s., he will tend to stop saving a little sooner. The check to work means that production at the moment is carried less far than it might have been, and the check to savings hinders the expansion of capital equipment upon which production in the future depends. Moreover, if the rates of taxation in this country are high, not only absolutely, but also relatively to those ruling in other countries—and they are bound to be higher than in countries that were neutral during the war, and may be higher than in former belligerent countries, should these themselves decide to wipe out debt by a special levy—the damage to production will be intensified by a tendency on the part of some rich people to take themselves and their capital abroad. When on income-tax is superimposed taxation of the type of the excess profits duty, the discouragement to productive effort is probably much greater than it is under an equivalent weight of income-tax. When there are added again various sorts of indirect taxation, there will follow, besides a reduction in the quantity of production, a disturbance in its direction—a diversion of resources from the sorts of production that people would favour if left to themselves,—and, therewith, a further element of real loss. These considerations lead to two very important propositions. The first is that, whatever the amount of the annual budget, to relieve that budget to the extent of 300 millions (or of any other sum) will have a good effect on national productivity. The second is that, the greater the annual budget, and, therefore, the higher the rates of taxation



which it involves, the greater the benefit resulting from a diminution of 300 millions in revenue requirements is likely to be. The reason, of course, is that, while a certain amount of money can be raised by taxation of a kind and a degree that is not specially obstructive, as more and more money is required resort must be had to worse and worse kinds of taxation and to more and more oppressive rates. From these propositions it appears to follow that the imposition of a special levy now to wipe out our immense war debt, since it would enable taxation to be substantially reduced from a level that is dangerously high, would promote work and saving and, through them, national productivity in a very important degree.

The amount of force in this argument for a special levy clearly depends on *how high* tax rates generally will have to be in order to finance the debt charges, together with other Government expenditure, if a levy is not imposed. Some evidence as to this can, of course, be derived from the existing facts. But, since we are concerned with tax rates, not merely at the moment, but over a long period of years, account must also be taken of future prospects. If there is reason to believe that, before very long, the high rates of taxation that rule now will no longer be necessary, the case for a levy is so far weakened; on the other hand, if there is reason to believe that even higher rates will be required, the case is made stronger. It is, therefore, important to inquire what, in fact, future prospects are.

First, it is often urged that, as the world in general, and this country in particular, recover from the effects of the war, the rate of interest at which it is possible to borrow money will fall: that, therefore, the Government may hope to effect a conversion of its long-time debt, replacing, perhaps, its 5% obligations by obligations of

4½%, or even 4%. If it succeeds in doing this, the amount of revenue which will be needed to provide interest on any given amount of war debt will be proportionately reduced, and, consequently, less high rates of taxation will suffice. There is, of course, some force in this consideration. But it is less important than it appears to be at first sight. To begin with, while the greater part of our national debt bears interest at 5%, war loan at this rate now stands in the market at about 80. This means that money on Government security cannot now be borrowed at less than 6%. The rate of interest will, therefore, have to fall very considerably below its present level before it will be possible for the State to reborrow on terms even as favourable as 5%. The prospect of reborrowing on terms substantially more favourable than this is, therefore, somewhat remote. Moreover, even if the rate on which new borrowing could be effected were substantially below 5% at the present time, a large part of our war loan cannot, under the terms of issue, be repaid at par until a number of years has elapsed. Finally, even if conversion made it possible some years hence to reduce the interest payable on the national debt by as much as one-tenth on the average, this could hardly lead, in view of the continuing need of other Government expenditure, to a reduction in the aggregate revenue required of more than one twenty-fifth. The possible reduction in rates of taxation which this would make possible, though it would do something, could not possibly do much to make the need for a special levy less urgent.

Secondly, there is good reason to believe that the productive power of this country will continue to increase in the future as it has done in the past. Possibly, as a result of the stimulus of war, it may even increase at an accelerated pace. This increased productivity will in-

volve increased incomes, and so, it is argued, will make it possible to raise the same revenue as now by means of much lower rates of taxation. There is in this contention an important element of truth; but some qualification is necessary. Plainly, if our national debt were contracted in terms of commodities, an increase in the productivity of the United Kingdom *must* make it easier to budget for the annual debt charges. Whereas, before improvement, these charges absorbed, say, one-hundredth part of the real income of the people, after it they might absorb, say, one two-hundredth part; and the rates of taxation associated with them might be roughly halved. But the national debt is contracted in terms, not of commodities, but of money. This complicates the issue. If increased production has no effect in reducing prices, money incomes will increase in the same proportion as production increases; and the rates of taxation needed to yield a given revenue will be diminished to exactly the same extent as they would be under a system of payment in kind. In fact, however, an increase of production tends, other things being equal, to cause a fall in prices, and if, as is to be expected, the increase is not confined to this country, but is world-wide, a very considerable fall. But, when prices fall, a given volume of production is represented by a smaller money income. If, for example, production doubles, but at the same time prices fall by a quarter, the sum of real incomes will be doubled, but the sum of money incomes will only be increased to one and a half times the former amount. This does not prevent the increased productivity from having its full effect in lowering the rates of taxation needed to finance *normal Government expenditure*, because a Government that still wishes to buy the same quantity of things and services as before will now require only

three-quarters as much money revenue. But the position is different as regards *Government expenditure on debt charges*. The money revenue needed for this purpose is the same as it was before. Real incomes all round have been doubled, but money incomes have only increased in the proportion of 3 to 2. Consequently, the rates of taxation required to finance war debt will not be halved, but only reduced in this latter proportion. It should be added that an increase in productivity up to double its existing amount in any short period would be a very exceptional occurrence. It has been calculated that in recent times the average increase has been about 3% per annum. Hence, while the case for a special levy to wipe out war debt is weakened in some degree by the prospect of increased productivity, it is not weakened very much, and is certainly not weakened to so great an extent as it might seem to be at first sight.

There remains a third consideration. During the war paper currency throughout the world has been greatly expanded. The result has been that gold, displaced from many of its former uses, has become much less valuable than before in terms of things. In other words, the prices of things in terms of gold have very greatly increased; they have, in fact, more than doubled. Over and above this, British currency, that is to say sterling, has depreciated to the extent of about 20% in terms of gold; so that the prices of things in British money have increased substantially more than their prices in gold have increased. It is not, of course, possible to forecast what the various Governments of the world will do in currency matters during the next few years. In view, however, of the widespread demand for 'deflation,' it is not unlikely that some of them will act in such a way as to increase the world requirement of gold, and so to raise the value

of gold—which is the same thing as reducing gold prices. Moreover, it is practically certain that the British Government will endeavour to restore the pre-war parity between sterling and gold, so that a pound sterling shall again be worth 4·86 gold dollars instead of, as at present, from  $3\frac{1}{2}$  to 4 gold dollars. Hence, while the prices of things in terms of gold *may* fall through currency causes, the price of gold in terms of sterling will almost certainly fall. This means that the prices of things in terms of sterling will probably fall before long to some extent, and may fall to a considerable extent. If, however, a fall of prices due to currency causes comes about, the money representation of any given amount of real income must fall correspondingly. Hence, in order to raise a given money revenue to meet debt charges, the Government will have to impose rates of taxation higher—perhaps much higher—than are required now. We must not, of course, ignore the effect of a fall in prices upon that part of Government expenditure which is not concerned with the debt. This expenditure should be reduced proportionately with the fall in prices. Consequently, the aggregate money revenue needed by the Government will not increase, relatively to the aggregate money income of the country, to the same extent as the part of the revenue that is required for debt finance. Still the proportion between these two sums, and, therewith, aggregate rates of taxation, must increase to some, and may increase to a substantial extent. These considerations are important. The heart of the matter can be set out in a crude statement thus: if prices are halved through currency causes, the tax-payers will have to pay to fund-holders the equivalent of twice as many things as they have to pay now: fund-holders will gain and taxes will increase to exactly the same extent as they would have done if prices had remained

constant and all war obligations had been doubled in amount. The imposition now of a special levy to wipe out debt would protect us from this danger. This is a strong point in its favour.

