

A
NATIONAL SYSTEM OF TAXATION

BEING A STUDY OF THE THEORY OF TAXATION
IN RELATION TO NATIONAL WELFARE
WITH SOME APPLICATIONS TO BRITISH INDIA

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PREFACE.

In this book an attempt has been made to set out in more or less systematic form, some of my own views on the subject of taxation. Having a profound faith in the validity of the doctrine that the end and aim of all state existence and activity is the promotion of the well-being or good-living of the members of the community for whom it exists, I have tried in these pages to trace in outline, the path along which the logic of the doctrine, in so far as it may apply to the taxative policy of a modern national state, appears fairly to lead. The theory of taxation, discussed on the basis of the doctrine, points to certain important conclusions regarding the conditions and construction of a national system of taxation, which, though they may require further investigation at the hands of research students are well worth the attention of all finance ministers and National Legislatures. So far as the present book is concerned, no pretence is made, that it

contains a complete or comprehensive discussion of the subject of taxation from the standpoint of the doctrine, nor is any claim made to expert knowledge of economics, finance and politics, or even a full acquaintance with the literature on the subject. The aim of the book is very humble and it contents itself with merely suggesting and indicating the lines on which the taxative policy of a modern national state requires to be guided and governed: thought in some important matters it has been thought useful to elucidate some of the general considerations arrived at by application to conditions obtaining in British India. On the whole, whatever may be thought of the usefulness of the book from the standpoint of the expert reader who will probably find nothing new or original in it, it is my humble hope that my exposition of the subject may incite further exploration and help the way to a clearer understanding of the nature and conditions of a national system of taxation as it ought to be.

Before I sent the mss. to the press, I placed it in the hands of the late Dr. Alfred Marshall who, while expressing his inability on account of extreme old age to give me any help by way of suggestions and corrections, went through the matter, and

communicated to me that he found it to be an interesting and suggestive contribution on the subject. Dr. Marshall is now dead, and in view of the fact that the little knowledge of economics I possess, and my interest in economic and social problems are largely due to the inspiration of his writings, I dedicate this book respectfully to his memory.

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CHAPTER I

NON-TAX SOURCES OF REVENUE

IN the modern state, taxation occupies a prominent place in public finance. In ancient and mediaeval times the financial requirements of the state were mainly sought to be met from sources other than the taxation of individuals. The state itself was owner of considerable property in lands and forests, and the rents and profits derived from its domains comprised the larger part of its revenues. The sovereign depended for the most part on the incomes derived from his own estates, and only to a small extent on the taxes paid by his subjects. It was an accepted principle of policy in those times that the ruling power 'should live of his own'; and the maintenance of the state from out of its own resources with as little resort as indispensable to taxation, was considered to be a criterion of good government. But the public finance of modern times is quite different. One conspicuous feature of modern financial develop-

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ment is the great and continuous growth of state expenditure due to the continuous increase in the functions and activities of the state. The existing sources of revenue are daily becoming more and more insufficient to meet its growing wants and expanding aims and desires, and the limited nature of the available non-tax sources of revenue is naturally leading statesmen to look to taxation as almost the only proper and available means under existing conditions, of meeting every increase in the ordinary expenditure of the state. In fact, taxation has become the central feature of the financial systems of modern states, modern state-finance being at bottom little else than state-taxation.

The object of the present book is to make a study in brief outline of the general principles that should guide and govern the imposition and regulation of taxation by the state. It will be commonly agreed that the end and aim of all state existence and activity is good government and if we mean by 'good government' the promotion through governmental machinery of the greatest aggregate well-being of the members of the community for whom it exists, we get a basis from which to work out our principles. Taxation being only a means to the further end of maintaining the state, it follows that every tax and every system of taxes must find their

justification in this supreme principle Our study in these pages will therefore proceed on this basis.

For a clear understanding of the subject of taxation it is desirable to note at the outset the exact nature of the non-tax sources of revenue that are available for a modern state ; so that it might be seen whether or not the revenues derived from such sources could be augmented under any circumstances. For, generally speaking, taxation being necessarily a deduction from the resources of individuals, and as such a sacrifice from their point of view, any means by which the burden that it imposes on the members of the community can be reduced or at any rate prevented from increasing to any extent, may be taken to cause a net gain to the community itself in the aggregate. If therefore it should be possible to increase the revenues of the state from sources other than taxation, that would mean so much less tax-burden, and so much individual wealth spared for the individual enjoyment and use of the members within the state. An understanding of the nature of the non-tax sources of revenue will thus have an important bearing on the welfare of the people in the state and also throw considerable light on the practical financial policies pursued by 'that crafty, and insidious animal vulgarly called a statesman or politician'

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in his efforts to the due balancing of expenditure by income.

Under ordinary circumstances, there are broadly speaking, three main sources of revenue other than taxation available for the state, namely, the public domains in lands and forests, profits derived from the business activities of the state, and fees levied for certain public services. So far as the domains in lands and forests are concerned, though they fulfilled a very important role in former times, their importance has considerably declined in modern finance. Three circumstances may be said to have contributed to their decline. In the first place, in almost all countries (of which India is conspicuously one) a very large portion of the lands belonging to the state has been in the course of time given away by the ruling powers in the shape of gifts and grants for services and by the recognition of occupiers of lands as full owners, so that the balance of landed property that still belongs to the state is very limited in extent and contributes but a very insignificant proportion to its revenue. In the second place, the continuous growth of state expenditure due to the widening sphere of its governmental activities, so marked a feature of modern civilization, has made it increasingly necessary to resort to other means of raising

revenue, leaving this inelastic source to occupy but a secondary place in the sphere of state finance. Thirdly the belief that the ownership and management of lands by the state would not be so much an economic gain to the community as the parcelling out of such lands to private individuals has led to the gradual alienation by the state of a good portion of its domains to private individuals. All these circumstances acting cumulatively have led to the decline in importance of public lands as a source of revenue to the state.

But this does not include lands which have continued to remain forest lands. In almost all countries forests are owned and controlled by the state and they form the largest part of the public lands. Any revenues that modern states derive from their public domains are mostly from their forest resources. To take some of the more important countries, more than a fourth of Germany is forest area of which a third belongs to the state. In France nearly a fifth of the country is forest belonging to the state and its sub divisions. Sweden, Russia and Austria and Hungary have all vast forest areas belonging to their governments. In all these countries, though the forest resources still remain unutilized to a large extent, the revenue which the state derives from this source is

considerable. The thickly populated and small island of Great Britain is the only important country in Europe, where the forest area belonging to the state is almost nil. In our own country India, the Government has a vast estate in forests extending up to nearly 250,000 sq. miles of territory, and yielding a net revenue under the present undeveloped condition, of nearly 2 crores of rupees. But the largest owners of public domains in modern times are the new countries of the United States of America, Canada and Australia. In all these countries there are, at the disposal of the state extensive territories of woodlands and forests, which though not yielding much revenue for the present, have vast possibilities for the future. In all of them there is an abundance of cultivable land which, though owing to the scarcity of population has practically no value at present, can be made to yield a considerable amount of revenue, by the development of their latent resources. A liberal policy pursued in the direction of encouraging immigration by the offer of facilities for incoming settlers and giving of concessions to them in the matter of reclaiming, cultivating and holding of waste lands is sure to enhance the social value of land in those countries and make it a permanent source of revenue to their governments.

But in connection with public waste lands and forests, the more important point that arises for our consideration here is the manner in which the state should dispose of such lands—whether it should sell or assign its lands outright to private individuals or lease them simply, on commercial principles, with the ultimate ownership vesting in itself. It may be stated as a general proposition that in no country would it be wise to make a complete alienation whether it be by sale or otherwise. Except perhaps in countries where it may be conducive to national interests to encourage the formation of a class of peasant proprietors by parcelling out to them small plots of cultivable waste land, outright alienation of any portion of the state's domain must certainly be condemned as sacrificing large future advantages in the shape of unearned increments of rent, that might accrue to the state with the growth of population, developed means of transport and easier access to markets. It seems therefore necessary on sound economic principles that the state in offering its lands to private individuals should so deal with them as to get for itself a fair share of the increase in future land values. The best method of doing this will be to let lands for a fairly long term of years, say 20 or 30, which while not discouraging the making

of improvements on the land, will at the same time give the state an opportunity of adjusting its rent at the end of every such period, to the increased values if any, due to the general influences of progress during the term of the lease. A policy pursued in this manner is sure to bring into the state treasury a far larger revenue in process of time, than any other method of dealing with the public lands.*

In dealing with the state ownership of land, and considering the scope that exists for developing its revenues from this source, we have to consider one other important point, namely the desirability of nationalising all the land in the country. By nationalisation of land is meant that the state should assume the ownership of all the landed property now in the hands of private owners. The basic principle underlying this proposal is that from the point of view of society, land, unlike the other agents of production is limited in stock, and if the rental as well as the capital value of land should increase as it is bound to increase with the pressure of population and general progress of society it seems obviously unjust that the private individuals who happen to

* Professor Bastable is also in favour of this view. See his "*Public Finance*" III rd Edition Book II Chapter II Sec. 7 pp. 182-183.

own landed property but without any effort on whose part the value has increased, should benefit at the expense of society as a whole. It is therefore considered proper for the state that it should make a compulsory acquisition of all the land in the country and own it and lease it out in parcels to individuals, so that any benefit that may accrue to this agent of production on account of the general influences of progress may come over to the state as representing the whole community and not appropriated as at present, by a few individuals only within the community. There is much truth and great force in this argument, and but for the financial difficulties that the state may experience in immediately buying all the lands from private individuals, and the possibly heavy sacrifices that it may throw on the present generation for the sake of what may perhaps be termed 'uncertain' * future advantages, a policy of Nationalisation is

* The advantages are said to be uncertain for two reasons. In the first place inventions and improvements in the arts of agriculture may, by increasing the productivity of land, lower the value of produce and thereby the rental value of land. Secondly the condition precedent to the rise of the rental land viz. the growth of population at a rate faster than the increase of production may not itself happen either owing to the desire of people to check the growth of numbers or on account of political or natural causes. But these are mere possibilities. If under existing conditions it is prudent for us to conclude that what in the natural course of things has been in the past, is likely to be in future, we may fairly expect a steady increase in the world population, and with the pressure of that population on the means of subsistence an increase in land rents also. At any rate there is no prospect of a decrease in such rents.

fully justified and ought to be followed in all countries. By this means the whole surplus rental resulting from the unearned increment of land values will, instead of enriching a small minority of land owners as at present go to the national exchequer and be utilized for the general good of the whole people.

This policy of nationalisation should not however be mistaken for any systematic socialism. There is no attempt here at confiscation of private property or social levelling or the exclusive control by the state of all the means of production. There is no hindrance to private acquisition of non-land wealth. Only land, owing to the peculiar feature of its being a limited gift of nature and not depending for its supply on human industry or ingenuity, is sought to be made the exclusive property of the state as representing the community. Nor is this result to be achieved by any process of confiscation without payment of compensation to the private owners. Under the policy of nationalisation contemplated here, the state is meant to pay the present full market value for any land it should acquire. The only object of the policy is to secure to the state and through it, to the whole community all gains accruing from the future increases in the public value of land. If private individuals are

allowed to benefit by such increase, it is clearly an unjust thing, in as much as such individuals gain at the expense of the community, and make no return for the same. Nationalisation of land therefore is highly justifiable apart from socialism or collectivism. This policy of nationalisation can well be achieved by the state, by gradually acquiring a definite portion of land every year. Instead of heavily throwing the burden of such acquisition on any single generation, the state may even extend the process to spread over two or more generations. * If all land thus comes to be owned by the state, then apart from the other and important social results that it may have, from the point of view of the revenues of the state, there can be little doubt that unearned increments of land rent due to the increasing public values will add a considerable amount to the state treasury, and make it even possible to dispense with taxation altogether.

This kind of nationalisation of land which is to be achieved not by forced expropriation but by payment of compensation to the private owners,

* It is worthy of note that in a recent book *A Philosophical View of the Land Question* the writer Mr. Henry Fox who also advocates the nationalisation of land, not by means of forced expropriation but by payment of compensation suggests the issuing of "National Land bonds" which are to carry interest equal to the present net income from the land to its owners. By this means all the land can be immediately nationalised. But the throwing of millions worth of such bonds suddenly into the world market will so inflate prices in the national and the world markets that there will be a tremendous crash.

has received the support not only of out and out socialists but of economists and philosophers of the Individualist and Liberal School, all of whom recognise it as a valuable measure of securing for the common good the future unearned increments of land values, which must inevitably result from every advancement of civilization and the progress of society. But there are a few objections raised against it—apparently seriously advanced, which call for some notice here.*

In the first place it is stated that in so far as the existing land owners are to be deprived of their landed estates, they will become impoverished by the change with the result that their contributions to the imperial and municipal revenues and to public charities will diminish. This objection has however no force. It ignores the fact that what the state or society loses in this way, it will gain manifold in the shape of the rent of land, including all the unearned increments which under the existing organisation is being intercepted by the land-owners who are enriched at the expense of the community and without any effort on their own part. There is therefore no ground for fearing that either the work of government or the conduct of

* For a summary of the objections see Article "Land, nationalisation of" in the Dictionary of Political Economy Vol. II. edited by Sir Inglis Palgrave.

the public charities will suffer for want of funds.

The second objection is that there is a great quantity of land now held by corporations—ecclesiastical, municipal, educational and charitable rendering a variety of public services, all of which will have to be provided for in other ways if their landed estates should be taken over by the state. But nobody advocates this kind of step. At any rate the nationalisation suggested here only aims at extinguishing the proprietary rights of private individuals in land, and vesting all their landed properties in the state or its subdivisions. With regard to charitable and other institutions of general public utility, the state does not gain anything by confiscating their estates, in as much as in the interests of the people, it will have itself to support such institutions with its own funds, should they possess no property of their own. In the case of public institutions the state has one of two courses open: It may either take their estates under its own control and management, in which case it will have to maintain them with its own funds, or it may leave them in undisturbed possession of their properties, so that they may maintain themselves as at present, out of the rents and profits derived from their properties. Thus in either way, public institutions will not suffer. Further even if

the state should assume the ownership of their lands, the amount paid to them by way of compensation will serve as an equally good, though substituted source of income for their maintenance.

Thirdly it is suggested that the ownership of all the land in the country will necessitate a costly public department with an immense staff for the dispatch of agrarian business. This argument will be valid only if it can be shown that the total cost of the state's administration of the land would be greater than the aggregate of the present cost of management to the private land-owners plus the actual cost now incurred by the state in assessing and collecting its existing levies on the land. The experience of land revenue administration in India where the state as *qua* land owner is collecting a share of the rental value of agricultural land in the greater part of the country, shows that though any such administration necessarily requires an elaborate machinery for its efficient working, and the cost of maintaining it is considerably large,* it bears but an insignificant proportion to the total revenues collected. If all the land in India should

* There is reason to believe that the cost of the Land Revenue Administration in India will be much lower than what it is if the machinery should as far as possible be Indianised. Not only are European officers highly paid but their ignorance of local conditions necessitates an additional staff of clerks and subordinate officials for putting them in the way. All this unnecessary expenditure can be saved under an Indianised administration.

be immediately nationalised, the existing land revenue machinery will be more than enough to carry on the new task instead of the old ; the state will be getting the whole of the rent of land now accruing to the private land owners, and not only that, the entire cost of management now incurred by the latter, will be saved to the country as a whole. The condition in other countries may not be so favourable as in India, but in all civilized countries the existing machinery for administering the land-tax can certainly be utilised, with a certain elaboration and modification where necessary, for purpose of administering the land under a system of state ownership also.

The fourth objection against land nationalisation is that production will suffer for want of adequate improvements on the lands. It is said that all the permanent improvements until now done by the private land-owners will have henceforth to be executed by the state or its tenants. The state will have to borrow capital and there will be a heavy charge for interest and sinking funds ; and if tenants were to effect the improvements they will have to be strongly induced by the concession of fixity of tenure and fair rents. On these premises it is concluded that the additional revenue expected from the state ownership of land

will be neither large nor permanent. A little reflection however, will show that there is no substance in this objection also. So far as general permanent improvements such as irrigation, transport, and other facilities are concerned, the state is always in a better position to effect them than a private owner. With regard to the cost of making such improvements, the view based on past experience, that it will be heavier than under private management, cannot stand scrutiny. The fact that in the past governmental enterprises have proved more costly than private enterprises—due almost invariably and in all cases to inefficient organisation and improper management, does not and cannot support an unqualified and universal proposition that all governmental undertakings must necessarily be more costly than private ones. There is no essential difference between the position of the state as land owner and that of any private person possessed of large landed estates, efficient administration being as capable of economy in the one case as in the other. Nor is the circumstance that the state will have to borrow capital even supposing that it has to borrow at all, a disqualification for its position as land owner. On the other hand, it is a great advantage to the state that it can command greater credit and

borrow at cheaper rates of interest than private owners. Again the fear that there will be a heavy charge for interest and sinking funds on account of the capital borrowed and invested in the improvements, is equally unfounded. Whatever is spent in improvements—unless the same is ill-spent, can reasonably be expected to enhance the productive powers and therefore the rental value of the land ; from out of which not only can the interest and sinking fund charges be fully met, but a net profit to the state treasury also expected. With regard to improvements to be effected by tenants—which however will only be short-period improvements, the best way of encouraging them will be for the state to lease out its lands, compatibly with its rights to revise the rents periodically, for fairly long periods of years, say 20 or 30 years, which will be sufficiently long enough to encourage the tenants to make short term improvements, but not too long for any appreciable unearned increments of rent going to them. No permanency of tenure or fixity of rent is necessary to encourage tenants' short term improvements. It is only long term and permanent improvements that require these things, but such improvements are made by the state. Thus, this objection also, fails.

We may therefore broadly conclude that a

prima facie case for the nationalisation of land by payment of compensation to their present private owners, is clearly made out and established. The subject of land nationalisation is now gaining strength in all progressive countries and it is one of the fundamental aims of the Labour Party in England today. "The Labour Party regards the present arrangements for the production and distribution of food in this country, and the life to which many thousands of country dwellers are condemned, as nothing short of a national disgrace, and as needing to be radically altered without delay. What is essential is that the Government should resume control of the nation's agricultural land, and ensure its utilisation not for rent, not for game, not for the social amenity of a small social class, not even for obtaining the largest percentage on the capital employed, but solely with a view to the production of the largest possible proportion of the foodstuffs required by the population of these islands under conditions allowing of a good life to the rural population, with complete security for the farmer's enterprise, yet not requiring the consumer to pay a price exceeding that for which foodstuffs can be bought from other lands." *

* Programme of the British Labour Party on Social Reconstruction after the War, under the heading 'Agricultural and Rural Life'.

Thus besides the financial importance of land nationalisation, its social effects on the community will be far reaching. The ownership by the state of all the land in the country, and the leasing of it in small holdings to as large a number of the people as possible will be not only conducive to the production of the largest possible quantity of the foodstuffs required by the population, but directly promote a more equitable distribution of land wealth among them and help the healthy growth of a large agricultural class free from the tyrannies of land-lordism. The whole unearned increments of rent resulting from the progress of society will go to the state as representative of the community and be utilised for the common good. And the idle landlord class—so lamentable a feature of the existing social order—will disappear, to the great good of society.

We see from the above discussion that there is much scope for the increase of the revenues of the state from lands and forests. There is also another head of revenue which is of great and growing importance. The various kinds of income which the state derives from its industrial and business activities may be brought under this head. Revenue derived from the postal, telegraphic and telephone services, from the state management and

control of railways, and from state banking and manufactures are examples of these. Though the amount of such revenues varies widely among the various States according to the scope for and extent of their economic activities, the existence of such a source of revenue is a significant factor in modern finance, and may become increasingly important with the growth of a wider understanding of the possibilities of state industrialism and state socialism. Even under existing conditions the economic receipts of the state may be increased by a discriminate control and management on its part of those enterprises which are best fitted for its own undertaking. State management of those industries that tend to monopoly or in which a monopoly is economically or for social reasons an advantage, and of the large and important industries connected with the means of communication and transport, is a net gain to the community as a whole. Those enterprises again which are fitted for joint stock companies can also be properly undertaken by the state, there being no essential difference between the two as regard their methods of working. In cases where as in banking, insurance and kindred businesses, publicity is a positive advantage rather than a draw-back, and in all cases in which large command over capital is necessary, the fitness as

well as the superior ability of the state to engage is clearly indisputable. The state can also justly undertake the production of those commodities that are needed for its own public services. In other cases it may usefully help the establishment and working of various industrial concerns by the granting of concessions and privileges, reserving to itself in return for the rendering of such help, the ultimate reversion of such concerns after a fixed period. The scope for the activities of the state in all these directions, and for governmental assistance to private industries in return for a share of profits is in all countries unlimited.

If we look into the existing condition of state industrialism we find that even in the most progressive countries it has not much developed on any of these lines. State industries whether national or municipal have been mainly confined in the past to certain fiscal monopolies and a few such undertakings of general public utility that private individuals cannot easily provide for themselves. Influenced by the theory of *Laisser Faire* and the belief that industries in general are likely to thrive better under private than public management, governments in the past have been too slow and unwilling to take to industrial enterprises of any kind. It is only very recently that

they have come to realise that strict adherence to the principle of *Laisser Faire* in economic matters is not so conducive to the furtherance of the general well-being as a discriminate socialistic interference on their part, and begun to appreciate the scope that exists for governmental activity on the industrial and social side of human life.

In this connection it will be instructive to note the programme of the Labour Party in England on 'Social Reconstruction.' They stand for the immediate assumption by the state of the ownership and management of all essential industries free from the reckless profiteering of private capitalists and for working the same for the common good of all. In their own words "the Labour Party stands not merely for the principle of the Common Ownership of the nation's land to be applied as suitable opportunities occur, but also, specifically, for the immediate Nationalisation of Railways, Mines, and the production of Electrical Power. We hold that the very foundation of any successful reorganisation of British Industry must necessarily be found in the provision of the utmost facilities for transport and communication, the production of power at the cheapest possible rate and the most economical supply of both electrical energy and

coal to every corner of the kingdom”*. They advocate further the immediate expropriation by the state of the entire business of the industrial insurance companies, and the manufacture and retailing of liquors, all to be worked and administered from the stand-point of the promotion of aggregate national well-being and no longer deflected by individual profiteering. With regard to local governments, they want the municipalities and county councils not merely to confine their activities to the administration of education, sanitation, and police or to the supply of local water, gas, electricity and tramways, but that they should greatly extend their enterprises in housing and town planning, parks and public libraries, the provision of music and the organisation of popular recreation and also that they should be empowered to undertake not only the retailing of coal but also all other services of common utility, particularly the local supply of milk and other necessary food stuffs.†

Whatever may be the profitableness or otherwise of these undertakings by the government and its sub-divisions in the sense of their yielding a net addition to the public revenues, there can be little doubt, judged from the standpoint of the promotion

* Programme of the British Labour Party on Social Reconstructions after the War., under the heading ‘The Democratic Control of Industry’.

† *Ibid.*

of maximum aggregate national well being, that such a policy must put an end to many of the worst evils of private profiteering and afford a sufficient safe-guard "against that insidious Degradation of the Standard of Life which is the worst economic and social calamity to which any community can be subjected." Now that the Labour Party has come to power in England, it may be confidently hoped that a well thought out and intelligent economy policy will be pursued by their government so as to conduce to the greatest common good, and if and where possible, to the public revenues also.

Now coming to our own country, India, the scope for governmental intervention in industry both for the purpose of advancing the general well being of the community and for increasing the revenues is vast. Even at the present time nearly half the revenues of the central government are derived from economic sources. From the manufacture of salt and opium, from the management and control of railways, from the business of banking, and from royalties, the Indian Government is deriving a large and permanent income which under a more businesslike management can surely be made to yield a better revenue. The scope for governmental enterprise in India is vast in all

directions. The existing railway system is totally inadequate for the needs of the country. In a country extending over 1770000 sq. miles of territory and having a population of over 315 millions the railway construction has not spread over more than 37000 miles, of which 26864 miles of line now belong to the State. * A comparative study of the railway system of the United States of America or of Great Britain will show that in this country there is yet very much to be done in railway construction. † Similarly there is much room for the development of the Banking organisation, adequate to encourage and cope with the industrial enterprises of the country. Again the

* In March 1923.

† The following figures show the area and railway mileage (in 1921) of the most important countries of the world.

	Sq. Miles.	Ry. Mileage.
Germany	208,000	38,000
France	204,000	31,000
Great Britain	88,000	} 24,000
Ireland	32,000	
Italy	110,000	11,000
Spain	196,000	9,000
Sweden	171,000	9,000
India	1,766,000	37,000
Japan	148,000	6,000
China	1,300,000	5,000
U. S. A.	3,577,000	242,000
Canada	3,510,000	25,000
Australia	3,000,000	} 22,000
New Zealand	103,000	

While India has only 115 miles of Railway for every million of her population. Australia has 4955, Canada, 4825, the United States 2533, and Great Britain and Ireland together 515.

immediate organisation of a national system of Life Insurance under the direct control and management of the Central Government, and the ownership by it of the entire means of communication and transport including all the shipping lines, will be, not only fiscally productive, but of far-reaching social importance. The activities of the Central Government can possibly be directed in these and similar directions.

The Provincial Governments have equally vast scope for the development of their forest resources, and for financially assisting and partaking in such other industrial undertakings as are deemed manageable by joint stock companies, and suited for production on a large scale. In particular as it is pointed out in the Report of the Indian Industrial Commission (1916-18) the field of possibilities is clearly large for the commercial development of various descriptions of forest produce on new lines; and as the Commissioners themselves deplore 'the national forest estate is of vast extent and value but a scrutiny of the output per square mile proves that its actual yield has hitherto lagged far behind its possibilities, and is, in most areas, greatly in defect of what the natural increment must be. The chief needs of the Forest Department are undoubtedly the development of transport facilities;

the exploitation of the forests on more commercial lines and the extension of research and experimental work which should, when necessary be carried out on a large scale and under commercial conditions.* The net income of the forests at present is less than Rs. 80/- per sq. mile. But considering that the various kinds of forest produce are essential for the daily life of the people and also for various industries, the development of transport facilities and an improved system of exploitation are sure considerably to increase their net revenue from forests and relieve the Provincial Governments of much of their chronic financial difficulties. What is immediately wanted is an efficient Industries Department in each Province.

In the case of Local and Municipal Governments, the facilities for industrial activity are greater still than in the case of either the Provincial or Central Government. This is chiefly due to the fact that conditions are localised in this case. Such monopolistic and public enterprises as lighting, water works, gas works, tramways, telephones, town planning, house building, dairy farming and the retailing of such indispensable necessities of life such as food-stuffs and fuel, are specially suited to the Municipalities of towns and in some cases to

* Report of the Industrial Commission (1916-18) para 61.

the Local Boards of district areas. In fact, the Corporations of the chief cities have actually been engaged in such industrial undertakings. But none of the numerous other municipal towns or Local Boards have taken to any enterprises on commercial lines and even in the big cities, there is much scope for further industrial undertakings.*

State industrialism, whether it be of the central, provincial or local governments, has thus a vast future in India. There are further special facilities open for Governmental management of business in this country. The people of India have a great faculty for obedience, being naturally docile and submissive, and a Government which is all powerful and has already under its control the banking and currency organisation and the transport facilities, has the best opportunity for the management of industrial activities, which is not so easily possible in other countries. That there will result

* It is said that in a return relating to 1279 Prussian towns of all sizes the following undertakings were shown to be under Municipal Management. 1. Water works, 2. Gas works, 3. Electricity works, 4. Tramways, 5. Abattoirs and stock yards, 6. Docks and quays, 7. Market halls, 8. Bathing establishments, 9. Sea and therapeutic baths, 10. Salt and mineral springs, 11. Milk cure establishments, 12. Warehouses and sale halls, 13. Wine business, 14. Stone and lime quarries, turbaries and sand and gravel pits, 15. Breweries, 16. Inns and restaurants, 17. Hydropathic establishments, 18. Fruit preserving factories, 19. Wine cellars, 20. Refrigerating works, 21. Timber warehouses, 22. Mines, 23. Bakeries, 24. Factories, 25. Brick works, 26. Mills, 27. Locksmitheries, 28. Rope works, 29. Dairies, 30. Dancing halls, 31. Ferries, 32. Fishery enterprises, 33. Livery station. See William Harbert Dawson's *Municipal Life and Government in Germany*, pp. 184-185.

additional revenue from such activities there can be no doubt. The financial needs of the Indian Government being great and growing at the present moment, the duties of the statesmen responsible for its finances will not be duly discharged unless they raise all possible non-tax revenue before resorting to the taxation of private riches or income.

