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PRINCIPLES OF JUSTICE IN TAXATION

STUDIES IN HISTORY, ECONOMICS AND PUBLIC LAW

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**PRINCIPLES OF JUSTICE IN
TAXATION**

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PREFACE.

THE subject of this monograph was chosen in 1891 while I was taking post-graduate work at Columbia University. The first draft was nearly finished in the spring of 1894 when I was compelled to give up work for a time on account of ill health. Engaging in academic work in the fall of 1894 I was again obliged to set the monograph aside until the winter of 1900. Since then it has been completely rewritten and chapter VIII added.

For his constant interest and encouragement I feel greatly indebted to Professor Seligman, for otherwise the monograph would not have been completed. I wish, also, to take this occasion to express my appreciation for the courtesy shown to me by the Faculty of Political Science of Columbia University in giving so much extension of time for the completion of my monograph. To Dr. Alvin S. Johnson, of Columbia University, I am indebted for verbal changes of text and for reading of proof.

S. F. W.

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CHAPTER I

INTRODUCTION

A THEORY of taxation is necessarily bound up with fundamental questions of political science, economics and ethics. By abstracting any one of these elements and making it alone the determining factor, or by giving it an undue importance, a theoretical solution of the problem may be made a comparatively easy task. But such a solution, like most schemes based upon one-sided or partial truths, is necessarily defective and not infrequently utopian. The real difficulty arises when these factors are comprehended in their full significance, or in their true relation to one another; but only in this way can the problem be fully understood in its various bearings, or a solution be offered that is satisfactory alike to reason and to the requirements of justice. This difficulty is two-fold. In the first place our views will necessarily be colored according to which of these factors we consider the foundation-idea of our theory and which we regard as incidental or supplementary; and in the second place very much depends upon our interpretation of the fundamental idea and of the character of its relation to the other factors. Even if but one of these factors is considered as having any importance, the question is not altogether a simple one, for there still remains the difficulty arising from the interpretation we may give to the chosen factor as the only one for consideration. It is such facts as these that account for the general disharmony in theories of taxation.

An illustration of the difficulties referred to is found when

the political factor is made the only one or the fundamental one. For if, on the one hand, we regard the individual as the only important factor, and the state as merely an accidental but necessary evil, the tendency will be to an extreme of individualism; if, on the other hand, the individual be regarded as a mere part of an organic whole, a cell of a living organism, we are in danger of the opposite extreme of socialism. The one extreme tends to the contract theory of Hobbs, Locke and Rousseau with its individual independence and its protective theory of taxation; the other to a personified social organism which directs the economic activities of its units and utilizes taxation to produce artificial equalities of wealth. Both of these extremes are false, although they involve the important truth that principles of taxation are intimately associated with a political philosophy.

Not less are the difficulties, nor more satisfactory the results, if the question be approached from a purely economic point of view. Different theories will be maintained and different conclusions reached according as production, distribution, or consumption is made the basis of the economic theory. Moreover, different conclusions will result from different assumptions respecting economic principles, or from the importance attached to specific economic laws. If, for example, production under a *laissez faire* régime be regarded as the chief end of human activity, it will be concluded that taxation should interfere as little as possible with capital and its accumulation, while the relative productive powers of individuals should be the same after as before the payment of a tax. Or if there be implicit confidence in the doctrine of free competition there will be little concern about the tax system, the shifting and incidence of the tax through the action of competitive forces being relied upon to effect the ends of justice. Similarly we have only to exaggerate other economic elements to get other results.

So, too, the ethical factor may lead to equally divergent results according as Hedonistic or utilitarian principles, or the realization of the *idea* of man, is made the dominant feature of our ethical system. The difficulty is here further exaggerated by the fact that there is frequently a difference between theoretical and practical ethics. Harmony between these, whatever our ethical principles, is by no means easy to accomplish. Yet a substantial harmony must be established, or, on the one hand, we shall have only utopianism founded upon abstractions, and, on the other hand, expediency founded upon concrete facts without reference to ideas of justice.

But a more fundamental difficulty than that which arises within the separate factors themselves is the determination of their relative importance. Each one must receive due consideration; the political, because the relation of the state to the individual is primarily involved; the economic, because matters of taxation are essentially of an economic character; the ethical, because the subject and the end of the whole proceeding is *man*, a spiritual and therefore an essentially ethical entity. But which is the ruling factor? The importance of this question, together with the full recognition of the separate factors, is so great that we shall treat this aspect of the subject somewhat at length before taking up the main question—that of justice in taxation. Indeed, this method of procedure is indispensable since the principles of justice can not be determined before the basis upon which they rest is established.

It may be premised here, however, that the whole subject of taxation revolves about man as its center—man in his relation to society, to his family and to himself; to the ends, that is, of his own existence. It has not, indeed, to do with the whole of man's activities and relations, but only with a small portion of them; in fact, with only a portion of those

involved in his political existence—the maintenance and support of the state, or what may be called the satisfaction of the collective needs of the individual. But because these needs and their satisfaction are common and involve *human* relations, an equitable distribution of the burden is demanded. In brief, the question of taxation is a part of the larger question of distributive justice. But it is not with ideal men or ideal conditions with which we have to do, but with actual men and conditions. Hence, the specific forms which the principles may take will depend upon the prevailing moral and intellectual, the political and economic development.

But while the ultimate end is ethical, the means thereto are largely economic. Both a theoretical and a practical determination of what is justice in taxation presupposes a knowledge of economic laws and of their influence upon the effects of any system of taxes.¹ It could not be otherwise, since all the phenomena concerned are economic. The end alone is ethical. But the ethical is not so far conditioned by the economic that it is only a consequence of economic laws. There are, however, certain fundamental principles in taxation (and it is these with which we shall have specially to do) that are not directly concerned with economic laws. They presuppose, indeed, certain economic conditions and certain economic forces, but their real justification is to be found in a political philosophy and in the ethical end of man. It is more directly with the practical side of justice that economic forces have their importance; although it is true that the theoretical principles of justice depend upon economic facts for their interpretation.

Notwithstanding this close relation of the economic and the ethical, they are entirely distinct, being related as means to an end, or as proximate and ultimate ends. This fact is

¹ Cf. Bastable, *Public Finance*, p. 9.

universally recognized in every financial doctrine; for, consciously or unconsciously, the ultimate sanction of every theory is its conformity to what are assumed to be the ends of justice. Even those who, like Sax, deny that ethics has any place in finance, are forced to this standard, as we shall have occasion to see later. With all, the attainment of justice in the distribution of the tax burden, is the ruling idea. Thus, in fact, as well as from the nature of the subject itself, the ethical element is made the predominating element in determining the principles of taxation. But unanimity of thought respecting the end does not guarantee unanimity of doctrine. Such agreement of doctrine depends upon the conceptions of ethical ideals, and in these the differences are as great as those already noted.

Finally, the difficulties of the problem of taxation and of the attainment of a common agreement of doctrine do not consist alone in differences of fundamental presuppositions or of ideals. Not the least of the difficulties is a logical consistency in the development of a theory from its presuppositions. Too frequently prejudice, sentiment or expediency usurp the place of logical thinking, which not unfrequently results in conclusions in no way related to the premises assumed, even if they are not in direct opposition to them.

Without a further enumeration it must be evident that the problem that we have assumed to discuss is full of perplexing difficulties. That we shall be able wholly to avoid them can not be presumed, for many of them are inseparable from the subject itself. We must necessarily start with assumptions, and the merits of our treatment must be measured by the rationality of these assumptions and the logical consistency with which the idea contained in them is developed. A philosophical or scientific treatment must further be devoid of any personal bias. While it shall be my aim to attain this standard there will undoubtedly be some who

will consider my point of view, if not my reasoning, vitiated by an undue ethical emphasis. But apart from the fact that the real subject of my study is an ethical one, I believe that in emphasizing the ethical element of the problem I am only recognizing what is implied, if not expressed, in other theories. While we start out with the idea of ascertaining the principles of justice in taxation we endeavor to start without any presuppositions as to what those principles are. Our presuppositions are in the assumption of fundamental principles, not in the conclusions; but without such assumption no rational treatment of the subject is possible.

What, then, is the assumption with which we start out? It is the conception of man as a personality, and as such as an end in himself whose fullest realization is the purpose and end of his existence; and that this realization takes place very largely in and through institutions, one of the most important of these being the political institution—the state. The assumption, however, is not a *mere* assumption. It has rational justification; but the demonstration of this belongs to the field of metaphysics¹ and for our purpose will be presumed. Of special and more immediate importance to our thesis is the relation of the state to the individual in this process of realization. Hence, a conception of the nature of the state and its relation to the individual will constitute the foundation of our thesis and form the basis of our argument. What the nature of the state is belongs to political philosophy to determine; but since political philosophy affords so many different conceptions of the state, and since our own argument must depend upon our own conception, it will be necessary to lay our own foundations by first discussing the origin and nature of the state before discussing the principles upon which the state should be maintained—or the principles of taxation. This we shall

¹ See T. H. Green's *Prolegomena to Ethics*.

attempt to do in the following chapter so far as is necessary to make clear our own point of view. We shall then discuss the nature of taxation and its relation to economics and ethics, after which we shall take up the subject of our thesis proper.

Before beginning our discussion, however, it may be well to clear up an ambiguity suggested in the wording of our subject. "Justice in Taxation" may be considered either from a practical or from a theoretical point of view. Under the former the subject would involve the setting forth of a detailed system of taxes that would realize justice to the individual taxpayer. A theoretical treatment, on the other hand, involves a discussion of principles rather than of kinds or systems of taxes. It is the latter view that forms the chief subject of our inquiry, although from neither point of view can a discussion of justice in taxation wholly ignore the effects of taxation; as, for example, the phenomena of shifting and incidence are closely related to the problem of rates and exemptions. Principles, however, must precede definite systems just as a fundamental assumption must precede the determination of principles, for without a norm of judgment no definite conclusions are possible.