We may now, leaving aside speculations as to interest rates, productivity and price levels in the future, come back to the central argument. Broadly put, the case for a special levy is that, by enabling the high rates of taxation which would otherwise be necessary to be reduced, it would encourage work and saving, and so indirectly stimulate national productivity. This central argument is open to several objections, which have now to be considered. The most far-reaching of them may be summarized as follows. 'Granted,' it is said, 'that high annual taxation over a long term of years is injurious, is there any reason to suppose that a single levy to wipe out debt, which, though it only takes place once, must be enormously larger than the contribution of any single year under the taxation system, will be less injurious? Will not the greater size of the levy cancel the benefit of its less frequent imposition?' This objection in the above general form is not valid. A special levy to wipe out debt must be assessed on the basis of existing facts, on the capital that people have now, or on the income that they have now, or, at all events, on the basis of some objective criterion that is known now. Consequently, whatever different individuals have to pay—it does not matter whether they have to pay at once or are allowed to pay in instalments—is fixed independently of their future conduct. Thus, a special levy equal to, say, 200% of a man's current income is roughly equivalent in yield to a permanent income-tax of 10%. But, whereas the permanent 10% tax implies that one-tenth of whatever he may get in the future by work or saving will be taken

by the Government, under the 200% single levy he will have to pay a definite amount, fixed once and for all; and however much he may increase his income in the future, he will not have to pay anything more. Unless, therefore, people are afraid of further levies, the single levy plan is bound to hurt production less than the continuing tax plan.

But the qualifying clause in the last sentence brings up a new and very important objection. The imposition of a large special levy for the purpose of paying off debt cannot fail, it is said, to create an expectation that it will be repeated, not merely to wipe off any debt that the first levy may have left standing, but also, it may be, for purposes not connected with debt redemption at all. This expectation will discourage people from saving and so adding to the capital stock of the country, and this check to capital will react injuriously on productivity. The injury wrought in this way will, it is urged, be very great. It cannot, moreover, be prevented by any assurance of the Cabinet, or even of Parliament, that a repetition of the levy is not contemplated, because no Government can effectively bind its successors.

There is force in this argument. But it is open to an effective rejoinder. So long as a 'capital levy' forms a plank in the programme of an important political party, the fear that a levy will be imposed exists already. It is even arguable that, when once a levy had actually been made, people would feel that things were settled, at all events for a considerable time, and would, therefore, be actually less fearful of the future than they are now. In any event, it must be remembered that, if the levy policy is rejected, there is the *certainty* of long-continued high taxes. This can hardly fail to be more damaging to enterprise than the speculative fear of a distant and uncertain danger,

Were we, however, to stop at this point, we should not have a true picture of the situation. The whole of our discussion so far has turned on the assumption that a large special levy to wipe out debt is an alternative to, and a means of avoiding, high taxation. This assumption may be denied. If, it may be argued, a levy is imposed, and, in consequence, the annual revenue required to provide interest and sinking fund on the debt greatly reduced, the result will be, not lessened taxation, but increased extravagance on the part of the Government. Having found that it is possible to maintain, for example, an income-tax at a standard rate of 6s. in the pound, the Government will merely use the saving on debt interest as an excuse for more spending; so that in the end, instead of the levy being a substitute for high annual taxes, it will turn out to have been an addition to them! This argument is, from a practical standpoint, a very important one. There can be no doubt that, when so large an amount of revenue has to be raised that the tax system is strained, this fact strengthens the hands of the opponents of public wastefulness. The argument, 'the country cannot afford unnecessary officials, and so forth,' has a greater backing of votes when the budget is 1,000 millions than when it is 200 millions. It is true that against this must be set the attitude of mind of the spending departments themselves. With a budget of 1,000 millions, such a sum as, say, 10 millions seems a bagatelle, whereas with a 200 million budget it is a grave matter. This consideration is, however, almost certainly outweighed by that just set out. On the whole, a wiping out of war debt would weaken the country's defence against Government extravagance.

This, however, is not the whole case. Not all sorts of Government expenditure are waste. A Government



may easily be accused of extravagance because it has increased its expenditure on educational services, the payment of old age pensions, or other socially ameliorative enterprises. The cry, 'we cannot afford this,' may, in short, be directed against good things as well as against bad. It may even happen that it is more effective against the good things: that the Treasury, for example, has greater success in vetoing a 10 million increase in educational charges than in clipping, to the extent of 10 millions, the wings of some unduly 'grandiose' ministerial establishment. This is a real danger. There are, of course, limits to the extent to which it is for the national advantage for the Government to spend money on social betterment. But the limits are dependent on the proportion between the real income of the country and the real expenditure which it undertakes through the agency of the Government. So far as the budget is swollen by charges connected with internal debt, it does not correspond to this real expenditure, because the money raised to meet the charges is not spent in any ordinary sense, but is merely transferred from one group of citizens to another. This fact not being generally realized, the case against further Government expenditure has an appearance of greater strength than properly belongs to it. True, this helps resistance to wasteful spending; but it also, at least equally, promotes resistance to wise and desirable spending. This is a fair rejoinder. Should new Government expenditure be undertaken in consequence of the relief to the budget brought about by debt repayment, it is gratuitous to assume that it will all be mere waste. Some of it, at least, is likely to be expenditure which ought to be undertaken, but has not been undertaken hitherto because of the technical difficulty of enlarging an already enormous

budget, coupled with the inability of the public to understand the distinction between taxation for real expenditure and taxation for interest on internal debt. It is true that good Government expenditure equally with bad involves a forcing up of tax rates. But, since good expenditure is, almost by definition, expenditure the advantage of which is greater than the disadvantage involved in raising the money for it, such increase of rates as it involves cannot be taken to cancel the original lowering of the rates for which a levy is responsible. The whole of that lowering must be counted to the levy for righteousness, even though the country decides, after the lowering has been accomplished, to put rates up again in a cause that it considers worth the damage to production that high rates involve. I conclude, therefore, that the case for keeping debt unrepaid, as a means of dragooning spendthrift governments, is not a strong one. The balance of argument so far is in favour of imposing a special levy to secure quick cancellation.

#### IV.—THE QUESTION OF FAIRNESS

So far our discussion has paid no attention to questions of distribution between different groups of people. The general considerations set out above have suggested that, so far as they are concerned, a special levy to wipe off debt is desirable. Plainly, however, this conclusion would be reversed if it could be shown that such a levy could not be arranged without great unfairness. This aspect of the matter has, therefore, now to be examined. I shall consider first the fairness of a levy policy in principle, and thereafter fairness as dependent upon the particular form which a levy might assume.

The most far reaching objection to a levy policy that

has been made from this point of view is that it would involve unfairness between the present and the future. If, it is said, the present generation pay off the whole, or the bulk, of the war debt by a special levy now, people now living will have shouldered the whole costs of the war. But the benefit in security and so forth that the war may be supposed to have secured will be enjoyed also by future generations. It is reasonable, therefore, that they should pay their share; and, if there is a special levy, they will not do this. This contention rests on a misunderstanding, the removal of which involves a rather complicated discussion.