In connection with state intervention in industry—whether of the national, provincial, or local or municipal government, there are however a few objections, usually advanced, which for the sake of completeness of argument call for some notice here. All the relevant objections when analysed are found to be grounded on the belief that the state and its subdivisions being political bodies and constituted for their political rather than for their commercial qualification are likely to be not quite fit for commercial leadership, that the hand of Government being heavy tends to slacken progress in whatever matter it touches, and that “business influences are apt to corrupt politics, and political influences are apt to corrupt business”. These objections however are carefully analysed and answered by Prof. Pigou in a passage in a recent book, which may be quoted here. * He says, “The

* Prof. Pigou *The Economics of Welfare* Part II, Chap. XIII, pp. 297-9.

principal disadvantages of municipal and national representative assemblies as organs for the control or the operation of business are four in number. First, these bodies are primarily chosen for purposes quite other than that of intervention in industry. Consequently there is little reason to expect in their members any special competence for such a task. Secondly, the fluctuating make-up of a national Government or of a town council is a serious handicap. Sir W. Pearce wrote, "I have the experience of electric lighting in my mind. Large municipalities overcome the difficulty by forming small and strong committees and selecting the same chairman and thus maintain a kind of continuity of policy. Small corporations start with very large committees that are constantly changing, and the result is that you find sometimes inability to agree upon the system to be used, sometimes inability to agree upon the means to be employed to conduct the service, and it is incessant trouble and squabble." This incident of fluctuating membership, may lead to action based on short views, views bounded by the next election, instead of looking to permanent interests of the state. Thirdly, the areas to which public authorities are severally allocated, are determined by non-commercial considerations, and consequently are often likely to

prove unsuitable for any form of intervention with the working of an industry. It is well known for example that attempts on the part of some municipalities to regulate, and of others to operate, the service of street-traction and the supply of electrical power have suffered greatly from the fact that these services since the development of modern inventions can be organised most economically, on a scale much in excess of the requirements of any one municipality. Finally, as indicated above, regular Governmental agencies, in so far as they are elective bodies, are obviously liable to injurious forms of electoral pressure. These four disadvantages are all serious. But all of them can be in great measure obviated. The first, second and fourth are practically done away with under a system of municipal Government such as prevails in Germany where the burgomasters and aldermen, corresponding to the English Chairman of Committees, are whole time paid experts with practically permanent tenure of office. All four disadvantages can be overcome, perhaps even, more effectively, by the recently developed invention of 'Commissions', that is to say, bodies of men appointed by Governmental authorities for the express purpose of industrial operation or control. An example of a 'Commission' for operation is afforded by the

Railway Department of New South Wales, and one of a Commission for control by the inter-state Railway Commission of the United States. The members of these Commissions can be specially chosen for their fitness for that task, their appointment can be for long periods, the area allotted to them can be suitably adjusted, and their terms of appointment can be such as to free them, in the main, from electoral pressure. It may be added that the system of Commission also in great part escapes a further important objection to intervention in industry by municipal councils. This objection, as stated by Major Darwin is that such intervention 'lessens the time which these bodies can devote to their primary and essential duties, and by increasing the unwillingness of busy men to devote their time to public affairs, it lowers the average administrative capacity of the Local authorities'. When industries are operated or controlled by special public commissions, this objection is obviously inapplicable. The broad result is that modern developments in the structure and methods of Governmental agencies have fitted these agencies for beneficial intervention in industry under conditions which would not have justified intervention in earlier times".

We may now pass on to consider the

receipts from "Fees". We use the term 'Fee' here to signify all payments made in return for services rendered by the state primarily in the public interest but conferring a measurable special benefit on the fee payer. As Professor Seligman says "The essential characteristic of a fee is the existence of a measurable special benefit together with a predominant public purpose."* In the case of these payments the individuals who specially seek the benefit of the particular services of the state make special payments for such services. Perhaps it may be considered a very desirable and highly equitable thing if it were possible for the state to charge a 'Fee' for each of the services which it may render to each and every individual. But only some of its services are ordinarily capable of any money measurement, so far as the individuals who receive the benefits are concerned. Most of the governmental activities of the state are incapable of such apportionment. The work of defence, of the protection of person and property, and the innumerable general efforts to further the physical, moral and intellectual well being of the individual members composing the community, are all functions of Government not capable of a money estimate, with regard to the quantity of

* Seligman *Essays on Taxation* pp. 303.

measurable benefit which they bring to each particular individual. The levy of fees therefore is restricted only to those cases in which the state can at least to an approximate extent measure the value of its services to individuals. The cost of all the other services of Government must only be met out of the general revenues of the state. As Professor Bastable points out 'Fees come in only as a supplement to the other receipts of the public exchequer, and have to be confined to certain cases of measurable services where the citizen is brought into direct contact with the public power.' * Administrative fees such as Court fees, Registration fees and seignorage are conspicuous examples of fees. The principle underlying all fees is that they must be more or less proportionate to the actual cost of the particular public service rendered to the community. If the Government derives a greater revenue from, say, Registration fees, or Court fees, these cannot strictly be called fees pure and simple. An element of taxation becomes comprised in them. A fee becomes a tax from the moment that it exceeds the actual cost to the State of providing the service for which it is charged, from the moment when "instead of fees being born of the State's activity, the activity of the state is born

* Bastable '*Public Finance*'. Bk. II. Chap. IV-p. 241

of the desire for fees." In such cases, 'The state hungering for taxes copies the outward semblance of the fee so as to render the proposed impost more acceptable; that which constitutes the essential element of the fee—some useful service, it puts aside.'* When for instance documents are required to be compulsorily registered in order that they may be made admissible in evidence in legal actions, and a duty is charged for such registration, the levy is more in the nature of a tax than a fee. The advantage to individuals here is merely an artificial advantage created by the state itself, and but for its own laws, nobody would care to pay such duty and have his documents registered. Similarly when court fees are regulated and levied, so as to yield a net revenue over and above the amount required for meeting the actual cost of the administration of Justice, they comprise both the elements of a fee and a tax, of a fee in so far as courts of Justice render their services to the particular individuals who pay such fees, and of a tax on litigation in so far as they are made to pay more than what such services really cost. We shall not therefore be deceived into believing that whatever goes by the name of a fee is really a fee properly so called. On the whole, however there

* Ehler's *Finanz Archiv* 1896 ii page 24, quoted in Dr. Pierson's *Principles of Economics* Vol. II pp. 377.

is no financial principle involved in the collection of fees, and the law which regulates them has merely an administrative interest, having little bearing on financial policies. Nor under existing conditions is it an important or developable source of revenue to the state or its sub-divisions. At any rate, in India it bears a very small percentage to the total revenue of the state. *

It will be seen from the foregoing survey that except in the case of fees the other sources of non-tax revenue are highly developable and under a well-considered financial policy, capable of considerable expansion; but they are not under existing conditions sufficient enough to satisfy the growing wants of the state. It is true that in some countries like India, the revenues of the state, other than from taxation, are appreciably large in themselves, and have kept the tax burden from being heavier than what it is. But the continuous growth of state expenditure, an inevitable consequence of the growth of state activity which is a characteristic feature of the modern social constitution, combined with the present and

* After the new Reforms Act of 1919 (The Government of India Act 9 and 10 Geo V ch. 101) the registration fees and court fees, the two important classes of 'fees' have been allotted to the Provincial Governments, and these Governments have in their attempts to balance their growing expenditure by increased income, so highly raised the rates of these fees that they have now practically become taxes on registration and litigation in the guise of 'fees'.

immediate inexpansiveness of the existing non-tax sources of income, has pushed to the forefront of financial studies the problem of considering the means by which the additional requirements of the state are to be satisfied. The problem presents itself in greater seriousness when we look through the possibilities of the future requirements of an active state. The functions and activities of Government are daily becoming wider, and with the growth of ideas of state socialism and collectivism, and a wider understanding of the possibilities of Governmental action for social welfare, it is highly probable that there will be a steady increase in the outlay required by the state for the carrying on of such additional work of Government. As we have already seen, there is much scope for increasing the revenues of the state without resorting to taxation. It is however clear that, while the possible extent of the expansiveness of the non-tax sources is not estimable at the present stage, the increasing expenditure required by the state, being a definitely expected phenomenon will have to be met, at least until the state fully takes upon itself the economic functions indicated in the preceding sections, mainly by the imposition of taxation. Further, in actual practice modern states have, though quite improperly, not attached any very

great importance to the developable characteristic of their non-tax sources of revenue, and rely more and more on taxation as almost the only source of satisfying their ordinary needs. For these reasons, the problem of taxation has an immediate practical importance and gives a special interest to modern students of finance.

Perhaps, it may be said that the state can well meet its requirements by means of loans. In fact in modern states large supplies are actually obtained through loans. We have therefore to see the conditions under which loans should be contracted by the public powers. With regard to this means of supplying the funds required by the state or its subordinate political bodies, it must however be noted that on the general principles governing the modern credit system which are the same for public and private economies alike, public borrowing should be resorted to only under conditions similar to those under which it would be prudent or advisable for private individuals to borrow. Such conditions arise either when funds are required to meet an extraordinary necessity for heavy and enlarged consumption which could not without painful sacrifices be met out of the income of any single year, or when they are required for productive purposes of such a kind as are capable

of yielding enough profit both to pay the interest on the loan raised and also repay a certain portion of the principal amount itself. In the case of public borrowing, owing to the fact that the state and its subdivisions do not exist for their own sakes but only for the good of the community whom they represent, a further consideration may also prevail. If the amount raised by the loan is to be employed for objects of either permanent or temporary public utility, whether the return of profit is or is not a measurable quantity, the accrual of public benefit is itself sufficient justification for the loan. In such cases meeting expenditure by means of loans rather than by taxation is undoubtedly sound, as the public works which the state undertakes are calculated socially to profit the community and increase their general prosperity and efficiency and through that, the productive powers and taxable capacity of the nation. For example, heavy expenditure in this country, on irrigation, public health, primary education of the people and the means of communication may advantageously be met with borrowed capital, the annual interest charge on such capital being left to be paid by means of taxation on the community. The increased efficiency of the nation that will result from such improvements, will itself increase the

national dividend and therefore the prosperity and taxable capacity of the people and enable them to bear a heavier tax burden with comparatively greater ease. Where the loan is to be employed directly productively as for instance, for the laying out of railways or opening up of other industrial enterprises, it is as prudent for the state as for a private individual or Joint Stock Company to start and run the whole concern with borrowed capital. Such productive outlay will in many cases be financially profitable and bring a net gain to the State Treasury over and above the annual interest that may have to be paid on the capital borrowed, and the amount that may be set apart every year for the sinking of the principal debt. Raising loans for this purpose therefore, is highly recommendable except in cases where the state indulges headlong in merely speculative enterprises which, even when undertaken by private individuals are a grievous hindrance to progress. To attempt to meet heavy capital outlay by means of taxation will be next to impossible, and in such cases borrowing is the only proper course open. Just as it will not be possible for an individual to supply the capital of a business concern from out of his income of a single year, so also it will not be possible for the state to find out the funds required

for any productive purpose or other work of public utility. In both cases the raising of a loan is a justifiable and proper course.

In the case of extraordinary, unexpected expenditure such as that caused by a war or famine, borrowing is equally necessary and justified. In such circumstance, an annual debt charge which only so far increases the tax burden as to be just sufficient to pay the interest and sinking fund charges on the loan raised, is clearly preferable to the steep and heavy increase in taxation which would otherwise be required to meet such expenditure, if borrowing should be avoided. In the latter case, the suddenness of the increased levy combined with the painful sacrifices which individuals will have to undergo in bearing the weight of a very heavy burden of taxation, payable out of their incomes of one or a few years will dislocate and paralyse the economic organisation of the community and inflict a very severe blow to national prosperity. If, as was the experience of Great Britain and other countries in the recent European war, the amount of money required to be raised is larger than the total annual income of the community, it is actually impossible to raise it by means of taxation or confiscation of the incomes of the members of the community. In

such case, the only possible courses open for the state are either to make a levy on property or to borrow. The former course being economically disastrous in its consequences on the nation, especially on their material existence, the latter is the only course left open.

We thus see that for meeting extraordinary requirements as well as for productive purposes and for objects of public utility it is legitimate for the state to satisfy its needs by means of loans. In both cases borrowing is justifiable on principles of sound financial economy. It is important however to note that except for these purposes the power of borrowing though tempting should be sparingly exercised and after due deliberation. It should never, it may be noted, be exercised for meeting any portion of the ordinary recurring expenditure of the state. In the case of huge non-recurrent expenditure borrowing will not only be expedient but also necessary. But where there is a prospect that any expenditure though abnormal and extraordinary to begin with, will extend over a series of years and be for all purposes ordinary in its nature, it must be met out of the annual receipts. "The probable duration of extraordinary expenditure is an important element in determining the mode of providing for it. A sudden and large demand for a single year may well be met by borrowing (unless the movable taxes

and the suspension of debt redemption suffice) as it would not be desirable to disturb the whole tax system for such a purpose. Where there is a fair prospect of continuous outlay on the increased scale, a re-adjustment of taxation at the outset is the prudent course. Failure in this cardinal point of sound finance was the cause of the great accumulation of debt in England at the opening of this century.....”* An indiscriminate exercise of borrowing power for meeting any portion of the regular and normal expenses of government is sure to bring the state into financial difficulties and pave the way to bankruptcy, in the same way as an individual who is supporting his daily life by means of loans will be reduced to bankruptcy. In a recent book Professor Pigou speaks to the same effect: “There can be no question that in a well ordered state all ordinary recurrent expenditure.....will be provided for out of taxation and not by borrowing. To meet it by borrowing, whether from foreign or domestic lenders, would involve an ever-growing national debt and a corresponding ever growing obligation of annual interest. In the end more would have to be spent in providing the interest every year than would have been required if the government had paid its way out of taxes from the beginning. The national credit would suffer heavy damage, and

* Bastable *Public Finance* Bk. V Chap. V p. 678.

ultimately the government might find itself forced into bankruptcy. These considerations are not indeed incompatible with the financing by loans of abnormal expenditure. If a certain class of expenditure occurs, not annually but at intervals of a number of years, it is admissible so far as the present argument goes, to meet it by borrowing, provided that a sinking fund is established to discharge the debt out of taxes within the limit of each interval. And if an expenditure has to be undertaken which is reproductive, in the sense that it yields an annual return to the government, adequate to pay full interest and also to provide its own sinking fund, taxation will not need to be resorted to at all."*

An emphasis on these guiding rules of public borrowing has a special significance for British India. In this country it has been a lamentable feature of the public finance during the past six years that the Government has not been able to meet current expenditure by current income. Every year a huge deficit has had to be cleared by means of loans.† Instead of meeting its ordinary expenditure by means of its recurring revenues, the Government of India has been year after year budgetting for a

* Prof. Pigou *The Economics of Welfare* Part IV Chap. I page 589.

† By the end of March 1923 the accumulated deficits of the previous five years stood at 98 crores of rupees approximately.

deficit and then covering it largely by means of loans and thus swelling the public debt. Of course there has been in recent years an enormous growth of governmental expenditure which the country has been called on to provide for year after year. But the remedy for this is to be sought not in the method of public borrowing, but in a well considered scheme of retrenchment of expenditure or if that should fail or be not practicable, in finding such sources of revenue as taxation, which will be giving a recurring income to extinguish a recurring deficit. As it was properly remarked in the *Servant of India*, "The government have been unable to make both ends to meet in the past, and they are unable to do so now; an individual who arranges his life on these lines, who spends more than he has got and trusts to the money-lenders to see him through finds himself pretty soon in the bankruptcy court; and a state which adopts this spend-thrift policy cannot in any way end differently."* If there is any truth in these remarks, the Government of India have specially to guard themselves against indiscriminate borrowing and thus paving the way for the country's financial ruin.

So the only practical solution of the problem which the growth of state expenditure is presenting

* Article 'Bankruptcy' in the *Servant of India*, of date 9th March 1922.

to our generation and which it is likely to present in greater seriousness to later generations, lies in the imposition of additional taxation, in the absence of any other source of revenue. Further it may be remembered that even when loans are raised legitimately for the purpose of meeting extraordinary, productive or other useful capital outlay, taxes, in the absence of any other source of revenue are still necessary for paying the annual interest charges which make a permanent addition to the state's ordinary expenditure. We have thus to look to taxation as the ultimate means under present circumstances of raising the greater part of the funds required by the State for the carrying on of its work of Government.

We are thus brought to that branch of public finance which is the main subject of our study in this book. The importance of the subject has led many modern writers on finance to regard it as almost the only topic for study in financial matters. The reason for this is to be found in the fundamental difference between taxation and other sources of public revenue. Unlike the non-tax sources of revenue which can all be treated more or less on the same general principles as those governing ordinary private economy, taxation involves questions of political as well as economic and moral considerations of a far reaching nature requiring

special attention and treatment. Taxation being necessarily a forced contribution, and a subtraction from the material resources of individuals, entailing a sacrifice on their part, the important problem of determining the manner in which it must be distributed among the members of the community has a living practical interest for all people. It is commonly believed and there is much truth in the belief, that the distribution and regulation of taxation, much more than the distribution and regulation of income or wealth, in general, which are determined by the qualities and capabilities of human nature, are 'matters of human institution solely', capable of perfection by legislative interference; and that by their taxative policies, governments can do much for the furtherance of the well being of their respective communities. Much therefore depends on the nature and constitution of the governmental organisation which legislates and controls the finances; and without a proper and powerful financial organ which is at once interested in the welfare of the people and capable of enforcing sound reform fearless of any sectional opposition among them, the problem of taxation is difficult of solution in any country.

The problem of taxation is as much a political and ethical as it is an economic problem, and cannot, as Dr. Pierson rightly points out be

regarded as 'exclusively economic'. As the same writer says, "The rules to be applied in procuring the means wherewith to defray the state expenditure cannot be based solely upon a consideration of the material welfare of the nation. In framing those rules regard must be had to the canons of justice, of morality, of public health; to the great importance of avoiding serious discontent, at home, and complications with foreign Powers. The theory of the state revenue extends beyond the domain of economics, so that it will be impossible in this section always to keep strictly within the limits of the latter. In most cases, however, it will be possible to do so, owing to the close connexion that exists between the material and the higher interests of mankind. Imposts that are unjust, and such as are objectionable for moral, political, or hygienic reasons cannot be defended on economic grounds."*

Thus the problem of taxation requires for its solution various considerations of justice, equity and good government, besides references to the productional and distributional principles of economics. The subject has therefore to be studied from a broader stand-point than purely as a branch of political economy.

* Dr. N. G. Pierson '*Principles of Economics*' Eng. Translation Vol. II pp. 346-7.

CHAPTER II.

JUSTIFICATION OF TAXATION.

Before considering the principles that should guide the imposition and distribution of taxation, we have to understand the grounds of justification for its imposition. It is an ancient and long obtaining popular view that taxation is the price paid by individuals for the benefits which they derive from the state, that is to say, for the benefits which the services of the state bring to the collective and individual living of the members of the community. It is said that national defence, the maintenance of law and order, and the promotion of the general well-being are all advantages derived from the work of government, for whose maintenance and services taxes are necessary to be levied from the members of the community.

The view of taxation thus expressed, may be termed the benefit theory of its existence. In one sense the theory is substantially true. If we take the state as a beneficial institution, having for its end and aim the furtherance of the individual and collective welfare of its members, then viewed from

the general stand-point of the whole community it can be truly said that there is a return of benefit for taxes paid, and nobody can seriously dispute this proposition. Some of the older definitions of taxation express this conferring of benefit on individuals by the state as being the motive for taxation. Thus Hobbes in a passage in his *Leviathan* expounds the theory of taxation: "The impositions that are laid on the people by the sovereign power are nothing else but the wages, due to them that hold the public sword, to defend private men in the exercise of their several trades and callings. Seeing then that the benefit that every one receiveth thereby is the enjoyment of life, which is equally dear to poor and rich, the debt which a poor man oweth them that defend his life, is the same which a rich man oweth for the defence of his; saving that the rich who have the service of the poor, may be debtors not only for their own persons, but for many more." In his *De Corpore Politico* also he expresses the same view, and says that taxation should be proportionable to the benefit which a person receives from the commonwealth; and according to him it is taxation of this kind that will be according to the law of nature, for he says, "the burden of the commonwealth being the price that we pay for the benefit thereof, they ought to be measured thereby."

Von Justi again, in his "*Staatswirts chaft*" reasons as follows :—"It is equally a fundamental principle that taxes and imposts (*Steuern und Abgaben*) should be levied on all subjects in just (*gerechter*) equality for here the obligations of all the subjects are proportionate and all have an equal share in the protection of the State and other benefits arising from the unity of a Common body. If however, the just equality is to be observed, then the proportionate amount of property must chiefly be taken as a basis because the protection of the State expresses itself chiefly in respect of property, and because those who possess much property undoubtedly enjoy more protection than those who have little or none. Thus a larger view must be taken of subjects that are poor or that have little property in arranging imposts (*Abgaben*), for generally speaking we cannot say that they gain anything. For whether indeed they earn their most pressing necessities and sustenance, yet it cannot be maintained that they gain anything, if they can spare nothing."*

Among other writers Cossa would define a tax as 'that part of the wealth of private individuals which the authority of the State, province, or municipality appropriates in order to provide for

* Von Justi's '*Staatswirts chaft*' quoted in Jones' '*The Nature and First Principle of Taxation* page 75.

the public expenses incurred for the advantage of the general body of tax payers'. In Montesqueu's opinion 'the revenues of the State are the portion of his property that each citizen gives in order to have security for the remainder, or to enjoy it in comfort.' In the view of the famous National Assembly of France, taxation is the 'common debt of all citizens, and the price of the advantages that society affords them.' Similar is Proudhon's assertion that 'Taxation is an exchange in which the State gives services and the contributor, money'. And Mirabeau would have it, that 'Taxation is only an advance to obtain protection for social order!' * Even Adam Smith in the first of his famous maxims of taxation, specifically mentions this beneficial aspect of the state as being the motive or reason for the contribution of taxation by the subjects of the state. He says, 'The subjects of every State ought to contribute towards the support of the government, as nearly as possible in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the State. The expense of government to the individuals of a great nation is like the expense of management to the joint tenants of a great estate,

* All these quotations are taken from Bastable's '*Public Finance*,' 3rd edition Bk. III. Chap. 1. Section 4.

who are all obliged to contribute in proportion to their respective interests in the estate.* Thus in all these views of taxation, we see that the benefit accruing to the community in whatever form from the state's services, has been considered as the real purpose of all imposts of taxation.

The existence of the state being itself a matter of utility from the social point of view, taxation which is only required for the maintenance of the state and the carrying out of its governmental functions, cannot be regarded as having any other purpose than the end and aim of the state itself. The justification of taxation therefore as representing the price paid for the services of the state in return for the benefits received by the community is substantially correct. Unless this view is accepted, it is difficult to understand both the object for which the state itself exists and the purpose for which it levies its taxes.

But this way of explaining taxation requires one qualification. Though the purpose for which taxes are levied is the conferring of "good" on the community, taxation does not represent the exact value of the 'good' conferred, nor is it the price for what is conferred. As we saw before, the state has other sources of revenue besides

* Adam Smith '*Wealth of Nations*' Bk. V. Chap. VIII. Part. II.

taxation, and it is quite possible that a development of such other sources may enable the state to dispense with taxation altogether and still be of full benefit to the community. Only when other sources of revenue are insufficient, to the extent of that insufficiency and no more, ought taxation to be resorted to by the state. It is not therefore correct to say that taxation is exactly the price of benefit received from the state. But one thing is clear, that whatever taxation is levied, the purpose for which it is taken is and ought to be the conferring of benefit on the community, and to this extent the proposition is incontrovertible.

There is however a special application of the benefit theory of taxation which is obviously incorrect. It is said that the amount of tax which any individual will have to pay, should be so adjusted as to be in proportion to the quantity of benefit which he actually receives from the state. According to this theory the state is conceived to be something like a large joint stock company, in which the individual citizens are shareholders; and each citizen is imagined to derive from the activities of this corporate institution a definite amount of profits in accordance with his investments in the enterprise of running the institution. Since the operations of government are not designed to yield a dividend in terms of actual money, the

profits are conceived of primarily as being something in the nature of an intangible but none the less appreciable and fairly calculable dividend; and as the most obvious functions of government consist in the protection of person and property, it is conceived that the quantum of benefit that each individual receives stands in a certain proportion to his wealth or income; and that taxes must therefore be deemed to represent nothing but periodical payments made by the individual in order to guarantee the continuance of his profits in the huge joint stock enterprise in which he partakes.* The proposition thus stated enunciates a distributional principle of taxation which is untenable for the following reasons:—

In the first place, it ignores the fact that we just now noticed, namely that the quantity of benefit conferred by the state may have no relation whatever with the amount of tax paid, for the simple reason that the state has other sources of revenue which it equally utilises on behalf of the good of the community, and taxation is only the last resort where every other source of revenue fails, or is exhausted and proves insufficient. If the full expenditure of the state is met by taxation alone, perhaps the 'benefit conferred' as a principle of distribution may have some force. But taxation

* Seligman *'Essays in Taxation'* Chap. X. page 336.

contributes only a portion of the state's revenues, and as we have already seen it is very possible for the state under a wise administration to meet the whole of its outlay from the non-tax revenue, and dispense with taxation altogether. In such a case there will be no taxation and still people will be receiving the benefits of the existence and activities of the state under which they live. It will be therefore incorrect to say that the quantity of benefit conferred should form the basis for the distribution of the tax-burden. In the second place, even assuming that taxation is the only source of revenue available for the state, the benefit conferred by it is so large and general that any method of measuring or calculating it for the individual for the purpose of apportioning taxation in proportion to the benefit will be neither possible nor accurate. The benefit derived from the state is literally speaking, an incalculable and immeasurable good, having no dependance whatever on the amount of the tax paid. Nor is the benefit received conditional on the payment of tax or a result of paying it. Except in the cases of special assessments and fees where the amount of the levy is more or less in proportion to the quantity of special benefit received, there is no ascertainable relation between taxes paid and benefits conferred. It is thus clear that any attempt to distribute taxation in proportion to benefit is

unrealisable in practice. Thirdly and more importantly the acceptance of the benefit theory as a basis for the distribution of taxation offends against the ultimate end and aim of the state itself. Taking the promotion of the aggregate happiness of the community as the goal of all state existence and activity, any attempt to apportion the burden of taxation according to the benefit theory must inevitably stand in the way of the state realising its ultimate object. If, for example, we take into consideration the most important of its functions, namely national defence and the maintenance of law and order, the benefits which they confer, may for the sake of simplicity be taken to be the same for rich and poor alike; in which case it will logically follow that the poorer should contribute as much as the richer man for the support of such work of government. But the happiness or satisfaction derivable from any given sum of money being greater for the poorer than for the richer man, any attempt to tax the poorer man, and every attempt to tax him equally with the richer man so as to make him pay the same sum as the other, will hinder the realisation of 'maximum aggregate happiness or satisfaction' which the state has to strive for. On this point more will be said later on. What we have to note here is that 'benefit' cannot form the basis for any theory of distribution

of taxation. But at the same time it is undeniable that the state is a beneficial institution, and that every tax that is paid goes towards the support of the state's activity. It will not therefore be incorrect to say that taxation is a contribution made for the services of the public powers and that the purpose of its imposition is nothing but the conferring of 'benefit' on the community. At any rate this is the view of the present writer.

There is, however, another view with regard to the theory of the justification of taxation which is held by some eminent writers on finance and politics, and which may even be said to govern the taxative policies of some of the modern states. According to this view, the state is considered an integral part of ourselves, to which all of us as members are bound to contribute. It is as much a necessary of our existence as other indispensable necessities. It is our duty to support the body politic as well as our own individual bodies. Our sense of civic duty and patriotism dictates to us as right-minded citizens that we ought to contribute towards the state, if necessary, even to the injury of our health, and at the risk of our lives. No question of any return of benefit arises in connection with our payment of taxes. In the words of Professor Seligman "the state is as necessary to the individual as the air he breathes; unless he

reverts to stateless savagery and anarchy, he cannot live beyond its confines. His very action is conditioned by the fact of its existence. He does not choose the state, but is born into it; it is interwoven with the very fibres of his being; nay, in the last resort he gives to it his very life. To say that he supports the state only because it benefits him, is a narrow and selfish doctrine. We pay taxes not because we get benefits from the state, but because it is as much our duty to support the state as to support ourselves or our family; because, in short the state is an integral part of us.”*

This view which is founded on the organic theory of the state. is eloquently expressed in the following passage taken from a German writer of eminence:†—“The work done by the state is not of a kind to be measured by economic standards. The ideal blessings brought by law and order, the tokens of the visible power of the State cannot be valued by their money’s worth. It is impossible to compute in these terms the benefit which it is to be a Prussian, and to live under the protection of a Prussian State. The favourite saying that the state creates unembodied wealth makes no difference to this truth, for it is only degrading to spiritual and intellectual labour to describe its

* Seligman, *Essays on Taxation*, page 73.

† *Politics* by Heinrich Von Treitschke Eng. Trans. Vol. II, pp. 495-7

result in these words. It would be admitted that Goethe's *Tasso* cannot fairly be so described. Where do we find the unembodied wealth which an unfortunate but an inevitable war brings to the state? What were the abstract value gained by France in 1870 and 1871? No more than a certain amount of self-knowledge at the most. Therefore it is quite wrong to apply the same standards to the state, as we apply to private property. The individual tax-payer thinking only of himself and his private budget is justified in reckoning the taxes he pays among his costs of production, and in opining that the fewer taxes there are, the better; but the politician who surveys the state as a whole can by no means share this view; for him the question is not how much does the state do for each of its citizens, and how much has each one of them to pay back in proportion, because this would lead to the conclusion that the pauper in the workhouse should contribute the most because he owes the whole of his physical existence to the state. The person of private means on the other hand who only cuts the coupon off his foreign bonds receives very little from the state, and would consequently be expected to pay very little.

“This way of reckoning is absolutely false. It is wrong to start with the idea that the citizen should repay the state through the taxes for benefits

he has received. The proper way of looking at it rather is that it is the duty of all citizens to contribute according to their means towards the collective costs of administration. Because the state is the people legally united, it becomes both its right and its duty to draw upon the resources of its members for its own maintenance. In the last resort the wealth of the nation is identical with the wealth of the state, and when two states are engaged in a life and death struggle, the national assets decide practically which of the two can hold out the longest."