The necessity of this norm must be our answer to the "practical man" who distrusts all theorizing not based upon empirical facts alone, and who seeks to determine justice in taxation by purely objective standards. Such a procedure is, to our mind, comparable to the attempt to obtain a knowledge of an object from mere sensations without reference to a unifying and interpreting agency to give them meaning. Like sensations, *mere* facts are without significance. The so-called facts of the empiricist must be given a meaning by reference to fundamental concepts. The principles once established, it is for the practical statesman or financier to put them into operation. If the principles

are not practicable they must be considered as utopian, at least under existing conditions. The ideal, however, has its place and importance, but the necessity of its modification in practice according to circumstances must be recognized. The nearest approximation to justice is always the ideal under any given conditions.

CHAPTER II

THE ORIGIN AND NATURE OF THE STATE

A STUDY of the origin and nature of the state is a necessary preliminary to a study of the nature of taxation and is indispensable as a foundation for the determination of the principles on which taxation should be based. It furnishes, moreover, an explanation of the reason why these principles should be based upon ideas of justice. That justice should be the aim in all taxation, is now universally admitted, and appears, indeed, so self-evident that proof is deemed unnecessary; but the proof is always implied, and is to be found in the nature of the state, or rather in the nature of the individual and his relation to the state.

I. THE INDIVIDUAL AND SOCIETY

The nature of the state is determined by the nature of society as the nature of society is determined by the nature of the individual. But the individual and society are so intimately related that they mutually condition each other, and hence our study must begin with a study of the individual and society.

Beginning, then, with man, the individual, it is possible to conceive of him in three different aspects: As related to himself, that is, as a distinct personality; as related to society, or as a complex personality; and as related to the Infinite, or as a permanent personality. These three aspects are expressive of the ethical, social and religious nature of man, and without their co-ordination we have only the imperfect and undeveloped man. Our concern, however, is

with only the first two of these aspects—man the individual and man in society. In respect to the former we assume, and without attempting a metaphysical proof, that man is a human spirit and, as such, a personality, and therefore exists as an end in himself; that it is the purpose of his life to realize that end—to develop his highest personality, to perfect himself. Otherwise man would exist without any rational purpose. It is not the nature of the human spirit to be content with mere existence, except, perhaps, in its lowest form, where the animal predominates over the human. It is rather its nature to develop, to unfold itself, to manifest its possibilities, and in doing so it reveals and perfects its own personality.

But the development of individual personality can not take place by itself. It is possible only in and through a society of similar personalities, a society of *persons*. As a person in a society of persons the individual, in being conscious of his own end, as an end in itself, recognizes that every other individual is likewise an end in himself, and therefore an end to be realized. In this reciprocal recognition of similar natures, effort towards the realization of others becomes a part of the realization of self. Thus, though an end in himself, the individual does not exist solely for himself, but is at once his own end and a means to the ends of others. His development is conditioned by their development, as their development, in turn, is conditioned by his. The joint effort towards the realization of individual personality centers in the social nature of man and necessarily involves social relations. Only through the development of the social nature is the development of the individual nature made possible, as only by the co-ordination of the individual and social side of human nature can true personality exist.

The development of the social, and therefore also of the individual, nature of man takes place in manifold ways, but

more and more, with the progress of his development, through social relations that manifest themselves in social institutions, in whose complex phenomena we have what is called "society." To borrow Hegelian terminology, the human spirit in realizing itself objectifies itself in social institutions—in society. Such a society being a manifestation of, and so constituted by, persons is something more than a mere aggregate of individuals, a mere numerical *quantum*. It is the result of social forces, and aggregation is not socialization. The bond that transforms human aggregates into living societies is psychical. But at the same time that it is a uniting, it is also a differentiating force; thus, while giving unity to the social elements and to the social whole, it permits expression of the manifold human interests in social effort. It is, furthermore, purposive in character, uniting common interests to common ends, and so re-enforcing the recognition by self-conscious spirits of persons as *means* to the ends of others, as *ends* to themselves. To the extent that this common interest and recognition do not exist the self-seeking spirit of man tends to the disintegration of society; or to the assumption by a part of society that certain classes of individuals are only means to the ends of others, a practical denial of their existence as persons, as ends in themselves. The existence of such a negative force in society has far-reaching consequences, not only in matters of taxation but in the whole economic and social life; for to the failure to recognize individual personality as an end in itself are very largely due the antagonisms of social classes. Only in the complete recognition of the ethical nature and end of the human person can society fulfill its highest purpose, as expressing the objective realization of the individual—of personality; and the more this becomes a reality in life the more will justice between man and man be realized. And the more that society is recognized to be a society of persons the more will these ends be attained.

But if it is true that society is constituted of persons, and that without *persons* there is no *society*, it is not less true that without society there are no persons.¹ Persons and society are, in fact, correlative to each other. Each presupposes the other. In society personality and individuality unfold themselves; in society the human spirit seeks its realization. Without society the person has only potential capacity, while it is only in society, "only in the intercourse of men, each recognized by each as an end, not merely as a means, and thus as having reciprocal claims, that the capacity is actualized and that we really live as persons."² If the evolution of social relations, indeed, is but the gradual tracing out of the evolution of the human spirit, these relations, as they at any time exist, are the embodiment of all past, and condition all future, social development. But although society and the individual mutually presuppose each other the end of social evolution is not in society, *as such*, but in the realization of the individual, to which end society is a condition and a means. And in the character of society as a society of persons, and as a condition of their development, we have indicated the ethical character of all social institutions, and the necessity of ethical considerations in all social relations. Related as subjective to objective the development of one implies the development of the other. And as the development of the ethical life takes on the form of a change in extent rather than in the fundamental ideas,³ embracing an ever larger circle of persons in the consciousness of the unity of purpose and ends, so in social evolution there is an ever increasing multiplicity in the numbers and variety of social institutions, an ever growing organization of common interests and common ends, the complexity of the social relations being a reflex of the complex nature of the

¹ Green, *op. cit.*, p. 199.

² *Ibid.*, p. 192.

³ *Cf.* Green, p. 269.

individual, a means of his giving expression of himself—of his being a person.

The complexity of social relations is not a miscellaneous complexity. Every human interest, when it becomes sufficiently important and sufficiently general according to circumstances, is focussed in an organized body of persons with the purpose of giving realization to the common interest. Thus, out of social relations are formed social groups, whose totality constitutes society. These groups tend to embrace every human interest of social importance—intellectual, moral, religious. They divide and subdivide, ever increasing in numbers and variety with intellectual, moral and religious progress. In content these groups tend to become more specialized, in extent more generalized; a condition due to scientific progress, as in means of communication, on the one hand; and to a broader human fellowship, an enlarging consciousness of the unity of interests and ends, on the other hand. But the consciousness of a community of interests and ends that gives rise to social groupings is not a reflective consciousness of ultimate ends, except, perhaps, in certain religious groups. The determining consciousness is that of immediate interests and ends. Consciousness of ultimate ends has little direct influence upon social groupings. The ultimate end is revealed only by a reflective analysis of the philosophy of social life with reference to the life of the individual. Yet it is only in and through the almost countless number of these groups, ever increasing in numbers and variety, that the human spirit finds its fullest realization. And the "unity in complexity" of these groups is typical of the highest form of social evolution.¹

The tendency towards social organization, however, is not without its opposing influences. The presence of self-seeking spirits as the dominant factor in human life is a dis-

¹ Cf. Spencer, *Principles of Sociology*, Pt. v, chs. 2-4.

integrating social force and produces a retardation if not a negation of social organization. Social development is conditioned not only by the presence of positive social forces and favorable conditions, but by the absence of negative forces and conditions. Progressive realization of the human spirit is possible only where the conditions are favorable to its voluntary and spontaneous activity, both with respect to individual undertakings and with respect to associated effort such as is manifested in the social groups seeking a common purpose. That these positive and negative conditions should be maintained becomes, then, a matter of the first importance and of general interest. To this end a coercive power is a necessary requisite, and hence, in its maintenance and support there is a universal interest. Such a power is realized in the political organization of society, the state—the all-comprehensive social group representing the universal common interest. In this group is centralized both the objective and the subjective complexity of society; in it social life reaches its highest culmination.

II. ORIGIN OF THE STATE

With the actual historical origin or with the evolution of the state we have no concern. Being in search of principles our point of view is wholly that of a philosophy of the state, and is therefore an inquiry into its underlying principle and cause, of which the historical state is a manifestation, whatever may have been the course of its development. From this point of view the state's origin may be considered under two aspects, its objective necessity and its subjective necessity.

By objective necessity I understand the necessity, pointed out above, of a coercive power to give unity to society and to make possible the conditions of social, and thereby individual, development. For without such a dominating

social group society would at best be but an unorganized mass of social groups in perpetual and unrestrained conflict with anti-social forces, thus destroying the effectiveness of social organization and social effort in the work of the realization of man. The necessity, indeed, of this restraining and controlling power has been recognized, however unconsciously, from the very dawn of society, though its earliest manifestation was in other social groups, such as the family and religious groups. In the course of time the ever increasing manifoldness of interests, by a process of social evolution, gave rise to a differentiation of the groups, a distinct political group ultimately emerging with the specific function of maintaining the order and conditions necessary to the ends of individual and social life. Assuming the realization of the individual as the unrestrainable and impelling force, the necessity of the objective conditions may be considered as one of the unconscious forces that brought the state into being. In brief, its very indispensableness is the cause of its being. With human nature as it is the state can not be conceived not to be.