The costs of the war, except in so far as they were met by foreign borrowings, were necessarily provided by Englishmen at the time. They were met partly by extra work, partly by economies in personal consumption, partly by economies in new capital construction, and partly by using up resources which would normally have been employed in keeping existing capital equipment intact. So far as they were met by extra work and by economies in consumption, the future had no share in them: but, so far as they were met at the expense of capital equipment, the future was hit to the extent of the loss of future output which the check to capital equipment involves. Thus, the burden to be thrown on the future was determined by the action of individuals at the time. Contrary to common opinion, the proportionate part played by taxes and domestic loans in war finance had very little to do with it. It had, of course, *something* to do with it, because it influenced to some extent the action of individuals. Whether, however, a man made his contribution to war costs in the form of taxes or of contributions to war loan was only a secondary and subordinate factor in determining whether

he made it by extra work and personal economies, or at the expense of capital equipment. So soon as this is understood the next step is plain.

Just as the share of the war burden thrown on the future was not directly affected by the choice made at the time between taxes and domestic loans, so that share will not be directly modified by the imposition of a special levy to wipe out domestic debt created by loans. So long as the debt exists, it implies an obligation on the part of the people of this country in their capacity of tax-payers to make a certain annual payment to themselves in their capacity of holders of war loan. This obligation affects distribution as between people at any given time, because people in general are not tax-payers in the same proportion as they are fund-holders. But it does not directly affect distribution as between people at different times. To wipe it out by repayment of the debt would not, therefore, make any direct difference to the share which posterity takes in the real burden of the war. Of course, if, by making the present generation *think itself poorer*, it caused more savings to be made and more capital to be accumulated, it would indirectly shift some burden from the future to the present. But this shifting would almost certainly be so slight that the question of fairness as between different generations does not, for practical purposes, arise. It will be understood that the more important extra savings, that the present generation may be led to make in consequence of the reduced rates of taxation rendered possible by debt repayment, would not be "at the expense of" that generation and ought not, therefore, to be brought into account here.

The other general consideration concerning fairness has to do with fairness between different people among the present generation. They may conveniently be set out

under three heads. To begin with, it has been argued, that a levy is bound to be unfair because it hits indifferently people who have already suffered heavily on account of the war and people who have made fortunes out of it. A man whom the war has already deprived of half his wealth is now, it is said, threatened with the further loss of half of the remainder, and the war profiteer is treated in no way differently. The general drift of this contention is, of course, correct. It is not, indeed, suggested that, if one of two men, who had equal fortunes before the war, has lost half his fortune while the other has doubled his, the two men would, under a levy, be mulcted equally by the State. They would not even be mulcted in *equal proportions*, because the levy would presumably be graduated so that richer men paid at a higher rate than poorer men. But it is suggested, and it is true, that in the assessment of a capital levy no allowance is generally contemplated for the losses that some persons have incurred during the war and for the gains that other persons have made. If, however, this fact is used to condemn a capital levy, it must equally be used to condemn the whole body of existing taxes; for no one of our taxes, whether direct or indirect, makes allowances of this kind. The truth is, and it has only to be stated to be perceived, that this argument, though *pro tanto* a valid argument in favour of the special taxation of war fortunes, if that should prove to be practicable, is not a valid argument against a general levy on all wealth designed to wipe out war debt. No doubt, if the issue to be decided was between a general levy and a war wealth levy calculated to yield an equal sum, the argument would be highly relevant. But, as will appear presently, nobody has ever supposed that a war wealth levy can yield enough money to make any substantial impression

on the national debt. It is not, therefore, an alternative to a general levy. At best it is a supplement to it. The only alternative to a general levy is continued high annual taxation of the ordinary type over a long period of time. This taxation fails in exactly the same way as the levy would fail to discriminate against war wealth. Plainly, therefore, the fact that the levy fails to do this cannot properly be used as an argument against it.

Again, it has been argued that a levy—in so far as it is a capital levy—is bound to be unfair because it strikes people who have saved money during the war and lets off those who, with equal opportunities but less patriotism, have squandered their money in luxurious expenditure. That a levy must act in this way is, of course, true. But, here again, exactly the same thing holds good of the alternative system of continued high taxes. A man who had £10,000 a year during the war was taxed during the war on that £10,000. If he saved half of it he will be taxed again in the future on all the income that the saved half yields; but if he spent all of it he will not be taxed again at all. This inequity cannot be remedied by any action open to the Government now except resort to retro-active legislation. No attempt is made to remedy it in any existing tax. The fact, therefore, that it would not be remedied in a special levy, which is an alternative to some existing tax, cannot properly be used as an anti-levy argument.

Yet again, it has been argued that the imposition of a levy, so far as it takes the form of a levy on capital, would be in substance, though not, of course, in form, a breach of faith with all the people whom the Government persuaded during the war to purchase war loan. Now, of course, if it was proposed to make a levy on holdings of war loan from which other forms of private wealth were

exempt, this charge would be justified. But no such proposal has ever been made. War loan would be treated in exactly the same way as—certainly it would be treated no worse than—other forms of property. It has always been understood that income from ordinary war loan will be treated, for taxation purposes, like other income. There is no inequity, therefore, in treating the capital of ordinary war loan like other capital. On this general issue there can, I think, be no serious dispute. There are, however, two subordinate considerations to which attention should be called. First, it is sometimes argued that, though in theory a levy would not discriminate at all against the holders of war loan, yet in fact it would do so because, since everybody's holdings of war loan are recorded at the Bank of England, any levy made in respect of them would be certainly recoverable, whereas some holders of other forms of property would probably, by concealment, evade a part of their proper obligations. This is, no doubt, true; but evidently, though it affords a strong argument for making the collection of any levy that may be imposed as effective as possible, it cannot serve as sufficient ground for refusing to impose a levy. If such a contention were conceded, it would be impossible to impose any tax at all; for always some people are in a stronger position than others to evade their lawful obligations. Secondly, there is a small amount—some 20 millions—of 4% war loan that was issued free of income-tax; and war savings certificates are also free of income-tax. In so far as a levy is regarded as an alternative to income-tax, the holders of these securities have a valid claim for exceptional treatment under any levy that might be imposed. What exact form this exceptional treatment should take need not be considered here. The amount of money affected, in comparison with the general

scale of our problem, is trifling. It is enough to note that some special adjustment in this matter is necessary.

The considerations set out so far have been relevant to the fairness of any sort of special levy. We now turn to matters of a less general character. In the public mind at the present time a special levy to discharge war debt is generally taken to mean a 'levy on capital.' That is to say, the sum assessed under the levy on different people would depend on the amount of their material accumulated capital, and no account would be taken of their capacity to acquire earned incomes. In principle this is unfair. One man, we may imagine, has spent £10,000 in buying some property that is expected to yield him an income of £1,000 over the next fifteen years; another has invested the same sum in training and developing his own mental powers in such a way as to enable him to earn £1,000 a year for the next fifteen years. Under a capital levy as ordinarily understood the first of these men would be hit and the second allowed to go free. There can be no warrant for this. Moreover, if the levy is conceived, as I have suggested it may be, as a substitute for future taxation, it is plainly proper that those who have the power to earn income, since they will benefit from the reduction of future taxation, should bear a share of the levy. Unless they are made to do this, the imposition of the levy will have the effect of substantially altering the burden borne by different citizens to the advantage of those possessing the immaterial capital of capacity to do profitable work and to the disadvantage of those possessing material capital as ordinarily understood. This shifting of burden is exactly similar to what would take place if the policy of a levy were rejected in favour of the orthodox system of annual taxation, but the rates of tax on unearned income



(i.e. income from property) were largely raised, and those on earned incomes largely reduced. Of course, it is open to anyone to maintain that the existing discrimination between the rates of income-tax on the two sorts of income is less favourable than it ought to be to earned income. But nobody would propose exempting earned income altogether; and this is what in substance would be done, in respect of whatever tax revenue was affected, by relieving future taxation through the agency of a levy imposed upon material capital alone. In principle, therefore, fairness demands that the special levy should not be imposed upon material capital alone, but that the power to make earnings should also somehow be brought under it. In a later section the serious practical difficulties which an attempt to do this would have to overcome will be examined in detail. For the present we are concerned only with the principle.