The argument thus strongly advanced against any attempt towards the taxation of individuals according to benefit received from the state, does not however disturb the finding that every citizen receives from the state a real benefit for the tax he pays. Such a benefit may be 'above all price'; it may or may not be capable of a money measure, but still the benefit is there. It may be that the state is the people legally united, and that it is its right and its duty to draw on the resources of its members for its own maintenance even to the extent of making use of the whole wealth of the nation. But the State is nothing if it is not a benefit to the community which is the nation. If it can take away the entire wealth of its citizens it is

because such a course is necessary for the preservation of the nation itself. Benefit to the community is the only justification for the existence of the state and but for this, it had better die.

This method of interpreting the purpose of taxation should not however be taken to lend any support to the benefit theory of taxation as a principle of distribution. For the individual taxpayer, taxation is certainly not a *quid pro quo* though from the point of view of the whole community it will not be incorrect to so regard it.

Apart from its affording a justification for the imposition of taxation, an emphasis on the beneficial aspect of the State, as being the purpose of all taxation, will be useful in considering new tax proposals. When it comes to a question of raising additional revenue by means of a further levy, the matter that ought to require consideration shall be to know the object for which the additional levy has to be imposed. If it is not to be for the good or benefit of the community then such taxation is extremely objectionable, and ought to be avoided. If it is only to make up a general deficit, then the proper course is first to see whether or not it is possible to reduce a portion of the expenditure by effecting economy in any direction in which the beneficial aspect of governmental expenditure is

either absent or doubtful. Thus, though a consideration of the subject in this aspect belongs more to the study of the methods of expenditure than of raising revenue, it will be useful in all taxative proposals as a test that should be applied in judging the actual advantages that are expected to accrue from the utilisation of the revenues sought to be newly obtained. It will be no justification to say that the state has unrestricted right to draw on the resources of its citizens for satisfying its own financial requirements. Every imposition of taxation must point to some good to accrue to the community from the expenditure of the revenues to be obtained by it. Otherwise the state has no right to impose the tax.

All these remarks apply with special force to the case of British India. In a country governed by an alien power, the people cannot from any point of view, regard the government as part of themselves or as representing their interests. The absence of identity of interest between the rulers and the ruled gives special significance to the principle that the benefits to be derived from the state should be taken as the proper standard or criterion for the imposition of taxation as otherwise every attempt to impose a levy is liable to be condemned as oppressive and unreasonable. In a country with popular influence and control over its government, the state being a representative of

popular opinion, the interests of the state cannot go against the interests of the community; and there is little chance for the activities of the state being directed in any manner not conducive to the welfare of the people themselves. Where there is thus a general satisfaction with regard to the work of the state itself, the special considerations in respect of the imposition of taxation become of minor importance. For there is a confidence created in the people that whatever tax they pay will be utilised in a manner most conducive to their own good. But in the case of a dependency like British India, there is always the danger of the dominant ruling power unduly sacrificing the interests of the governed for benefiting the governors; and a consideration of taxative policies in their beneficial aspect has a real significance for such countries, while it is absent in self-governing communities.

If we take the actual condition of the public finances of British India, we see a good portion of the revenues of the Government being spent for purposes the benefit of which to the people is more than doubtful.* There is further a perpetual fear that the interests of the country will be sacrificed to the interests of the ruling race. In a dependency

* The disproportionately huge expenditure on the military in a case in point.

therefore which, we take it, is held in trust by the foreign power that rules over it for the time being, it is incumbent on the Government to be fully satisfied of the utility to the people accruing from any proposed taxation, before beginning to levy it; so that the imposition may not become unpopular and a breach of trust in the absence of a beneficial purpose.

CHAPTER III

DISTRIBUTIONAL PRINCIPLES OF TAXATION

Having thus discussed the purpose for which taxation is to be levied we shall now proceed to determine the distributional principles that should guide and govern any imposition of taxation on individuals. With the growth of ideas of justice in financial matters there has evolved in the history of public finance what is known as the principle of equity in the distribution of the State's burdens. Viewed from the point of view of the tax-payer, nothing is more essential for a good and just government than an honest endeavour to achieve an equitable apportionment of the burden or sacrifice that its taxation imposes on individuals. In these days of democracy and popular influence over government, the desire for the improvement of the general well-being of the members composing the community has given special prominence to the principle of equality in taxation as a mode of achieving that end ; and it may now be said to be

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the ruling distributional principle of taxation in most modern states. It cannot be denied that in reforming or regulating its taxation or introducing new taxes, exclusive adherence by a government to the aspect of productivity alone, that is to say, to the matter of the yield of revenue, may be capable of leading to much injustice and unfair treatment of individuals, not to speak of the disastrous economic consequences that might even follow from it in some cases, to the members of the community either collectively or individually. Though the prime object of a tax is the raising of revenue, no good finance minister can ignore its larger effects on the members of the community. It will be his solemn duty to choose such taxes as will satisfy all or most of the accepted canons of taxation, instead of resorting to expedients, solely guided by the principle of productivity. The only thing that is essential for the successful working of any human institution is the support or at least the absence of opposition on the side of popular opinion. As Professor Bastable points out * 'the prevalence of even an unfounded belief that the public burdens are not fairly divided among the different classes and individual members of a society, is a seriously disturbing force. Finance touches on the domain of politics, and no method

* Bastable *Public Finance*, 3rd Edition Ek. III Chapter III S. 1 page 297

of fiscal administration, however successful in other respects, can be worthy of approval, unless it seeks, so far as existing conditions allow to realise the idea of an equitable distribution of the public charges. The establishment of general principles on this point for the guidance of financial policy, and their recognition by the people in general are so eminently desirable, that the investigation of the grounds on which taxation should be distributed. is a work of utility in the narrowest practical sense.' Thus from the point of view of practical politics also it is eminently desirable that the important principle of 'justice' besides mere fiscal expediency should guide taxative policies. Every tax and every system of taxes should be just, and not only just, but must be recognised as such, by the generality of those who submit to the same.

While thus the principle of what may be termed 'justice' or 'equity' has come to be recognised as the accepted, and is in fact the prevailing principle of distribution of the tax-burdens, there is being pushed to the fore-front of our studies a new and more comprehensive principle of distribution which is sure to become the sole determining factor of taxative policies with the growth and prevalence of ideas of socialism, and a better understanding of the conditions of social

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well-being. This principle concerns and is largely based upon the objects for which the state itself exists. It will be admitted by all people that the ultimate end and aim of every state is 'good government.' If we mean by 'good government' the promotion of the happiness or well-being, both collective and individual, of the members composing the community, we get a basis from which to deduce the principles that should govern taxative policies. Every tax and every system of taxes should be so contrived as to be least detrimental, and wherever possible most conducive to the achievement of this fundamental aim of the state.

It must however be remembered that taxation is necessarily a deduction from the material resources of the individual members, and as such operates as a curtailing factor of individual happiness or well-being. At any rate this is its direct and obvious result, immediately flowing from its operation. We have therefore to see how taxation can be imposed with the least detriment to the welfare or happiness of the members within the state.

In this connection there is another point also to be noted. Taxation by itself is only a means to an end, and not an end in itself. Apart from its purpose of meeting the expenditure of the state,

taxation has no other aim. It logically follows and is clear therefore that the object for which the state itself exists must form the basis for any valid theory of taxation. For if any tax were to be imposed in any manner detrimental to the purpose of the state's existence, the state will be defeating its own end. At the same time, any tax that furthers its purpose, even though it may do so only indirectly by its effect, will have a double advantage, in that, while serving as a means of supplying the wants of the state, it helps also to the achievement and realization of its ultimate aim. We have thus to determine a proper system of taxation in the light of 'Good Government' as the end and aim of all state activity.

We shall first consider the subject from the point of view of 'justice.' Viewed from this standpoint, it is widely recognised that taxation should be equal, that is to say, the burden that is imposed by taxation should be evenly distributed among the members of the community. The problem therefore reduces itself to the question how to achieve 'equality of taxation.'

The term 'equality' however is capable of different interpretations and requires explanation with reference to our present discussion. We may not mean by 'equality of taxation' a mere division of

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of the sum total of the taxes to be paid by the number of members within the state. For such an apportionment will be regarded by every one as extremely unfair and unequal, in view of the fact that the capacity of individuals to bear the tax-burden depends on the strength of the material resources which they possess and on their earning power. If each person is asked to pay the same amount of tax, irrespective of his ability to pay, there will be not only no equality of distribution, but obviously the greatest inequality. But nobody in modern times interprets the term in this sense. Equality of taxation is more generally taken to mean proportional equality of some kind. The view that each person must help the state in proportion to his ability to help himself, is the common form in which it is expressed. It is embodied in the first of Adam Smith's classical maxims that 'the subjects of every State ought to contribute to the support of the Government as nearly as possible in proportion to their respective abilities.' But this principle of pure proportional equality though simple and easy of application, is not however capable of bringing about a just distribution of the public burden.

With the growth of modern economic knowledge, and the application to the economic aspects

and conditions of human life, of what is known as the 'law of satiable wants or diminishing utility,' the principle of equality of taxation has been interpreted to signify quite a different meaning, in order to realise the ends of justice in the matter of the distribution of taxation. This calls for some explanation.

The law of satiable wants or diminishing utility which is based on our observation of a fundamental tendency of human nature, has been stated and explained by Dr. Marshall thus:—"The total utility of a thing to anyone (that is, the total benefit or other pleasure it yields him), increases with every increase in his stock of it, but not as fast as his stock increases. If his stock of it increases at a uniform rate, the benefit derived from it increases at a diminishing rate. In other words the additional benefit which a person derives from a given increase of his stock of a thing, diminishes with every increase in the stock that he already has.

That part of the thing which he is only just induced to purchase may be called his *marginal purchase*, because he is on the margin of doubt whether it is worth his while to increase the outlay required to obtain it. And the utility of his marginal purchase may be called the marginal utility of the thing to him. Or, if instead of buying it, he

makes the thing himself, then its marginal utility is the utility of that part which he thinks it only just worth his while to make. And thus the law just given may be worded :—

The marginal utility of a thing to any one diminishes with every increase in the amount of it he already has.”*

There are two points here to note. First the greater the quantity of a thing which a person has, the larger is its total utility to him. This is clear and easily perceivable. Secondly, every increase in the quantity of the thing which he has adds a less than proportionate amount of utility to him, when compared to the utility of the last previous addition of quantity. That is to say, the utility of every additional quantity of a thing to any one is smaller than the utility of any portion of the previous stock. To express the same in another way, the greater the abundance of a thing with any person, the less is the utility of any portion of it to him, and the less intense is his desire for further increments of the thing.

Now an application of this doctrine of diminishing utility to the possession of material resources or wealth or its general representative ‘money,’

* Marshall ‘*Principles of Economics*’ Sixth Edition Bk. 3 Ch. III. S. 1, page. 93.

establishes two propositions (1) that the richer a man becomes the less is the value or utility to him of every rupee-value of those things which he has; and (2) that of two men, one richer and the other poorer, the richer man attaches less value to a rupee and derives less pleasure or satisfaction from the possession of the same than the poorer man does.

The reason for this tendency of human nature is well explained by Dr. Marshall himself in a passage which may be quoted. "Next we must take account of the fact that a stronger incentive will be required to induce a person to pay a given price for anything if he is poor than if he is rich. A shilling is the measure of less pleasure or satisfaction of any kind, to a rich man than to a poor one. A rich man in doubt whether to spend a shilling on a single cigar, is weighing against one another smaller pleasures than a poor man, who is doubtful whether to spend a shilling on a supply of tobacco that will last him for a month. The clerk with £ 100 a year, will walk to business in a much heavier rain than the clerk with £ 300 a year; for a three-penny omnibus fare measures a greater benefit to the poorer man than to the richer. If the poorer man spends the money, he will suffer more from the want of it afterwards than the richer would

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The benefit that is measured in the poorer man's mind by three-pence is greater than that measured by it in the richer man's mind."* Again "the richer a man becomes the less is the marginal utility of money to him; every increase in his resources increases the price which he is willing to pay for any given benefit. And in the same way every diminution of his resources increases the marginal utility of money to him and diminishes the price that he is willing to pay for any given benefit."†

Thus the amount of pleasure or satisfaction represented by the same sum of money will differ to different persons, and under different circumstances. Though even to the same person a rupee may measure a greater pleasure or satisfaction at one time than at another, owing to variations in his sensibility or habit or other circumstance, and though in considering particular cases it may not be safe to say that any two persons with equal incomes derive equal benefit from its use or possession or feel for the loss of a given sum of money to an equal extent, yet when we take into account large numbers of people, these personal peculiarities and differences that characterise individuals can be ignored as counter-balancing with one another;

* Marshall *'Principles of Economics'* Book I. Ch. II S. 1 page 19.

† Marshall *'Principles of Economics'* Book III. Ch. III. S. 3. page 96.

and we may presume for our general studies—and our presumption will not be far from the truth, that people with equal amounts of money derive the same pleasure or benefit, or feel for its loss to the same degree, and that the same person will attach more or less value or importance to a given sum of money, according as money with him is dear or plentiful. That is to say, a rupee is the measure of less pleasure or satisfaction to a person if he is rich than if he is poor, and to a rich man than to a poor person. That is to say, the richer a man becomes the less is the value which he attaches to every rupee in his possession and vice versa. The law of diminishing utility with reference to wealth in general (including all its kinds) may now be briefly stated thus :—The utility to any one of every rupee value that he has, diminishes with every increase in his stock of wealth, and increases with every diminution in such stock.

Now human nature being normally the same, or at any rate more or less the same, when we take the averages of large numbers of people, the same law applies to our consideration also of groups of persons, whether under the same or different circumstances. The chief motives to all human action in the ordinary business of life being supplied by definite amounts of money, we may

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fairly presume that human beings in general are affected more or less in the same way as one another with regard to any material circumstance affecting their daily life. In considering social problems with reference to large numbers of people, it will be ordinarily correct to say that persons with equal incomes will derive equal pleasure from its use or suffer equal pain from its loss and the strength of the incentive supplied by any sum of money will move them to action more or less the same way. In explanation hereof, we cannot help quoting Dr, Marshall again who says:—"If we take averages sufficiently broad to cause the personal peculiarities of individuals to counter balance one another, the money which people of equal incomes will give to obtain a benefit or avoid an injury is a good measure of the benefit or injury. If there are a thousand persons living in Sheffield, and another thousand in Leeds, each with about a £ 100 a year and a tax of £ 1 is levied on all of them, we may be sure that the loss of pleasure or other injury which the tax will cause in Sheffield is of about equal importance with that which it will cause in Leeds, and anything that increased all the incomes by £ 1 would give command over equivalent pleasures and other benefits in the two towns, This probability becomes greater still if all of them

are adult males engaged in the same trade ; and therefore presumably somewhat similar in sensibility and temperament, in taste and education. Nor is the probability much diminished, if we take the family as our unit, and compare the loss of pleasure that results from diminishing by £ 1 the income of each of a thousand families with incomes of £ 100 a year in the two places.*

Again "if we know for instance that a bank failure has taken £ 200,000 from the people of Leeds, and £ 100,000 from those of Sheffield we may fairly assume that the suffering caused in Leeds has been about twice as great as in Sheffield; unless indeed we have some special reason for believing that the shareholders of the bank in the one town were a richer class than those in the other ; or that the loss of employment caused by it , pressed in uneven proportions on the working classes in the two towns, By far the greater number of the events with which economics deals affect in about equal proportions all the different classes of society ; so that if the money measures of the happiness caused by two events are equal, it is reasonable and in accordance with common usage to regard the amounts of the happiness in the two cases as equivalent. And further as money

* Marshall '*Principles of Economics*' Book I. Ch. II. S. 2, page 18-19

is likely to be turned to the higher uses of life in about equal proportions, by any two large groups of people taken without special bias, from any two parts of the Western world, there is even some *prima facie* probability that equal additions to their material resources will make about equal additions to the fulness of life, and the true progress of the human race.”*

We see from the foregoing explanation of the law of diminishing utility in its application to the possession of wealth by individuals that men with equal incomes may be said to derive equal pleasure or benefit from its possession or use. It necessarily follows from this also, as we have already observed, that the happiness which a poor person derives from a given sum of money is greater than that derived by a rich person. For the rich person is not so much in need of the money as the poor one, and if he spends it out, he will not suffer so much from the want of it afterwards as the other.

We shall now apply these considerations to the problem of the distribution of taxation. Looked at from the stand-point of the law of diminishing utility, it will be seen that a deduction by way of taxation, of a rupee from an income of Rs. 100/- will inflict a greater pain on the individual con-

* Marshall '*Principles of Economics*' Book I. Ch. II. S. 2. page 19-20.

cerned than a deduction of two rupees from an income of Rs. 200/- For a rupee to the first man measures a greater utility to him than Rs. 2/- to the second man. This follows from the application of the law of diminishing utility which has been explained at some length in the foregoing paragraphs. According to the law of diminishing utility, it will be remembered, the utility of every rupee unit of income diminishes with every increase in the amount of income. And if this be so, it mathematically follows that a levy of one rupee on the first man imposes a greater sacrifice on him than a levy of two rupees on the second. In which case, mere proportional equality in the amount of tax levied is not, in spite of its being a seemingly just distribution of the burden, equality in the real sense of the amount of enjoyment or benefit sacrificed. That is to say, there is no equality of the pressure of taxation, the pain of sacrifice caused to the first man being greater than that caused to the second.

We shall also explain the position by means of an arithmetical illustration. For our present purpose we shall not complicate the situation by attempting to qualify the law of diminishing utility, in relation to the minimum income required for subsistence; we shall have occasion later on to

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consider that subject in detail. It may now be assumed that the utility of income diminishes with every successive addition of Rs. 1,000 as follows :—

For the first	Rs. 1,000	the average utility	is	1,000	units
"	second Rs. 1,000	"	"	950	"
"	third Rs. 1,000	"	"	880	"
"	fourth Rs. 1,000	"	"	780	"

and so on.

Now according to the law of diminishing utility, this only means that the second thousand rupees gives only 950 units of benefit, the third 880 and the fourth 780. That is to say, if the same person has his income increased by thousands as above, the utility to him of each successive addition will be less than that of the previous addition. If instead of the same person having his income increased, four different persons have four different kinds of income Rs. 1,000, Rs. 2,000, Rs. 3,000 and Rs. 4,000, then the utility of his total income to each will be only 1,000 units in the first case, 1,000 plus 950 or 1,950 units in the second, 1,000 plus 950 plus 880 or 2,830 units in the third and 1,000 plus 950 plus 880 plus 780 or 3,610 units in the fourth. Now supposing that a proportional tax of 5% is levied on these incomes, the first will pay Rs. 50, the second Rs. 100, the third Rs. 150 and

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the fourth Rs. 200. But if we calculate these payments on the basis of the units of enjoyment sacrificed by each, we get the following results:--

The first man pays 50 units.

The second pays $\frac{100 \times 1950}{2000}$ or $97\frac{1}{2}$ „

The third pays $\frac{150 \times 2830}{3000}$ or $141\frac{1}{2}$ „

The fourth pays $\frac{200 \times 3610}{4000}$ or $180\frac{1}{2}$ „

It will be seen from this that the sacrifice or loss of enjoyment for the four persons, far from being equal, is greatly unequal, the burden of sacrifice on the part of the richer being lighter than that on the poorer. If equality of taxation has to be achieved, then if the first man pays Rs. 50,

the second will have to pay $\frac{100 \times 2000}{1950}$ or

Rs. 102-9-0; the third $\frac{150 \times 3000}{2830}$ or Rs. 155-7-7;

and the fourth $\frac{200 \times 4000}{3610}$ or Rs. 221-9-8.

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Thus it is clear that equality of taxation can really be achieved only when there is an equal distribution of the tax burden by each being made to bear equal sacrifice of enjoyment. This cannot however be effected by mere proportional taxation, which according to the law of diminishing utility fails to achieve that result. We are thus led to consider what is called the progressive taxation of incomes, under which the rates of tax levied are graduated on a rising scale according as incomes are rising high. This is essentially based on the principle of diminishing utility as applied to incomes of individuals. Of course, the rate of diminution of unit-utility, which follows the increments in quantity is indeed unknown, and what we have taken in the above illustration is quite arbitrary. But the fact that unit-utility diminishes with every increase in income is undeniable ; and whatever illustration we take on that basis, will lead to the same result, namely progressive taxation, increasing for higher incomes. Though the rates of progression must necessarily be unknown, the case for some kind of progressive and not mere proportional taxation is clear and indisputable.

This, from the point of view of 'justice and equity' as a principle of distribution. It will however be seen from our study of 'good govern-

ment' as affording a basis for purposes of taxation that the case for progression and that in a steep form gains greater strength on that basis.

We shall now pass on to consider the distribution of taxation from the standpoint of 'good government.' Good government, as we have already seen, means a government the object of which is the furtherance of the general happiness or well-being of the members of the community, or to use the familiar Benthamite expression, the promotion of the greatest happiness of the greatest number. Viewed in this aspect, taxation has to be distributed not merely on the basis of *justice* but in such a manner as to achieve the greatest happiness for the community.

Happiness is a wide term and may be taken as synonymous with well-being or good living, and includes within it all kinds of satisfaction which human beings are capable of; and every pleasurable sensation is happiness in this sense. But pleasures which are obviously base and ignoble and which, by the general consensus of opinion ought not to be indulged in by any person either for physical, mental moral or social reasons, are excluded from our consideration of happiness, true well-being or good living consisting in a prohibition of such indulgence.

Now human wants and desires being countless in number and very varied in kind, the happiness of human beings depends on the satisfaction of those wants and desires, which in its turn depends on a variety of circumstances such as the possession and use of material wealth, family affection, social intercourse, religion, service, freedom and imagination. But generally speaking, in ordinary life, nothing contributes so largely or regularly for the attainment of human happiness as the command over material wealth. For wealth or its representative 'money' being general purchasing power, it is sought as a 'means to all kinds of ends, high as well as low, spiritual as well as material'. The following passage taken from Dr. Marshall will show how important is wealth for human well-being or happiness and how much misery and degradation poverty causes. 'And very often the influence exerted on a person's character by the amount of his income is hardly less, if it is less, than that exerted by the way in which it is earned. It may make little difference to the fulness of life of a family whether its yearly income is £ 1,000 or £ 5,000; but it makes a very great difference whether the income is £ 30 or £ 150; for with £ 150 the family has, with £ 30 it has not, the material conditions of a complete life. It is true

that in religion, in the family affections and in friendship even the poor may find scope for many of those faculties which are the sources of the highest happiness. But the conditions which surround extreme poverty, especially in densely crowded places, tend to deaden the higher faculties. Those who have been called the Residuum of our large towns have little opportunity for friendship, they know nothing of the decencies and the quiet, and very little even of the unity of family life; and religion often fails to reach them. No doubt their physical, mental and moral ill-health is partly due to other causes than poverty, but this is the chief cause.

‘And in addition to the Residuum there are vast numbers of people both in town and country who are brought up with insufficient food, clothing and house-room, whose education is broken off early in order that they may go to work for wages, who therefore are engaged during long hours in exhausting toil with imperfectly nourished bodies and have therefore no chance of developing their higher mental faculties. Their life is not necessarily unhealthy or unhappy. Rejoicing in their affections towards God and man, and perhaps even possessing some natural refinement of feeling they may lead lives that are far less incomplete than those of many

who have more material wealth. But, for all that, their poverty is a great and almost unmixed evil to them. Even when they are well, their weariness often amounts to pain, while their pleasures are few; and when sickness comes the suffering caused by poverty increases tenfold. And though a contented spirit may go far towards reconciling them to these evils there are others to which it ought not to reconcile them. Over-worked and under-taught, weary and care-worn, without quiet and without leisure, they have no chance of making the best of their mental faculties.* Thus it is clear that the attainment and use of material wealth have an important bearing on the well-being and happiness of man.

Now from the point of view of 'good government,' if the state should further the happiness of its members, it can do so in various ways by developing their virtue and intelligence as well as by adding to their material resources. In whatever way it adds to their happiness, by such addition it will be realising the end and aim of its own existence. We have now to see whether and how far the state can realise its aim of promoting good government by means of its taxative policies.

* Marshall *'Principles of Economics'* Book I ch. I. S. 1. page 2-3.

But with regard to taxation the action of the state has to be viewed in two aspects. In its positive aspect the state can confer real happiness on its people by so framing its taxative policy as to afford the best opportunity for the development of the virtue and intelligence as well as the material conditions necessary for making their lives truly happy. It can in particular hinder by heavy import and excise taxation the baser forms of consumption, develop by customs duties the productive forces of the country and impose a levy on every luxury of life. In these and numerous other ways, the state can by positive methods of taxation improve the mental, moral and physical well-being of its people.

More important than this is the negative aspect of taxation. We have already seen that the effect of taxation is the compulsory taking away of so much wealth from individual enjoyment and use, for which there is no direct and specific return of benefit made to the individuals by the state. In connection with the state's taxative policies we have therefore to consider not so much the promotion of happiness (which is possible only under certain given circumstances) as the possibility of reducing the tax burden in such a manner as to inflict the least sacrifice on the members of the community. Taxation being essentially a sacrifice

from the point of view of the tax-payer, the state aiming at conferring good government on its people, ought to make that sacrifice a minimum.

This principle of least or minimum sacrifice, in its application to the distribution of taxation, is capable of two different interpretations. In the first place it may mean 'least individual sacrifice', that is to say, least sacrifice individually to each and every member composing the community. According to this view, the sacrifice inflicted on each citizen should be the minimum necessary for the state; no one should be made to bear a greater than the least sacrifice that is required of him. It is clear that this can be achieved only by making all the members bear equal sacrifice, in proportion to the strength of their resources. For otherwise some will be pressed more than others, and there will be no minimum sacrifice of enjoyment or benefit on the part of each. From this it follows that, under this interpretation of the principle of least or minimum sacrifice, each person should be made to contribute to the state a sum of money the loss of utility of which to him must bear the same ratio as the loss of utility to others caused by their like contribution. It was seen in a preceding paragraph that mere proportional equality of taxation will be really inequality, in as much as it would press more

heavily on the poorer than on the richer, and that therefore progressive rates of taxation with a graduated scale rising for higher incomes will be the only means of achieving equality of taxation. If that be so according to the reasoning in that paragraph the principle of least sacrifice, which means only 'equal sacrifice' must also point not to proportional but to progressive taxation. In the earlier paragraph we based progressive taxation on the theory of 'justice'; here we find it supported by the theory of 'minimum individual sacrifice'. Thus viewing either on the principle of justice and equity, or of minimum individual sacrifice (the negative aspect of maximum individual happiness) considered as part of good government, we get at the same result, namely the distribution of taxation on a progressive scale.

The other interpretation of 'minimum sacrifice' is based on the organic theory of the state and the social and collective rather than the individual importance of human life. According to his view, the state is an organic whole in which the nation is considered to be everything and the individual important only as a member of it; and consequently the state is not so much to care for maximum individual happiness, as for the total happiness of

the members of the community taken collectively.* Conversely minimum sacrifice is taken to be not 'minimum individual sacrifice' but minimum aggregate sacrifice, that is to say, minimum sacrifice from the point of view of the community taken as a whole. From this it may result that some members incur a greater sacrifice than others, and some others no sacrifice at all. What the State is concerned with is that the total sacrifice which it imposes on the community should be the minimum unavoidable. The promotion of maximum aggregate happiness and the infliction of minimum aggregate sacrifice are the essence of all good government. As we have already indicated, it may be that the state can also promote the happiness of its members in various ways other than by adding to their material resources. It may be that the happiness which is realised by individuals in those other respects may vary for them in different degrees and under varying conditions. And it may also possibly be that the influence on their material happiness, exerted by the increase or diminution in the material requisites of their

* "We are members one of another. No man liveth to himself alone. If any, even the humblest is made to suffer the whole community and every one of us, whether or not we recognise the fact, is thereby injured. Generation after generation this has been the corner-stone of the faith of Labour. It will be the guiding principle of any Labour Government" Labour and the New Social Order, under the sub-heading the Universal Enforcement of a National Minimum.

well being may not necessarily increase or diminish as the case may be, the sum total of the happiness of the individuals concerned. That is to say, it may be possible that the happiness of an individual derived from his use of material resources may not be great, but he may be deriving, at the same time, a large amount of happiness conducive to his well being from, say, his religious activities, or from friendship or from his family relations or by rendering social service. So that to judge of maximum happiness as determined merely by the material requisites of well being may not lead to correct results. There is some truth in this argument, but in as much as we do not take into consideration, the other circumstances and conditions of happiness in any individual case, we may take it that the happiness accruing from the other sources, is in all cases equal or at any rate not unequal so as to disturb the results of our present inquiry. Further as we saw before, well-being whether physical, mental, or moral, depends in this world chiefly on the acquisition and use of material resources, and the worst evils are the result of poverty. As Dr. Marshall rightly points out in passages already quoted, money or the command over material wealth is general purchasing power, and is 'sought as a means to all kinds of ends, high as well as low,

spiritual as well as material.' 'It is true that in religion, in the family affections and in friendship even the poor may find scope for many of those faculties which are the source of the highest happiness. But the conditions which surround extreme poverty.....tend to deaden the higher faculties. Those who have been called the Residuum of our large towns have little opportunity for friendship; they know nothing of the decencies and the quiet, and very little even of the unity of family life; and religion often fails to reach them. No doubt their physical, mental and moral ill health is partly due to other causes than poverty; but this is the chief cause.* Thus human happiness depending to a very large extent on the command over material wealth, it follows that even the other sources of happiness fail the poor, and that their happiness from these other sources also is consequently small. It is therefore evident that the assumption which we make in respect of happiness derivable from such other sources namely, that all will be equally happy in other respects—is itself too strong a presumption against the poorer classes, and will strengthen rather than weaken the results of our present enquiry.