But the objective necessity is not the only cause of the state. Back of that and co-operating with it is a subjective necessity that springs from the nature of the individual. On the one hand it is the necessity of self-realization in the most effective manner; on the other hand, it springs from the social nature of man² that impels him to associative effort for individual ends of a common interest. In this respect the state does not differ from other social groups. These differ among themselves chiefly in content and immediate end, but also in the form of organization and government. Nor is the social nature that binds men together in societies a mere instinct such as prevails in animal societies. It is rather a partly conscious and partly unconscious

² Aristotle, *Politics*, i, 2.

recognition of common ends of immediate interest; and with the highest development, also, of ultimate ends. Philosophically the social nature of man as distinct from the social nature of the animal, has its reason, if not its spring, in the conscious or unconscious recognition of man as an end in himself and as a means to the end of others.

III. THE NATURE OF THE STATE

The real nature of the state is revealed on the one side in its origin and on the other side in its end. Its origin, nature and end are, in fact, but different ways of viewing the fundamental conception of the state as an indispensable instrument in human development. In determining its origin we have, therefore, determined in general its nature and end. But a more specific determination of its nature is necessary, and this may best be done by a more specific determination of its end, for, as Aristotle long ago pointed out, the nature of a thing is determined by its end.¹

What, then, is the end of the state? We must first of all distinguish between the end of the state and the functions of government. A government is only the agent of a state, an organization within the state for effecting its will—its purpose. A state is a body of people organized into a body politic to effect the purpose or ends of individuals. The functions of government, then, have reference to the organized will of the people; the end of the state to the end of the individual. We may, however, consider the end of the state as of a two-fold character: proximate and ultimate. Proximate with reference to the establishment of preliminary conditions; ultimate with reference to the final end. Accordingly Professor Burgess calls the proximate end the establishment of government and liberty;² but if we may

¹ Aristotle, *Politics* i, 2, 8.

² Burgess, *Political Science and Constitutional Law*, Vol. i, p. 86.

consider government as inseparable from the state, though distinct from it, the proximate end might be more justly considered as the guaranteeing of rights and justice between man and man,¹ the direct maintenance of them being a function of government. What the specific functions may be is a question that is determined at any time by the existing state of culture and civilization, by the prevailing conception of the relation of the state to the individual. But into this question we need not enter here.

The ultimate end of the state is the ultimate end of its units—of the individuals of which the state is composed. The state by itself can have no end that is ultimate, since ultimate ends pertain only to entities that are ends in themselves. The end is ultimate to the state only with reference to its supreme purpose—to the ultimate purpose of its existence—not with reference to itself. This purpose, and therefore the ultimate end of the state, is the completest realization of the individual—his capacities, his *personality*, the highest human development, the perfection of humanity.² Considered with reference to itself the ultimate end of the state is the maintenance of the conditions that are essential to the self-realization of the individual. The state is a means; man alone is the end.

In brief, a state represents the organized effort of a people to realize the fullest development of human personality; or it is the supreme conditioning instrument of that realization. And to be such a condition and instrument constitutes the real essence of the nature of the state. But all other human institutions are conditions as well as means to the development of the individual; and since their existence and utility are conditioned by the existence of the state, we may characterize the state as *the* condition of conditions that are

¹ Cf. Lilly, *First Principles in Politics*, p. 30.

² Cf. Burgess, *op. cit.*, p. 85, and Lilly, *op. cit.*, p. 51.

necessary for the realization of man. This supreme importance of the state to the individual makes it of universal interest, while the ethical character of its end, a consequence of the ethical character of its units, makes it an ethical institution. These characteristics of the state—the universal interest and the ethical character—may be called derivative characteristics of its nature. There are also other characteristics of the state that are essentially connected with the nature of the relation of the state to the individual. A definite conception of the most important of these is necessary to a clear understanding of the nature and principles of taxation. They are: The character of the relation of the individual to the state; the character of the state as an organization; and the character of the state as a supreme controlling power. We shall discuss these characteristics of the state briefly under the following heads: The voluntary and involuntary character of political organization; the organic theory of the state; the nature of sovereignty.

IV. CHARACTERISTICS OF THE STATE

1. *The Voluntary and Involuntary Character of Political Organization.* We have thus far seen that the state is the supreme and most important of social institutions; that it originates on the one hand in the social side of human nature, and on the other hand in the effort of man to realize the possibilities of his nature; that its origin dates from the very dawn of social life; that in its development in form and organization it has gradually become differentiated from other social groups, assuming the special function of establishing the conditions that make their development, as well as all social evolution, possible, its ultimate purpose being the realization of human personality; that, finally, it is an ethical institution in which there is a universal interest. Its dominant feature is its conditioning character, but while this

feature is prominent in every field of social life it has perhaps its greatest significance in the economic life; not only because economic or industrial conditions are the best objective indication of progressive enlightenment and civilization, but because the economic life is in a sense the foundation of both individual and social life, and so also of the state itself. In such a social body, whose existence is so important to the individual that without it he could not exist as a person, what is the character of the membership? In other social groups membership is limited, and is determined by choice based upon an idea of the Good for the self but with limitations imposed by each social group for itself. Choice and permission are both essential; there is no compulsion either from within or from without, but only a subjective necessity. Is membership in the state of the same character? Membership in this or that particular state is determined by various influences, as language, custom, tradition, nationality; but with intellectual and economic enlightenment and growth in personal freedom, membership becomes more and more determined from choice, from an idea of a personal Good. But membership in a state is universal, there being no stateless persons in civilized society. It is also universally necessary, and this necessity is not only subjective but is also objective: subjective, because as we have seen, it is the inevitable expression of certain qualities in human nature; objective, because in civilized society there is no escape from membership in a state and subjection to its laws.

But is this membership voluntary and free, or involuntary and compulsory? Our answer must be that from different points of view it is both voluntary and compulsory. From the point of view of political science it is compulsory, but from the point of view of a philosophy of the state it is voluntary. Objectively considered, that is from the point of

view of empirical political science, the state is undoubtedly founded upon *force*; and membership in it, support for its maintenance and defense, is compulsory. Without the exercise of force, or the possibility of its exercise, no state could endure. Without it there would be only individual and factional strife, the "war of all against all," barbarism, undeveloped humanity. But important as is the element of force in a state, force viewed as the foundation of the state expresses but a half-truth. Considered from the point of view of subjective political philosophy, the only point of view that reveals the true relation of the individual to the state, the foundation of the state is *will*.¹ Or, if force is the foundation of the state, *will* is the foundation of force. In fact, the force which the state typifies is but the embodiment of the wills of its members, the objectified will of persons. Hence also membership in the state is both compulsory and voluntary. The state, as *force*, exacts support and obedience, but the state as the embodiment of will is created and maintained by the voluntary acts of free agents—of persons.

This dual character of the state and of membership in it, a little reflection will make evident. The element of force and compulsion is too self-evident and too admittedly necessary to need special justification; but that the force of the state can not be permanently effective, except as it is the expression of will, reflection must make equally clear. The fact, indeed, is well illustrated in the practical impossibility of enforcing unpopular laws—of laws out of harmony with the general public sentiment. The fact that the state is a people organized into a political society, originating in a common interest to achieve a common purpose and common end—based upon an idea of a Common Good²—is likewise the clearest evidence of the implication of will as its source,

¹ See Green, *Political Obligations*, pp. 121-141.

² *Ibid.*, p. 126.

and that there is not fundamentally any forced subjection to any external power. The purpose of realizing a common good can have no meaning except it be grounded upon consent; but consent is choice, choice is an act of will,¹ and will is based upon an idea of a Good. And, it may be added, in the *willing* of a common good, the pursuit of a common end, which implies a conscious presentation of the end to the subjects willing, is the final proof that the state is an ethical and not merely a natural institution.²

The real fact is that membership in a state—or the support and obedience which it implies—is a result of compulsion only in the case of this or that individual, where ignorance and selfishness has set up a personal good as opposed to the common good. Without such compulsory conformity to the idea of a common good, dissolution would set in and the state soon cease to be a state; but this compulsion becomes less and less a factor in the life of a state, while voluntary participation in and support of the state, becomes more general, the more enlightened a people becomes—the more it rises to the idea of a common humanity possessed with common interests and like ends. Upon the state as a whole, indeed, there can be no compulsion, since the state is itself a body of people organized for the maintenance of rights. Compulsion must be by the whole upon the individuals who contravene these rights. Compulsion is from without, and the state is not a body external to itself that can coerce itself. The people as a whole and individually will the enforcement of law for the maintenance of rights. Even the violator of law wills the enforcement of the law upon every member of society, and therefore upon himself. He merely takes his chances for a greater personal, temporary good for himself by evasion of it.

¹ Cf. Aristotle, *Nicomachean Ethics*, iii, 2, 1.

² Cf. Green, *Political Obligations*, p. 132.

In brief, the case is this: By virtue of a recognition of persons as ends in themselves there arises the idea of the *rights* of persons, and therefore also a common interest in the maintenance of these rights by the combined force of all. To this end the state is organized—to centralize the force of the whole upon the individual. For the realization of rights, therefore, two conditions are essential: a conception of persons as possessing rights because of their character as *persons*, and the collective enforcement of these rights. Or, as Green says, force co-operates “with those ideas without which rights could not exist.”¹

2. *The Organic Theory of the State.* What, now, is the character of the political organization in which the citizen freely participates for the realization of himself? Is the state a mere aggregate of individuals, a social organism, or an association of individuals psychically united by a common interest in common ends? An answer to this question will throw light upon the nature of the state and also upon certain principles of taxation, particularly respecting the basis of taxation and the exemption of the minimum of subsistence. Our own answer has practically been given in the preceding discussion, but we may re-enforce our argument by a brief consideration of the opposing theories.