A more special point arises in connection with the relation between natural persons (i.e. individuals) and fictitious persons (i.e. companies and corporations). In the United Kingdom income-tax is assessed on the income accruing to individuals through companies in which they have shares, and also on that part of the income of companies which is not distributed to shareholders but passed to reserve. This analogy suggests *prima facie* that under a special levy both the shares of companies in the hands of shareholders and also the reserves of the companies should be assessed. But this is incorrect. The capital value of the shares represents the whole value of a company's property, including the reserves in whatever form they may be held. When, therefore, share capital has been assessed in the hands of the shareholders, all that there is has been assessed once. To come down on the companies again would involve double taxation,

Companies, therefore, should be left outside the levy. The position of corporations whose property is not represented by shares, such as universities, colleges, churches, clubs, and so forth, is different. If they are not made subject to the levy in their own persons their property will escape altogether. In principle clearly it ought not to escape, though it is arguable that certain sorts of corporations of special public utility should be exempted for the same sort of reason that the income of charitable trusts is exempted from income-tax. There are, however, difficulties. A scale of levy graduated appropriately to individuals could not be applied to corporations; it would be absurd, for example, to make an institution like a college, comprising a large number of persons, and possessing, say, a million pounds, contribute as large a quota as an individual millionaire. It would be necessary, therefore, to fix, for such corporations as it was decided to assess, some general arbitrary flat rate substantially below the maximum rate under the scale. This plan should probably be extended to cover municipalities and other local authorities. The logic of the situation requires that trade unions, friendly societies, and co-operative societies should also be assessed, though it might be proper, in view of the comparative poverty of most of their members, to apply a different and lower flat rate to these bodies.

The question of what is fair has to be faced again when we come to determine the rates of levy proper to people of different degrees of wealth. Everybody would agree that under a special levy, as under an ordinary income-tax, people below a certain level of wealth should be exempted altogether, while, for people above that level, the rates of levy should be made to increase with increases of wealth, in such a way that, if one man's wealth

exceeds another's in any given proportion, his levy payment should exceed the other's in a larger proportion. It is impossible, however, to lay down any general principle in accordance with which either the level of the exemption limit or the form of the graduation scale should be determined. As with income-tax, so also here we are forced to rely on the subjective judgment of governing persons as to what, on the whole, seems to them to be reasonable.

This problem of fairness as between people of different degrees of wealth is exactly analogous to that which arises in connection with income-tax and involves no niceties. The problem, however, to which we now turn, of fairness as between single persons, married persons without children, and married persons with large families has, in connection with a special levy, puzzles peculiar to itself. It is generally agreed that, for income-tax purposes, a man with a wife and family should be taxed less than a man of equal income who has only a wife, and that such a man in turn should be taxed less than a bachelor. Would it be fair to make the same class of allowances under a special levy? At first sight, the proper answer to this question seems clearly to be yes. But there is a difficulty. A man may be a bachelor one year, a married man the next year, a married man with five children six years hence, and, it may be, a widower with no children at all seven years hence. Under income-tax all these vicissitudes are followed from year to year, and appropriate adjustments are made for them. But a special levy is not an annual tax; it is a single impost raised once only. If allowances corresponding to income-tax allowances are made in it, the man who has a wife and large family alive in the year in which the levy happens to be made is favoured as

against the man who is a bachelor then, but is going to have a large family in a few years' time. The advantage which the first of these two men obtains is plainly arbitrary, and cannot be justified on grounds of fairness. For this reason, the case for family allowances is very much weaker under a special levy than it is under income-tax. No entirely satisfactory solution of the difficulty seems to be possible. It is true that arrangements can be imagined that would take account of a man's probable future family status as well as of his actual status—under which, for example, a bachelor of twenty would be treated differently from a bachelor of sixty; but they would almost certainly prove too complicated and too controversial for practice. Probably the most generally acceptable solution would be to make some allowances, at all events among poor people, but to keep them small.

What has been said leads up to yet another problem. In the United Kingdom there is a system of graduated duties on properties passing at death, which, for large properties, are at a very high rate. If a man died immediately after his property had been mulcted under the special levy, the remainder of that property would at once be hit again. On this ground it may be argued that the special levy should be assessed at a lower rate on old men than on young men with equal incomes. But the inference is not well-grounded. After all, a young man may die immediately after the levy as well as an old one. A more appropriate way of meeting the difficulty would be to make some allowance in respect of death duties for estates falling under them soon after they had paid the special levy. No allowance for age in the special levy itself seems to be called for.

## V.—THE BASIS OF ASSESSMENT

For the purposes of this section it is convenient to use the term capital in a wide sense, so as to cover, not only material capital, but also the immaterial capital of personal qualities to which reference was made above. On this understanding the problem we have now to study is: if it is decided to impose a special levy, is it better to assess that levy on a basis of capital in this wider sense, or on a basis of income, or on a mixed basis? This problem will be considered from three points of view: that of national productivity; that of equity; and that of administrative technique.

On the side of productivity all that need be done is to clear out of the way a common fallacy. It is often argued that imposts on capital are necessarily more injurious than imposts on income because they trench, in a way that taxes on income do not, on the productive equipment of the country. This is a blunder. It arises out of a failure to distinguish between the *object* on which an impost is assessed and the *source* out of which it is paid. An impost assessed on capital may quite well be paid out of income, and one assessed on income out of capital—or, which comes to the same thing, out of resources which, apart from the tax, have been turned into capital. The choice of the object of assessment does not, in short, determine the source of payment. Nor, in general, does it have any significant effect upon the source of payment. Suppose, for example, that the Government decides to take £100 from a man with £10,000 of capital yielding £500 of income. It can do this either by a 20% income-tax or by a 1% capital tax. There is obviously no ground for supposing that the man will take the £100 he has got

to pay from one source if the tax is called an income-tax, and from another if it is called a capital tax. The widespread confusion of thought that exists on this matter arises in a very simple way. As a matter of practice, imposts assessed on capital, such as death duties, call for much larger payments at one time than imposts assessed on income. The larger, however, an impost becomes, the greater is the proportion in which it is likely to be taken out of capital. If, for example, a man has to pay in a year more than his income for the year, he *must* draw on capital. It is easy to imagine death duties of about the same amount as now assessed on a basis, not of capital values, but of the income in the last completed year before death. Nobody would contend that a change of this kind would alter the extent to which death duties are paid out of capital. It is the same with a special levy. *Given the amount of the levy*, it would make very little difference to the source out of which it comes, and, therefore, to national productivity, whether the basis chosen for assessment were capital or income.