Now judged on the application of the theory of diminishing utility, the doctrine of maximum

* See pages 85-86 supra.

aggregate happiness as the essence of good government will lead to this result; if the existing distribution of incomes can be so altered as to effect an equal distribution of them among all the members of the society, happiness can be *prima facie* increased to its maximum limit. This mathematically follows from the application of the law of diminishing utility. For it is clear that the richer from whom that portion of their riches in excess of the equality limit is confiscated, do not lose as much utility as what is derived by those who being poorer below that limit are enriched up to the equality limit, in the redistribution. That is to say, there is a net gain of utility, looked at from the standpoint of the whole community, if a portion of the properties of the richer is taken from them and given to the poorer.

This result which is a logical consequence of the doctrine of maximum aggregate happiness, based on the diminishing utility theory, is fervently advocated by extreme socialists as the indication of a better social order and the goal of human evolution. There are however very strong considerations, political and moral and economic, which far out-weigh the possible advantages that might be derived from this course; and these must be considered deeply before any attempt is made to

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translate this logical doctrine into a principle of practical policy. A confiscation of that portion of the incomes of individuals which is above a certain level, will have the effect of deadening the energies of mankind and arrest progress. A reflection on the history of economic progress up to the present time will show that "nearly all the innumerable inventions that have given us our command over nature has been made by independent workers." * The consciousness that whatever one earns and saves will be his own private property, and at his own complete disposal, has always stimulated human action and is responsible more than anything else for human progress in the past. An equal distribution of the earnings of individuals must inevitably check the whole-hearted devotion of individuals to the means and methods by which they could increase their earnings, and thereby their wealth. If it be known that a man's income or wealth above a certain limit, will be confiscated by the State or redistributed to others, he will have no incentive to devote any portion of his energies to the earning of any wealth beyond that limit. The result will be that human genius and ability will not have full scope to develop, and economic progress will be arrested, to the great detriment

* Marshall "*Principles of Economics*" Sixth Edition (Book VI. Chapter XIII S. 11. page 712.

and deterioration of mankind. As J. A. Hobson points out "In a state of society where endeavours are made to infringe this right (he refers to the right of every individual to the natural property of his own effort) the result is a restriction of productive energy given out and the consequent diminution of the functional activity of the producer, an impairment of vitality, and of incentive to development. Man desires not merely to live, but to live more abundantly, and for that end will undergo increased effort. But where more abundant life is not secured, nature withholds the effort; under such conditions torpor sets in, activity becomes inured to a low routine, and soon the very possibility of progress disappears by atrophy of the will and the intelligence."*, Thus the resources mental, moral, physical and material necessary for acquiring man's further command over nature, will be put to the risk of decay. Economic progress depends on the free development of human energies; and the steadiest motive for human action in the ordinary business of life being supplied by the desire for money, any limitation put on such desire must inevitably impede and discourage such action. Any redistribution therefore, of wealth or income so as to achieve an equal

* "The Social Problem" by J. A. Hobson. page 106.

distribution will have disastrous economic consequences of a very serious nature far out-weighting the temporary advantages that may result from any such equal distribution. We have therefore to reject the equal distribution of wealth as a criterion or condition of good government.

But it is undeniable from the social point of view that maximum aggregate happiness as the real aim of all good government ought to be striven after by every state, and every attempt that is made for reducing the inequalities of wealth, without at the same time discouraging individual effort to the fullest extent is a real gain to the community. Though it will be a great evil to attempt at levelling or limiting individual incomes or properties, there is absolutely no justification for the inequalities that exist under the existing order of society, and every means ought to be employed to reduce them as far as possible, caution being taken only against the adoption of any means which will have the effect of sapping the incentive to free individual effort. That the existing inequalities have no justification will be seen from a passage from Dr. Marshall, who though a cautious student of economics, is always alive to the progress of thought and never falters with truth. After surveying the economic and social perils of collectionism

and noticing that the existing inequalities of wealth are often exaggerated he goes on to say, "But this cautious attitude does not imply acquiescence in the present inequalities of wealth. The drift of economic science during many generations has been with increasing force towards the belief that there is no real necessity and therefore no moral justification for extreme poverty side by side with great wealth. The inequalities of wealth though less than they are often represented to be, are a flaw in our economic organisation. Any diminution of them which can be attained by means that would not sap the springs of free initiative and strength of character, and would not therefore check the growth of the national dividend would seem to be a clear social gain. Though arithmetic warns us that it is impossible to raise all earnings beyond the level already reached by specially well-to-do artisan families, it is certainly desirable that those who are below that level should be raised, even at the expense of lowering in some degree those who are above it."*

It will be seen from this that inequality of wealth is in itself an evil, and every cautious attempt to reduce it will be towards a net social gain. We have now to consider whether any principle of distribution of taxation can help to achieve

* Marshall "*Principles of Economics.*" Bk. VI. Ch. XIII. S. 12 pp. 713-4.

this object. It was noticed a little while before that the confiscation of a portion of the properties or incomes of the rich, and distribution of the same among the poor, though a logical conclusion from the theory of maximum aggregate happiness ought not to be put into practice, as it must inevitably lead to disastrous social and economic consequences. Similarly, the theory of minimum aggregate sacrifice which is but a negative application of the doctrine of maximum aggregate happiness, must, if it should form the basis of any distributional principle of taxation, also lead to the confiscation of a portion of the larger incomes. For a deduction of any portion from the smaller incomes must involve a greater sacrifice than a similar deduction from larger incomes, if the theory of diminishing utility should be believed. It follows therefore that the state will be inflicting less sacrifice on the community if it levies the full amount of the tax it requires exclusively from the larger incomes than if it should collect even the slightest amount from incomes which are not so large.

Strictly speaking the theory of minimum aggregate sacrifice points logically to the confiscation of all excess incomes above a certain amount and the exemption of all incomes falling below that amount. If the state has to raise say, a crore

of rupees out of the incomes of its members then according to this theory, what it has to do is to lop off the topmost crore of the richest incomes, and leave untouched all other incomes. If for example there are a hundred persons with incomes of a lakh of rupees each, a hundred and fifty with fifty thousand rupees each, five hundred with twenty thousand rupees each, and a thousand with ten thousand rupees each, and the incomes of all other members fall below ten thousand rupees, the state will be inflicting the least aggregate sacrifice on the community if, beginning with taking away the excess incomes of the richest above their next richest neighbours, it continues the process downwards until it obtains the amount it wants, namely the crore of rupees. Thus the excess fifty thousand rupees of each of the richest hundred persons will have to be first taken, and this will make up 50 lakhs; then twenty thousand rupees from each of these hundred as well as from each of the 150 others, all of whom will now be equally possessed of Rs. 50000 each, will be taken and this will make up another 50 lakhs, thus altogether making up the crore. The practical effect of this is that all the richer incomes are cut down to Rs. 30000, while individuals earning incomes below that amount pay nothing at all. If instead of one crore of rupees,

2 crores are wanted, the same process of paring away will continue until all the higher incomes are cut down to Rs. 10000 when the State will get the amount required. Thus the theory of minimum aggregate sacrifice translated into practice leads directly to the confiscation of the higher reaches of individual incomes.

We have already seen how serious the objections are to this kind of confiscation of properties or incomes, and how in the interests of good government itself, such confiscation has to be avoided. If it be known that all excess incomes earned above any particular limit will be taken away by the state, no one will be induced to devote his energy and enterprise in earning that excess income. The fact that there is no maximum limit fixed for the earning of incomes or accumulation of wealth by individuals, and the consciousness that the fruits of one's own effort will normally go to himself as having a right therefor, have been the main stimulus under the existing social order, to the unlimited devotion of private energetic enterprise to the production of utilities. So any attempt at the entire confiscation of the excess incomes of individuals earned above any particular limit, has to be given up as being extremely perilous to national prosperity and destructive of the dynamic life of the community.

We have now to see whether there are any means by which the distribution of taxation can be so effected that while not discouraging the free and full development of individual effort in the production of utilities, it will conduce as far as possible to the realisation of minimum aggregate sacrifice as a principle of practical policy. A little reflection will show that if instead of confiscating the whole of the surplus incomes exceeding any particular limit, the state should so arrange its method of taxation as to take something less than the whole of such incomes in order that it may leave to the individuals earning the same a portion at least of such incomes by way of reward or remuneration for their efforts, the consequences anticipated from an entire confiscation will not happen. For human nature being what it is, individuals will no longer find it to their self interest to withhold their energies from being devoted to the fullest extent and they will therefore continue to increase their earnings and make them as large as possible. What they want is that the fruits of their further efforts should not be taken away from them in entirety; they must be assured for themselves a share at least of such fruits. And if they are not to be so assured of a remuneration however little that may be for every

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additional dose of effort which they are to put forth, it will not be to their interest to make any such efforts, with the result that the further incomes will not be earned at all. Thus if it be known that all surplus incomes above Rs. 10000 or 20000 will be taken away by the state, no one will be induced to earn more than that sum. But if the state arranges to take, say, 75 percent only of all surplus incomes exceeding any limit and leave the remaining 25 per cent to their private earners, then individuals will still find it to their advantage to continue to earn to an unlimited extent, as every additional effort that they make will bring them some additional gain, and add to their total income.

Now it is clear from this that taxation should fall short of entire confiscation in all cases, though it may be the heaviest in the case of surplus incomes reaching above what would otherwise have been the confiscation limit. With regard to incomes falling below that limit it follows from the application of the law of diminishing utility viewed with reference to the doctrines of maximum aggregate happiness and minimum aggregate sacrifice, that no deduction of tax ought to be made from such incomes. For any attempt to do that will result in a greater diminution of aggregate satisfaction and cause greater sacrifice to the community than

every attempt to take away any portion or the whole of the surplus incomes above the confiscation level. But seeing that the whole of such incomes cannot be taken away but only a portion (though it may be the largest portion) the state will have to fall back upon a taxation of incomes below that level also. In such case the taxation of incomes below the level should be as light as possible when compared to the taxation above the level. In other words a steep form of progressive taxation is pointed out falling lightly on the lower reaches of incomes, thence rising rapidly for higher reaches and falling heaviest on the higher reaches.

Of course, as we already indicated, it is not possible for us to deduce the rates or scales of progression, as the law of diminishing utility is itself incapable of being calculated in terms of any definite arithmetical quantities. It cannot be determined what will be the rate of increase or decrease in utility for any given increase or decrease in our stock of wealth or other commodity. The principle of progression in rates of taxation, which is based on this theory is also equally incapable of any definite deduction. But the phenomenon or fact of diminution of utility is certain and noticeable, and can form a working principle in practice. As Professor Edgeworth points out, the premises

however inadequate to the deduction of a definite formula, may suffice for a certain negative conclusion. The ground which will not serve as the foundation of the elaborate edifice designed, may yet be solid enough to support a battering-ram capable of being directed against simpler edifices in the neighbourhood.....Now some presumption in favour of progressive taxation is afforded by the principle of equal sacrifice. "The function" according to which the satisfaction attending income—and the sacrifice attending taxation varies, is, indeed "necessarily unknown." But something about that function is known or at least strongly presumed, namely, that satisfaction as dependent on income increases at a rate which diminishes more rapidly than does the rate of increase pertaining to the simple function proposed by Bernoulli as apt to represent the relation of means to satisfaction"* Thus, though the function is "necessarily unknown" and the deduction must be 'in the air', we know something definitely about the nature of the function namely, that the satisfaction derived by a person from every increase of his wealth, increases at a rate which diminishes more rapidly than his wealth increases. This diminution

* See Prof. Edgeworth's Note "*Mathematical Formulae and the Royal Commission on Income-tax*" *Economic Journal* (1921).

is most rapid when we reach the higher incomes. If the policy of confiscating large fortunes exceeding any limit is not advisable on other considerations, at any rate the heaviest taxation of such incomes, compatible with the free play of individual initiative and enterprise and with economic progress, is defensible on the principle of minimum aggregate sacrifice (leading to maximum aggregate happiness) as a condition of good government.

The principle of a steep form of progressive taxation rapidly rising for higher incomes, becomes thus important. We saw in our discussion previously that equality of taxation based either on the principle of 'justice and equity' or of maximum individual happiness (and minimum individual sacrifice) pointed to progressive taxation, when examined in the light of the theory of diminishing utility. If that principle is supplanted or at least supplemented by that of maximum aggregate happiness (and minimum aggregate sacrifice) whatever presumption is afforded by the former becomes considerably strengthened, as the latter even points to the entire confiscation of incomes above a certain level. It is thus seen that whatever basis is taken, the case for progressive taxation and that in steep form is clearly made out as the ruling distributional principle of all taxative policies.

But even against a steep form of progressive taxation falling short of entire confiscation the objection is sometimes urged that because it has the consequence of falling heavily on the larger incomes it will tend to check the supply of industrial effort on the part of the richer people and by doing so discourage the accumulation of wealth and thus contract the supply of capital. For it is said that a heavy incometax implies a very worsened return obtainable from the exertion of a given unit of mental or physical ability, and that it is not easy for the motive of self-interest to reconcile itself with a partial remuneration for the effort supplied. The scope of this economic tendency of a heavy incometax falling on the incomes of the rich is examined by Prof. Pigou in the following passage which may be quoted : "The extent of the restriction on the supply of industrial effort is determined partly by the extent to which the tax drives able men abroad and partly by the extent to which it relaxes the efforts of other able men who are not driven abroad. These two routes may be examined in turn. The influence of imposts on the earnings of ability in driving able men abroad operates through their effect on the comparative income and general amenities obtainable at home and in foreign countries. There is however some danger of

misapprehension on this subject. It is not *necessary* that a tax diminishing the relative advantages of residence in England should drive any one abroad. For, when as between two places movement from one to the other involves cost or inconvenience the earnings of persons of the same ability may differ by any annual amount the capitalized value of which does not exceed the equivalent of this cost and inconvenience. There is in fact a *locus* or range of possible differences between earnings in the two places such that any difference within the *locus* might exist without the movement between the two places being induced. In these circumstances if the tax is imposed on earnings in one of the two places, it is not certain that movement will occur, unless the tax is larger than the difference between the maximum possible excess compatible with equilibrium of earnings in A over earnings in B and the maximum possible excess compatible with equilibrium of earnings in B over earnings in A. It is not *probable* that movement will occur unless the tax is such that its capitalized value is nearly equivalent to half the sum representing the cost and inconvenience of the act of movement. If therefore the cost and inconvenience of movement are large, a very large tax would be needed to drive people abroad. In my opinion a domicile in

their native land means so much to many rich men particularly since the advantage of wealth is largely social advantage that the cost and inconvenience of movement would be enormous. I do not think therefore that even in the least favourable case a reasonable tax upon earnings derived from ability would have any significant effect in driving ability abroad. There remains the tendency of taxation to check the output of ability on the part of the able men who are not driven abroad. Here again in my view the effect would be small. A moderate impost certainly could not affect the training of ability. And when an able man is actually engaged in industry his aim is so largely success—an aim in no ways interfered with by a tax absorbing part of his profits—that he is likely to work much the same whether a moderate tax does or does not prevail. Hence I do not think that the expectation of any reasonable scheme of taxation upon the expenditure of the rich would have any significant effect in checking the supply of industrial effort on the part of the rich.”* To this we have only to add that so far as the migration of capital and ability is concerned, if in every civilized country a progressive income tax should form part of its tax system such a

* Prof. Pigou “*Wealth and Welfare*” part III, Chap. X, S. VII pages 372-373

tendency cannot exist at all. With regard to the checking of the output of industrial ability in the taxing country itself, such an effect will not happen in as much as under the scheme of taxation we have suggested every additional dose of effort gets some remuneration. What is wanted for the free display of effort and enterprise is that there should be no limit placed to the acquisition of income or property, and every additional dose of effort should have some remuneration. This condition will be satisfied by the method of progressive taxation which we shall propose later on (see Chapter VII below) under which every higher rate of tax imposed will be made to fall not on the total taxable income of a person but only on the increments of his income. This is easily done as under the existing English Income-tax, by the adoption of a general rate of tax for all taxable incomes, supplemented by a super tax rising in rate for every higher reach of income.

Progressive taxation as a principle of policy has been gaining strength in modern times, due to other circumstances also. The growing spirit of democracy, and the increase of popular influence over government have inevitably led to governmental sympathies with the poorer classes and efforts to elevate their standard of life in all

possible ways. Governmental action for social welfare is daily gaining strength and people are beginning to outgrow the belief that poverty is necessary. The existence of enormous riches side by side with extreme poverty has come to be recognised as an evil to be cured by steady action on the part of the state, and in fact state socialism is one of the tenets of modern democracy. With regard to the possibilities of re-organising society, public opinion has been steadily advancing in the direction of socialism and collectivism. And in one direction in particular the growth of public opinion is unmistakable; that is, with regard to the heavier taxation of the richer classes. 'The shifting in the centre of political gravity that the growth of democracy has brought about, has' as Professor Bastable points out, 'as one of its consequences a tendency to alter the distribution of taxation in favour of the most powerful class (i. e.,) the numerical majority. This can only be accomplished by putting a heavier burden on the wealthy. Further the diffusion of socialistic ideas combined with the growth of popular government, has found in progressive taxation 'one of those agencies that seem likely to facilitate the transition from the capitalist to the socialist regions, and it consequently has the support of the various sections of

that party.' But there is no meaning in attributing to progressive taxation a merely party support when it is fully justifiable on such valid grounds as 'justice' and 'good government.' If the nationalistic characteristic of state existence is admitted, and if the ultimate end and aim of the state is taken to be the promotion of the greatest happiness of the greatest number, then progressive taxation is amply justified as a means of helping to some extent at least the solution of that paramount problem of the present age 'whether it is really impossible that all should start in the world with a fair chance of leading a cultured life, free from the pains of poverty and the stagnating influences of excessive mechanical toil.' In particular it may be directly helpful in turning a portion at least of the resources of the rich to high account in the service of the poor, especially in providing those conditions of their well-being which they cannot easily provide for themselves. Thus on its political and social side, progressive taxation has received its full justification as an engine of social improvement. And in fact it is earnestly advocated by the Labour Party in England to-day as one of the chief means of providing the funds necessary for improving the general condition of the community in all conceivable directions. "In their own words

“ One main Pillar of the House that the Labour Party intends to build is the future appropriation of the Surplus [of individual incomes above the Standard of Life] not to the enlargement of any individual fortune, but to the Common Good. It is from this constantly arising Surplus (to be secured on the one hand, by Nationalisation and Municipalisation and, on the other, by the steeply graduated Taxation of Private Income and Riches) that will have to be found the new capital which the community day by day needs for the perpetual improvement and increase of its various enterprises, for which we shall decline to be dependent on the usury-exacting financiers. It is from the same source that has to be defrayed the public provision for the Sick and Infirm of all kinds (including that for Maternity and Infancy) which is still so scandalously insufficient; for the aged and those prematurely incapacitated by accident or disease, now in many ways, so imperfectly cared for; for the education alike of children, of adolescents and of adults, in which the Labour Party demands a genuine equality of opportunity, overcoming all differences of material circumstances; and for the organisation of public improvements of all kinds, including the brightening of the lives of those now condemned to almost ceaseless toil, and

a great development of the means of recreation. From the same source must come the greatly increased public provision that the Labour Party will insist on being made for scientific investigation and original research, in every branch of knowledge, not to say also for the promotion of music, literature and fine art, which have been under Capitalism so greatly neglected, and upon which, so the Labour Party holds, any real development of civilization fundamentally depends. Society, like the individual does not live by bread alone, does not exist only for perpetual wealth production. It is in the proposal for this appropriation of every surplus for the Common Good—in the vision of its resolute use for the building up of the community as a whole instead of for the magnification of individual fortunes, that the Labour Party, as the Party of Producers by hand or by brain, most distinctively marks itself off from the older political parties.....”*

* Programme of the British Labour Party on Social Reconstruction after the War, under the sub-heading “The Surplus for the Common Good”.

CHAPTER IV.

EXEMPTION OF THE MINIMUM OF SUBSISTENCE.

So far we were concerned with the manner in which the imposition of taxation should be distributed among members with different amounts of income. We shall now pass on to consider another important problem with regard to the distribution of taxation, namely whether on the fundamental basis of taxation which we discussed, it is necessary that the tax-burden should be imposed on all the individuals in the state. Whether on the ground of 'justice' or of minimum individual sacrifice (and maximum individual happiness) either of them leading to the principle of 'equal sacrifice' the only proposition that is so far deducible is that the rate of taxation should increase with every increase of income. It does not lead to any inference as to the question whether all persons in the state should or should not be taxed; or rather it may be taken to point to the levying of taxation on all persons who are possessed of material resources.

If the law of diminishing utility is accepted as unqualified and of universal application, then its operation may be assumed in all cases from the smallest conceivable to the largest possible incomes. Then the theory of equal sacrifice must necessarily lead to the position that all persons with any amounts of income, should contribute to the state, though in the case of small incomes the amount of contribution may be very small and insignificant. But it must be noted the law of diminishing utility is not of universal application but importantly qualified with regard to the case of the necessities of existence, and of incomes required to provide such necessities. The utility of what is required for keeping life and efficiency is, it is rightly maintained, unlimited and immeasurable; and it is not possible to say whether the increments of utility attending increments of income up to the level that may be termed the subsistence minimum, that is, the amount that is absolutely required for providing the necessities of life and efficiency, are, or are not, at a diminishing rate. Every increment of income up to the minimum of subsistence, being as necessary for man's living as any previous increment, or at any rate, being of equally immeasurable value as any other, it cannot be said that utility diminishes with every addi-

tion of a further rupee that is added to a man's income up to the minimum required for his sustenance. Nor can it be said to obey any law of increasing utility, and increase with every increase of income up to that limit; for every part of a man's necessities is as important as any other part. There is thus a strong presumption that every increment of income up to the necessary limit obeys the law of constant return, bringing an immeasurable utility with itself. This being so, it is clear that all incomes which do not reach above the necessary level ought to be exempt from taxation; for otherwise any portion of what makes up the minimum necessary for subsistence having immeasurable utility and therefore involving immeasurable sacrifice to the individual concerned if it is deducted from his own enjoyment and use the sacrifice incurred by any such person—however small and insignificant it may be, will still be greater than the sacrifice incurred by one who is to pay his tax out of the surplus income he has over and above what is required for his necessities of life. It is therefore impossible to achieve equality of taxation if any one whose income does not reach above the minimum of subsistence is required to pay any tax at all, for even the smallest particle of the amount that he is made to pay will have

unlimited utility to him. We may therefore regard measureable sacrifice as commencing when a person has enough to support life and efficiency, and conclude that a man's taxable ability begins at that point.* Thus the principle of distribution of taxation, viewed in the light of the 'equal sacrifice' theory—whether based on 'justice' or 'minimum individual sacrifice'—points to the exemption of the minimum of subsistence from taxation.

The question viewed from the standpoint of minimum aggregate sacrifice (and maximum aggregate happiness) points to the same conclusion with greater emphasis. It was seen before that this principle logically led to the confiscation of incomes above a certain limit, all incomes below the limit being exempt from taxation. But we also saw that the disastrous economic, social and moral consequences that might arise therefrom forbade such a procedure, and on that ground found that a steep form of progressive taxation was the best

* This view is also supported by Dr. Marshall. In considering the notion of consumer's surplus and its measureability, he says "There is however a special difficulty in estimating the whole of the utility of commodities some supply of which is necessary for life. If any attempt is made to do it, the best plan is perhaps to take the necessary supply for granted, and estimate the total utility only of that part of the commodity which is in excess of this amount". See *Principles of Economics* Book III Chap. VI S. 4, page 133 Note 1. For the same reason the same author also says in another place that "we may regard the satisfaction which a person derives from his income, as commencing when he has enough to support life" *Ibid* Book III Chap. VI S. 6 and page 135.

under the existing social order, at any rate until human nature acquires a power of unselfish devotion to the public good. While being calculated to promote maximum aggregate happiness and inflict minimum aggregate sacrifice, it avoids the perilous effects of confiscation. By effecting only a partial appropriation, it still leaves to individuals the incentive to private action in which alone lies true economic progress. Now when this principle justifies the exemption of all incomes below a certain high limit, it *a fortiori* justifies the exemption of the minimum of subsistence, as otherwise the levy of taxation on incomes required for the sustenance of life will inflict an immeasurable sacrifice on the community, and thus offend most against the doctrine of minimum aggregate sacrifice. Thus the exemption of the minimum of subsistence from taxation is justified from this standpoint also.

There is however a special difficulty in determining and fixing the minimum required for subsistence. Subsistence minimum means what is necessary for the sustenance of life. But what is meant by the necessaries of life? Are we to mean that, if they are not to be had, death will result, or a loss of strength and vigour only? In ordinary life there are various grades of insufficiency of necessaries the direct effect of most

of which is only to lower efficiency and not to cause death. So we have to understand by the term 'subsistence minimum' what is required for the getting of all those things that are essential not only for the maintenance of life in the physical body but also sufficient health and strength, physical, mental and moral, which are the basis of human efficiency and without which life is not worth living. From this it follows that all resources that are necessary for maintaining life and efficiency should be exempt from taxation.

In determining however in actual practice what is required for maintaining life and efficiency, much difficulty will be experienced on account of the fact that besides circumstances differing according to climate, the seasons of the year and other natural conditions, even in the same country, the minimum limit may differ according to place, habits of life, occupation and social conditions and according as a person is a single individual or has a family to support. So the minimum or minimums of subsistence have to be fixed in each country with regard to its own special conditions of place, time and circumstances. In fixing the minimum, care should be taken for allowing a fair margin in favour of the exemption limit, in order not only to allow for the errors of calculation in determining the limit but

for affording sufficient scope to individuals to improve the conditions of their well-being, and also make sufficient provision for meeting their own future necessary wants.*

We may now pass on to consider certain political and moral objections that are advanced against this exemption of the minimum of subsistence from taxation. In the first place, it is said that the state is as much a necessary of life as food and clothing and indispensable for man's existence, at any rate under present conditions of social development; so that it is the duty of every citizen to contribute towards its maintenance. As expressed by Cohn, "The state belongs as much to the

* Even in the most progressive states, very little attention has been paid in their taxative policies to this last point, namely, the allowing of a sufficient margin for ensuring the future necessary wants of its members. Human beings cannot expect to work and earn all their lifetime or to be uniformly fortunate in the continuance of their earnings; and have therefore to make due provision not only for old age but for future contingencies of possible misfortune, which might at any time happen. It may be that in the case of a large number of families, by the time the parents get old, their children grow up and earn sufficient enough for the maintenance of their families including their aged parents. But no father and mother ought to be driven to the mere expectation of a future support from their children if, but for the intervention of the state, through taxation or otherwise, they could make a saving for their own future sustenance. Again, although there may be many a fortunate person who is for years together in good health and earning power and has no disappointments with regard to the certainty of his earnings or conditions of work, no prudent person can count on the certainty or steadiness of his future earnings. It is therefore necessary, that in the interests of the continuance of well-being of its members, the state should so estimate the minimum income to be exempted from its taxation as to allow a reasonable sum, say, not more than Rs. 250 per annum in India, to be contributed towards ensuring the future upkeep of healthful existence.

life of every civilised man as his daily food or the air; without the state a civilised existence is not thinkable. The minimum of every moral existence includes the blessings of the state. It follows that the minimum of outlay for existence must also include the necessary expense of the state.”* This argument is based on a misconception of the nature of the state’s existence. It is certainly not a necessary of life from the individual’s point of view; for so long as the state is composed of more than a single individual, it is absolutely not necessary to draw on the resources of the poorer among the community, except only where the state itself thinks it desirable that the poorer also should be made to contribute. Viewed from the point of view of the whole community there is no doubt that the needs of the state are part of the needs of the community, and can only be met out of the aggregate national income. It does not however follow from this that every member in the state should contribute a portion of his income towards its maintenance. The best answer to Cohn’s objection is contained in the following passage extracted from Mr. Cohen’s Stuart’s book on the *Progressive Taxation of Incomes*, by Dr. Pierson in his *Principles of Economics*, “I am quite willing to admit that a

* Cohn, in *Political Science Quarterly* iv 64-65, quoted by Professor Bastable in his *Public Finance* Book III. Chap. III. §. 11. page 319.

right-minded citizen, however scanty his means, ought to contribute towards the state, if necessary even to the injury of his health, and at the risk of his life. I admit too that the citizens of Leyden showed a proper sense of civil duty and patriotism, when on learning from the Burgomaster that the food supplies were exhausted, they made the famous reply that, rather than surrender, each would eat his left arm, so that he might fight on with his right! But I should like to see it adopted as a rule that nobody need start eating his left arm so long as any provisions remained in the fortress. By taking from a man a part of his possessions, the State may injure him in two very different ways; it may deprive him of some of his luxury, of his enjoyment in the widest sense; but it may also bring his life or his health into danger. Now the fundamental injustice does not consist in doing the latter, but in doing it to some while others are living in comfort. We do not wish to fix an absolute boundary which the State must never overstep; all we would claim is that if that boundary must really be overstepped, it should be overstepped in respect to everybody at the same time.”*

In the second place the exemption of the subsistence minimum is objected to as offending

* Cohen Stuart “*Progressive Inkomstenbelasting*” pages 43-44 quoted in Dr. Pierson’s *Principles of Economics* Vol. II. pages 469-70 (Eng. Trans.)

against the principle of natural justice that all citizens living in and deriving benefits from the state should equally bear the burden of its cost. A *per capita* levy, it is argued, is the justest of all, as imposing on each individual his proper share of the cost of maintaining the state. The state affords the benefits of protection and society to all its members, and there is no reason why some of those who receive the benefits should escape, while others are made to pay. There is seeming force in this argument. But if we look deeper into the matter, it is clear that those who have no properties or incomes or who cannot save and accumulate anything over and above what they require for their own sustenance, derive really no substantial benefit in supporting and defending the existence of the state; or rather, they are interested in pulling it down if possible. For they do not gain anything so specially by the existence of the state as propertied individuals do. Perhaps if there was no state the non-propertied could by their combined numerical strength, prevent the accumulation of large individual fortunes, and impede the growth of unlimited wealth side by side with poverty. It is the state that puts a restraint by its laws on the poorer interfering with the properties of the richer and encourages the growth of individual riches limitlessly. But for the state's hindrance, the

poorer would not keep quiet and be satisfied with their lot as they do at present. In short, the state exists for the rich and it is they who are interested in maintaining it. It is a grave problem for the future whether, even in spite of the state's existence, intelligent, or what is more dangerous, rude and exasperated combination on the part of the poorer classes, will not give a death blow to the unrestricted growth of accumulated individual wealth. The solution of the danger undoubtedly lies in the richer classes understanding the causes of poverty and attempting to cure them as best as possible, without detriment to general progress. The danger may be considerably mitigated by a wider understanding on their part of the social possibilities of economic chivalry. 'A devotion to public well-being on the part of the rich may do much, as enlightenment spreads, to help the tax-gatherer in turning the resources of the rich to high account in the service of the poor, and may remove the worst evils of poverty from the land.' When the duty of the richer classes even from their own selfish point of view, is thus imperative towards their poorer brethren, it cannot be seriously maintained that the minimum of subsistence should not be exempted from taxation, that those who are already poor should grow poorer still and their pangs of poverty aggravated.