The theory that the state is a mere aggregate of individuals need not detain us long, as there are few, outside of the anarchist or the extreme individualist, who would maintain so irrational a doctrine. Clearly, a *mere* aggregate of individuals cannot make a society, or a social group, any more than a *mere* sum of sensations can issue in knowledge. Society, like knowledge, implies unity in multiplicity, but such unity is possible only if there is a common principle that pervades the multiplicity—the individuals or sensations—

¹ Cf. Green, *Political Obligations*, p. 140.

and binds them together about a common idea, purpose or end. Without this uniting principle there can be no society.

But is the unity that makes society an organic unity? Is society—the state—an organism? Such has been the accepted doctrine of widely different schools of thought, as Spencer on the one side and German philosophers and economists on the other side. The theory of the social organism is to-day one of the most widely accepted doctrines respecting society or the state.¹ That there is a striking analogy between the structure of the state and an animal organism there can be no doubt; and that this analogy is helpful to a clearer understanding of the nature of the state must also be admitted. But it is a poor logic that argues from an analogy of structure to an identity of character or nature. Indeed, the analogy even with qualification is quite as harmful as helpful, since it is suggestive of an entirely erroneous conception of the relation of the individual to the state, and logically carried out would lead to strange conclusions in principles of taxation, as in political matters generally. Upon the whole I believe it to be in the interest of scientific truth, notwithstanding certain similarities, to abandon the analogy entirely, not only because of its misleading tendencies but because in its most important features the analogy is entirely false. Without attempting a detailed criticism I would mention three facts any one of which is sufficient to overthrow the doctrine that the state is a social organism. These are: 1. Differences in the character of the units; 2. differences in sentiency of organism and society. 3. differences in the end of the units and the whole.²

1. The units of an organism differ from those of a society

¹ It is interesting to note that there is a growing tendency among American authors to reject the organic theory of society, as notably, Giddings, Willoughby and Fairbanks.

² See Spencer, *Principles of Sociology*, Vol. I, pp. 478-9.

or state, in their discreteness, their mobility, their consciousness. (a) The units of an organism are concrete, material things physically united, though endowed also with the physical principle of life. The units that compose a state are materially discrete, though being essentially psychical in their nature are psychically united. (b) The physically united unit of the organism is immobile and performs a specific function in a specific portion of the organism. The psycho-physical unit of the state being discrete has great mobility, and performs various functions in various portions of the body politic. (c) Not only is the social unit endowed with mobility, but it has also consciousness, indeed, self-consciousness. It has, thus, the capacity of the self-direction of its movements and activities in the pursuit of various purposes that it sets before itself as desirable to attain. Hence its ability to attach itself to this or that society—"social organism"—or to perform functions not only in the various groups—"organs"—of the same society, but also at one and the same time in different societies or states. In no sense does such consciousness and such self-direction exist in the unit or cell of an organism. There is, in brief, all the difference between a *thing* and a *person*.

2. Again, in the animal organism there is a common sensorium for the whole organism which is the center of its sentient and psychical existence. No such sensorium exists for the state, since it exists only in corporeal substance and the state is not such an entity. It has no sentiency or psychical life apart from that manifested in its unitary parts, while in the organism there is no sentiency or psychical life apart from that manifested in the whole. It does not exist in the units or cells. So far as there is any comparison, indeed, it is between the organism as a whole and the units that make up a state. But since these units are in reality the organism with which the comparison would be made, we

should have only what the logicians call an identical proposition.

3. But perhaps the most decisive difference between an organism and the state is in the ends of the units and of the whole. In the organism the cells—units—are merely contributory parts in the life of the whole and exist only for the sake of the whole. They have no end of their own and no function apart from the specific organism to which they belong, and apart from it also no reality. The units of the "social organism," on the other hand, do not exist for the whole, but the whole exists for them, for their development. They are ends in themselves, have functions of their own to perform as well as those for the whole, and have a reality of their own. But the organism, as such, has its end in its own existence, while the state has its end in the highest existence of its members—its constituent parts. In the state the whole has its existence in and for the parts; in the organism the parts exist in and for the whole.

These objections, to which others might be added, are a sufficient refutation of the widely-accepted doctrine of a social organism. But if the organic theory of society is false, so also is the extreme individualistic conception of society. If the state is not an organism for which the individual exists, it is nevertheless true, as we have seen, that it is only in the state that the individual has his highest and most complete existence. The only true theory lies between the two extremes, and sees the mutual dependence of the state and the individual, never forgetting, however, that the ultimate factor of permanent importance is the individual, for whose end all else is at bottom subordinate.

Important conclusions follow. For if the view that we have held is the true one, it follows that the individual must contribute to the support and maintenance of the state, but that in doing so his own personality, and therefore ethical

considerations, should ever be kept in the foreground. But on the theory of a social organism contributions to the state should be determined rather by principles of expediency than by ethical principles, since the ends of the individual would be of no concern, as they would have existence only for the "organism." On the basis of an extreme individualism there would be no contributions to the state, or if so, only voluntary ones.

3. *The Nature of Sovereignty.* We are not concerned with all of the characteristics of sovereignty, but only with such characteristics as have any importance in the determination of principles of taxation. We shall, therefore, consider sovereignty only with respect to its dual nature and the characteristics of each, and with respect to the rights of individuals.

1. By common consent the chief attribute of sovereignty is supreme, coercive power over the lives and property of individuals, or associations of individuals, that are members of a state; a feature that is common to no other social group. But sovereignty is something more than supreme power—force; but to understand its twofold character it is necessary to keep in mind the distinction between state and government so clearly and forcibly made by Professor Burgess.¹ A state is a body of people organized as a body politic; a government, as we have seen, is the agent of the state, the instrument for effecting its will. It is in the government that is manifested the direct exercise of sovereignty, but the source of this power is in the people back of the government. It is the former that the statesman or lawyer ordinarily has in mind, but to the political philosopher the latter is of chief importance. The former—the sovereignty of government—we may, with Professor Ritchie,² call *legal*

¹ Burgess, *Political Science and Constitutional Law*, Vol. i, p. 57.

² Ritchie, *Principles of State Interference*, Appendix, note B.

sovereignty; the latter—the sovereignty of the people—*ultimate* sovereignty. More definitely, ultimate sovereignty is the organized will of a people respecting life and property, liberty and justice, or the conditions of human development. Legal sovereignty, on the other hand, is the immediate exercise of supreme power in accordance with the general will of the people.

This double aspect of sovereignty may also be characterized as the sovereignty of *force* and the sovereignty of *will*, or objective sovereignty and subjective sovereignty, a view which follows from our conclusions concerning the nature of the state. The force of the state, or its supreme power, and the will of the state are but two aspects of the same thing and mutually supplement each other. For will implies a conscious activity directed towards a definite end, and without such activity is only a mere subjective *wish*. So also sovereign force of a people, as distinct from mere force, implies intelligent direction; or we may say that such force is intelligently directed will, but with supreme power for the execution of its ends. That is, the intelligently directed force and the will, necessarily in one and the same persons, are, as we have said, obverse sides of the same fundamental fact—*will*, or the activity of will. Hence, the sovereign power of the state is the activity, or expression, of the sovereign will of the people of the state, and are related as effect to cause. The primary, subjective fact is will; the immediate, objective fact is force, power.

If we consider sovereignty with respect to its sanction, or to the extent of its power, we meet with the same primacy of will. For it must be clear that the sanction for the exercise of supreme power by a state, apparently in the fact of the power itself, is in reality in the sovereign will. To be otherwise sovereignty would be no more than brute force. Objectively viewed, indeed, the sanction is in the fact of the

possession of supreme power, but without the originating and directing will there would be no such power, nor does the power extend beyond the range of the organized will of the people, the sovereign will of the state. But for the sovereign will there can be no sanction outside of itself, for will is a fundamental fact so far as our purpose is concerned, since we have not to do with the metaphysics that traces it to the *supreme* will imminent in the human will.

So likewise with respect to its extent. Sovereignty, indeed, as an objective fact is, by its very definition, unlimited in the degree and range of its power, since there can be no other power within a state to which it may be subordinate. But since sovereignty is also objectified will it is conditioned by the range of the activity of that will. Thus, again, will is the ultimate fact. The extent, or perhaps better the content, of sovereignty is determined, therefore, by the character of the will which it represents; that is, by the character of the wills of the persons in whom the sovereign will is embodied. Therefore, though in a sense will is a law unto itself, sovereign will is, by the very nature of the individual and the nature and purpose of the state, an ethically determined will; for, as we have seen, it is organized will directed towards the good of every person represented in it.

2. Is there, then, any limitation to sovereignty, or, are there rights of the individual as against the sovereign power? Politically, it must be admitted, sovereignty is absolute over life and property. Under no other condition can a state endure. The right of the state to exercise compulsion upon the individual has been sufficiently discussed in discussing the character of membership in the state, where it was shown that forced obedience is justified as against the individual who sets his selfish will in opposition to the general will, as in the violation of law, the non-payment of taxes; though

philosophically there is much truth in the contention of Hegel that the criminal wills his own punishment, wills, that is, the direction of the force of the state against himself.