I turn to the question of equity. For ordinary annual taxation it is generally agreed that annual income is a fairer basis of assessment than capital or property. Of course, if every £100 of 'unearned,' or investment, income implied exactly the same amount of capital as the source of the income, the choice between income and capital as a basis of assessment would be quite immaterial. When £100 of income is derived from £2,000 of capital, it makes no difference, interest being reckoned at 5%, whether income is taxed 20% or capital 1%. In either event exactly £20 a year is raised. But, in fact, the relation between income and the capital from which it is drawn is not the same for all incomes. Thus, one property is

expected to yield £100 a year for ever ; another is expected to yield nothing at all for ten years, and, thereafter, to yield about £163 per annum for ever. If the rate of interest is and remains 5%, the first of these properties is worth now and will continue to be worth exactly £2,000. The second is also worth now (approximately) £2,000, but its value will gradually increase, until after ten years it will become £3,260, thereafter remaining at that figure. Under a 20% income-tax the former of these properties pays £20 a year from now onwards : the latter pays nothing for ten years and thereafter £32 12s. 0d. a year. These two sets of payments have equal present values, and, since the two properties are equal, this is clearly right. If, however, capital is taken as the basis of taxation, the former property, as before, pays £20 a year from now onwards ; but the latter, besides paying £32 12s. 0d. a year annually after ten years have passed, also pays during the first ten years an annual sum starting at £20 and gradually rising to £32 12s. 0d. In the aggregate, therefore, it pays much more tax than the other, although its present value is equal to that of the other. What happens in effect is that the income after ten years is taxed both when it arrives and also in anticipation of its arrival. We thus see that the adoption of a capital basis for annual taxation causes properties which are expected to appreciate to be taxed too much relatively to stable properties ; and, by parity of reasoning, it causes properties which are expected to depreciate to be taxed too little. It is true that against this disadvantage of the capital basis there has to be set an advantage. One property—a holding of war loan, for example—may be worth £10,000 because it yields £500 a year of money income ; another property—a yacht, for example—may be worth an equal sum because it yields an equivalent

income, not in the form of money, but directly in satisfaction. The taxable capacity of a man who owns his own £10,000 yacht is substantially the same as that of one who, having £500 more of money income, spends this in hiring a yacht from somebody else. Under the income basis of annual taxation, since income-tax takes account only of money income, the yacht owner goes free but the yacht hirer is hit. Under the capital basis this inequity disappears, and both men are taxed equally. This advantage of the capital basis must, as I have said, be set against the disadvantage described above. On balance, however, there can be little doubt that the disadvantage is the more wide-reacting of the two. Moreover, if the capital basis were adopted, it is difficult to see how the disadvantage associated with it could be palliated; while that associated with the income basis can be, and has been, in some measure met by the imposition of special duties—such as the motor-car tax—on possessions that yield an income of amenity.

It is sometimes thought that the reasoning which has led to the general adoption of an income basis for ordinary annual taxes can be extended, without further debate, to the assessment of a special levy. Indeed, certain critics of current proposals for a levy on capital have believed that these proposals can be overthrown by the citation of familiar arguments against annual property taxes. This is a mistake. The fact that income is a better basis than property for continuing annual taxation is no evidence that it is a better basis for a special levy to be raised on a single occasion. In fact, it is easily shown to be a worse basis. The objection to a capital basis for continuing taxes is that on this basis properties yielding little or no return now, but destined to yield a substantial



return presently, are taxed on their future return both now and also in the future. When we have to do, not with continuing taxes, but with a single levy, this objection changes sides. If the income basis is adopted, people with properties that are of great value because they are expected to yield income some years hence will pay nothing at all. Plainly they ought to pay. For annual taxation the income of the year, supplemented, perhaps, by special amenity duties on certain durable consumption goods, is the fair basis, because the income of every year is subjected to tax. For a single levy ability to pay depends, not on the income of the particular year in which the levy is made, but on the prospects of income over a considerable period. This capital measures, but the income of the current year frequently does not. Moreover, the owners of such things as yachts and pearls and motor-cars, though they may be hit for annual purposes by supplementary amenity duties, will escape altogether under a special levy unless this is based on capital. For this reason it seems clear that, from the point of view of equity, capital is a better basis than income for the assessment of a special levy.

There remains administrative technique. Here the advantage is on the side of income. In the United Kingdom an enormous mass of knowledge about people's incomes is already in the possession of the revenue authorities. The machinery of income-tax administration could readily be turned on to assess a special levy, at whatever rates were desired, on the basis either of current incomes or of the average of incomes over, say, the last three years. Moreover, earned and unearned (or investment) income being already distinguished, any discrimination which it was decided to make between them could be easily worked. If, on the other hand, a

special levy had to be assessed on a capital basis, the tremendous problem of a general valuation would have to be faced. Even though, for the moment, we leave out of account immaterial capital, this would present great difficulties.

So far as property is held in the form of securities, a simple return could be asked for, and it could be checked to some extent by means of the knowledge already in the hands of the inspectors of taxes. For securities for which there is a wide market values could then be satisfactorily determined by reference to the prices that had ruled in the market over some assigned period. For securities that are not often dealt in it would be more difficult to make a fair valuation. Property not represented by securities would present much greater difficulties. Here, either immediately or, at all events, as an ultimate check on the returns, there would have to be a special appraisalment by Government valuers. Private businesses, houses, furniture, jewellery, works of art and other such things would all, so far as it was decided to include them under the levy, have to be treated in this way. It would be impossible to carry through such a general appraisalment quickly, and it could hardly fail to prove both irritating and expensive. If the immaterial capital of personal capacities had to be included as well as material capital, the revenue authorities would almost certainly find the task impracticable. The capital value of a man's capacity to earn so much income depends on the man's expectation of life, and so would be different for men in similar occupations but of different ages. Account would have to be taken, too, of prospects of promotion; and, in strictness, not merely of existing capacity, but also of capacity to acquire capacity. Clearly this will not do: we are in a region of fiscal dreams. The

idea of a special levy assessed in a thorough-going way on a full basis of material and immaterial capital together must be dismissed as administratively impracticable.

It is possible, however, to fall back on more than one variety of compromise. The problem presented by immaterial capital can be got over by simply constricting the scope of the levy. Material capital alone might be assessed, but the resultant unfairness to property owners, as against rich professional men, might be countered by a readjustment in the relative rates at which earned incomes and unearned incomes are assessed to income-tax. We might, for instance, take the line that a special levy on material capital represented the conversion of so much tax on unearned income; and that, therefore, unearned income was entitled to a relief from future income-tax to which earned income had no claim. Alternatively, of course, it might be held that under the present income-tax law earners are not relieved, as against property owners, as much as they should be, and a levy confined to material capital might be welcomed as a means of setting this right. I shall not attempt here to solve the problems which these considerations raise. For the present purpose it is sufficient to know that the practical impossibility of evaluating immaterial capital is not fatal to the idea of a special levy, nor even to the choice of capital as the basis for its assessment, because such adjustments, if any, as the omission of earners from assessment under the levy may be thought to make necessary can be provided through changes in the income-tax.