The moral objection to the exemption is mainly based on the possibility of disappearance in the minds of the poorer classes of a sense of self-reliance and civic duty, and a dullening of the feeling of degradation attached to poverty, with a resulting want of spiritedness and desire to go out of it. This objection has absolutely no force for the very reason that the object of the exemption is itself to elevate the poorer classes by affording facilities for their health and strength and therefore earning power, and encouraging their saving and accumulation of wealth. It is therefore difficult to conceive how such an exemption will tell on their character or deaden their faculties to any extent.

So far our arguments were concerned with justifying the exemption of the minimum of subsistence from taxation. We wanted the state in the interests of the well-being of its members, not to interfere with their resources, to the extent to which they would be necessary for maintaining life and efficiency. All this however is only a negative duty imposed on the state for the furtherance of 'good government'. But there is a positive programme, for the promotion of national welfare now being earnestly pushed forward to the forefront of economic studies, and actually come to be discussed in some National Legislatures as a principle of practical policy, viz., the universal enforcement

of a national minimum standard of life for all people in the state. According to this, a minimum standard of real income should be assured to all individuals within the state, so that no one should suffer from want of those minimum conditions necessary for the maintenance of a 'healthy life and worthy citizenship', namely some defined quality and quantity of food, clothing, house accomodation, medical care, education, leisure, the apparatus of sanitary convenience, safety etc. Under this programme it is considered the duty of the state to see, and the right of every citizen born in it to insist that the prescribed minimum of these objective conditions of well-being is secured to him. In its programme of Social Reconstruction that the British Labour Party has formulated, this has been adopted as the first and foremost principle of a truly national and democratic government. In their own words, "The first principle of the Labour party—in significant contrast with those of the Capitalist system, whether expressed by the Liberal or by the Conservative Party—is the securing to every member of the community in good times and bad alike (and not only to the strong and able, the well-born or the fortunate), of all the requisites of healthy life and worthy citizenship. This is in no sense a "class" proposal. Such an amount of

social protection of the individual however poor and lowly, from birth to death, is, as the economist now knows, as indispensable to fruitful co-operation as it is to successful combination; and it affords the only complete safeguard against that insidious Degradation of the Standard of Life, which is the worst economic and social calamity to which any community can be subjected. We are members one of another. No man liveth to himself alone. If any, even the humblest, is made to suffer, the whole community and every one of us, whether or not we recognise the fact, is thereby injured. Generation after generation this has been the corner-stone of the faith of Labour. It will be the guiding principle of any Labour Government."

This proposal for the enforcement of a national minimum is not merely a party programme, as it might seem, but it has received also the support of eminent economists. It will be enough here to quote a passage from that humane economist Professor Pigou, than whom nobody has done greater research or can speak with greater authority on the subject of economic well-being. He says, "There is general agreement among practical philanthropists that *some* minimum standard of conditions ought to be set up at a level high enough to make impossible the occurrence to anybody of

extreme want; and that whatever transference of resources from relatively poor persons is necessary to secure this, must be made, without reference to possible injurious consequences upon the magnitude of the dividend. This policy of practical philanthropists is justified by analysis, in the sense that it can be shown to be conducive to economic welfare on the whole, if we believe the misery that results to individuals from extreme want to be indefinitely large; for then, the good of abolishing extreme want is not commensurable with any evils that may follow, should a diminution of the dividend take place.”*

Applying these considerations, to the subject of taxation we may conclude that a good system of taxes should be so contrived as not only not to encroach on the real income necessary for procuring the minimum conditions of civilized human existence, but to facilitate as far as possible by positive action the procuring of such conditions.

* *Economics of Welfare* Part V. Chap. XII. pp. 789-90.

CHAPTER V.

CONSTRUCTION OF THE TAX SYSTEM.

(1) CUSTOMS DUTIES

In the preceding chapters we were concerned with the distributional first principles of taxation, and suggested certain general conclusions with regard to the same. We may now pass on to consider the conditions and construction of a good system of taxation. Taxation as we have already seen is a deduction from the resources of individuals, and as such a sacrifice from their point of view. That being so, the first thing that we have to consider is whether and to what extent any means exist by which the amounts which the state finds it indispensable to raise by way of taxation can be so raised without encroaching on the resources of its own people. Customs duties immediately suggest themselves. One important feature of such duties is that unlike other kinds of taxes which are imposed upon and borne by the people within the state itself, it is levied on goods passing through the processes of international trade, and when carefully regulated can be made to fall to some

extent at any rate on foreign shoulders. The conditions under which the foreigner may be made to bear any such burden are these :—In the case of an import duty, if the taxing country is the sole or main importer of the article in question and if the foreign producers of the article cannot in order to keep away from the duty easily transfer their capital plant and business organisation to the production of other articles, then the greater part of the burden of the duty will have to be borne by the foreign producers themselves. This will be the case where manufacturers in any foreign country have adopted expensive plant to the needs of the people of the taxing country, so that they might rather prefer to work with but low returns than let their plants lie idle. If however the taxing country is only one among many markets for the article or if capital or organisation can easily migrate to other countries then only a small portion of the duty will fall on the foreign producers, the greater part being borne by consumers within the taxing country itself in the shape of a higher price for the article. But in all cases when the conditions of production of the article in the foreign countries are such that high marginal profits are being earned by the producers, the duty if moderate, will have merely the effect of reducing a

portion of such profits, and may not lead to any great rise in price. In the case of an export duty if the taxing country is in the habit of supplying the larger part of the world demand for the article and if substitutes for the same cannot be easily had, then the duty will mainly fall on foreign buyers. The share borne by the foreigners will be great or small according as the taxing country is supplying a greater or smaller proportion of the article to the world market, and according as substitutes are difficult or easy of being procured. If the article exported is in the nature of a necessary of life or a requisite of production of a necessary of life, then the demand for it being more or less inelastic, the deflection on the foreigner will be more certain and complete.

All these points can be well illustrated by the case of the Indian customs duties. India is a big country having a large population, of more than 315 millions, nearly a fifth of the human race. If an import duty should be levied in India on any article of import which is made in the country of its manufacture either exclusively or mainly for consumption in India, then the duty will be to a large extent borne by the foreign manufacturer. For the demand for such article being exclusively or mainly Indian the rise in price in India on account of the duty cannot be to the full extent of the tax. As

there will be a less demand for any article when it sells at a higher price the manufacturer in order to market his articles in this country—he having very little scope for marketing the same elsewhere—must reduce his price to the loss at least of a portion of his profits. Of course, if he can reduce his supply without any loss of profit to himself or if he can divert his capital and organisation in other directions he can escape the burden of the duty; in which case the Indian consumer will suffer through payment of a higher price for the article or from a reduced consumption of it or both ways. But these latter courses will not be easily possible for the foreign manufacturer, if manufactures in general in his country are subject to the disadvantage of customs duties when sent to other countries or are subject to the law of diminishing returns in production, under which circumstances, if the duty imposed in India be moderate he will be rather willing to lose a portion of his own profits than to reduce his production or divert his capital to other uses. If the conditions of production of the article be such that the supply of it cannot be reduced without any loss to himself but must find a market in this country, then the whole or nearly the whole of the duty will have to be borne by the producer, as otherwise he cannot find effective demand for his article at any price other than the pre-tariff

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price. In the case of articles for which India is neither the exclusive nor the largest consumer but one among many consumers, any import duty levied by her will have to be borne by herself to a large extent. Of course, that may have the effect of discouraging the production of such articles in the respective countries of their manufacture to some extent or of raising their price in the world market and distributing the Indian tax-burden imposed on them among the whole world of consumers and not merely among the Indian consumers of such articles. But such effect will be slight in as much as the impediment to import into India will be small relatively to the total production and the world demand.

Similarly in the case of exports from India, the whole or a portion, as the case may be, of an export duty on any article may be shifted to the foreign consumer. If India is the only or chief producer and exporter of an article which is a necessary of existence and for which substitutes cannot be easily found then the whole or almost the whole of the duty can be deflected to the foreign buyer. For the thing being a necessary the demand for it will be inelastic and will not therefore diminish; and at the same time India being the sole or chief exporter will have no competitors to

undersell her with regard to such supplies. If India instead of being the sole supplier, supplies the same to a large extent then the competition of other suppliers will not go a long way in satisfying the world demand and the Indian supply being large will still be the determining factor as regards the price of the commodity in the world market. The result will be that the article will sell at a higher than the original price but not to the full extent of the duty. The foreigner will bear a portion of it and the Indian producer a portion. The share borne by the foreigner will be great or small according as his demand for the article is inelastic or elastic and according as his facility to find substitutes for it is small or great. This, when India has a monopoly of supply of the article or is the largest supplier of it. If however her supply is small or if there are numerous suppliers or if the article in question is one for which substitutes can be easily found or the demand for which is very elastic then almost the whole of the duty though not the full extent of it will have to be borne by the Indian producer himself. If a large quantity of the article is supplied by foreign producers the Indian supply offered at a price enhanced to the extent of the export duty will not find buyers. In such case if the Indian supplier should find a market at all for the

goods he exports he must sell them at a price considerably lower than the enhanced price which will be in the neighbourhood of the pre-duty price and slightly in excess of it. For, the export duty on the Indian supply of the article will have the consequence of slightly increasing the price of it in the world market generally from whatever source it may come; unless it be that the foreign sources of supply are elastic enough to keep pace with the effective demand at the original price, in which case the world price will not increase at all.

Now, if we look into the actual condition of the exports and imports of India we find that the imports are chiefly manufactured articles and machinery and other plant, while the exports consist largely of foodstuffs and raw materials for industries. If we apply the general considerations in the preceding paragraphs to the actual articles of import in the country we find that for almost all of them India is not the sole market, unless she be considered the sole market for the cotton piece goods of Lancashire and Japan. But still India being a large market for the manufactures of other countries the duties which are imposed on articles of import into the country will lead to a restriction of the quantities imported and cause a rise in their prices in the country and a fall in such prices in the

world market outside. But neither the rise nor the fall will be to the full extent of the duty. Some portion of it will have to be borne by the foreign manufacturers as they will be required to market outside India a considerable portion of their goods otherwise intended for India—which they cannot do if they want to sell at the original price. Nor can capital plant and other factors of production take to other industries, if, as is actually the case, the import duties levied in India are imposed on all kinds of foreign manufactures so that industries in general in foreign countries are affected. Thus in the case of import duties India does gain to a greater or less extent in throwing a portion of such duties on foreigners, according as India is a great or a small market for the commodities under consideration.

In the case also of exports the burden of the duty may be shifted to the foreigner. As we have just mentioned, exports from the country consist chiefly of foodstuffs and raw materials of industry, most of them products of agriculture. Only five kinds of articles of export are subject to duty at present—rice, tea, jute (raw and manufactured) hides and skins, and pepper. With regard to the last three India is almost in the position of a monopolistic supplier to the world outside. And in the

case of the other two, she is one of the main suppliers. Of these articles, all except hides and skins are direct products of agriculture and the effect of the export duty on them has been to lower their prices in this country, discourage their production and induce agriculturists to take to the substitution of other crops the produce of which is exempted from duty when exported abroad. If export duties should be levied on agricultural products it will be economically sound to levy the same on all kinds of such products instead of doing so on some of them at random. If this policy be adopted the duties will affect all the agricultural products equally and there will be no tendency on the part of the producers to substitute one crop for another and agricultural production in the country can be prevented from being diverted in undesirable directions. This will give a double stimulus to industrial development in as much as export of raw materials will be restricted and they made available and cheap for home industrial use; and at the same time labour and capital as well as land finding that the substitution of one crop for another is not economical, will try to pass on to industrial purposes within the country. With regard to non-agricultural exports, they are very few in number and insignificant in quantity except hides and skins. In these last, however, India stands in the position

of a monopolist and the duty can therefore to a very large extent be shifted on to foreign buyers, the rate of duty being only limited by the scope for substitution of other materials for it in foreign industries. If the duty is kept at a moderate level it will almost be wholly borne by the foreign buyers.

It will be seen from the above discussion that customs duties if discriminately imposed can be made to fall on foreign shoulders, at any rate to a large extent. But it is essential in the interests of good government that particular attention should be paid to political expediency. The customs duties imposed by any country should not be such as to exasperate any other nation to tariff or other wars. In the interests of peace it is highly expedient to conciliate other countries as far as possible and appease their discontent, only taking care that national interests are not given up. It may well be argued that in an world state or union there can possibly be no restriction on international trade in the same way as in every country there is now no restriction on the internal trade between its various parts. There is much force in this contention, and but for the fact that under the existing order of society there is no near prospect of an world-state or federation, we shall be logically

correct in stating that customs duties can find no place in a good system of taxation in an ideal world state. Under present conditions however we have to deal with national states, each striving to become prosperous within its own limited sphere of activity. But even here there is the prospect of a universal League of Nations being formed in the near future—powerful enough to prevent wasteful wars and bring about a feeling of brotherhood among all peoples; and if such a union should come into existence a condition of it will certainly be the establishment of free trade between all its members. But until then each nation will have to regulate foreign trade in the interest of the community within itself only taking care that the policy pursued by it does not create jealousy and resentment in other countries strong enough to lead to political rupture.

With regard to our own country, India, it is expedient in the interests of peace and good government that mutual good relationship should be maintained between her and Great Britain and the other parts of the Empire. It will be to the benefit of India to support and strengthen the tie of Imperial Unity. To realise the actual value of the Imperial connection it is only necessary to imagine the fate of an isolated and solitary India in her dealings with the rest of the world. At any rate

until the whole or at least the civilized world is brought under a single state or confederation or a league of nations the value of the Imperial connection to this country as a protective and peace giving factor, against the jealousy and rapacity of the rest of the world can hardly be denied. By the Imperial connection each part of the Empire derives strength from every other part and there is need to be a sympathetic treatment of one another in all their mutual dealings. It follows that there must be a favourable treatment by every member of the Empire of the other members in regard to their economic relations also. We are thus led to consider the feasibility of what is called Imperial Preference, in the matter of import and export duties. Preference in this connection is meant to take the form of a concession by way of a reduction or abolition of duty on imports from, or exports to the other parts of the Empire. It must however be noted that this kind of preferential treatment of the other parts of the Empire should not stand in the way of the development of the Indian industries or the prosperity of the Indian people. That is to say, by giving such concession India should not impede her own industrial development or the welfare of her people. In giving preference therefore we should eliminate from our consideration those articles of import which have an economic

advantage for being produced in this country and also those articles which if taxed or preferentially treated will make the Indian consumer incur loss of utility for purpose of benefiting the people of the other parts of the Empire, without a corresponding gain to India. Thus in the case of the import of all those articles which, being necessary for healthful existence ought to be free in the interests of the people of India, the question of preference does not and cannot arise. Nor should articles which have productional advantages in this country—such as cotton manufactures, paper, soap, glass, sugar, leatheren goods and matches—be included in any scheme of preference. A lower rate of duty on these and similar articles manufactured and sent from other parts of the Empire to India, will give a sort of protection to the production of such articles in those places as against similar industries in foreign countries outside the Empire, the imports from which will be subjected to a higher rate of duty. In cases like these, protection should proceed purely with a view to further Indian interests and there ought not therefore to be any preferential treatment in respect of the imports of such articles from other parts of the Empire. Judging from this stand-point the proper policy/

with regard to Imperial Preference will be this :— Excluding from our consideration those articles of import for which there are production facilities in India as well as articles which are necessities, the commodities in respect of which preferential treatment can be meted out to the other parts of the Empire should be of such a nature as to have larger facilities for production within than without the Empire. That is to say, the Imperial source or sources of supply should be more elastic than the non-Imperial sources. At any rate they should not be less elastic for otherwise the economic loss to India will be greater and the burden on the Indian consumer larger than the gain accruing to the favoured Imperial producers. A condition of preferential treatment is that the source or sources of supply on whose behalf it is given must have comparatively greater facilities of production than the sources more onerously treated. Viewed in this aspect, preference can advantageously be given to the following articles of import from Great Britain which would appear to have good facilities for their production there :—motor cars, cycles and accessories, chemical dyes, electrical materials, machinery, and mill-work and paints and colours. With regard to these India has no advantages for home production, at any rate under her existing econo-

mic condition; and Britain's only serious competitor in the field is the United States of America, except that in the matter of dyes Germany is also to be reckoned with. The grant of a preferential treatment to the British imports of these articles must develop their respective industries in that country to the great advantage of both herself and India. So far as the other members of the Empire are concerned though there is some scope for showing some concession to their imports also into India, no question of a preferential treatment can arise so long as they refuse to treat this country on a level of equality with themselves. Imperial preference being itself the outcome of a desire to maintain mutual good relationship, cannot exist where there is a positive refusal to have any such relationship. India is rightly indignant at the anti-Asiatic Laws passed by the various British Colonies, so as to affect her own people; and so long as the Colonies persist in upholding such laws, India will have nothing to do with them. In this connection, the Minority Report of the Indian Fiscal Commission is emphatic. It says,* "We cannot agree to any trade agreement being entered into with any Dominion which discriminates against the people of this

* See Minute of dissent (Paras 42-3) attached to the Fiscal Commission Report (1921-22.)

country. We believe we are voicing the unanimous opinion of the people of India when we say that no agreements based even on reciprocity in trade matters should be entered into with any Dominion which has on its Statute-book any anti-Asiatic legislation applying to the Indian people. Our colleagues point out the fact that Canada and New Zealand have conferred certain preferences on India. To the Indian people their self respect is of far more importance than any economic advantage which any Dominion may choose to confer by means of preferential treatment. We may confidently state that the people of India would much prefer the withdrawal of such preference as they would not care to be economically indebted to any Dominion which does not treat them as equal members of the British Empire having equal rights of citizenship.

“ We are not opposed to negotiations being opened for trade agreements on a reciprocal basis, but the condition precedent must be the recognition of the right of Indians to equality of status. The first principle of Imperial solidarity must, in our opinion, be equal treatment of all nations forming part of the Empire. The facts as regards the treatment meted out to Indians are too well known to be mentioned here. We will therefore content ourselves with recording our emphatic view which

we think reflects the feeling of the whole country that no trade agreement should be entered into with any Dominion unless it agrees to treat the Indian people on a footing of equality and to repeal all anti-Asiatic legislation in so far as it applies to the people of this country". Thus the question of Imperial Preference, though economic, assumes an essentially political character and is determined here as in all other countries largely by political considerations.

With regard to the exports from this country, which consist mainly of food-stuffs and raw materials of industry, no question of a preferential treatment of goods sent to the Imperial markets will arise if the tariff policy of India should be regulated from the stand point of the country's own national well-being. But in respect of one important class of exports—hides of skins—a concession by way of a reduction of export duty may well be shown to consignments bound for Great Britain.

Now taking all these matters into account, our conclusion with regard to the imposition of customs duties is this;—That under a well-considered and carefully adjusted scheme, it may be so contrived that the whole of these duties do not fall on the consumer or producer as the case may be within the state; so that the rise in prices in the case of

import duties and the fall in prices on account of export duties caused to the society within the state do not in either case extend to the full amount of the tax. Thus the revenues derived from this source can be made to yield a net gain over and above the loss occasioned to the community. But one thing will have to be noted. The whole of the tax cannot be shifted on to the foreigner but only a portion of it. That portion which is shifted on to him is not separable from the portion that may have to be borne by the people inside the state, so that the tax will be partially a tax on consumption and production within the state itself. Care must therefore be taken to see the real as distinguished from the superficial burden that any particular tax on imported or exported articles imposes on individuals within the state. A tax for instance on any imported necessary of life of the poorer classes though it may not raise the price of the article to the full extent of the tax in the taxing country, and the burden of it may even be partially shifted on to the foreign producer or manufacturer, will nevertheless hit severely on the poorer classes, in as much as the rise in its price may lead them to reduce their consumption schedule, and spread the reduction among some or all of their necessities of life; and in the case of those who had previous to

the tax any comforts or luxuries, to reduce or give up some or all of such comforts or luxuries, in order to enable them to have the full quantity of this necessary of life at the higher price. Whatever may be the case, there is no doubt that the higher price hits at the poorer classes more severely than it can possibly affect the richer classes. This is evident from the well-known and already noticed fact that the significance of a given rise in price is greater for a poor man than for a rich one, as the worth of a rupee is greater for him than for the other. Judged from this point of view, a tax on an imported necessary of life, even granting that a portion of it is shifted on to the foreigner, will throw a greater burden on the poorer classes of the community than the amount of revenue it may bring to the state. Similarly a tax imposed at random on certain export articles, though a part of it may still be shifted to the foreign buyers by means of the higher prices that they are made to pay, may cause a greater loss to the home producer than the gain it brings to the state. It may hamper production to such an extent as both to weaken the productive energies and deaden the interest which producers may have for producing abundantly. This will show itself in a reduction of the national income to a greater extent than the gains which

the state derives from the tax. But these considerations do not affect the validity of the general proposition that customs duties well-considered and carefully chosen, throw some portion at least of the burden of such duties, however small that may be, on the shoulders of foreigners. Thus in any well-regulated system of taxation customs duties can properly find a place. There are no other known means by which the ordinary revenues of any given state can to any extent be derived from outsiders.

(II) TAXES ON NON-NECESSARIES.

We have next to see what other kinds of taxes should be included in our tax-system. If as we have understood, taxation is only a means to an end, and if the end of the state is good government, meaning by 'good government' the promotion of the virtue and intelligence and generally the happiness of the human beings composing the community, then the hindrance by taxation of all things that hinder the achievement of such objects by the state becomes supportable on two grounds— In the first place, the taxation of such things lessens or weakens the obstacles that stand in the way of promoting the mental and moral qualities and the happiness of the people. And secondly, it brings in some amount of revenue to the state in addition.

Instead of devoting a portion of its activities and incurring expenditure in preventing or reducing the evil propensities of any of its members, which will have the effect of not only hindering greatly their own mental and moral development and well-being, but setting an evil example to others, the method of hindering the mischief of such evils by means of a kind of taxation contrived for that purpose, is undoubtedly a double advantage to the state in that it adds to the state revenues, and reduces the state expenditure in this particular direction. The best examples of such taxation are excise and import duties leviable on the consumption of such harmful and noxious luxuries as intoxicating drinks, opium, tobacco and ganja and their manufactures, and taxes on such offensive occupations as the practice of prostitution, the keeping of brothels and gambling houses, and other things opposed to good morals. The rate or amount of tax leviable on such things will depend on the degree of seriousness which the state may attach to the evils involved in such things, having regard to the positive morality prevalent in the community. If the harm resulting or expected to result from any of them is not considered of a very serious nature, the tax may not be high; if it be thought to cause much mental or moral depravity

or other evil of a grave kind, a heavy levy would be quite proper. What we have to note here is that such taxation is not only desirable but necessary from the point of view of the fundamental aims of the state.

In the case of those innumerable goods and services which not being harmful to human existence, are not at the same time essential for the health and strength, either mental, moral or physical, of the consumers, the necessity for taxation though less urgent, is not for that reason, less justifiable. If the object of the state is to develop the virtue and intelligence and not merely the material apparatus of well-being of its members, it is incumbent on the state to educate its people into proper ways. The consumption of luxuries which are mere superfluities and do not add to the efficiency of the persons who consume them, ought to be discouraged by the state. Its aim must be to educate people against a mere display of their wealth and the exhibition of personal vanity and also for the avoidance of all such uses of their wealth as do not contribute to the satisfaction of real wants. By a taxation of luxuries, expenditure on superfluities will be lessened and a greater saving of wealth effected by the people, which will usefully be applied to the production in greater

abundance of those things which are necessary for securing healthy life and worthy citizenship for all. Judged from this point of view the taxation of all luxuries which add nothing to the efficiency, mental, moral or physical of those who use them is highly recommendable, though they are not to be subjected to such heavy imposts as luxuries which are positively harmful or opposed to good morals. Thus a levy on luxuries of all kinds becomes a necessary part of our tax system.

This brings us to a consideration of commodity taxation—customs and excise duties—with reference to the nature of the articles on which they are to be levied. Broadly speaking, articles used by human beings (and all such articles are subject to the processes of international trade) may be classified under two heads, necessities and non-necessaries or luxuries, the former comprising those commodities that are necessary for the maintenance of life and efficiency and the latter, other commodities. The latter head of non-necessaries may be further divided into luxuries which are comforts and superfluous and undesirable luxuries.

We have already seen that from the point of view of good government the promotion of the aggregate happiness of the community and the development of their virtue and intelligence should

be the end and aim of all governmental activity. Looked at from this stand-point it is clear that when all the people in a country are not having their necessaries of existence, that some should starve while others live in luxury is opposed to such an aim. If any of those who suffer from want of necessaries are enabled to have their needs satisfied—even if it should be by means of restricting to any extent the scope for the enjoyment of non-necessaries by those who can command them—that would be conducive to the aims of good government. For as we have already seen aggregate happiness can *prima facie* be increased by the satisfaction of necessary rather than non-necessary consumption. It follows that the regulation of customs duties in such a manner as to encourage a cheap and plentiful supply of necessary articles for consumption in the country will contribute towards that end. With regard to non-necessaries, the first class of them comforts, are not opposed to the aims of good government; and except that they are not essential for life or efficiency are not in themselves undesirable but are capable of giving real satisfaction though only inferior to and less intense than the satisfaction derived from necessaries. In fact the state should itself encourage the use of comforts, only taking care that such encouragement does

not restrict either directly or indirectly the scope for the supply of necessary articles of consumption and proceeds on the principle of "no cake for any one until all have bread." In the case of the other class of non-necessaries, their consumption ought to be discouraged if not prohibited, as being opposed to good and virtuous living. Superfluous and undesirable luxuries, whether they are positively noxious, harmful, or wasteful, or are merely objectionable as not affording real satisfaction are a drag on human resources and in the interests of national welfare both their production and consumption require to be checked.

Viewed on this basis the policy of the state with regard to the taxation of the import as well as the home production and export of commodities in general may now be indicated. In the case of necessaries the aim of the state being to procure a cheap and abundant supply of them in the country so that all people may have enough to maintain life and efficiency, import of necessaries and their requisites of production should be encouraged and let free, while their export should be restricted by means of export duties, so that the price of necessaries in the country may be kept at as low a level as possible without at the same time weakening either the productive forces or the interest in

production which the nation may have. With regard to non-necessaries those which are of the undesirable and harmful class should in the interests of the welfare of the people be restricted in their supply and made less available for the consumer; and this can be achieved by means of an import plus excise duty levied respectively on the imports of such articles and on their manufactures in the country. Export of them ought to be free and may be encouraged inasmuch as the less they are made available for home consumption the greater it is to the good of the people within. In the case of the other class of non-necessaries namely comforts of living, a discriminate policy has to be pursued. It being the object of the state not to discourage their supply for consumption except in so far as they may stand in the way of developing the sources of supply of necessities, the policy of the state with regard to them will be this: There ought to be no excise duty on their manufactures in the country; but if in the case of any particular article of comfort an encouragement of its production has a tendency to divert any factor of production otherwise available for the manufacture of a necessary article of consumption, then the imposition of an excise duty on the production of such competing article is desirable and necessary. With

regard to exports of this class of articles a protective export duty may be levied on such of them as are raw materials which can be utilised in industries having greater facilities of production at home than abroad; and on such of them as are finished products no export duty should be levied so that their respective industries in the country may be encouraged and labour and capital benefited. In the case of other kinds of raw materials and finished products export duty may be levied, with the adoption wherever possible of a preferential policy under which any such articles may be let free or charged at a lower rate of duty when sent to countries where the demand for them is more elastic than when sent to countries where the demand is not so elastic. Then with regard to the import of this class of articles a similar discriminate policy may be pursued. There may be a protective import duty on all those manufactured articles for the production of which there are greater economies available at home than abroad, or at any rate there are equal economies in both places; and in the case of other manufactured articles a moderate duty may be imposed with a preferential treatment of the elastic as compared with the inelastic sources of supply, which may be given by taxing or taxing at a higher rate the imports coming from the latter

sources. With regard to the raw materials connected with the manufacture of comforts and the requisites of their production imports of these things may be allowed free provided they do not divert any factor of production in the country from the production of necessities to that of non-necessaries.