But are there no limits to this power of the state over the individual? Only a moral limit. And hence the only rights of the individual against the state are moral rights. Politically, that is legally, the sovereignty of the state is absolute; but in virtue of its own ethical character, as well as the ethical character of the individuals in whom, upon whom and for whom it is exercised, it is subject to moral limitations. Or, there are rights of the individual that the sovereign power of the state is morally bound to respect, rights that flow from the very law of his being. They are in a very true sense "natural rights." They do not depend upon the state for their existence as *rights*, but only for a more assured reality. As Green puts it: "The state, or the sovereign [he means the government] as the characteristic institution of the state, does not create rights, but gives a fuller reality to rights already existing."¹ Not all "natural" rights are made legal rights, but only such as are of universal interest; and legal rights that are not "natural" or *moral* rights are not permanently enforceable, since they are antagonistic to the general will, to the prevailing idea of *right*.

The ridicule so commonly heaped upon the doctrine of "natural rights" loses its force if the distinctions we have made between sovereign force and sovereign will be insisted upon; and only by such distinctions is it possible to arrive at a true philosophy of taxation. The plea for justice in taxation, implied if not expressed in almost every theory of taxation, is proof of the general conviction that there are "natural rights" of the individual which the state does not create but should enforce; that the sovereign power of the state *ought* to be governed by definite conceptions of these

¹ *Political Obligations*, p. 138.

rights, by ideas of justice; that the state—individuals in association—no less than the individual, should be ethically determined. No other conclusion is possible from the conception of the state upheld in this chapter, which conceives it to be the purpose of the state to enforce right and justice to the end of the highest realization of the individual. The right to develop, to realize himself, is fundamental to every individual, and this implies a right to the means necessary to attain the end, but with a recognition of the equal rights of others. These rights of the individual necessarily involve obligation on the part of the state, whose very essence it is to provide these conditions, to make possible this development. It is by virtue of these facts—this conception of the state—that ethical principles in taxation are demanded; and it is in accordance with them that ethical principles must be determined.

Our conception of the nature of rights of the individual, and of the corresponding obligations of the state, may perhaps be made clearer by an illustration. Take, for example, the question of property rights. The right to property, it is usually assumed, is a purely legal creation, property being a question of law and not of right. From the legal point of view this is entirely correct; but the statement expresses only a half-truth. Property, that which is *one's own*, is also an economic good, produced directly or indirectly by individual exertion for the satisfaction of human needs, by which the self is realized. Such economic "good," therefore, belongs of right—a moral, "natural" right—to the individual as his own, his property, because it is the objective expression of his effort to provide the material means, not only of life but for individual, human advancement. Or, to borrow, again, Hegelian terminology, property is the outward manifestation of one's self; is, in a sense, the objectified self. Property as a legal right is only a confirmation by the government of an already existing moral right.

The moral, or "natural," right to property the state is bound to respect in its demands upon the individual, as it respects the right to individual development. And, in fact, this right to private property in the product of one's own labor has been recognized from the very beginning of economic life. The case is quite different with land, which as a common inheritance was first held in common and only later, partly as a matter of expediency and partly from a general recognition of the right to the improvements made upon the land, was made private property. As Locke puts it, whenever one's own labor, which is his own, is added to a natural object "the common right of other men" is excluded.¹ To this right to the products of one's own labor the government gives a legal existence.

If there is only a legal right to property, if property has only legal existence created by the sovereign power of the state, or by the government acting for it, there can be no question of the rights of the individual to any economic goods which the state may demand, or of the obligations of the state respecting them. Expediency, not justice, would supply the norm for taxation. But if property, that is economic goods, belong of right to the producer of them, as representing his effort and sacrifice to realize the possibilities of his nature, then this right should be recognized as fundamental in the determination of principles of taxation. Expediency must give place to justice.

The preceding theory of the nature of the state and the individual, involving reciprocal rights and obligations, will be assumed as the basis of the following discussion of just principles of taxation. The marked feature of this theory is the emphasis that it gives, at least by implication, to the idea that the problem of taxation is an ethical one: that in taxation as in other matters the good of the individual is the

¹ Locke, *Civil Government*, ch. v, sec. 27.

fact of fundamental importance, the ultimate object towards which the operations of the state must tend; that, in fine, the view-point of the problem of taxation, as of all social phenomena, is *man*. There will, however, be no attempt to make this theory the basis of new and startling conclusions. The object of this study is rather, upon the basis of a theory of the state that, it is believed, best explains its philosophy, to ascertain the true philosophy of taxation; upon this basis to discover, by analysis and criticism of existing theories, the true principles of taxation; and above all to give them a rational justification, and not, as is commonly done, merely assume the justice of certain principles without full consideration of all that is implied in the mutual relations of the state and the individual.

CHAPTER III

TAXATION, ECONOMICS AND ETHICS

I. TAXATION

1. *The Nature of a Tax.* In the preceding chapter we have learned that the state is an organization of persons effected for the realization of a common end, a common "good"—a good that is "common" because it is the good of every member of the state; that this "good" is from one point of view the attainment of right and justice, while ultimately it is the fullest realization of the personalities of the individuals who in their organized totality constitute the state; that primarily necessary for carrying out the ends of the state is the establishment of government—an organization within the state—charged with the general purpose of acting as the executive agent of the collective will of the state.

Thus we find that a government, as the agent of the state in the realization of right and justice and in the maintenance of conditions for the highest possible human development, is a fundamental collective need indispensable to every individual, to every *person*. Now such a government is not a mere subjective idea; it is also an objective fact, consisting as it does of a body of persons selected for the performance of its functions, for executing the will of the people—the state. But that these persons may perform the functions of government, certain material conditions, or means, are necessary. Hence the need of a government, and so the needs of government, involve two classes of needs: personal service

and material goods. But since the persons who act as the government retain their individuality—therefore their personal wants satisfied by means of economic goods—demand for their services resolves itself into a demand for economic goods, or the means for their procurement. Thus, directly or indirectly, the whole needs of a government may be summed up in the need for economic goods; on the one hand, food, clothing, shelter, etc., for the governing class; and on the other hand, land, buildings and such equipment as is necessary to provide place and material for the performance of the service, for the preservation of records, etc., and armament, ships and other essentials for national defense, both of which conditions are essential for the maintenance of government. Immediately and directly, however, the need of government is revenue—money—by means of which it can procure both service and the material goods necessary for the performance of its functions.

In the past the services and material goods required by a government have been procured in a variety of ways: By tributes and booty, by feudal services, grants, aids, etc.; by the cultivation of crown lands, and by direct service to the state—as military duty and the *corvée*; and latterly, indirectly by means of revenue collected in the form of money from the citizens of the state in which the government in question exercises its functions.¹ In earlier times tributes and booty constituted the principal source of revenue, in medieval times feudal dues and crown lands were the most important source, but in the modern civilized state the chief source of revenue is taxation—money contributions from the whole people—though fees, fines and, in some countries, government lands and industries yield a not unimportant part of the total revenue. We are concerned, however, neither with the history of governmental revenue, nor with

¹ See Wagner, *Finanzwissenschaft*, ii, sec. 103 et seq.

a study of the principles underlying the various kinds of revenue, but solely with the principles that should determine the collection of that revenue which comes from taxation.

What, in brief, is the nature of the tax, whose principles we seek to determine? Numerous definitions of a tax have been given, though not with complete success, since too great precision is attempted in a single sentence. For our purpose, at least, it is better to state the fundamental idea of a tax and afterwards to note its leading characteristics. Otherwise there will be inaccuracy of statement, or the need of too many qualifications. I would, therefore, define a tax as a contribution from individuals out of their private property for the maintenance and defense of government, to the end that it may perform its functions and the ends of the state be realized. The fact that contributions from private property are necessary for the support and expenses of government results, in part, from the change from collective to private economy, and in part, also, from the gift or sale of crown, or national property, to individuals as private property; in a word, to the fact of private property. And so long as the system of private property subsists individuals must contribute from their property for the support of government. But whether the individual is a member of the state to whose government he contributes is a matter of no importance. The fact is that contributions are due from all (with exceptions to be noted later) over whom a government may directly exercise jurisdiction, as with respect to their property, or for whom any of its functions may be directly performed, as for the defense of their persons or property.

In viewing the tax as a 'contribution' we have regarded it solely from the point of view of the individual, and we believe that this point of view is justified by a true philos-

ophy of the state as emphasizing the most distinctive feature of a tax, philosophically considered. But it must be admitted that there is another aspect to a tax, the point of view of the government. And from this point of view the tax may be considered as a method of procuring a revenue to meet the expenses of the government by means of collections from the private property, or income, of individuals. From the point of view of the individual, therefore, a tax is a 'contribution,' from the point of view of the government, a 'collection.'

2. *Characteristics of a Tax.* The tax regarded as a 'contribution' or as a 'collection,' or as both, does not reveal its full nature, but only its general feature. Particularly important to a clearer understanding of the nature of a tax are two characteristics that are in part suggested by its general feature as described above. (1) First, the question whether a tax is a tax upon persons or property; (2) Second, whether the tax is voluntary or compulsory. Both questions are of importance, not only because their answers will throw light upon the nature of the tax, but because important principles of taxation depend upon their determination.

(1) In the first place, then, is a tax imposed upon persons or upon property? That a tax is nominally levied upon property no one will question. But is the tax in reality, in its *essence*, a tax upon property? Economically speaking, or viewed as an objective phenomenon, a tax is undoubtedly upon property. A government requires economic goods in the form of a money revenue to defray its expenses in the performance of its functions; and this revenue is obtained by a collection made upon the private property of individuals. Government, in brief, requires property and procures it by assessments upon property and collections of property. But this view of a tax explains only its external and mechanical character, its *formal* character.