The difficulties which have been set out in connection with the appraisal of certain sorts of material capital are also not insuperable. Three alternative plans are avail-

able. First, all persons *prima facie* liable to levy may be required to send in a valuation of their properties by some assigned date. On this valuation they may be assessed in the first instance. Thereafter Government appraisers may set to work and gradually, during the course of several years, may go through these private valuations and, when necessary, correct them. After the proper valuation has been finally determined, any adjustment required to correct the original valuation may be effected by payments from the tax-payer to the Exchequer or *vice versa*. Secondly, the levy may be assessed in the first instance on the basis of those kinds of property only the valuation of which presents no difficulty. Such things as furniture, jewellery and works of art may be left over till each several property comes up for valuation in the natural course at the owner's death. Then the ordinary death duty assessment may be supplemented by a further assessment in respect of postponed special levy upon these things. The disadvantage of this method is, of course, that it makes difficult the proper graduation of the levy. The rate of levy should vary with the aggregate size of different properties. If only a part of these properties is brought under review when the main levy is assessed, this cannot be done. Any error that results might, however, be corrected by manipulating the rates at which the supplementary levy is assessed later on. Thirdly, elements of property which are exceptionally intractable to valuation might be left out of assessment altogether, on the ground that, though this would undoubtedly be unfair, yet a certain amount of unfairness must, as in all tax matters, be endured in order to avoid administrative complications. Clearly no one of these devices is wholly satisfactory, and this fact is, so far, an argument against making capital the basis of assessment.

It is well to remember, however, that, in view of the large amount of property that is held in the form of securities, probably not more than one-quarter would involve any serious difficulty in valuation. Moreover, even though a very large proportion of the objects specially awkward to value—furniture, jewellery, works of art and other forms of consumption capital—were left outside the range of capital assessment, the capital basis might still be much better than the income basis; for on the income basis all these things are ignored completely. On the whole, therefore, I am inclined to sum up in favour of the capital basis, subject to the condition that the precise range of capital which it is worth while to include is studied and determined by revenue experts. It is desirable to add, however, in so many words, because the point is not always understood, that the decision for or against the broad policy of a special levy is not dependent on any conclusion that we may come to about the basis of assessment. A special levy *could*, if it were so desired, be assessed on the basis of income. It does not stand or fall with any particular plan, or indeed with the whole body of possible plans, for making a valuation of capital.

#### VI.—METHODS OF PAYMENT

We now reach the last head of this discussion. It is often argued that the process of paying a large levy could not be carried through without completely dislocating the industry and commerce of the country. This argument is expressed in several forms. First, it is argued generally that the plan involves withdrawing an enormous sum of capital, thus depleting industry of its means of life. But industrial capital consists of factories,

machines, material, and the store of goods out of which real wages come. None of these are withdrawn. The utmost that can happen is that so much purchasing power is taken by the Government from one set of people (the payers of the levy) and handed over to another set of people (holders of war loan) inside the same country. This can have no direct effect upon industry in general. Secondly, this being granted, it is argued that capital will, nevertheless, have to be withdrawn in large masses from particular industrial concerns, that this capital will probably not be immediately replaced, and that, therefore, many concerns may be forced to close down. This argument is more substantial than the other. It points to a real difficulty. But the difficulty is much smaller than the argument suggests. The reason is that the main part of the industry of the country is in the hands of public companies, and that these companies, not being subject to the levy (though, of course, their shareholders are subject to it), cannot suffer any withdrawal of capital. There remain private concerns. So far as the owners of these possess resources outside their business—war stock, for example, that is not serving as security for loans—sufficient to meet the levy upon them, they will be able to manage. It is true, however, that if firms, the whole of whose resources is locked up in their business, either directly or as collateral for loans, had to meet a large levy all at once, they might be broken and their business largely destroyed. For such firms it is necessary to make special provision. This can and should be done by permitting the Treasury, when good cause is shown, to accept payment (with interest) in instalments spread over a definite number of years. There is no reason, and, indeed, in my view it would be very undesirable, that this method of payment should become the normal one. But

it might appropriately be used for the relief of hard cases. A third argument, which is very widely employed, proceeds to industry indirectly through finance. In order to raise the money to pay their quotas, people, it is said, would be compelled to throw securities on the market to such an extent as to cause a serious fall in values, and this would not only dislocate arrangements for loans on collateral, but would give rise to a financial panic, with inevitable repercussions upon industry. This argument rests on a misconception. Even though the levy had all to be paid in actual cash, since the proceeds would be employed in paying off holders of war loan, these people would have presumably about as much money seeking securities as the payers of the levy had securities seeking money. Any momentary gap between the time of the levy and the time of using it to buy war loan could easily be adjusted through the banks. There is, therefore, no reason to fear anything like a general slump in values, though, of course, some particular securities might suffer a little relatively to others. But this is not the whole answer. There would be no need to require payment of the levy in cash. Payment in war loan stock would be even more acceptable to the Treasury, and payment in other first-class securities not less acceptable. Arrangements might also be made, as under the German Capital Levy Law, by means of a specially created institution for holding property on behalf of the State, to permit people who so desired to pay in other less readily marketable securities, or even in some forms of real property. It is very unlikely that, with reasonable arrangements on these lines, any considerable part of the levy would, in fact, be paid over in cash.

## VII.—SUMMARY

The results of the foregoing discussion may now be summarized in a few sentences. In view of our enormous budget requirements and of the consequent necessity for kinds of taxation and rates of taxes that are seriously repressive to industry, a large special levy for the purpose of repaying internal national debt is desirable from the standpoint of national productivity. If, as it would probably have to do, the levy left out of account the immaterial wealth of mental and manual earning powers, it would be fair to revise the comparative rates of income-tax upon earned and unearned incomes in the light of this fact. On the whole, capital seems to be a better basis for the assessment of a special levy than income, though an assessment based on income would be easier to administer. A levy, if made, should be graduated, and persons below a certain limit of wealth should be exempt. The revenue authorities would need to investigate what, if any, categories of wealth it would be desirable, in the interests of administrative simplicity, to leave outside the scope of the levy. Payment of levy quotas should be accepted not merely in cash, but also in war loan stock and, probably, other first-class securities. Provision should be made to allow of payment by instalments from persons to whom immediate payment would involve exceptional hardship. The imposition of a special levy conceived on these general lines, the proceeds to be devoted to repayment of debt, would, in my judgment, help forward the economic recovery of the United Kingdom. Detailed proposals and estimates of the amount of money that would be yielded by different scales of levy



can only be made satisfactorily by the Inland Revenue authorities. Such inadequate study as I have been able personally to make suggests that a reasonably graduated scale rising to a maximum of between 40% and 50% might bring in 4,000 million pounds.

## CHAPTER III

### A LEVY ON WAR WEALTH

A LEVY on war wealth is a very much smaller enterprise than a general capital levy. Whereas by means of a general levy we might hope to raise 4,000 million pounds, or even more, towards debt repayment, nobody has ever imagined that a levy on war wealth could yield more than 1,000 millions, and many people think that half that sum is the most that could be looked for. Partly on this account, while a general capital levy is usually thought of in relation to the whole of the national debt, the objective which most people assign to a levy on war wealth is the comparatively small part of it which is represented by Treasury bills and by advances from the Bank of England. This 'floating debt,' which stands at present at some 1,200 million pounds, is fiscally more objectionable than the funded debt because of the need of continually renewing it. This need, by making the Treasury dependent on the market, hampers them in their currency policy. One of the arguments most vigorously urged on behalf of a levy on war wealth is that it would enable the floating debt to be reduced to more manageable proportions.