Such in brief outline is the policy that may be advocated on principles of good government. We may now illustrate the same by application to Indian conditions. Commodities produced in or imported into and made available for use in India are broadly divisible under three heads. 1. Necessaries and their requisites of production, 2. Luxuries and the requisites of production of luxuries and 3. State imports and exports. The second group may be further sub-divided into luxuries which are comforts and luxuries which are superfluous, undesirable and wasteful.

With regard to state imports and exports, there will be no need to consider them separately here but for the fact that under the existing tariff policy they receive a special treatment, no duties being levied on them at all. The policy, it would appear, is based on the assumption that if the duty is to be levied on any article imported or exported by the state, the state itself will have to bear the burden of it, paying in the shape of a higher price if it be an article of import and losing by getting a

lower price if it be an article of export, whatever it may receive into its treasury by means of the duty. If this assumption be correct there will, no doubt, be no use in levying any duty on such articles. But a little reflection will show that state imports and exports can be made to exert an important influence on the development of a country's own industries. With regard to those of the state's requirements that have good productional facilities in the country itself, the policy of the state should never be to purchase them from abroad. In the case of its other requirements, the state must always buy them from those sources of supply which are more elastic than others. There need be no levy of duty on such articles imported as no purpose will be served by the same. With regard to exports by the state it has to be noted that under existing conditions few of the modern states export anything of their own to other countries. Perhaps if state ownership of land and state industries come into existence, questions may arise as to the policy that should be adopted in connection with the various kinds of articles that might be exported by a state. But even then there is no reason for departing from the general policy governing exports and imports in general. We have seen that the export of necessaries should be

restricted by a duty while all non-necessaries excepting the raw materials and other requisites of production of comforts may have a free pass. The same thing holds good of state exports also. In all cases the only point to be considered is whether the duty will bring a net gain to the country either by adding to the State treasury or increasing the aggregate well-being of the community or strengthening their productive powers so as to lead to an increase of such well-being.

Judged on these lines, the existing policy of the Government of India with regard to its own imports and exports requires radical change. The Government is doing a great disservice to the country by importing almost all of its requirements from abroad whether they are or are not capable of being manufactured in India itself. If the Government really exists for the good of the country this policy ought to be immediately discontinued. The Government should make it a point to buy only Indian-made goods in respect of such of its requirements as can be supplied by Indian manufacturers themselves and this even when the Indian price is slightly higher than the foreign price. Articles coming under this head are, stationery, oils, and paints, and the clothing and leatheren articles required for the Army Clothing^oDepartment. In getting its other

requirements such as guns, rifles, and other military stores for which there are no productional advantages in this country, the Government should as far as possible buy them from such sources of supply abroad as are comparatively more elastic than others though in suitable cases, it may on Imperial considerations encourage Imperial sources of supply even if they should be less elastic than non-imperial sources. In the matter of exporting, the only article of government export in India is Opium, in which it has a monopoly of trade. Being a noxious commodity the export of this article should on the general considerations noted before be let free. But one observation should be made in this connection. It is really reprehensible that a government should indulge in the manufacture and sale of a commodity which is objectionable on moral grounds. By engaging in this trade the Government of India is subjecting itself to grave rebuke. Perhaps it may be said that the article is manufactured by the Government only for export abroad, such as to China and other countries and that the Government is deriving a large revenue therefrom. But it must be recognised that every state owes a duty to other states and to humanity at large. Judged in this aspect the Opium trade of the Government of India must stand condemned as base and immoral. The

sooner therefore the trade is discontinued the better it is to the credit of British Culture. It is refreshing however to note that the trade has been steadily declining in recent years on account of the growth of ideas of international morality and mutual obligation; and now that the subject has been taken up for consideration by the committee of the League of Nations at Geneva it is reasonable to hope that the manufacture as well as the trade will disappear in the near future, except to the extent if at all, of satisfying the purely medicinal demand for the article.

Then passing to the main groups of imports and exports, we have simply to apply the general considerations noted already. First we shall take the case of necessaries and their requisites of production. The Indian tariff schedule shows that many of those things which may be brought under this head and which according to our general reasoning ought to have a free pass into the country, are subjected to the levy of import duties, with the result that they cause much hardship to the poorer classes of the community, both on account of the restriction in the quantity of supply of those articles, and the increase in prices resulting therefrom. Such things include food-grains and salt, firewood, kerosine and matches, coal and coke, the coarser kinds of piecegoods and yarns, wood, timber and other building materials, paper and stationery (but

not the fashionable and costly sorts), the machinery for the production of all these things, and railway and electrical material. If the welfare of the people of India is the real aim of the Government, it is difficult to justify the import duty on any of these articles. On similar considerations it is difficult to approve of the policy of free export pursued with regard to wheat and other food-grains, and raw cotton and other raw materials of industry. A restriction of the export of these things must certainly contribute to a plentiful and cheap supply of food stuffs, clothings and other necessary articles of consumption to the people of India. It may be said that an export duty on necessaries will discourage their production in the country, and encourage in their stead the production of non-necessaries. We have already seen that this tendency can be effectively prevented by the imposition of an excise duty on the production of all those non-necessary articles which are likely to compete with necessaries for the employment of land, labour, capital or organisation. There is therefore no force in this contention.

In the case also of non-necessaries and their requisites of production, the existing policy of the Government has to be changed in conformity with the general principles already mentioned. A

perusal of the tariff schedule will show that there is no discriminate policy pursued either with regard to the import of those articles of comfort which have productional advantages within the country or with regard to the import and export of undesirable and wasteful non-necessaries. Almost all articles of comfort coming into the country are subjected to import duties, though the duties on many of them are kept at a moderate level. But there are no protective duties imposed on any of them, even when there are great facilities for the development of their Indian sources of supply which require only to be protected in their infant stages from destructive foreign competition. Of course in the case of one important commodity in particular, namely refined sugar the levy of a duty of 25% on its import, seems to be capable of affording some amount of protection to the native sugarcane industry in general, but the protection is neither sufficient nor permanent enough to encourage the industry to any appreciable extent. The other industries that are badly in need of protection in India are those connected with cotton, leather, soap, glass and glass-ware, superior paper and stationary etc. In all these cases the duties imposed on imported goods should be of a protective character. Export of raw materials connected with

any of them must be restricted by an export duty, while the machinery and other requisites of production that may be imported from abroad for their use should not be subjected to more than a nominal duty. With regard to these industries it must however be noted that none of them should be encouraged at the expense of the production of necessary articles. For example finer counts of cotton yarn and finer kinds of cotton cloth should receive less encouragement than the coarser and cheaper varieties. To achieve this end, the simple method will be to levy an excise duty on the manufacture of superior yarn and cloth, superior soap and superior leather goods, thus making their production less advantageous than the production of necessary and cheaper kinds of the same articles.

With regard to the other class of non-necessaries, namely superfluities and other commodities of a wasteful kind, the tariff policy of the Indian Government is equally unprincipled and imperfect. These commodities being neither necessary nor useful for human existence—they add absolutely nothing to the fulness or elevation of human life—are merely a drag on the country's resources, and in the interests of the community's welfare, both their production and consumption require to be checked, and if possible even wholly prohibited. We have

already seen that on the imports of these kinds of articles prohibitive import duties ought to be levied though the rates may vary according to the degree of undesirableness of each. For similar reasons the production of such articles within the country requires also to be restricted by prohibitive excise duties. Among those articles of import into and manufacture in India that require such prohibitive duties to be levied on them are spices and perfumery, tea and coffee, silk and silk piece goods, ivory, precious stones etc, gold and silver jewels and other articles, toys, dogs and other animals sought merely for the sake of the pleasure of their possession, liquors, tobacco and smoker's requisites, opium, ganja and other such drugs. In all these cases the rates of duty will have to be determined having regard to the extent to which they are likely to impede the promotion of the sum total of national welfare.

In dealing in the preceding paragraphs with the principles relating to the taxation of imports and exports we had necessarily also to observe the lines on which excise duties should be imposed, owing to the vital connection between the two kinds of taxes. Both of them are governed by exactly the same considerations with regard to their regulation, namely the furtherance of the aggregate happiness

of the community and the development of their virtue and intelligence, which in this book we have taken to be the basis of all governmental activity; and both are calculated to achieve this object by promoting or restricting as each case may require the supply, and consumption in the country, of the various kinds of commodities used by its members.

Proceeding on this basis and adopting the classification of material commodities into necessities and non-necessaries, and non-necessaries further into non-necessaries of comfort, and non-necessaries which may be considered superfluous and undesirable, we arrive at the following conclusion with regard to excise taxation: It being desirable that there should be a cheap and plentiful supply of necessities in the country, no excise duties ought to be levied on the production of any such articles. With regard to non-necessaries, those of the class which not being necessary for life or efficiency, are still of a comfort-giving nature, may also be exempt from the duty, as they are not opposed to the fundamental aims of government, except when and to the extent to which they may compete with the production of necessities and divert the factors of production to their own use. In the case of the other class of non-necessaries, which add absolutely nothing to the fulness of life, but are mere superfluities causing waste of human resources

and in some cases proving even positively harmful to well-being, it becomes incumbent on a good government not merely to discourage their import by levying heavy import duties, but to discontinue their production at home by prohibitive excise duties.

Now applying these considerations to the Indian excise duties, we find that under the present financial policy of the Government excise duties in India are levied on the following commodities ; salt, kerosine, mill-made cotton cloth, (both coarse and fine), motor spirit and petroleum, liquors, opium and hemp drugs. [After the new Reform Act of 1919, the excise revenue from liquors has been allotted to the Provincial Governments, while the revenue from the other heads is retained by the Central Government. Of these the duties on salt, liquor, opium and hemp drugs have long been in existence while that on motor spirit was imposed for the first time in 1917, owing to an increase of financial pressure, and the duty on kerosine was only introduced in 1922 for the purpose of meeting the huge uncovered deficit which the Government had been called on to make good when budgetting for that year.] For the same purposes the duty on salt was doubled in 1923, but has since been reduced to its original level, on account of popular opposition.

It has to be noted that this excise policy of the Government of India has been proceeding on no other principle but that of getting revenue for the state. It has cared very little for the principles of maximum aggregate happiness and minimum aggregate sacrifice. Salt, kerosine and the coarse kinds of cotton goods are necessities of the people of India and a taxation of any of these articles of consumption must necessarily inflict a greater aggregate sacrifice on the members of the community than a taxation of any non-necessary article. The Indian excise policy to this extent cannot therefore be too severely condemned. No state which pretends to exist for the welfare of its people can impose any restriction on the free supply of necessities for their consumption until and unless it has already exhausted every other available source from which it can raise its revenue. In the case of excise duties we have already stated that the restriction of harmful and superfluous non-necessaries, and also of any other non-necessaries that may compete with the production of necessities, is conducive to the good of the people. Instead of doing so, to tax necessities, or continue and defend the taxation of them, which originally might have been ignorantly and thoughtlessly imposed, is a determination unworthy of any civilised

government and especially of a paternal government like that of our administrators in India. It is no valid argument to say that the tax on these articles presses very lightly on the people. Even the slightest restriction imposed on the supply of any necessary of existence inflicts as we have already seen a greater injury on the community than the heaviest tax on non-necessaries. It is therefore imperative that the duties on salt, coarse clothing and kerosine should be abolished, if the real aim of Government is to promote the aggregate happiness of the people. With regard to the duties on non-necessaries of the class of comforts, the existing levies so far as they fall on the production of finer counts of yarn and cloth, may with advantage be continued, and fresh and new impositions on the production of refined sugar, jute, tea, coffee, cardamom, etc., will also be desirable in as much as any restriction of them will encourage a larger production and supply of country jaggery and food grains in their place. But the duties in such cases must be moderate and where the articles have special advantages of production in the country, must be sufficiently lower than the import duties of the same articles, so that an impetus may be given to their production at home though at the same time not so much enough as to compete with the production of necessities.

The case of non-necessaries of the harmful and undesirable class is quite different. In the interests of the aggregate welfare of the community an unqualified restriction of their production as well as import is desirable and necessary. This can best be done by means of prohibitive excise duties equal in their rates to the corresponding import duties. Besides liquors, opium and intoxicating drugs, the articles that urgently require restriction by heavy excise duties in India are tobacco, betels and nuts, explosives, fireworks, silk and silk goods, jewellery, precious stones, smoking requisites, and the requisites of such merely fashionable sports and games as tennis, billiards, and cards. Of these, those which are positively harmful should be more severely treated than those which are merely superfluous and uneconomic. Whatever may be the details of policy, the broad fact is clear: that non-necessaries of this class are a proper-subject of excise taxation. There is no excuse for the Government of India to leave this class of articles untouched and continue its accustomed methods of taxation of the poor by taxing necessary commodities.

CHAPTER VI

CONSTRUCTION OF THE TAX SYSTEM—(*Continued.*)

(III) INHERITANCE TAXATION.

In the construction of our tax system we may now proceed to consider whether there are not any other taxative means by which the requirements of the state can be raised with the least disturbance of the material acquisitions—whether they be incomes from possessions or earnings, of persons who can feel the burden, namely those who are living and those who are to be born. If there are any such sources available it is obvious that the funds required by the state can well be supplied from out of them in such a manner as to inflict the least injury to the resources of existing or future individuals; for it is the welfare of those who are living and of future persons that the state has to consider in all its aims and policies. The properties of persons who are dead thus suggest themselves in the process of elimination as a fit and proper source from which to replenish the state treasury. But such properties are under the existing organisation of society, governed by what

are known as the rights of bequest and inheritance, under which other and living persons become entitled to them from the moment of the death of the original owners. So that if the state should raise any revenue from this source, it must do so either by abolishing such rights altogether—in which case it can appropriate the whole of the properties to itself, or if that cannot be done, by levying a tax on the inheritance of such properties. We have therefore to consider which of these two courses is the more proper and conducive to good government.

So far as the first course is concerned, beside the general social and democratic considerations on which it may be recommended, namely the rectification of the existing inequalities in the distribution of wealth, and the utilisation of all the wealth that unearnedly accrues to the members of the community, for their common good, there is one specially forcible argument in its favour, which may be noted. It is said that properties passing by inheritance, by enabling the inheritors to live upon the energies and savings of others disable them to independent existence and make their lives economically parasitic. As Mr. J. A. Hobson points out, "A man who receives and uses a property which is not his own making is paid to withhold so much of his personal energy in production,

is paid to give out a smaller amount of organised and directed activity than he would otherwise have given. If he receives a series of such gifts, or one gift the numbing influence of which is spread over a long period of time, he becomes an idler or an anarchist,.....the property of another which he uses will gradually crush his own property, his capacity of vigorous self-expression. Relieved of the necessity of painful effort, he will only undergo such efforts as are easy; so the habit of hard work disappears, and with it the zest of enjoyment which the re-action from hard work brings. The higher kinds of concentrated mental effort, with their corresponding enjoyments, go first; then the lower; even the physical exercises involving skill, constant practice, and play of mind, yield to the simpler forms of animal enjoyment. This is the normal and necessary effect of living upon another's property. One by one the higher activities are debilitated, and cease to work; the attempt to consume without producing, to enjoy without effort, at once lessens the quantity and lowers the quality of life. The logical end of a society living upon unearned incomes would be death by over-feeding, or by inability to digest and assimilate their food. No economic or moral defence of the right to receive rent or interest, or to take by inheritance or

bequest another's property, however cogent it may appear, can abrogate this application of the natural law."* The argument thus advanced, against the receipt of property by inheritance, nay against all kinds of gifts, though somewhat over-emphasised cannot be lightly ignored. It cannot be gain-said that the existence of the right of inheritance or the acquisition or the expectation of acquisition of property by that means has a tendency to diminish the stimulus to self-help and industry on the part of the inheritors and induce them to withhold or minimise their own productive efforts. So it must be admitted that bequests and inheritances are a hindrance to progress.

But there are other and important considerations which in the interests of progress itself, make it undesirable that the state should put an end to the existing rights of bequest and inheritance, except to the extent of disallowing intestate succession beyond a limited circle of near relations of the original owner. These rights are under the existing social order founded on family affection and the tie of kinship and recognised in almost all civilized countries. Of course in a state where on developed socialistic principles private property comes to be non-existent, all property being held

* J. A. Hobson " *The Social Problem* " pages 117-118.

collectively by the community there will be no place for private bequest or inheritance of any kind. But no country in modern times has attained the ideal conditions necessary for the reaching of that social order. And if there is any force or incentive to human private effort in our own time it is the opportunity afforded by society for the unrestricted acquisition and enjoyment of and power of disposition over private property. It may however be argued that though freedom may exist as regards the acquisition and use of wealth by individuals, there is no need for the devolution of one's property on others who have made no efforts to earn the same. The answer to this is that the tie of blood relationship and family affection as well as the consciousness that one has the power to dispose one's property in one's own way constitute so much the most potent factors for private accumulation and saving of wealth that if it be ruled that the properties of every individual should go to the state after his demise, its consequence will be disastrous on the incentive to human action in the pursuit of wealth. As Dr. Marshall says very few people acquire property for their own sakes and the strongest motive for saving is family affection "Were it not for the family affections many who work hard and save carefully would not exert

themselves to do more than secure a comfortable annuity for their own lives."* They may not care to leave anything behind them. Thus it follows that family affection being the strongest stimulus to human energy and enterprise, anything that is calculated to frustrate it, must have inevitably a dire consequence on the production and accumulation of wealth. It is therefore necessary in the interests of progress that until at any rate people rise above family affection and acquire a power of unselfish devotion to the public good and realise their own social responsibility for the furtherance of the general well-being of the community the rights of bequest and inheritance, as well as other rights connected with the institution of property must continue to exist as necessary ingredients of progress. We have therefore to start with the position that rights of bequest and inheritance exist, and must be reckoned with in our discussion.

It must however be noted that the above argument does not lend any support to the extension of the right of inheritance to others than near relations. A person's affection being normally confined to one's own family members and nearest collaterals, any extension of the right of inheritance of his property, to others than such close relations is un

* Marshall "*Principles of Economics*" Sixth Edition. Book IV. vii 6. page 228.

-necessary and undefendable on any ground. Intestate succession should therefore be strictly limited to the circle of those for whom the deceased would be naturally disposed, or morally bound to provide. In the absence of any such relatives the whole property of the deceased should escheat to the state as representing the community.

So far as bequests are concerned it is clear that testators ought to be given full freedom to dispose of their properties in whatever way they like; for, should any restriction be placed on such freedom it must greatly diminish the motives to industry and saving on the part of all present and prospective acquirers of property who may expect to be fettered by such restriction. Further, as pointed out by Henry Sidgwick "any interference running strongly counter to the natural inclinations of such persons would be likely to be extremely evaded by donations before death;"* For these reasons it is desirable that testators should be allowed a free hand with regard to the disposition of their properties by will or otherwise.

Thus the case for the state abolishing private rights of inheritance and taking to itself all the properties of persons who are dead, failing,—except to the extent of excluding remoter relations in

* Henry Sidgwick " *Elements of Politics* " Chap. VII. S-4 page 105.

respect of intestate succession, we are led to consider the nature of a tax on inheritance in the cases allowed. Such a levy is undoubtedly to take precedence of any attempt to tax the earned acquisitions of living persons, in as much as there is absent in the case of an inheritance tax, the feeling of that pain of sacrifice caused by the pressure of taxation which must characterise a levy on the acquired resources due to self-exertion. Now accepting the propriety of a levy on inherited wealth we find that there is much to differentiate and distinguish. Even among the near circle of relations there is a gradation in consanguinity and affection beginning with the closest feeling of relationship in the case of a husband or wife or son or daughter, and diminishing gradually with distance. Among the immediate family members of an owner, the intensity of mutual affection almost brings about a feeling of identity of ownership and enjoyment of properties so that when such properties pass by inheritance to them on his death, they are felt to be as nearly dear as the product of their own self-exertion. But the distinction between self-acquired and inherited property is fundamental and cannot be ignored; and all properties got through inheritance ought to be made to contribute to the state without exception, though

in a scale progressively graduated according to the degree of distance of relationship.

This applies to succession in cases of both intestacy and bequest. But a special point arises for consideration as regards bequests in favour of strangers. In such cases there is no natural affection between the testator and the legatee. But in as much as there is a definite expression of affection in the bequest itself, a legatee of this kind may be placed in the same position and treated, as regards the amount or rate of tax, on the same terms as the nearest of the relations in the circle of heirs to be determined for intestate succession.

The next question that arises for consideration is with regard to the principles that should guide and govern the methods of assessment applicable to this kind of taxation. From what we have already seen in Chapter III dealing with distributional principles the case for the application of a progressive method of assessment, increasing with the size of the properties inherited, becomes clear. But there is also another principle specially applicable to inheritance taxation which follows from our discussion in the preceding paragraph namely, a method of assessment based on the fact that the more remote the degree of relationship between the deceased man and the inheritor, the

less defensible is the latter's right of inheritance and the greater the justification for governmental interference through taxation. It will not be wrong in many cases to confiscate to the state the entire properties of those who have died intestate and left no near relations. For in such cases there will be no hardship caused to the would-be inheritor; for as Bentham says. "Hardship depends on disappointment; disappointment upon expectation; and if the law of succession leaves him nothing—he will not expect anything". It follows therefore in such cases that a very heavy tax even to the extent of entire confiscation will be not only proper but highly necessary for the ends of the social justice.

Now combining the two principles of progression—one according to the size of the properties inherited, and another according to the remoteness of the degree of relationship of the inheritor, we may suggest the following scheme of assessment:—

With regard to one's own husband or wife or lineal descendants one single rule may be adopted and it will be justified on the ground that every one has normally a natural affection for such relations. The rule is that progressive rates steeply rising for larger inheritances, subject to a maximum of, say, 10 per cent may be charged in the case of all these heirs without distinction.

In the case of other heirs a method of double progression may be pursued, one according to the distance of relationship of the inheritor, and another as in the case of succession of lineal descendants and other near relations, according to the value of the estate coming to him. Thus the rate applicable to the degree of relationship may be first charged, and after determining the amount due on that basis, the rate governing the value of the estate may be applied, and then the amounts together due under both heads, made payable as a first charge out of the estate inherited.

In determining distance of relationship there is however a special difficulty to be got over. The law of succession varies according to different communities, the degree of nearness or remoteness of relationship in each of them being determined partly by custom (tribal and local) and partly by religious Beliefs and traditions ; so that there is no single universally recognised line of succession in all the world. Thus under the Hindu Law, the capacity of a blood relation to offer spiritual benefit to the soul of the deceased by means of libations, oblations, and otherwise (which for ought we know he might or might not perform at all) and the degree of its supposed efficacy, determine the line of the deceased's heirs ; so much so, that a sister,

sister's son, aunt or aunt's son does not come in until all the conceivable male collaterals are exhausted. Similarly the Mahammedan Law, the Buddhist Law and every other recognised Law has its own modes of succession.

The solution therefore of how the rates of taxation have to be fixed according to the distance of relationship of heirs lies in some such arrangement as this : whatever may be the law of succession, if we determine the number of the place of the actual heir in the line of the series of heirs, then we can fix the rate according to the place he will occupy in the order. Thus if an heir is 10th, 15th or 25th in the order of succession, then whatever may be the law of succession prevailing in any given society, the rates fixed for the place he occupies in the line of heirs, will be the rate governing his succession.

Thus both a vertical and a horizontal rate have to be adopted in the case of other than lineal heirs and near relations.

In this connection a subsidiary question may arise with regard to the manner of levy of the tax, and it may at once be dealt with here. The question is, how can a person who inherits property not in the shape of liquid currency but in other ways, be made to pay the tax in terms of money

(which is generally the prevailing and usual mode of collecting taxation) all at once when the inheritance opens. Of course in the case of property other than money it is exceedingly difficult for the inheritor to pay the government its due percentage all at once. The matter will be specially difficult in cases where the properties are not easily marketable, and the tax a large percentage. In such cases the government ought to be most equitable and reasonable with regard to the time and manner of collecting its share. Adam Smith's third maxim of taxation that 'every tax ought to be levied at the time or in the manner in which it is most likely to be convenient for the contributor to pay it', is specially applicable to the case of an inheritance tax. A period of one or two years may fairly be given for the payment of the tax, and in cases of failure the whole or any portion of the properties may be sold in tax-auction, and the amount realised. Or an option may be given to the tax payer for a partition at once of the properties, and the government's share paid immediately in kind. If the tax is made payable in one or other of these modes, there will be no real hardship to the tax payer.

Now when we apply these general considerations to the case of an inheritance tax for India, we

are met with a special difficulty. We have to deal in this country with a peculiar law of devolution so far as the Hindus are concerned who form the major portion of the population. Unlike in all other cases where the properties of individuals belong to themselves exclusively and pass on their death to their own heirs, in the case of a vast majority of the Hindus—except with regard to the self-acquired and absolute properties of individual members, which pass by succession to their own personal heirs, properties are largely held by what are known as joint Hindu families in which every member of the male sex takes a right by birth and no one can point to any particular portion of the properties as his own. On the death of anyone member the right to the whole of the property passes by survivorship to the other existing members, and every new member that is born in the family becomes entitled to joint enjoyment of the properties by his very right of birth. The following passage from Maynes' Hindu Law and Usage contains a clear and concise statement of the law. "There is no such thing as succession, properly so called in an undivided Hindu family. The whole body of such a family, consisting of males and females, constitutes a sort of corporation, some of the members of which are coparceners, that is,

persons who on partition would be entitled to demand a share, while others are only entitled to maintenance. In Malabar and Canara, where partition is not allowed, the idea of heirship would never present itself to the mind of any member of the family. Each person is simply entitled to reside and be maintained in the family house, and to enjoy that amount of affluence and consideration which arises from his belonging to a family possessed of greater or less wealth. When he dies his claims cease, and as others are born their claims arise. But the claims of each spring from the mere fact of their entrance into the family, not from their taking the place of any particular individual. Deaths may enlarge the beneficial interest of the survivors, by diminishing the number who have a claim upon the common fund, just as births may diminish their interests by increasing the number of claimants. But although the fact that A is the child of B introduces him into the family, it does not give him any definite share of the property, for B himself has none. Nor upon the death of B does he succeed to anything, for B has left nothing behind to succeed to. Now in every part of India where the Mitakshara (law) prevails, the position of an undivided family is exactly the same, except that within certain limits each male

member has a right to claim a partition if he likes. But until they elect to do so, the property continues to devolve upon the members of the family for the time being by survivorship and not by succession. The position of any particular person as son, grandson, or the like, or as one of many sons or grandsons, will be very important when the time for partition arrives, because it will determine the share to which he is then entitled. But until that time arrives he can never say, I am entitled to such a definite portion of the property; because next year the proportion he would have a right to claim on a division might be much smaller, and the year after much larger, as births or deaths supervene". *

Now it will be extremely difficult if not impossible to apply the principles of inheritance taxation to the case of Hindu joint family properties which are not inherited by any one but pass through continuous stages of survivorship, until the members of the family divide, and form separate families of their own. Of course the separate property of every Hindu whether divided or undivided from his family, passes on his death to his own heirs, as in the case of other people; and there is no difficulty in applying the tax to cases of this kind. But in the case of joint family property no one

* Mayne "*Hindu Law and Usage*" Ninth edition. pages 344-5.

member can indicate any portion of it as his own, until and unless it is divided and becomes in the absence of other members to share it with him, his own separate property, descendable to his heirs. If and so long as it should remain joint family property the possible share of every member is as liable to increase by the death of any existing member as to diminish by the birth of new members. Thus there is no fixity or steadiness about the share that will come to any one member; and the inheritance tax which requires as a condition of its application, the definite devolution of the determinate property of a deceased person to another and living person, is not from its very nature applicable to the case of Hindu joint family properties. A practicable scheme of inheritance taxation should therefore exclude from its operation such properties. Considerations of equity and good government however require that such properties should not escape from the levy, while other properties pay the tax when passing from one hand to another. It may be suggested that a survivorship tax at the same rates at which the inheritance tax is leviable on lineal descendants and other near relations, may well be levied on the value of the joint family properties, the management of which passes on the death of one

managing member to another who succeeds to his position in the family. As every family has, and is presumed in law to have a managing member (who is generally the father or other eldest male member) there will be a definite devolution of its management from one member to another and no difficulty felt with regard to the application of the tax. This is a fairly equitable arrangement capable of removing the injustice that would otherwise be involved in the exemption of the properties of a very large section of the people from taxation of this kind.