But as the nature of things in general, so also the nature of a tax is not determined by its formal character, but by its subjective idea, its subjective character. And the subjective character of a tax is not determined by the formal relation of a government to economic goods, but by the relation of a state to the persons in whom and for whom it has its existence. For, as we have seen, a state consists of *persons* organized as a body politic and has for its purpose their gradual development and perfection. State and persons are interdependent and correlative to each other. Consisting of persons, the state has direct relation only to persons and dependence upon persons. Government being the agent of the state, it is a necessary incident to it, and hence its maintenance and support is a requisite to the maintenance and support of the state. And as the agent of the state the dependence of the government for support is necessarily the same as that of the state, that is, upon persons. The relation, we repeat, is to persons and the dependence upon persons. This is involved in the very idea of the state. Moreover, as the state, and so the government, exists for persons and is a necessity to persons, the obligation of support must rest upon persons, as the necessity of support is a necessity to persons. Neither necessity nor obligation could rest upon property as such, though property is essential to state and government. The tax is and can be nothing else than a tax upon persons, at least upon our assumption of the true conception of the state. Nor, indeed, is the subjectivity of the tax, as a tax upon persons, any less apparent when viewed from its economic standpoint if only the subjective character of property be considered. For, subjectively considered, property is, as we saw, the objectified self; and hence a tax upon property becomes indirectly a tax upon persons, upon personal productive capacity and ability, upon the economic means of satisfying personal wants, and thus upon the entire personality of the taxpayer.

Thus, whether we consider the tax with respect to its necessity to the individual and to the corresponding individual responsibility and obligation (involving the relation of the individual to the state), or with respect to its economic relation to the individual, it is equally evident that, while empirically and objectively viewed, a tax is upon property, ideally and subjectively viewed it is upon persons. And it may be added that this subjective character of the tax has far-reaching results. It supplies the key not only to the true philosophy of taxation but to the principles by which it should be governed. It also furnishes the key to the solution of many otherwise difficult problems in taxation, and consistently adhered to avoids much error and confusion of ideas. "The subjectivity of the tax," says Vocke, "is the Ariadne thread that must be firmly held if one would avoid a multitude of dangerous mistakes and escape from the labyrinth of obscure (unklar), if also old views."¹

(2) Granting that a tax is a tax upon the person, is the tax contribution voluntary or compulsory? Again, it is necessary to distinguish between the objective and the subjective character of the tax, between the objective fact and the subjective idea. As objectively considered from the view-point of political science, or of the government, the payment of taxes is necessarily compulsory. Compulsion, in fact, is a necessary prerogative of objective sovereignty, and a necessary consequence of the right of the state to be. So dominant, indeed, is this aspect of the tax that the idea of compulsion has become a central feature in all of the definitions of a tax by both the legislator and the economist, the statesman and the financier. Yet, historically, the beginnings of the tax, as occasional "aids," "grants" and "donations," were entirely voluntary; and only gradually, with the change of society from *status* to *contract*, and the

¹ Vocke, *Die Abgaben, Auflagen und die Steuer*, p. 472.

growing insufficiency of other sources of revenue, did these contributions become regular and compulsory.' And curiously enough, as the consciousness of the unity and universality of interest in a stable government has developed, and particularly with the rise of the democratic state, the compulsory character of tax contributions has become more universal and more rigid.

But the compulsory feature of the tax represents only one side of the question, either historically or philosophically. For, correlated with the fact of an enlarged range, and the rigidity of compulsion, is the further fact that with the growth of a more definite consciousness of our citizenship, and of the vital relations that we sustain to the state and the state to us, there develops the conviction of an obligation to contribute towards the support of the government, and at the same time the right of the government to exact the contribution.² And, indeed, this conviction attests the voluntary character of the tax, at least where its true nature has been duly reflected upon. Nor is the voluntary character of the tax a mere subjective concept arising from conscious reflection upon the nature of a tax. Taxes are in fact voluntarily paid, even though the attempt is almost universally made to evade a part of them, or a protest is made against their amount. At least in all cases of pure democracy, or of representative governments elected by the people, the people voluntarily agree, directly or indirectly, to tax themselves. As was pointed out when discussing the character of membership in a state, the people who voluntarily make up a state voluntarily agree to tax themselves for its support and maintenance; and only here and there the self-seeking individual endeavors to make himself an exception to the general rule, and upon such it is agreed, individually and

¹ See Seligman, *Essays in Taxation*, pp. 1-7.

² Cf. Cohn, *The Science of Finance*, sec. 192.

collectively, that compulsion shall be applied, the voluntary and compulsory character of a tax thus implying each other.

But not only is the idea of voluntary taxation implied in the voluntary character of membership in a state, it is a necessary consequence of the subjective idea of the tax and of the state. If, as we have maintained, the fundamental basis of the state is will, then the same will that creates the state must will to provide the means for its maintenance; that is, contribution for the support of the state is a voluntary act. Any other theory can rest only upon the presupposition that arbitrary force is the sole foundation of the state, thus failing to distinguish between the empirical state and the Concept state.

Nevertheless, the subjective idea of taxation does not exclude the idea of compulsion. On the contrary, compulsion, we repeat, is in the voluntary conception of the tax; a fact that must become apparent the moment that we reflect upon the distinction between the general will and the individual self-seeking will, between the social will of the individual and his purely personal will, if we may be allowed the distinction. In any case, however, only the subjective idea of the state and the subjective idea of taxation can furnish a basis for ethical principles of taxation, for if force is the sole factor in the problem there can be no question of principles, but only of policy; still less a question of ethical principles. But, in fact, even the objective right of compulsion, as in the enforcement of the law of universality, rests upon the subjective idea, or, perhaps better, the subjective fact.

3. *The Limits of Taxation.* Granting the power of the state to impose taxes as a sovereign right—a right, however, that has its source in the general will—are there any limits to the taxing power? If the question be made to refer to the state proper it must be said that no theoretical limits to

taxation can be assigned; for if the state is the people organized, and represents their collective will, there can be no limit to its power other than that which it determines for itself, that is, which is determined by the general will in view of common ideals. But in view of the fact that the government, as the agent of the state, is the practical taxing power, it is with reference to the government that the question has its real significance.

In discussing, then, the limits of the power of the government in taxation we shall pass over all specific reference to the individual, since this phase of the question constitutes the essence of the main burden of our thesis. Here we wish only to note a few general observations, particularly respecting the amount of the tax burden. And in the first place, it may be observed that the limits are relative, not absolute; and that while no *a priori* rule can be given for the limitation, there are, nevertheless, both theoretical and practical limitations. In a general way we may classify the limitations under the following heads: political, ethical, economic.

(1) Politically speaking the power of a government in taxation is theoretically limited by its creator, the state; and most commonly the limit finds objective expression as a constitutional limitation, especially under constitutional governments. That is, the will of the people is the final judge. More than this, in all representative governments the people theoretically exercise a direct control over the amount of the tax in the choice of their representatives. Unfortunately, however, owing to party machinery and political methods, the control of the people is very largely theoretical only. Where, indeed, the government falls into the hands of a "political aristocracy"—the politicians—the people retain only the semblance of power, while the government becomes practically absolute.

And yet there are practical limitations, for if the burden

becomes too oppressive there is always danger of a revolution, such, for example as the Revolution of 1789; unless, perchance, the oppression successfully passes a point where resistance becomes hopeless, as is apparently the present condition of Italy and Spain. In countries of greater enlightenment and a larger freedom there is the restraint that the fear of being deprived of office, through the ballot, constantly exercises. Such a limit is, however, very indefinite. It depends in part on the ability of the governing power to throw the burden on those who have practically the least political power; in part on the ability to use the more or less deceptive method of creating public debts.¹ Thus, politically a government has in practice a wide range of discretion in the use of its taxing power, even the constitutional restraint being very largely negated in the fact that the government interprets the constitutional limitations put upon it.

(2) But though a government has a large range in taxation politically, there are certain ethical limitations that are incumbent upon it, for the government is, after all, constituted of moral agents. Still, no definite moral rule of limitation can be assigned. All that can be said is, that since the government is the agent of the state in making conditions possible for the highest human development, it is morally bound to consider the effects of any taxation in retarding this development. But such a limit is relative. It depends, on the one side, on the functions that are assigned to the government, and, on the other side, on the national wealth, on the economic condition of the people. But the functions of government are themselves relative²—relative,

¹ Cf. Adams, *Public Debts*, ch. ii and pp. 41-2.

² The theory of the relativity of the functions of government was warmly criticised by the Hegelian scholar, Dr. W. T. HARRIS, in a discussion following a paper by the writer on "The Functions of Government."

that is, to the habits and customs of a people, to their ideals, their intellectual and moral status, their industrial life, their political and economic freedom. The main ethical problem of a government in taxation, however, is the just distribution of the burden, a question we need not discuss here.

(3) Economically, also, the limitations of taxation have the same relative character that they have ethically, the same indefiniteness, the same want of definite rule.¹ Neither a fixed percentage of the national wealth, nor a *per capita* average can furnish valid criteria for judgment. Hardly more satisfactory is the rule that would limit the amount of the tax upon the individual to a fixed proportion of his revenue.² No less indefinite is the rule that the amount of taxes should be determined by the needs of the government, for not only are these needs relative to the functions of the government, but their satisfaction is conditioned by the national wealth and general economic circumstances. Of far greater importance, since it conforms both to the ethical ideal and to sound economic policy, is the rule of Stein, sanctioned by Professor Adams,³ that the amount of the tax should be so adjusted as to maintain a due proportion between the satisfaction of the needs of the state and the needs of the individual. True, the difficulty of this rule is the practical determination of a "due proportion," a problem that is very largely influenced by economic and ethical conditions. The solution of the problem, however, is made theoretically simple by the utilitarian economists by an application of the doctrine of marginal utility. But for reasons that will be given later, utilitarian economics has, to my mind, a very limited application in public finance, being subject to the delusions

¹ Cf. Wagner, *op. cit.*, 8:cs. 104-106. Cf. also Adams, *Public Finance*, pp. 26-33.