The difference between a war wealth levy and a general levy is not, however, merely one of size. There is also an important difference in point of view. Though, no doubt, some advocates of a general levy desire to relieve the receivers of earned income at the expense of

property owners, this desire is not, as was shown in the preceding chapter, an essential part of their case. The dominant purpose of a general levy is to substitute a single lump sum for a succession of annual payments, and not to alter the distribution of fiscal burdens. The dominant purpose of a war wealth levy, on the other hand, is to do that very thing. In a period of intense national strain, during which many men lost their lives and many others a great part of their property, some fortunate persons made enormous fortunes. Naturally and rightly public opinion resents this. It is not merely that some war fortunes were made by discreditable means. If these cannot be attacked under the ordinary criminal law, it is hopeless to distinguish them from other war fortunes by any form of fiscal discrimination. But the whole idea of war fortunes, however honestly, or even worthily, they may have been acquired, is repellent to public opinion. In famine and pestilence our sense of fitness revolts at seeing *any* grow fat. A levy on war wealth aims at compelling those whom the war has made rich to contribute from their gains in relief of their neighbours' needs.

Though, however, this is the main thing that advocates of a levy on war wealth contemplate, it is not necessarily the only thing that their policy would accomplish. It is, therefore, requisite, as with a capital levy proper, to examine that policy from several points of view; and, again as in that discussion, we may conveniently begin with the reactions upon work and saving. Here very little need be said. It was shown in the last chapter that the only way in which a capital levy proper could lessen work and saving would be by making people afraid that it would be repeated in normal times. Possible damage under this head had to be set against the stimulus to

work and saving to be expected from reduced taxation. With a war wealth levy this kind of reaction is impossible, because in normal times war wealth cannot come into existence. Hence, there is no damage to be set against the gain. Little, again, need be said about the methods of payment: for the discussion on pp. 45-7 is relevant to a war wealth levy as well as to a general levy. It is true that, under a war wealth levy, certain persons might have to pay out a larger proportion of their possessions than under a general levy, and that, therefore, the device of payment by instalments might have to be applied more widely. It is also true that special arrangements would have to be made when people had spent or given away portions of their wealth between the date for which assessment of it was made and the date on which the law establishing the levy was passed. These, however, are minor matters, and need not be studied in detail. Equity and problems of valuation give rise to larger problems.

The equity in principle of a levy on war wealth is disputed by nobody. It is sometimes argued, however, that in the United Kingdom resort to such a levy is precluded by the implications of the excess profits duty. In imposing this duty, it is said, the Government, in effect, announced to the business community that whatever war profits were not taken away under it should be left to those who had made them. Had it chosen, it could have put the tax at 100%, and so, in principle, left no war profits at all. It did not do this because, as was openly avowed, it feared that the result of doing it would be to discourage effort, enterprise and economy in occupations where these things were essential to our success in the war. For a government, which thus deliberately bought business energy by leaving to it in each year a definite fraction of war profits, to come down now, after

the goods have been delivered, and require the purchase price to be returned would, it is urged, be a serious breach of faith. To different minds this argument will appeal in different degrees. Nobody pretends that there was any explicit contract not to impose a war wealth levy, and an 'implicit contract' is a difficult conception to work with. Most people would probably agree that, in the circumstances, to take away now the whole of the war profits left over by the excess profits duty would be unjustifiable; but they would not object to taking a part of them. Moreover, it must be remembered that a great quantity of war profit has probably been made in one way or another without coming under the hammer of the excess profits duty at all. Clearly the argument of the implicit contract cannot apply to this.

If, then, it is agreed that a war wealth levy would, in a broad sense, be fair, the next thing to decide is the kind of scale that is appropriate. It has already been agreed that it would not be equitable to take from anybody the whole of his war wealth. Therefore the maximum of the scale must be substantially below 100%. On this basis what ought the general form of the scale to be? Should the same proportion of war wealth be taken in all circumstances, or should the scale be graduated? If it is graduated, should the graduation depend solely on the quantity of a man's war wealth or partly also on the quantity of pre-war wealth to which his war wealth is added? These are points which can only be settled by a rough general judgment as to what seems reasonable. It would be generally agreed, partly for administrative reasons, that small amounts of war wealth are best left alone; and again that, as between people whose pre-war wealth was equal, moderate amounts of war wealth should be assessed at lower rates than large amounts.

There is room for more difference of opinion as to the proper relations between rates of tax and quantities of pre-war wealth. It is argued, on the one side, that pre-war wealth (together with such war wealth as is left after the war wealth levy has been made) is hit, through the income it yields, under ordinary taxation, and, if a general capital levy is imposed, under that levy also, at rates graduated according to its amount. To take account of it again under a war wealth levy is like penalizing a man twice over for the same offence. On the other side, it is answered that, once we have decided not to make a clean sweep of all war wealth, a poor man, whose need is greater, may reasonably be allowed to keep a bigger fraction of his windfall than a rich man. On the whole, this 'human' argument should, I think, prevail. If this view is accepted, the rates of levy must depend both on the quantity of war wealth and also on the quantity of pre-war wealth to which it is joined.

I turn to the problem of valuation. This has to do with much more than mere administrative technique. It involves, also, large questions of definition. Since war wealth is obviously included in the additions to wealth acquired during the war, the first point to determine is the meaning of 'additions to wealth acquired during the war.' Had general economic conditions, price levels, the rate of interest and so forth been unaltered by the war, there would be no problem here. Additions to wealth would be measured simply by the difference between the pre-war and the post-war money valuation of people's property. But, in fact, general economic conditions have not been unaltered. First, the general level of prices has risen very greatly. A man may have exactly the same pictures and furniture as he had before the war, but the money value of these things may have become

twice as great. Has he thereby acquired an addition to his wealth? Clearly, if the rise of the money value of pictures and furniture has not been greater than the rise in money values generally, the answer must be no. Whether he keeps his pictures and furniture or exchanges them for something else, he will have no more things than he had before. The mere fact that the money label attached to his things has been altered makes no difference to the essential facts. Hence, before we can disentangle, by means of money valuations, additions to wealth acquired during the war, allowance must be made for the large change that has taken place in the general level of prices.

This point is generally understood. But there is a second analogous consideration to which less attention is usually paid. A large part of the property that people own consists of things, or rights over things, which are not of use to them directly, but which, so long as they are retained, give them a title to a fixed or variable money income. Holdings of securities are the most obvious example of this kind of property. The money value of such property depends in part on how much money income it is expected to yield. But it also depends on the general rate of interest. If this is 3%, the right to a perpetual annuity of £30 will be worth £1,000; if it is 6%, the same right will be worth only £500. With the rate of interest raised from 3% to 6%, any given expectation of income will thus be halved in capital value. If, therefore, a man who had £10,000 worth of this kind of property before the war also has £10,000 worth now, this means that he expects to receive a money income not far from twice as large as before. His income is the same as it would have been if the rate of interest had remained constant and the property had increased to £20,000.

Ought we not, therefore, to say that, though nominally the man's fortune has remained constant, really it has about doubled?

Plainly the allowances that are required on account of increased prices and on account of the higher rate of interest to some extent cancel out. If prices and interest had both exactly doubled, our £10,000 man would be getting twice as much money income as before, but his doubled money income would only buy the same income of things. In fact, prices seem to have risen in rather a larger proportion than the rate of interest, so that he is, on balance, rather worse off than before. But he is not nearly so much worse off as he would have been if the change in prices were the only change that had occurred and his £10,000 money capital implied only the same amount of money income as before. Hence, as regards properties the value of which arises out of the fact that they yield money income, the net allowance needed before additions to wealth acquired during the war can be truly estimated is very much less than common opinion supposes. Increases in the money value of property, such as pictures and furniture, which does not yield a money income, should be discounted to the full extent of the general rise of prices, but similar increases in property that does yield a money income should be discounted to a much smaller extent.