It is a point for comment that such an obviously just impost as the inheritance tax has never found a place in the tax system of British India, and no attempt made to improve the system in this or other respects, in the direction of 'justice' and 'good government', and according to the teachings of economic science. Such highly objectionable and iniquitous imposts as the duties on salt, kerosine, matches and other necessities of life have been persistently advocated and maintained by those who are responsible for the administration of the country without any care for the improvement of the well-being of the people. The bureaucratic administrators, both European and Indian have so long made common cause in their want of

sympathy with the poorer classes, and in vehemently protecting the interests of the richer. Though to their credit it must be said that they are not so bad now as they were in the 19th century, when as in France in the 16th, 17th, and 18th centuries, they had exempted the officials from some kinds of taxation, still no attempt has even yet begun in the direction of really good government. There is at present nothing more urgently requiring reform in the administration of the country than a complete improvement in its taxative policy to be effected from the stand-point of the promotion of the general well-being of the people.

It only remains to mention the economic objections, serious in the view of those who advance the same, urged against the taxation of inheritances. It is said that such taxation has the grave economic defect of falling on capital and other accumulated resources, retarding industrial development and reducing the national dividend, and thus impeding the progress and welfare of the people in the State. It may at once be admitted that the effect of the tax will be to cut the size of individual possessions and reduce the capital available in the hands of individual producers. But it does not follow from this that the productive powers of the nation as a whole will be weakened, or that the national

dividend will be reduced. Those who advance the objection forget that the amount realised by inheritance taxation does not disappear from the country but only comes into the hands of the state. The state having for its aim the conferring of good government on its people, will not spend the money in its hands except for purposes beneficial to the people. If it increases their welfare, it will add to their efficiency and therefore to their productive power. If it undertakes industrial undertakings, the apprehended ill-effects of the tax will *ipso facto* disappear. If it reduces the public debt with the help of the tax, the country will economically benefit to the extent of the reduction. It is thus clear that there can be no objection to the tax itself, but only to the improper uses that a state might make of the amounts realised therefrom. This book, however assumes throughout its discussion that the state which it concerns itself with, has for its sole end and aim the good of its people and honestly strives to achieve that end. The question of improper use therefore does not arise for consideration in our study of principles.

The second objection that is advanced against the taxation of inherited wealth is that it has a tendency to check saving. The objection assumes greater seriousness when the amount of tax levied

is considerably heavy. It is said that the expectation of an appropriation by the state of the whole or any portion of the property of a person on the occurrence of his death will have a restrictive influence on the quantity of saving effected by him by inducing him to make a greater consumption use of the wealth at his disposal during his own life-time. That the *certain* imposition of a tax of this kind on a person's death is capable of influencing his conduct during his own life-time is undeniable. But it cannot be said from this that either his efforts will decrease or his consumption use will increase and the motive to save thereby weakened, at any rate to any appreciable extent. So long as wealth gives a present power and distinction to its possessors and its acquisition is prospectively motivated by family affection especially towards one's own husband or wife or children, and the time of occurrence of one's own death is uncertain, so long will the incentive to saving continue, and will strengthen rather than weaken the habit of providing for the future. Whatever possible check the existence of the tax may put on the tendency to accumulate will be relatively small when compared to the other motives that stimulate saving. Any possible increase in the consumption use of wealth by its accumulator will be sufficiently

prevented or at any rate discouraged by the taxation of extravagant consumption which as we have already seen forms also part of our system of taxation.

Professor Pigou who discusses the economic aspect of "death of duties" (which is but another name for the inheritance tax) suggests further reasons in support of the view that the taxation will not to any appreciable extent check the accumulation of wealth. He says "A part of the stimulus to accumulation consists in the power and prestige that riches confer. In persons of only moderate fortunes who have or hope to have children this motive is not indeed likely to play a dominant part. A desire to provide for their children will be the main motive and if it were removed many of them would elect to 'retire' from work much earlier than they do now. But as Prof. Carver observes, "After one's accumulation has increased beyond that which is necessary to safe-guard one's offspring and to provide for the genuine prosperity of one's family, the motive to further accumulation changes. One then engages in business enterprises because of a love of action and a love of power. Accumulated capital becomes then one of the instruments of the game. So long as the player is left in possession of this instrument while he is one of the players, he is

not likely to be discouraged from accumulation merely by the fact that the state rather than his heirs gets it after he is through with it." In a like spirit the late Mr. Carnegie wrote "To the class whose ambition it is to leave great fortunes and to be talked about after death it will be even more attractive and indeed a somewhat nobler ambition to have enormous sums paid over to the state from their fortunes." Hence very heavy death duties could probably be levied on large legacies—particularly on legacies in the direct line—without causing any important check to saving and the national dividend."*

(IV) TAXATION OF UNEARNED PROFITS.

We have so far considered such sources of revenue as will not affect the personal resources of

* In this connection Professor Pigou goes further and approves of an ingenious plan suggested by Signor Rignano "under which death duties would be levied not only on the death of the original accumulator, but also on that of the second and third inheritors. On this plan resources would be taxed to the extent, say, of one-third when they descended from their original accumulator to his successor, the remainder would be taxed to the extent of two-thirds when this successor handed them on, while at the next succession the whole of what was left would be absorbed." Professor Pigou concludes, "there can be no doubt that a large revenue could be obtained from rich persons by this plan, in such wise that the expectation of the levy of it would involve an even smaller restrictive effect upon the supply of capital, and an even smaller injury to the national dividend, than is associated with the existing system of death duties. Indeed there is much force in S. Rignano's contention that his plan would actually lead to an *increase* of saving. For, as regards one's own children, every sum saved by the heir of a given patrimony would come to have, in his eyes, a much greater value, even three or four times greater than the same sum inherited by him; whereas to-day the heir of a great fortune is not much inclined to increase further the patrimony which he has inherited, for, as it is more than sufficient for him, he thinks it will be the same for his son." *Economics of Welfare* Part IV, Chapter VII. pages 643-4.

the members in general of the community within the state. Any members, if they willed, could escape the export and import duties, which we proposed. The inheritance tax falls only on dead men's properties when they pass to other and living persons, who except for the favourable and accidental circumstance of consanguinity and the law of succession based upon it, can have no right to the same. The taxation of luxuries is justified on social and moral grounds, and any one can escape the same by avoiding their use. In fact the very object of taxing them is to discourage their use. These imposts are thus advantageous sources of revenue which the state has first to exhaust before proceeding to a general taxation of the community. But there is still another source which it will have also to utilise, before it finds it necessary to resort to a general personal taxation of the earned resources of its members.

If we analyse the elements that contribute to the acquisition of wealth by individuals, we find that in many cases, not all the wealth that is acquired is due to personal exertion. That part of a man's resources which comes to him not by reason of the labour, mental, physical or otherwise, which he devotes or the capital that he invests but because of the conjuncture or social opportunity

attending his business, or of the increase in the public value of the landed property he possesses, is purely in the nature of unearned rent so far as he is concerned, and is not due to his own exertions. This wealth is either accidental as in the case of opportunity profits or 'wind falls,'* or is due to the public influences as in the case of increase in the annual as well as capital value of lands (both rural and urban) due to the growth of population or development of the means of communication or other causes of general progress such as the successful working of other lands in the locality, progressive works effected by the state and the existence of high markets for produce in the neighbourhood. In such cases it is evident that the person to whom the profits accrue has not done anything for earning such profits. Though in the case of opportunity profits it may be said that they are due to the fortune of the particular individuals to whom they accrue, even that cannot be said with regard to profits due to an increase in the public value of land which is dependent on the pressure of population and influences of progress. In both cases the profits are due to causes which are not the particular persons's own making. If that be so,

* That is, accretions to the value of a person's property which he has not foreseen and which are not due in any degree to the efforts made, intelligence exercised risks borne or capital invested by him. Professor Pigou '*The Economics of Welfare*' Part. IV, Chap. III. p. 600.

there is no reason why such profits ought not to be made to contribute a portion to the state which is the representative of the public interests. There is of course a special difficulty in finding out that portion of the income of any land which is due to its public value, as distinguished from the portion due to the exertions of the owners. And similarly, perhaps even more significantly, it is not possible to distinguish accurately the amount of opportunity or conjuncture profit as distinguished from earned profit. But they can be approximately estimated in both cases, and for the sake of being within the truth, they may be estimated after cautiously allowing a fair margin to cover the possible errors of calculation. The profits then which are due to other causes than the application of work and outlay by the individuals to whom they accrue, are properly liable to make a contribution to the state, which contributions may even go to the full extent of such profits. In this connection special mention has to be made of monopoly profits. Monopolies involve privileges conferred by the state, and the monopolists enjoy exclusive advantages. The profits which they derive are partly at any rate due to the prevention of the play of free competition, and to this extent the public have a right to

appropriate such monopoly profits, allowing to the monopolists only a reasonable portion of such profits, compensating them in addition for any special abilities shown in the business. There is in substance no difference between monopoly profits and other opportunity profits so far as the public interests are concerned, except that in the case of monopoly profits the state has clearly a greater right of appropriation, because of the exclusive rights it has conferred on the monopolists, which are the reason for the accrual of such profits.

On the whole then we arrive at this conclusion with regard to all unearned profits in general ; that in our system of taxation we can properly include an opportunity-profits duty (including within its operation monopoly profits also); and where there has been no nationalisation of land, a levy on land rents too (the latter being revisible periodically so as to conform to changing public values).

CHAPTER VII

CONSTRUCTION OF THE TAX SYSTEM—(Continued.)

(V) INCOME TAXATION.

Under existing conditions of individual and social life we do not find any other positive modes of taxation than those mentioned in the preceding chapters which are either pointed to or justified by the principles of 'justice' and 'good government.'* If the wants of the state cannot be satisfied with

* It may be said that stamp duties as a class, which have been widely recognised by the existing tax systems of the world, can properly find a place also in the mechanism of the system of taxation that we have here proposed. But a little reflection will show that stamp duties as such fall on certain transactions and acts of parties in their attempts to create *inter se* rights to property or status, and are not founded on any conceivable principle of justice or good government. As Dr. Pierson rightly puts it, they subserve no principle whatever and are mere fiscal legerdemain. Though on account of the large revenues which they yield and the ease with which they are collected, they have been temptingly retained by modern states generally, they are hardly defensible as a proper or sound source of revenue, from the standpoint of the fundamental aims and purposes of a national State. It may be that people have become so accustomed to the burden of these duties that they scarcely feel them as a burden; but there can be little doubt that when the duties are high (as they are now in India), they hit severely at commercial transactions, and impede economic progress. Though a wealthy community like the British or the Americans, may be able to bear their burden without detriment to their material progress, a poor community like the people of India ought not to be easily reconciled to them, having regard to the infant stage as well as the slowness of their industrial and commercial development.

the non-tax revenues and the collections made from the above-mentioned taxes, it will have to resort to such a mode of taxation as will best satisfy its financial needs without at the same time being incompatible with any of the principles herein before noticed. This last consideration points to the general taxation of the personal resources of the individuals within the state. The distributional aspects of such taxation have been already generally discussed, and we may notice here the logical result of a consideration of the same viewed as having a place in any good tax system.

Now with regard to such taxation, the simplest method that suggests itself is the taxing of every individual within the state for his existence therein and receiving of benefits, protection, society and order which it affords. The rate of the tax thus leviable will be obtained by the sum total of the deficiency of revenue required over and above what the foregoing taxes supply, being divided by the number of members living in the state, the quotient representing the amount that each will have to pay. There is indeed some force and a little substance too in the argument that every member should make contribution towards the maintenance of the state. But what shall be the contribution is not so easily capable of

apportionment as it is conceivable with regard to the case of many persons. A tax, as it is understood here, signifies only a contribution in terms of money or money's equivalent. If that be so, one on whom the tax is imposed must be capable of paying it and it must be in an easily collectionable form. Now all the individuals in any given state do not, under the existing social order, possess money or material commodities convertible in terms of money, a considerably large number of them being poor and able to live if at all only by getting wages for their personal services. In some cases there is not even the exercise of sufficient earning power which—may be due to either want of opportunity, or fitness or inclination to work, while in still worse cases (which it may however be hoped, is a steadily diminishing number) those who are known as the 'Residuum' of the community are physically, mentally and morally absolutely 'unemployable' and are surrounded by extreme poverty and destitution. In this state of things, it will be difficult in many and actually impossible in some cases to levy the apportioned amount of the tax from such persons. So a poll or capitation tax must eliminate from its operation those individuals from whom on account of want of property or earnings, the tax

cannot be levied at all. And these we may call the 'impossibles.' In the case of those who are earning but not sufficiently even for themselves, the collection of the tax will be a difficult and costly business, though not impossible. If a levy is to be insisted on in this case, it will lead to serious social discontent, but more importantly than that, will impair their efficiency and therefore their earning power, thus making them less able to pay the tax than before, and gradually driving them to the position of the 'impossibles.' Further if the 'impossibles' are to be exempted on account of their having nothing, and if the half-starving are also to be freed from the payment of the tax on the ground of poverty or insufficiency, the principle involved in the taxation of individuals as such ceases to operate, a new guiding principle being substituted in its place, namely, the possession of property or earning of income. The power to pay comes no longer to be judged by personal existence but by possession and earnings. Perhaps it may be said that whatever may be the practical difficulty, the principle of justice involved in a capitation levy cannot be easily denied; that it is a fact that every person living in the state receives from it his personal protection, though in the case of those who have properties or incomes, the pro-

tection of the state extends to their possessions also ; but that this latter factor can only show that over and above the general poll-tax, an additional levy may have to be imposed on those who receive the additional protection for their properties and incomes. But a little reflection will show that this contention is untenable. As we had already occasion to notice in connection with the exemption from taxation of the resources necessary for subsistence, the protection of the mere physical body, apart from the protection of property has no advantage in itself, at any rate in the view of those who have no properties to be protected by state interference. Or rather the view of such persons is that but for the state, those whose properties are protected would be entirely at the mercy of those who have no property and who by combination or otherwise could remove their own condition of poverty by interfering with the resources of those that have. In their view the existence of the state is a hindrance rather than an advantage to the poorer people. They will lose nothing and may possibly gain something by the destruction of the state as it exists. The state, therefore, is deemed to exist only on behalf of those who have possessions and want to preserve them. Viewed in this aspect, the duty of the state will be not to exasperate the

poorer classes and goad them to a combination for its destruction but to appease their discontent and poverty in all possible ways. If this view be correct, then *a fortiori* it follows that their poverty and discontent should not be increased by any taxation of their necessary resources. Again from the standpoint of good government also the reasons for exempting the poor whether with or without any properties or incomes, are apparent from what we have previously discussed. Further even supposing for the sake of argument that a *per capita* levy is necessary for the ends of justice, the problem of how such a contribution can be imposed upon and collected from them has still to be solved.

Perhaps it may be suggested that instead of the tax being collected in the shape of a money payment, it may be levied from them in the shape of personal services. There is indeed some force in this suggestion, but the practical difficulties involved in distributing and utilising such services are so great and insuperable that the principle which is already otherwise unsustainable on *a priori* grounds, is incapable of realisation under existing conditions of society and government. In the first place it is exceedingly difficult to distribute such services so as to throw an equal burden of sacrifice on all those who have to render them. The

measure of individual services according to their market value is no easy matter. The complexity of calculation required by the variety of the services that might be offered, and the inadequacy of a single measuring rod for all of them, are enough to deter the greatest financier of genius from attempting a taxation in the shape of services. Secondly, it is obvious that the state will not be in need of services which are not of any use to itself. The services required by the state being generally divisible into two kinds--those necessary for the carrying on of its work of government including all social activities, and those connected with the defence of the state from external aggression and internal disorder—the only possible ways in which the services of any members of the community can be availed of by the state, are circumscribed by these two kinds of utilities, unless the state takes upon itself as it might well do under conditions already indicated, profitable business activities which may give a further scope for the employment of such services. Now each of such services to be collected, it has to be noted, must necessarily be of a compulsory or semi-compulsory character—compulsory in cases in which they are wholly or partially unremunerative to the employees, the extent of non-remuneration indicating the amount

of tax payable by them; and semi-compulsory in cases where the remuneration paid to them is smaller by the amount of tax due from them, than the actual value which their services can command in the open market. In either case it is clear that, as the employees will do their work unwillingly or half-heartedly, the work done by them must necessarily be less efficient than fully paid services. Again, with regard to the services required for the carrying on of the business of government in all its directions, the employment of individuals without the special qualifications required for each kind of work, will not only prove inefficient and useless, but in some cases prove even positively harmful for the purposes which such work is intended to achieve. Hence if the state wanted to utilise the services of persons who are unable to pay the capitation tax in terms of money or other material commodities reasonably capable of a money measurement, it will have to train them at its own expense, before seeking to employ their services, unless they train themselves at their own cost. As the individuals we are here concerned with, are not from poverty, capable of training themselves at their own expense, the consideration arises whether it will be sound economy for the state to invest its monies on training them and then employing their

services at a lower than the market rate of wages, the difference indicating the amount of tax leviable plus the cost of training expended.

All this however is with regard to that portion of the work of government which requires specialised ability. But the military and the police services, as well as the lowest ranks of every branch of the governmental organisation, and in all cases when the state has undertaken economic functions on any large scale, the whole of the manual labour required for them, are all spheres of activity where there is vast and unlimited scope for the employment of unskilled physical labour which requires no special training, or at any rate no more than a little and almost inexpensive training as a qualification for entrance. In all these departments of government, it may be plausibly argued, the state can employ the services of those of its members who are unable to pay the capitation tax, and thus solve the problem of universal taxation. But a close attention will show that these departments as they are at present, do not give scope for the employment of any but a small and limited number of persons. A few hundred thousands at the most will be enough for the police and defence services, an even smaller number for the bottom ranks of the civil departments. Of course state indus-

trialism may give scope for the employment of some millions of labourers, but under existing conditions the industrial and other business activities of the state are small and limited. Under these circumstances, there is not scope for the employment of more than a few per centum of the untaxable classes among the community. The question of utilising the services of these people by the state thus reduces itself as part of the larger problem of want of employment which in modern economics still remains unsolved. If the state should think of solving its present question by arranging to give employment to all these people by distributing its available work in turns, that will involve besides other evils, want of uniformity in carrying on the business of government, want of responsibility in each discharging his duties, brought about by the frequent changes in each office or work, and a resulting greater complexity in the methods of administration and larger cost of supervision and management. And after all, what is to be the ultimate effect of these compulsory and semi-compulsory services? In these days of developing democratic feeling and popular influence over government, the tendency of government has come to be more and more to widen its range of action so as to increase steadily

the welfare of the poorer classes in all possible ways, than for making them bear any burden to the state and reduce their material conditions of well-being. In such state of things it will be more correct to view the aim of the state as intending to benefit the poorer classes if at all it aims at providing employment for any of them, than to take such employment to be for the utilisation of their service to the state as the alternative for their non-payment of any tax. Thus the principle involved in a universal capitation levy with its scheme of compulsory and semi-compulsory services in untaxable cases, become swallowed up and lost in the larger and more engaging problem of state socialism.

Again politically, the combined influence of a military recruited from the untaxable population, and naturally sympathetic toward the condition of the poorer classes and a democratic government craving for a socialistic organisation of society may lead to revolution instead of a cautious advance in the path of progress. The influence of the poor in every direction, and the opportunities for their easy combination might cumulatively lead to extreme impatience with the existing social ills and possibly produce large ill-considered changes in the socio-economic organism, and cut deeply

into the roots of social prosperity. Thus the political and social perils of any attempt at universal personal taxation, are greater and more serious than they at first appear. The employment on a large scale of the poorer classes of people by the state will only bring home to their minds a more intense hatred of the richer classes than they might otherwise have, by perpetually setting their minds seriously over the question whether they should at all be, in the words of Dr. Marshall, "doomed from their birth to hard work in order to provide for others the requisites of a refined and cultured life, while they themselves are prevented by their poverty and toil from having any share or part in that life." This will goad them on to further impatience and may possibly shake the very foundations of the existing social order. Thus there are strong political and social grounds for not increasing or rather for not attempting anything that will tend to increase the discontent and impatience of the poor by any action on the part of the state. And this in the interests of the richer folk themselves. It is rather better for the latter to pay higher taxes than in order to achieve a particular idea of justice, set the poorer folk in greater force against themselves. We have already seen the economic grounds on which the

exemption from taxation of all incomes that do not reach above the level of the subsistence minimum is defensible both in theory and practice; and they need not be repeated here. Considering all the circumstances therefore we have to reject the general *per capita* taxation as unpracticable and unsound, and omit it from our system of taxation. Failing the capitation tax, we are naturally led to a taxation of the material acquisitions of the members of the community. Such a tax should *prima facie* fall on all the material resources from whatever source they may come, though the case of resources not exceeding the subsistence minimum requires exemption from the levy for reasons already noted.

The next question is whether the taxation should fall on properties or incomes. But that is an easy matter to decide. As the expenditure of the state is of a periodically recurring nature, it necessarily follows that taxation which is required for meeting such expenditure, must likewise be periodically recurring. This naturally points to the taxing of incomes derived periodically either from the yield of properties or from the exertion of earning power or both. If instead of the incomes of properties the properties themselves are made to contribute a portion to the state,

it is clear that the properties will gradually diminish and disappear, leaving ultimately nothing for the state to levy on. Incomes of all kinds—whether they be derived from the usance of property or exercise of earning power—being the periodically recurring acquisitions of individuals, are therefore the most adequate subject of taxation. Thus failing a general poll-tax, we are led to the taxation of incomes accruing to the members of the community at stated periods, which for the sake of simplicity and giving reality to our discussion we shall assume to be yearly. Unlike the other taxes which may be justified on other and independent grounds than that of mere financial necessity, this tax has no justification apart from its being required to satisfy the financial needs of the state. It has therefore to be resorted to when all the other sources of revenue and taxation fail or prove insufficient to cope with the state's requirements.

For a clear understanding of the subject of income taxation, it is necessary to note at the outset the meaning of the term 'income'. In the most general sense it means and includes all 'comings in' or benefits derived by human beings. It may include a person's income of satisfaction which he derives from attending a music party or enjoying a

good breeze as much as what he derives from the produce of his labour, land or capital. But with the prevalence of a money economy the notion of 'income' has come to be confined in common parlance to those incomings which are expressed in terms of money. But from the stand point of the economic organisation of society as it exists in modern times, the term may be taken to include also a certain number of forms of income which though not expressed in terms of money, are reasonably capable of a money measure. For example a person dwelling in his own house or using his own carriage, furniture or jewels may not in the popular sense be said to derive any income from such property, but from an economic point of view, and also for purposes of taxation, one's enjoyment of one's own house, carriage, furniture, jewels and other material property, is capable of a money measure, in as much as each of them is rentable or hireable at specified rates of money in the market; and must therefore be included in the person's income. The point whether they should or should not be taken as 'taxable income' for purposes of incometax is to be judged by the test whether they are mere psychic incomes incapable of any external measurement or are fairly estimable at a rental value. If the latter, they should be included in

'taxable income'; if not to be excluded. In calculating therefore the incomes of individuals for purposes of taxation, such useance of property as can directly or indirectly be brought under the measuring rod of money, should be included. Only purely psychic satisfactions, though they are also incomes in the strict sense of the term, are to be omitted as they cannot be measured or estimated at a definite money value.

Now if we look into the actual state of income-taxation in various countries, we find that many kinds of incomes which are capable of a definite money measure have not been included in the operation of the tax for various reasons. Besides other exemptions those incomes of enjoyment in particular which are derived from the useance of one's own properties have not been included in taxable income. The main reason for this is that the several legislative bodies which are responsible for the imposition of the tax have generally been influenced by the popular view of 'income' and failed to recognise the full economic import of the term.

This and other matters connected with income taxation, we may now discuss with reference to our own country, India. The income tax in India is at present regulated by the Income tax Act of 1922. A perusal of the Act will show that even in the

case of incomes that are capable of a money estimate, various kinds of income are excluded from the operation of the tax. In the first place, the incomes of religious, charitable and other institutions of general public utility are exempted. The reason for this is obvious and it is defensible on the principle of 'good government' already noticed. Taxation being only a means for the conferring of good government, the state will be hindering its own aims and purposes by levying a tax on things which it considers to be good for its people. The second exemption is in favour of the incomes of local authorities such as the municipal and local Boards. Here also the reason for the exemption is obvious. The functions of these local bodies are only to improve the well-being of the people in the localities in which they exist, and this is the very purpose for which the state has created them. It is therefore not only proper but necessary that in the interests of good government the funds of such bodies should also be exempted. But it may well be suggested that from the point of view of the whole state it is necessary that all local bodies should be made to contribute a portion of their incomes to the maintenance of the Central and Provincial Governments, in proportion to the strength and richness of their

resources. Some of these bodies are poor and some others rich. Some raise most of their funds by means of local rates and others derive a considerable portion of their incomes from economic sources. Some exist over rich and populous areas, while others are not so. Under these circumstances, it is arguable that the national Central Government by giving peace and security is doing a real function for the prosperity of the people of the whole country (including all the local bodies), and on the analogy of the progressive taxation of incomes of individuals according to the amounts of such incomes, local bodies can legitimately be made to contribute a proportion in a progressive scale, of their annual funds to the national treasury. There is much force in this view, and it is not unsound. Some of the municipal and local Boards are getting very large incomes every year, while others are very poor. An exemption may be given in favour of those of such bodies whose incomes do not exceed, say a lakh of rupees per year, and in the case of others a contribution of from 5 to 20 per cent may be levied in a progressive scale according to the extent of resourcefulness of such bodies exceeding the minimum limit of a lakh of rupees. Thirdly, the exemption of the interest yielded by securities

held by Provident Funds and Provident Insurance Societies, and of Life Insurance premiums actually paid to the extent of one-sixth of a person's income, is based on philanthropic and humane considerations of policy rather than on sound economic principles, and is justified by the desirability of encouraging people to sacrifice some portion of their present incomes for future benefits to themselves, and thus develop a habit of providing for their own future. But it cannot be maintained by any stretch of reasoning that such monies are not the incomes of the societies or of the payers as the case may be. As Professor Bastable points out 'the case is one of concession to human feeling rather than a sound deduction from general principles.' Nor can the exemption of any lump or capital sums received in commutation of any pensions or as compensation for death or injuries, be justified on valid grounds. For they are real and measureable benefits hardly distinguishable from accidental incomes in any manner. The exemption again of casual and non-recurring receipts (unless they be capital amounts received in payment of insurance policies or as accumulated Provident Funds the premiums for which had already paid the income-tax) is equally baseless. The reason of their being casual or non-recurring receipts does not take away from them

the character of incomes chargeable to income-tax. It is difficult to conceive the *rationale* of exempting from the charge such receipts as those from lottery chits or profits from the sale of a copyright or patent, or gifts of any kind. Again legacies in India pay no tax at all. But they have been already considered in a previous chapter, and need no further discussion here. The last and most important and perhaps most seriously objectionable because the most persistent, is the exemption of agricultural incomes, and this requires some detailed consideration. The main ground on which it is generally sought to justify the exemption of agricultural income from being chargeable to the income-tax is that, as the land owners already pay land revenue—an ancient and immemorial levy—to Government, an additional levy of income-tax on agricultural incomes would be unjust and involve double taxation. A close scrutiny of the matter would however show that the extension of the income-tax to agricultural incomes would not only involve no double taxation but be helpful to achieving an equitable distribution of the tax. The fact that land revenue is already collected in no way affects the situation. We are not concerned here with the question whether the land revenue is a rent or a tax. That question does

not affect our present reasoning. The only relevant fact to be noted is that the land revenue has got a very ancient existence and is so permanently attached to the land itself that the ownership of the land, its market value, and the profitableness or otherwise of investments in it, are all calculated after a spontaneous deduction of the annual or capital value, as the case may be, of the land revenue to be paid to Government. So far as owners and purchasers are concerned the land revenue is a permanent burden on the land whose existence does not enter the calculations of private individuals in their ordinary business transactions. This point leads us to consider what is known as the 'amortisation' of land revenue as a real imposition adhering to the land itself. This can best be illustrated by an example. We shall take the case of Ryotwari land in the Cauvery Delta. There is the permanent burden of the land-revenue or '*kist*' on the land. The market value of the land and the profitableness of investments in it are both determined only after making due allowance to the existence of the *kist*. This will be seen from the motives that govern investments. A person wants to invest, say a lakh of rupees on 100 acres of land in the Cauvery Delta, or on certain securities. He has two options. The latter yields him $5\frac{1}{2}$ per

cent interest, and gets an annual income of Rs. 5,500. We shall suppose that he values the social distinction and dignity of ownership attached to the land at Rs. 1,500 per annum. Now he will be induced to invest on the land only if he can get a net income of Rs. 4,000 after payment of Government kist. If the kist be Rs. 10 per acre, then he will not be induced to buy the land unless the gross rent which he can realise from it be Rs. 50 per acre inclusive of the kist he will have to pay out of it. If he expects less than this amount of rent, he will not go in for the land. Thus in all private business transactions, the existence of land revenue is always allowed for whether consciously or unconsciously, in determining the market value of land and profitableness of investments in it. Again the 'amortisation' is much more clear when we note the fact that the market value of lands of equal fertility varies according as the amount of land revenue payable varies. In the case of '*Sarvamanyam*' or revenue-free lands, the market price is almost exactly higher than that of a neighbouring revenue-burdened land of equal fertility, to the extent of the capital value of the revenue payable on the latter. Again the market price of land which pays Rs. 6 or 7 as kist is higher than that of land paying Rs. 10, and lower than

that of Sarvamanyam land. Thus in the determination of the market price of lands the capitalised value of Government kist is always allowed for. The gross rent minus the kist is the annual value of the land to the private owner. If this be so, then from the point of view of private enterprise, it is clear that there is no difference between investments on land and other investments, nor between agricultural and non-agricultural incomes. For in either case, it is the profit of capital invested or deemed to have been invested that matters, and nothing else. Hence it is obviously unjust that one who invests in non-agricultural enterprises should pay income-tax on his incomes, while another who invests on land and derives an agricultural income should enjoy immunity from the tax. There is absolutely no justification for this exemption on any acceptable principle of taxation.