² See Vauban, *La Dime Royale*.

³ Adams, *The Science of Finance*, p. 28.

that are so common in reasoning from analogies. Still, the rule is economically and ethically sound as a rule for guidance. But, perhaps, the most practical economic rule is that taxes should not be so large as in any way to impair their source. That is, the economic limitation is determined by the effects of taxes upon industries, and so upon the sources of revenue. This phase of the question we will discuss under the following head.

II. TAXATION AND ECONOMICS

The economic life of a people is intimately related to its social life, not only because it is itself a phase of the social life, but also because economic goods form the material basis of the existence and usefulness of all social groups,—religious, philanthropic, scientific, etc.,—as well as of the political group itself. That is, social well-being is conditioned by economic well-being. Whatever, therefore, affects the economic life, or the economic conditions of a people, affects also its social and so its individual well-being. Hence it becomes of grave importance that a government in exercising its power of taxation, in collecting economic goods from individuals, should carefully observe any economic effects that taxes may have, whether due to the methods of taxation, the amount of the taxes, or to other causes.

These effects we cannot stop to discuss in any detail, but, must confine ourselves to pointing out some of their more important features and tendencies, not only to indicate the character of the problem involved, but also to emphasize the fact that justice in taxation cannot be realized except by due observance of economic laws and principles. For while this aspect of the question is essentially one of the economics of taxation, rather than of the principles of taxation, a clear understanding of the character of the effects of a tax is an indispensable prerequisite to the determination of principles ;

since the justification of principles must be found in the effects resulting from their practical application, not in *a priori* formulae. Indeed, it is because of the influence that taxation has upon the production, distribution and consumption of wealth that it is of special economic and ethical importance to consider its effects, since these have an important bearing upon principles of taxation, as no system can be just which unduly and unequally affects the opportunities, or material means of development. In the economic effects of a tax, therefore, and more particularly in the effects upon consumption, is to be found an important factor in determining the justice of principles of taxation.

1. *Taxation and Production.* The question specially involved here is not that of taxes as an element in the cost of production. It goes, indeed, without saying that taxes must constitute an essential element in the cost of production so long as government shall be necessary to guarantee the protection, security and order that make production possible, and so long as taxes shall be necessary for the support of government. More strictly, taxes are a preliminary expense that make the conditions of production possible; but they are none the less a necessary part of the cost. Nor, again, is the question one of the possible use of taxes to further production by the government, as, for example, by the purchase of railroads or other industries. This is a question of policy and of the functions of government as well as an economic question, and is too large a subject to be considered here. No, the question with which we are concerned, is the effect of taxes upon the production of individuals, and thus upon economic progress and the general material well-being of the individual and of society.

Do, then, taxes encourage or discourage production? To this question different answers have been given. On the one side there is the doctrine that taxes necessarily stimulate

production, a theory successfully overthrown by Hume.¹ McCulloch accepts the reasoning of Hume but qualifies his acceptance with the statement that, "it is undoubtedly true that the desire to maintain and improve their condition, stimulates most men to endeavor to discharge the burden of additional taxes by increased industry and economy, without allowing them to encroach on their means of subsistence, or on their fortunes."² On the other hand, J. B. Say, who viewed the problem from a different aspect, thought it "a glaring absurdity to pretend that taxation contributes to the national wealth," since "capital is but an accumulation of the very products that taxation takes from the subject;"³ that is, since the source of a tax and of capital is one and the same, and to increase the one is to diminish the other.

The fact of the case, however, is that general positive statements can not be safely made on either side of the question. The effects of taxation on production are relative to a great variety of circumstances and conditions, and these a government should, as far as possible, take into account in its tax systems and methods. What the effects of a tax upon production are, depends, in fact, very largely upon the laws of shifting and incidence in taxation. But these laws are by no means simple in character; they depend upon many conditioning influences, and are specific rather than general in their nature. We cannot, however, stop to discuss this aspect of the question further than to call attention to the evident fact that the effect of a tax, and therefore its

¹ See Hume, *Essay on Taxes*.

² McCulloch, *Taxation and Funding*, p. 7 (ed. 1852). For similar views of Petty and Temple see Seligman, *Shifting and Incidence*, p. 16. Cf. also Bear, *L'Avere e l'Imposte*, p. 126. Also Mill, *Polit. Econ.*, sec. 3, bk. v, ch. iii.

³ Say, *Political Economy*, bk. iii, ch. viii, sec. 1. For conditions in which the tax may lower or raise the "marginal cost," or influence the rate of remuneration, see Edgeworth, *The Pure Theory of Taxation*, in *Economic Journal*, Vol. vii, p. 57.

incidence, is indissolubly linked with the problem of justice; and also to point out some of the more important conditions determining the shifting and incidence of taxation. That is to say, the justice of a tax is largely conditioned by its effects, the effects are intimately connected with its incidence, and the incidence, as we have said, is determined by various conditions.

Among the more important of such conditions are the following: Whether the industries taxed follow the law of constant, increasing or decreasing returns; whether or not they are monopolies; whether or not there is mobility of capital and labor; whether the tax is based upon value or is a tax upon *surplus*; whether the demand for the taxed commodity is elastic or inelastic; whether or not the "law of substitution" is possible; whether the tax is high or low; whether special or general; the condition of the market for labor and capital; the economic condition of the industry taxed relatively to other industries; the form of the imposition and the kind of taxes, as, for example, whether the tax is direct or indirect; and the kind of industry taxed and the stage of the industrial process in which the industry is taxed. In brief, whatever conditions, arising from taxation, that have an influence upon price determine the manner and degree of shifting and incidence, since these are essentially phenomena of price, the objective determination of which is the law of demand and supply, the subjective determination the law of marginal utility.¹

¹ For the best statement of the history and theory of shifting and incidence, see Seligman, *Shifting and Incidence of Taxation*. See also Kaizl, *Die Lehre von der Ueberwälzung der Steuern*. For a theoretical study of the first four "conditions" mentioned in the text see the able article of Prof. Edgeworth on "The Pure Theory of Taxation," *Economic Journal*, Vol. vii. These conditions are not treated by Prof. Edgeworth singly but in groups of assumed combinations. He takes into consideration also the effects of "short" and "long periods," and whether the tax is on *rival or complementary* industries. The article is a splendid illustration of both the complexity and the difficulty of the problem of "shifting and incidence."

It is the influences of such individual or combined conditions as the above that help to determine the operation of a tax, and without a clear understanding of these influences it is impossible to determine the effect of a tax upon production. And yet they tell us but one side of the problem. By studying the effect of these influences we may learn the effect of a tax upon price and upon the demand and supply for the products taxed, but not necessarily the effect of a tax upon production. The question of the effect of a tax upon production is primarily and immediately a question of its effect upon the accumulation and employment of capital, and upon the zeal and industry of labor. An important element in the solution of this problem is undoubtedly the influence of demand and supply operating through price, itself largely determined by the above-mentioned conditions. But this is not the only element of the problem. It is necessary to know, not only the effect of a tax upon price and demand, but also the effect of a tax-determined price upon the profits of capital and labor. Nor even then can we say with any definiteness what effect these combined influences will have upon production. Positive statements concerning the effects can result only from an incomplete apprehension of the facts involved.

Let us take, for example, the assumption of Say, that taxes always tend to diminish production for the reason that what is spent as a tax would otherwise have been consumed as capital; or the opposite theory, that a tax tends to stimulate productive activity, or to "create the ability to bear it," on the ground that the desire to maintain a certain standard of living stimulates to greater industry and labor whenever a tax curtails the means of maintaining the desired standard. The fact is that both assumptions are only partial truths. In both also there is a *non sequitur*. Not only is it clearly not a fact that what is spent as a tax would otherwise have been

employed as capital, but it by no means follows that, because both the tax and capital have the same source, to increase the one is to diminish the other, since all other expenditures have the same source. How that part of the income which is consumed as taxes would have been spent but for the tax depends in part, indeed, upon the possibility of profits, but also in part upon the character and habits of the individual taxpayer. And in like manner is determined whether a tax effects a greater utility of industry and labor. Influences are at work in both directions and the final effect is a resultant of many opposing forces. But whatever the general tendencies, there can be no doubt but that an excessive tax curtails production, while a moderate tax may, at least under certain circumstances, afford a stimulus to greater production or to larger accumulations of capital.¹

It is, indeed, in the fact that taxes may work both ways upon both capital and labor, may even have one effect upon one class of producers and the opposite effect upon another class, that makes it of such importance that a government, in the determination of the amount and adjustment of taxes, should carefully consider their possible effects, and so the conditions under which those effects are likely to be produced. Nor is this importance confined to the immediate effect of taxes upon production. It is shown as well in the logical results of our assumptions. To assume, for example, that taxes always encourage production is not only to assume a fallacious doctrine, but also a dangerous principle, since there would be no logical limit to the extent of taxation; while the assumption that taxes always lessen production, besides being false, tends to exaggerate the rights of the individual as against the state and to cripple the necessary needs of the government. The possible indirect effects upon

¹ Cf. Marshall, *Principles of Economics*, p. 288 (2d ed.). Also Pantaleoni *Teoria della Pressione Tributaria*, p. 41.

production would be far reaching. Thus, both because of its direct and its indirect effects, a government is morally bound to consider the effect of its tax impositions, both with respect to their amount and their adjustment. The constant aim should be to interfere as little as possible with the processes of production.