To disentangle additions to wealth acquired during the war is not, however, the whole of the problem. For not all such increases are a proper object for a war wealth levy. In strict principle we should require to isolate from among these additions those which have been made *on account of* the war; for, plainly, additions to wealth which happen to have been made in the war years, if the war had nothing to do with them, ought not to be



treated differently from similar additions made at any other time. This distinction cannot, of course, be worked out completely in practice. Our knowledge of causal sequence is too vague. It would seem, however, that certain additions, which are evidently not due to the war, should be withdrawn from the scope of a war wealth levy. The most obvious of these are normal inheritances. To subject a son to a special impost because his father happened to die in 1917 and not in 1920 would be plainly inequitable: even if the father's death were due to the war, it would be ridiculous to treat the son's inheritance as war wealth. This conclusion must, however, be qualified. If the father, before his death, had increased his fortune by the acquisition of war wealth, his death need not deprive the State of its right to a levy. Hence, only such parts of inheritance should be left out of account as are not themselves the fruit of war acquisitions.

Yet again, many people are accustomed to add regularly to their property by savings. If a man's real income during the war remained exactly what it was before, and he continued to save at the same rate as before, it would be preposterous to treat the consequent addition to his property as war wealth. If, on account of appeals made to his patriotism, he reduced his personal consumption to a minimum, and saved more than before, to tax him for that would be still more intolerable. Equity requires that this should not be done.

In attempting to draw up a workable scheme for a war wealth levy, on the basis of the desiderata set out in the preceding pages, we are bound, for administrative reasons, to jettison refinements. Our statistical foci, in respect of any person subject to levy, are, first his money wealth on some assigned date after the war, secondly, his money wealth immediately prior to the war. The

Board of Inland Revenue are of opinion that, for the comparatively small number of persons whom a war wealth levy of the type they had under investigation would affect, both these facts could be ascertained with reasonable accuracy in a short time. When they had been ascertained it would be necessary to make for each individual, on the basis of his separate claim, the appropriate deduction for wealth, not itself war wealth, that he had inherited between the two relevant dates. The remainder left over after this deduction had been made does not take account of altered price levels nor of savings that are made from sources other than war wealth. But to make allowances for these things adjusted to the circumstances of separate individuals would involve impossibly complicated and detailed inquiries. The best that can be done, therefore, is to make general deductions, independent of individual circumstances, but based, in some more or less arbitrary manner, on the amount of pre-war wealth. In strictness, since it is feasible to save a bigger *fraction* of a big income than of a small one, these deductions should grow rather more than in proportion to the growth of pre-war wealth. By these processes rough figures representing war wealth would be obtained. If it were desired to graduate the levy simply in accordance with the amount of war wealth, a graduated scale would then be applied directly to these figures. We have agreed, however, that it is reasonable to take account in the graduation of amount of pre-war wealth also. This can be done most simply by modifying the deductions that have to be made from the excess of post-war wealth over pre-war wealth before any scale is applied. If, for example, we consider that a deduction equal to the amount of pre-war wealth would, for fortunes of all sizes, take adequate account of price changes and savings, deductions should

actually be allowed for small fortunes up to the full amount of pre-war wealth, and, as fortunes increase, up to a constantly *diminishing* fraction of pre-war wealth. The levy should then be assessed, on a graduated scale, upon the amount of the balance left over. Under this type of arrangement—the plan finally presented by the Board of Inland Revenue to the House of Commons Select Committee is an example of it—the rate of levy, as an easy arithmetical calculation shows, varies both with the amount of a man's war wealth and also with the amount of his pre-war wealth.

In the light of this discussion we may conclude that the main technical problems connected with a levy upon war wealth can, after a fashion, be solved. The solution, however, must be very rough, and it is impossible to avoid all unfairness. Under any practicable scheme some people would be hit more hardly than they ought to be, others less hardly. Whether, on the whole, the game is worth the candle will be decided differently by different minds. My personal inclination is to say yes. This is on the understanding that a levy on war wealth is a supplement to, not a substitute for, a general capital levy. If one of these two things had to be taken and the other left, I should choose the capital levy. But there is no reason why either should be left. To parody Gladstone's famous phrase: both fair sisters may properly be courted, though not with equal zeal.

## CHAPTER IV

### CONCLUSION

THIS study would not be complete without a reference to one matter of which hitherto nothing has been said. During the discussions that took place in connection with the inquiries of the Select Committee on War Wealth, it was made evident that many representative associations of business men are very strongly opposed to the taxation of capital, whether war capital or capital generally, in any shape or form ; and there is no reason to suppose that their opposition would be mitigated—though their argument might be confused—by the substitution of income for capital, in the way indicated in ch. ii, sec. v, as the technical basis of assessment. This opposition is important for two reasons.

First, it is important because, to the minds of many persons who have not had time to investigate these matters for themselves, it is authoritative. Business men, these persons hold, are experts, and finance is a matter for experts to decide. This is a common sentiment, but it is not a well-grounded one. It is true that a good business man is an expert—in his own business. A good boot manufacturer can make and sell boots, a good ship-builder can make and sell ships, a good banker can judge the standing of his customers, better than anybody else. But problems of taxation and national finance generally are not the boot manufacturer's or the ship-builder's or the banker's business. No doubt, some boot-

makers and shipbuilders and bankers have made a special study of them. If so, and if they are able men, their judgement is valuable. But it is valuable, just as the judgement of a doctor or a lawyer might be, not because they are bootmakers or shipbuilders or bankers, but because of the study they have made. It is not necessary, I think, to labour a point which, once stated, needs no proof.

Secondly, the opposition of business men is important because, if a large class from whom the State demands payments is convinced that the demand will ruin industry, this opinion must tend in some degree to promote its own fulfilment. Fear that a panic will happen itself breeds panic. Fear that the Government's fiscal policy will discourage enterprise itself discourages enterprise. It would be foolish to ignore these psychological reactions. The fact that many business men are afraid of these levies makes them less desirable fiscal instruments than they would be otherwise, and adds something to the weight of argument against them. But it does not add very much. If, as the foregoing discussion gives reason to believe, the graver fears of the business world rest mainly on misunderstandings, experience will belie them, and the damage they do will be neither extensive nor prolonged. The history of the British Factory Acts affords many instances of disaster prophesied by important business men and yet not realized. The moral of their opposition, for those who believe the policy of levies to be sound, is, not surrender, but education: to understand themselves, and to be prepared to explain to others the fabric of economic reasoning out of which their proposals grow.

## SUGGESTIONS FOR FURTHER READING

THERE is very little systematic literature in English on the subjects treated in this pamphlet. The only important book is a short work by Mr. Pethick Lawrence, entitled *A Levy on Capital* (Allen and Unwin). The author favours a capital levy. In the *Journal of the Royal Economic Society* for June 1918 there are articles by the present writer and by Mr. Sydney Arnold favourable to a levy; and in the same journal for September 1918 there is an article by Professor W. R. Scott taking the opposite view, and also an estimate by Sir J. C. Stamp of the amount of capital wealth in private hands in the United Kingdom. In the *Edinburgh Review* for October 1919 Sir J. C. Stamp, in an article entitled 'Taxation of Capital and Ability to Pay,' discusses the general question and concludes adversely to a capital levy. On the subject of a levy on war wealth little is available beyond the brief report of the Select Committee on Increase of Wealth (War), and the evidence submitted to it. An English translation of the German Capital Levy Act is printed in the *Quarterly Journal of Economics* (published by Harvard University) for May 1920. The Italian situation is discussed in a very interesting way by Professor Gini in an article in the *Journal of the Royal Economic Society* for September 1920.