Except what we have thus noticed, all other kinds of incomes are taxable to income-tax in this country. For the sake of clearness the Act classifies taxable incomes under these six heads:—

1. Salaries, 2. Interest on securities, 3. Property Incomes 4. Incomes from business, 5. Professional earnings and 6. Incomes from other sources.

The last head is evidently included for the sake of abundant caution. It is not necessary for

the purpose of this inquiry to enter into any analysis of these heads and add anything by way of criticism or suggestion. The details of enunciation are fairly exhaustive to include all kinds of incomes which the Act intends to reach. But in the light of the explanation of the term 'income' which we have previously given in this chapter, it is necessary to consider one or two points with regard to the cases of those property-incomes which are neither in the form of money nor money's worth of material goods, but come in the shape of direct utilities for the enjoyment of the owners of such properties. The Indian Incometax Act deals with the case of only one of such properties, namely house property which is in the occupation of the owner himself for the purpose of his own residence. A proviso to section 9 of the Act provides how an estimate has to be made of the annual value of such property and prescribes the mode of calculating it in terms of money. It states that the bonafide annual value of a house-property in the occupation of its owner shall be deemed not to exceed 10 per cent of the total income of the owner. It assumes that 10 per cent is the maximum proportion in which any person getting income will spend on providing house room for himself. But it may be submitted that

there is no warrant for this assumption, and indeed actual facts are against it. Though it may be approximately correct in the case of moderate incomes, it will not at all hold true in the case of the wealthier classes of people in India. In this country, the ownership of a house gives a distinction and a status and a delight in ownership, perhaps not quite known to European countries. The average wealthy man here is intensely inclined to display his wealth in possessing a house of high value, rather than spend only a ten per cent proportion of his total wealth. It will be far from actual facts, in many cases, if only 10 per cent of the total income is taken to be the average annual value of a person's residence. The only proper method then of arriving at the annual value of house property in such cases seems to be to calculate it at 5% of the estimated capital value of the property with reference to the market rate.

We have next to point out that there are certain kinds of property incomes which are not at all contemplated by the Act and therefore omitted from its operation. Every person who owns a motor car, or a coach and horses or other vehicles or a set of furniture or what is more common in wealthy houses in India a large number of household utensils and precious jewels of considerable

value, may be deemed to derive from the use of such articles a certain definite income of utility, measurable in terms of money. Instead of owning such articles himself, if an individual hires them for a period of, say, a year or a month, he pays a definite money rent for their use; and conversely, a person who owns such things can in business fashion derive a money income by letting them out for hire. When the income of satisfaction derived from such things is not a mere psychological feeling but capable of being measured by a definite amount of money, there is no reason why any such income should be left out of account for purposes of income-tax. In India the inclusion of such income for purposes of the income-tax is specially necessary from the point of view of good government. It is a notorious fact that the people of this country are in the habit of locking up a large part of their wealth in precious jewels and household utensils merely for the sake of display. It may be said without any fear of contradiction that not less than a fifth of the accumulated wealth of this country is so locked up. A tax on the income of satisfaction derived from the possession and use of such articles will not only educate the people of the country and improve them morally, but by discouraging the use of costly and luxuriant jewels

will release a large amount of capital from such investments and direct them to the production of more urgent national utilities. Neither the Indian income-tax nor the income-tax in other countries includes any such income within its operation. But its justification on economic grounds is clear. There is no logical distinction between the income of these other properties and that of house-property in the enjoyment of the owner himself. Perhaps it may be said that if we include all these incomes derived from the usance of property, it will lead to absurd results; that it will lead to the taxation of the income derived from the very clothing which we wear, such income being estimated by the amount that is payable for hiring the same for a year! This is the logical result of our proposition. But our answer is that such things are not generally hired because they are not durable for a fairly long period of years. In estimating the incomes from the usance of property by owners themselves, we have to remember that allowance should be made for wear and tear of the property out of the annual incomes thereof. Such allowance will be small or great according as the property is more or less durable in its nature. Judged in this aspect the net income derived from our clothing over and above the deduction for its wear and tear, will be so small that there is practically no use in troubling ourselves with the estimation of the incomes

from articles which are not fairly durable for a number of years or are of so small a value that they are not worth the trouble involved in assessment and collection. But in the case of jewels, utensils, vehicles and furniture, the articles being fairly durable, and aggregately of considerable value, their incomes are not a negligible quantity in the case of those whose incomes reach above a taxable minimum and particularly of highly wealthy people. The principle is already applied to the case of house-room. Where a person owns his own house, it is estimated to yield an income of satisfaction, capable of a money value. These other properties stand equally on the same footing and also yield a measureable annual value which in the interests of both justice and good government ought not to be excluded from the income-tax. It cannot be merely supposed that either jewels or the other properties under consideration yield little or no income. As we already mentioned nearly 20 per cent of the non-land wealth of the country now exists in the shape of jewels. In wealthy houses the desire for the possession of jewels and ornaments for the sake of display is so intense that not an inconsiderable portion of their wealth is invested in such things. On principle therefore, the bonafide annual incomes from such properties ought to be taken into account for purposes of income-taxation.

A principal feature of the Indian Income-Tax Act is that it provides after the fashion of the English Statute, that the rates of income-tax and supertax which are to be charged for any year will be determined annually by the Indian Legislature by the Finance Act passed for that year. It has to be noted that the tax itself is a permanent one, but only varies from year to year as to the rates at which it is to be charged. Before the present Act, there was a permanent schedule attached to the previous Income-tax Acts, showing the rate or rates at which incomes of particular amounts should be charged to income-tax ; and there was no time-limit for the duration of such rate or rates. But the new enactment has followed the English practice obviously for the purpose of providing a fairly elastic source of revenue to meet the requirements of Government in the last resort. If in any year the financial position was bad and expenditure could not be met out of the other sources of revenue the rates would be sufficiently increased for meeting the difficulty ; if the position was good, then the rates would be correspondingly reduced and the burden of the tax lessened.

Whether and how far the existing rates are in conformity with the principles enunciated in Chapters III. and IV. of this book, will have to be studied now. The existing rates including both the income-tax and supertax are as follows :—

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It will be seen from the above schedule of rates that except in the case of companies and registered firms which pay a uniform rate of one anna in the rupee as incometax whatever may be the extent of their incomes, and a supertax also of one'anna in the rupee in respect of all their excess incomes over fifty thousand rupees, the rates of incometax and supertax in all other cases vary according to the amounts of income. Then again complete exemption is given in the case of all persons whose total annual income is less than Rs. 2,000. In the case of those whose incomes amount to Rs. 2,000 or more there is a graduated scale of tax according to which the rates for particular amounts of total income are so prescribed that they are made to increase with definite increases in the size of such incomes up to the limit of Rs. 40,000 and thereafter to remain uniformly proportional at a prescribed maximum throughout, whatever may be the extent of income. In order to make the taxation progressive in the case of larger incomes, a supertax is imposed on all those incomes which are in excess of Rs. 50,000 the rate of such tax increasing with every given excess of income over that amount, until the total income reaches 6 lakhs of rupees ; and thereafter a uniform rate is charged as a maximum, whatever may be

the amount of income. It will be noted that the point at which the Supertax begins to operate is at a higher level than the highest limit at which the ordinary incometax rate ceases to increase. Again while the ordinary rate of incometax is the same throughout for assessing the whole of a person's income, there is a given rate of supertax for every given excess of income over the exempted limit of Rs. 50,000 and this rate increases with every given increase in the total income. With regard to the actual pressure caused by the operation of the two taxes one further point may be noted. While exemption is given in the case of those whose incomes are below the taxable minimum of Rs. 2,000, in the case of every one who gets an income of Rs. 2,000 or more, the tax is levied not on the surplus that he has over and above the exempted minimum but on the whole of his income. Thus if a person gets Rs. 3,000 he has to pay tax at the rate of 5 pies in the rupee not on Rs. 1,001 which is his surplus but on every rupee of the 3,000 he gets. We have already seen in our study of principles that the object of the exemption is only to ensure for every one the minimum necessary for subsistence and that in all cases only surplus incomes, if at all, should form the subject of taxation. Whatever may be the rate or rates at

which such surplus incomes are taxed, in no case should that part of a person's income which is required for furnishing him the necessaries of existence be invaded. Now when we examine the Indian Income-tax on this basis, we find that it works out a very unequal distribution of its burden and is the most oppressive in the case of small surpluses. In fact it consumes the whole surplus in the case of incomes which are just above the exemption limit. Though a progressive graduation is attempted by making the rate of tax increase with prescribed increases in the amount of income, the result achieved is merely an irregular percentage rate of tax oppressively regressive in its action on surpluses in the neighbourhood of the exemption limit and fitfully progressive in the case of larger surpluses. Of course, when the incomes reach above Rs. 50,000, the super-tax begins to operate and with it a steady progression which continues until the incomes reach above 6 lakhs of rupees.

Now viewed from the stand-point of the principles of 'justice' and 'good government' two questions arise for our consideration here. (1) Whether and how far the exemption from the income-tax of persons whose incomes fall below Rs. 2,000, is conducive to those principles and (2) in what manner a proper form of progressive

graduation in conformity with such principles can be achieved in incometaxation in this country.

First with regard to the question of exemption. By fixing the taxable minimum at Rs. 2,000, the Indian Legislature, it would appear, seems to have thought that all incomes below this limit would be necessary for providing the minimum of subsistence for individuals in this country. For examining the soundness of this position, it is necessary that we should consider it in three aspects, first whether the Legislature is correct in fixing the limit of personal exemption at the sum of Rs. 2,000, secondly whether the exemption should be given only to those whose incomes fall below that amount; and thirdly whether it will be in consonance with 'justice' and 'good government', to have a uniform limit of exemption in all cases or treat all kinds of incomes in the same way without differentiation.

The primary needs of civilised human existence, as we have already seen, are qualitatively the same everywhere, though in quantity and intensity they may differ according to [climate and the seasons of the year. Under the head of prime necessities may be included air² and water, food, clothing and house-room, fire and light, medical aid and sanitation, education, news,³ travel and

religion. All these are necessary for leading a healthy and cultured life anywhere; and they are the primary physical, mental and moral needs of man, which depend on environment for their supply and are characteristically economic. In estimating the cost of providing these necessaries in any country, we may err rather on the side of exaggeration than of minimisation, for it is much more necessary that one should be provided with an abundance of these things than that he should be made to feel a want for any of them. With regard to the first two items—air and water, it may however be noted that under existing conditions they are from the individual standpoint, the gifts of nature almost everywhere, and we may not be doing any violence to our present enquiry, if we take it that they are so in India also. In the matter of the other necessaries it may be stated that living in this country is comparatively cheaper than in Great Britain. The supply price of food is much cheaper here than there. The population per square mile being less here than there, and the abundance of land and ease of production being greater, food is a cheaper commodity for us than for the Britisher. But even supposing that on account of the existing facilities for transport we are not in better advantage in the matter of food supply than the

people of Great Britain, we are decidedly better off with regard to the necessity for clothing, house-room, fire and light. Natural causes have made these requisites of life, less imperative needs for us than for the people of colder countries; where heavier and larger clothing, a more protective house-room, a greater need for fire and heat and a larger use of artificial lighting are found indispensable. These indeed will consume a considerably larger amount of a person's income in Great Britain than in this country where the climatic conditions do not require such costly external apparatus for existence. Sanitation, medical aid, education and news and travel may be said to be somewhat cheaper in the other country than here, because of the greater influence exerted there by those agencies of economic progress which have contributed to the material apparatus of civilisation. Also in the matter of religion it may be said that the people of India (whether they be Hindus, Muhammadans or Buddhists) are adherents of more costly religions than the purely Christian Community of Britain. The religious ceremonies of the Hindus and Muhammadans are many and costly, and they consume considerable sums of money in the year. Without deciding as to the need for religion from the standpoint of the rationalist, we may

assume here that under the existing conditions of human society, the religious needs of a people are as necessary for their moral existing to be satisfied, as food and other things for the sustenance of their physical bodies. In fact religion contributes to an important extent towards the fulness of life of man in all civilised countries, and is in many cases the source of the highest happiness. All these are primary requisites for leading a cultured life; and in this country under the prevailing economic conditions they may be said to cost on a rough and at the same time liberal estimate a sum of Rs. 300 per head per annum in the case of the generality of people living in the rural areas. In the case of the urban population, the three important requisites of living, food, clothing and house-room are more costly than in the country side and their costliness differs according to the relative facilities which they afford for living. But broadly speaking we may take it that in small towns with less than 20,000 population, the total cost of living will be 15 per cent more than in the purely rural areas; that in the bigger municipal towns, it will be 30 per cent more; and in the chief cities of Bombay, Calcutta, Madras, and Delhi 50 per cent more.

The exemption limit in the English Income-Tax is now fixed at £ 135. In spite of the compre-

hensive nature of the reforms effected on the recommendations of the Royal Commission that sat in 1919, it is disappointing to find no differentiation made between the minimum cost of living in urban and rural areas. It cannot be gainsaid that at any rate in the matter of house-room and clothing town life is more costly than life in the country. The difference will appear more striking when we compare the cost of living in the city of London or Bombay with that in an interior village.

If we take all these matters into consideration in our study, we find no *rationale* for fixing a uniform limit of exemption in all places and that at Rs. 2000.

Then to pass on to another aspect of the question. Under the existing Income-Tax in India exemption is allowed only in the case of those whose incomes amount to less than Rs. 2,000. While all persons whose incomes fall below the taxable minimum, enjoy complete immunity from the tax, every person who gets an income of Rs. 2,000 or more is made liable to pay the tax, not on the surplus that remains to him after the minimum required for his subsistence is deducted, but on every rupee of his whole income. The result of this is that the tax falls most oppressively on those whose incomes exceeding the exemption limit, leave only small surpluses. In the case of larger incomes leaving larger surpluses

the tax acts but gently in its operation, being only subject to the 'jumps' due to increases in the rates at certain points in the scale. But for the specific provision in Section 17 of the Income Tax Act, the existing rate of tax (i. e.,) 5 pies in the rupee, on incomes just exceeding the exemption limit, will not only consume the whole surplus but even invade the tax-free minimum. Thus for example if a person's income is Rs. 2,025, the tax on that amount at the rate of 5 pies in the rupee will come to Rs. 52/11/9. and if this sum should be collected from him, his income would be reduced to Rs. 1972/4/3 and he would find himself in a worse position than one who does not command even the taxable minimum. To cure this defect and similar defects arising at every stage at which a higher rate of tax is imposed on account of the incomes exceeding the prescribed limits of Rs. 5,000, 10,000, 20,000 &c., the said section 17 of the Act provides that in the case of assesses who are liable to pay income tax or income-tax at a higher rate owing to the fact that their total incomes have reached or exceeded a certain limit, they might either give up the whole amount of the income in excess of the limit or pay the tax or pay it at the higher rate, as the case may be whichever is the lesser of the two. Thus, for instance,

an assessee getting an annual income of Rs. 2,025, who but for the section would be liable to pay a tax of Rs. 52/11/9, has to pay not the full amount of the tax at the rate of 5 pies in the rupee, which will reduce his income to below the exemption limit, but to give up the whole of the amount in excess of that limit. Similarly in the case of all those persons whose incomes exceeding any prescribed limit by a small margin, are made liable to contribute at a higher rate than incomes just below that limit, the section provides for the assessee giving up the excess income rather than pay the higher rate. It is however clear that only when the margin in excess of the fixed grades of income is slight, that they will find it to their advantage to utilise the provisions of this section. When all this is said, it has still to be noted that the section is only an awkward mitigation of an inherent defect due to the circumstance that each rate or increased rate of tax instead of applying to a particular increment of income as in the case of the super tax rates is made to apply to the whole of a person's income with the result that there is a 'jump' at every point at which there is an increased rate, followed by a gentle regression until the next point is reached for a higher rate to be applied; and so on until the super tax rates begin to operate

when a regular progressive graduation commences. The evil resulting from the application of a single rate of tax to the whole of a person's income, is most apparent in the case of incomes just above the exemption limit. It may be noted that under the existing system, the entire surplus left by incomes of between Rs. 2,000 and Rs. 2,052, is confiscated by way of tax; there is absolutely no difference in position between one who gets income of Rs. 1,999 and is free from the income tax and another who gets Rs. 2,052, but has to give up his surplus of Rs. 52 over the exemption limit. It will be noted that incomes of between Rs. 2,000 and Rs. 2,052, pay the whole of their surplus, that is 100 per cent of it as income tax. In the case of incomes between Rs. 2,052 and Rs. 5,000 the percentage of contribution out of surplus gradually decreases until a higher rate of 6 pies in the rupee is imposed at Rs. 5,000. It is clear from this that the effective rate of tax (as contrasted with the seeming rate) on small incomes is severely regressive. It was seen in our study of general principles that the minimum necessary for subsistence should be exempt from the state's taxation. That being so, it is but proper that this minimum should be deducted from total income in all cases, and only surpluses made liable for taxa-

tion. This is what also actually obtains in the existing English system. We therefore come to the conclusion that the deduction of the minimum of subsistence in all cases is just and necessary, and that only surplus incomes should be made liable to the income-tax, each increased rate applying to that particular increment of surplus income to which it pertains, instead of to the whole of a person's income as at present.

The third aspect of the question of exemption is concerned with the differentiation between individual incomes and family incomes. We see in actual life that the generality of people,—and this is particularly true of the people of India,—do not live alone as individuals but live in families with wife and children and other dependants who are either unearning, or earning but little incomes themselves. In such cases it is but just, if at all a civilised standard of life should be made possible for such families, that a fair allowance should be made out of the individuals' incomes for the maintenance of their families and dependants, the balance alone being made liable for assessment to the income-tax. For otherwise it will be a great hardship, for family men with small and moderate incomes to pay income tax out of that part of their incomes, which is necessary for maintaining a civilised standard of life for their families. Any encroachment on

the minimum necessary for the subsistence of a person's family will have the effect of lowering the standard of life of a family as compared with that of individuals who have no families to support. Further the expectation of the fact that exemption from taxation will be allowed only in the case of the minimum required for individual subsistence may discourage family life, create a desire for shunning family responsibilities and to some extent impair also the strength of married relationship, to the detriment of human virtue. So the claim for relief in respect of family dependants is grounded on the principle of social justice and may also be supported on the basis of good government. In the case of one's wife, the amount to be deducted may be fixed at 75 per cent of what is allowed to the individual himself ; and for two unearning children below the age of 16 (and where they are receiving full time instruction in any educational establishment, below the age of 23), it may be fixed at 40 per cent each; and in the case of a third or a fourth child and for every other necessary dependent at 25 per cent each. Perhaps it may be said that these allowances are insufficient. But they are fixed at these particular rates for the following reasons:—In the first place the cost maintenance per head is generally less, the greater the number of members to be

maintained jointly. This is only the result of the application of the principle of production on a large scale to the consumption-side of domestic economy. Secondly a person who is not quite able to support his wife or children has no business to marry or produce children, and more especially to increase the number of his children; and if he does so, he does so at his peril. From the point of view of good government it is essential that there should be some restraint put on indiscriminate marriages and irresponsible production of children. Further the placing of family men in a slightly less advantageous position than single individuals will give an incentive to earning on the part of other family members also. Thus an indirect restraint of this kind achieved by means of taxation is highly recommendable on the principle of good government. Thirdly it has to be remembered that we are not doling out any allowance but only giving certain concessions to family persons. In the case of any one who has his wife, children or other dependants making their own earnings, no deduction need be made on their behalf, from out of his income to the extent of their earnings.

It will be seen from the foregoing that the minimum income necessary for existence differs according as the person lives individually or burdened with family responsibilities, and in the

latter case, according to the size of the family he has to support. It is the surplus that remains over and above this minimum that should be liable to income-tax. The best and most effective method of taxation in all cases is to deduct the particular individual's minimum alone from his total income and afterwards grant relief on behalf of his family members and dependants by way of refund of the tax collected on application and proof by the individuals concerned, of the circumstances entitling them to the remission claimed. The income-tax authorities should treat all incomes as individual incomes and tax them as such, after deducting the usual minimum of subsistence allowed to the individual, according as he is a resident of a city, town or village as the case may be. This method of assessment will prevent any possible fraud on the part of interested assesseees.

Then coming to another point, a distinction has to be made on grounds of social justice between earned and unearned incomes. It is believed that the feeling attached to the sacrifice of earned incomes will be greater than that attached to unearned incomes; and this is natural though the distinction sinks into insignificance when we come to higher incomes and larger surpluses. In the case of lower incomes the distinction may well be made.

In fact it is actually made in the English Income-Tax which allows a deduction of one-tenth of earned incomes, not however exceeding in the case of any individual £ 200. The Indian system makes no such differentiation, all incomes there being assessed at the same rates. The distinction will not be felt in the case of assesseees with large incomes. But where the incomes are small the distinction will be really felt and ought to be recognised. It may be suggested that in the case of surpluses not exceeding Rs. 5,000, a deduction of a tenth of the earned incomes of individuals may be allowed, and the remainder assessed to income tax.

We may now pass on to consider the other question namely that which relates to the determination of a proper form of progressive taxation. From what has been seen in the preceding paragraphs regarding the existing rates of income tax it is clear that viewed from the standpoint of the general principles enunciated in Chapters III and IV, they are repugnant both to 'justice' and 'good government'; and if the aim of the Government of India is the same as what in this book we take it to be of any state, then a reform of the income tax in this country in conformity with such aims is imperative. We have already seen that only surplus incomes should be made liable to income tax in all cases. But with regard

to the rates of tax two different conclusions were arrived at, according as 'justice' or 'good government' was taken as the basis. On the former basis, it was found that taxation should not merely be proportional but progressive. The extent of progression however, was not indicated by it. But on the basis of good government, a heavy appropriation, falling short only of entire confiscation of incomes above a certain level, was found supportable. And as a compromise between the two bases, it was considered expedient to adopt a steep form of progression, as satisfying the requirements of both to a large extent. It might be suggested from the stand-point of good government that small surpluses should not be interfered with by taxation unless it is found that the required revenues of the State cannot be sufficiently met by a taxation however heavy, of surpluses in excess of any given limit, in which case, surpluses below that limit might be invaded. But this view does not satisfy the notion that all persons who are in command of surplus resources should contribute to the state in proportion to their respective abilities. A compromise of the two, pointing to the adoption of a steep form of progression in taxation, is therefore most expedient.

How to achieve this progression is the point next to be considered. The solution of the

problem is much helped by the existing English method of income taxation which is calculated to achieve a fairly steep form of progression, being at the same time practical and easy of application, and not complicated by the introduction of any complex mathematical formula. The same method may be adopted *mutatis mutandis* in the Indian Income tax in the following manner:—Exempting the minimum of subsistence allowed in all cases, and taking into consideration surplus incomes alone, a uniform rate of 2 annas in the rupee may be levied as income tax on all surplus incomes. Over and above this uniform rate of income tax, a progressive graduation may be introduced by a series of super taxes so arranged as to achieve on the whole a fairly steep form of progression. Thus:—

Income tax

	Rate.
On all surplus incomes ...	2 anna in the rupee.

Super tax

		Rate
		Nil
On the first 5000 Rs. of surplus	...	
From Rs. 5000 to 10,000	... 1	anna in the rupee.
” Rs. 10,000 to 20,000	... 2	do.
” Rs. 20,000 to 30,000	... 3	do.
” Rs. 30,000 to 50,000	... 4	do.
” Rs. 50,000 to 1 lakh	... 5	do.
” Rs. 1 lakh to 2 lakhs	... 6	do.
” Rs. 2 lakhs to 3 ”	... 7	do.
” Rs. 3 ” to 4 ”	... 8	do.
” Rs. 4 ” to 5 ”	... 9	do.
” Rs. 5 ” to	... 10	do.

CHAPTER VIII

CONCLUSION

It will be seen from our discussion in the preceding chapters that a good system of taxation should comprise the taxes indicated therein and no others. This logically follows from our consideration of 'justice' and 'good government' as the two fundamental bases of all taxative policies. Perhaps it may be said that all this is right in theory, but the practical statesman has many things to consider besides 'justice' and 'good government.' For example, he will have to take into account those diplomacies of home and foreign politics on which the stability of the state organisation largely depends; he cannot ignore the exigencies of the social and religious habits of the community, a consideration of which will be equally necessary for the tackling of any financial measures that he may propose, abrogate or modify; nor can he afford to introduce and experiment any drastic schemes of reform merely for the sake of bringing the existing order of things in

conformity with the ideal conditions dictated by theory; the practical financier has heavy and many-sided responsibilities and must recognise that short-cuts are dangerous and reform must be cautious and tentative. His duty ought undoubtedly to be for reforming towards perfection, but it must be done gradually and by peaceful methods, and not suddenly and completely by revolution.

Now all this is good advice for the practical statesman. But it may be submitted that nothing in it is inconsistent with or vitiated by the principles we have indicated here for guiding taxative policies. There is an erroneous impression among people in general that anything which is sound in theory is necessarily unworkable in practice, and that therefore whatever is stated as a theoretical proposition will not hold good for practical purposes. It is not difficult to expose the fallacy and baselessness of this impression. People ignore the fact that theory is nothing but a statement of law which conforms to practical tests. It may be that particular instances may not exactly conform to a stated proposition on account of certain important qualifications that are ignored in the application of the theory to the particular instances in question. But the theory itself is not to be found fault with and branded as incapable of

practical application, because in some cases such theory has not been properly applied. When once a proposition is accepted as sound in theory, there is no meaning in saying that practice can be suffered to continue otherwise than in conformity with such theory. Now if 'justice' and 'good government' are admitted as sound bases for taxation, there is no meaning in saying that the practical application of the same requires important qualifications. It may be that sudden and violent changes may bring about a revolution and on that ground, drastic reforms will have to be avoided. But this does not lend support to the view that even gradually tax-reforms ought not to be effected in conformity with sound principles. Otherwise we lose the benefit of advancement towards perfection—which is the real test of all progress. If, for example, an inheritance tax, a comprehensive taxation of all luxuries or a steep form of progressive income-taxation cannot be suddenly and drastically introduced in India, it may be done gradually in the course of a few years or a decade. It is no valid excuse for a financial statesman to say that, however sound may be the principles of justice and good government, he cannot avail himself of the same, because it will bring in innovations. One who does not want innovations because

they are innovations is, to speak plainly of him, an enemy of progress. True progress lies in the advancement of human existence (both individual and social) towards perfection; and if a Government should say that it wants to maintain the *status quo* at all cost, it only means, that it denies to its people the advantages of progress in knowledge, and action.

We thus see that every attempt ought to be made by a state whose end and aim consist in justice and good government, for the achievement of such end and aim, though not by revolutionary methods, at least by gradual and peaceful methods. From this it follows that taxation which as we have already seen has an important bearing on such end and aim, must also be reformed and regulated in conformity therewith. Of course a special difficulty is conceivable with regard to the case of export and import duties. Such taxation may result in serious foreign complications and possibly in war with those foreign countries which are affected by the same. This is really a serious difficulty in the way of a statesmen putting into practice the principles we have enunciated; and it importantly qualifies the application of the principles to the existing political order of the world. As there are in existence many States, large and small, strong and weak,

independent and dependent, each caring for the well-being of its own people, there is every chance of a clashing of their interests and therefore of warfare among them resulting in the instability of progress in each. That there should exist many independent states each caring exclusively for its own interests is a flaw in the existing political organisation of the world; and so long as this state of things continues there must remain the possibility of international warfare, whenever interests clash. These are days of intense nationalism but not opposed to a comity and brotherhood among nations. The drift of political progress after the recent Great War has been towards a League of Nations, for the purpose of effectual prevention of destructive warfare in the future. As the predominant powers in the world have interested themselves in the League, it may be confidently hoped that there will possibly be no warfare in future. But with regard to a dependent country like India, the problem of the future is at once difficult and easy. It is difficult in as much as it is dominated by a powerful foreign State, likely to be interested in its own welfare, and possibly opposed to the true progress of India whenever such progress will clash with that of the foreign power. But viewed in another aspect the problem may be considered completely easy of

solution. India has all the advantages of stability of peace and progress, which the strength of the predominant power on whom it depends, is capable of securing for it. It can freely advance in all those directions of progress which do not clash with the other's interests, and for this purpose we assume and unless the contrary is proved, we are bound to assume that the existing governance of India is *bona fide* in the interests of the governed. In the zone of conflict of interests, it may be possible that both the dominant and dependent countries may join hands and bring about an amicable relationship by the noble policy of 'give and take.' All this remark applies with special force to the regulation of import, export and excise duties by the Indian Government, in so far as they can affect British interests. When an amicable arrangement is effected between them, it becomes exceedingly easy for India to freely and securely (on the strength of the British connection) regulate and adopt her own customs policy, to promote her own best interests.

On the whole then, whatever may be the nature of the country we are dealing with, it is clear that the objections advanced against translating into practice the principles we have deduced in the foregoing pages, are not so serious and

insuperable as to deter the statesman from attempting to mould his tax system in conformity with such principles. On the other hand it would appear that it is the solemn duty of those who are responsible for the administration of any country to carry out all such reforms as are conducive either directly or indirectly, to the good of its people.

FINIS