Whether a government should encourage production by means of protective tariffs or otherwise—creating limited legal monopolies—is a different matter. This is a question of the functions of government and of governmental policy, not of public finance. But when a government by its tax system, or by the amount of its taxes, unnecessarily curtails production or produces unequal conditions of production, it does an injustice to the taxpayers affected by lessening their ability, absolutely or relatively, to satisfy their wants; and at the same time lessens its own efficiency by diminishing the source of its material means of usefulness; thus constantly threatening stagnation, if not degeneracy, instead of promoting the highest development, intellectually, morally and spiritually—by promoting the material conditions of such development. That the task of the government in duly observing the effects of its taxes and tax system upon production is a difficult one can not be denied. The complexity of the conditions that enter into the problem makes this inevitable. Nevertheless, consideration of these effects is necessary, both that production in general may not be unnecessarily checked, and that the production of one class may not be promoted at the expense of another class, thus effecting inequalities and injustice, instead of the equality and justice for which a government stands.

2. *Taxation and Distribution.* The effect of taxation upon distribution is not less important than its effect upon production, not only because of the influence of the distribution of wealth upon economic and social conditions, but

because the distribution of wealth is a very large factor in the determination of the character, methods and amount of production. For instance, large industries and large-scale production are economic phenomena which have their economic basis in large accumulations of capital, which change the whole relation of capital to labor as well as relative social conditions. Both the economic and social importance of distribution, therefore, demand that careful consideration should be given to the possible effects of taxation upon the distribution of wealth. The importance of the social and economic effects of the distribution of wealth must be assumed as self-evident. To adequately treat the question here would take us too far afield into a discussion of social and economic problems. I would, however, call attention to four different ways in which taxes do, or may, influence distribution; and at the same time call attention to some of the more immediate effects.

(1) In the first place there is the inevitable change in the distribution of wealth consequent upon taxation and the expenditure of its proceeds. Wealth is taken from the pockets of the producing class and transferred to the pockets of those who perform the services of the government or provide it with material goods. This is unavoidable in modern political societies where co-operative division of labor is so fully realized. But no hardship or injustice is thereby incurred. Those who provide the revenue and those who consume it in performing the functions of government are equally supporters and maintainers of the government, and both are equally gainers by this division of labor. There is no injustice, therefore, in this effect of taxation upon distribution, so long, at least, as the effect is but the normal result of legitimate taxation to meet the essential needs of the government.

(2) The second method by which taxation may (indeed

does) effect distribution is by the tax system itself. This method is essentially indirect. Two illustrations will make this method sufficiently clear: Protective tariffs and personal property taxes.

Granting the legitimacy and justice of protective tariffs, their first and more direct effect is to divert wealth from employment in natural channels of production to artificially created channels. This in itself may be an economic gain to the whole community as well as to those immediately concerned. But however this may be, protective tariffs have the further effect of establishing special privileges to certain classes, making possible the colossal fortunes of the Carnegies and Rockefellers. The same is true of any other monopoly-creating tax. The importance of these changes lies not only in their reactive effects upon the methods and amount of production, but also in widening social distinctions and creating social discontent.

The distribution effected by the abominable system of personal property taxes in the United States, while more indirect and less perceptible is not less certain, and at the same time results only in the most patent injustice. Such taxation is practically regressive; the richer classes having larger accumulations of personal property, more easily evade the tax assessor. The tendency of such a tax system is to foster the growth of large fortunes by relieving them of their just burdens, but at the expense of the smaller fortune. One class in society pays the taxes of the other class. The economic effect is precisely the same as if property was forcibly taken from the one class and transferred to the possession of the other. To this economic injustice there is added the political injustice of throwing the heaviest burden of taxation upon those who have the least ability to bear it. Thus, again, instead of promoting justice and equality the government is made an instrument in fostering injustice and un-

equal opportunities, with the attendant social inequalities. The same unjust influence upon distribution is effected by any system of taxation that results in an unequal assessment and collection of the tax burden.

(3) The influence of the rate of taxation upon distribution involves chiefly the question of progressive taxation, for a strictly proportional tax leaves the same relative distribution of wealth after as before the tax, effecting distribution only in such manner as is inseparable from the nature and use of taxation. The maintenance of the same relative economic conditions, or the equalizing of the burdens of taxation, may also be the special object of the progressive rate, and so far as this purpose is carried out the progressive rate simply corrects the defects of the proportional rate by accomplishing in fact what it stands for in theory. The justice of the progressive rate from this point of view will come up for discussion in a future chapter. We need only to observe here that however just the progressive tax may be it effects a different distribution from that entailed by a proportional tax, though only such as is incident to the system itself.

It is a far more serious question where progressive taxation is used with the deliberate purpose of effecting an artificial distribution of wealth, as in the social-political theory of Wagner.¹ Such a use of taxation is, however, a social use and does not strictly come within the province of public finance.² Moreover, it rests upon the assumption that it is a proper function of government to equalize the fortunes of individuals. This, however, is not an admitted function of government in the modern state, though it was practiced by the ancient Hebrews,³ was attempted by some of the Spar-

¹ *Cp. cit.*, li, pp. 207, 385-6 and 455-9. Also i, p. 47.

² *Cf. Meyer op. cit.*, sec. 67; Vocke, *op. cit.*, p. 43, and Marzano, *Compendio di Scienza delle Finanze*, p. 116.

³ *Leviticus*, xxv, 10.

tan kings,¹ and recommended by the agrarian reformers of ancient Rome.² At the present time this doctrine finds defenders only in the different schools of socialism. The weakness of the whole doctrine is excellently summed up by Professor Seligman, when he says that "a legal equality which would attempt to force an equality of fortune in the face of inevitable inequalities of native ability would be a travesty of justice."³ Further comment is unnecessary.

(4) A final use of the progressive rate is to effect a complete revolution in the distribution of wealth by converting private wealth into public wealth by a process of confiscation. This is advocated only by the extremes of socialism, and, with respect to land, by the disciples of Henry George. This use of the tax is so foreign to present ethical standards that it has no practical significance and needs not to be discussed here.

In the brief summary that we have attempted of the possible influence of taxation upon distribution, inclusive of the effects upon social and economic conditions—upon spiritual as well as upon material development—sufficient, I think, has been said to emphasize the necessity of great care lest distribution be too arbitrarily and too unnecessarily affected by taxes. It illustrates also the truth of the statement of Professor Adams, that "the distribution of wealth within a country is of as much importance to its public economy as the possession of wealth."⁴

But besides its social and economic importance, the use of taxation to effect a distribution of wealth other than is entailed in the system itself, has the further importance that it violates the "natural right" to property as understood in the preceding chapter. As was there indicated the claim of

¹ See Plutarch's *Lives of Agis and Cleomenes*.

² See Plutarch's *Lives of the Gracchi*.

³ *Progressive Taxation*, p. 69.

⁴ Adams, *Public Debts*, p. 151.

the state, or government, is limited to its needs. To go farther than this, to appropriate the property of some to bestow it upon others, however indirectly, is to transgress the "natural law," is to commit an injustice.

3. *Taxation and Consumption.* Only recently has consumption played any important part in either economics or public finance. With the classical economists the safe-guarding of production was regarded as a prime element in a sound theory of taxation; while the ethical economists and the socialists have given special attention to distribution—both the distribution of the tax burden and the use of the tax in the distribution of wealth. It has remained for the subjective economists—the Austrian school—to lay emphasis upon the relation of taxation to consumption.

Of these several interests consumption is of most vital importance; for objectively and economically considered, consumption is the end of all production, and we may add also of distribution; while subjectively and ethically considered, consumption is the process by which the wants of the individual are satisfied, so far as they are materially determined—that is, the self-perfected, realized. Emphasis upon consumption, therefore, is a recognition of man as a compound of needs whose realization is the essence of his being. It changes the view-point from the *thing* to the *person*, the means to the end. Not the creation of wealth, but the use of it, is made the fact of most importance.¹ In the power of consumption is seen the best measure of material well-being; but material well-being, at least until a certain standard is attained, has a most important bearing upon the development of the whole spiritual life of man.

In fact, consumption, both by its amount and by its character, entails far-reaching results. It profoundly affects production by affecting the efficiency of labor; for efficiency is

¹ Cf. Walker, *Political Economy*, p. 294.

determined more by what one consumes than by what he produces. The amount and character of consumption affect also distribution, as, for example, by their influence upon the standard of life, which, in turn, has its effect upon efficiency. Whatever, therefore, affects consumption affects the whole economic life; but whatever affects the economic life affects, directly or indirectly, man's complete development. For these reasons, and because private property is an expression of human personality, of the effort to satisfy human wants, the government is in duty bound to observe the greatest care that its system of taxation does not unnecessarily interfere with individual consumption.

But the practical determination of what part of individual wealth should go to the satisfaction of individual wants, and what part should be given to meet the needs of the government—to satisfy collective needs—is a problem of the most difficult character, involving as it does so many complicated conditions and circumstances. As worked out by the Austrian economists,¹ however, the theoretical solution of the problem is made simple enough, by placing the satisfaction of collective needs upon exactly the same footing as the satisfaction of private needs. That is to say, the same laws of subjective values, of marginal utility, that rule in private economy are made to rule in public economy.² The doctrine, however, contains no new principle, but applies to

¹ Meyer, Sax and Wieser. This school has a strong following in Italy, Ricca-Salerno being one of its most able exponents. His *Scienza della Finanza* is an excellent and lucid résumé of the more pretentious work of Sax.

² The credit of first applying the economic theory of subjective values to finance is claimed by Sax for himself. His theory, however, is substantially the same as that of Robert Meyer, in spite of the effort to prove a difference. The Italian economists do not concede the credit to the Austrians. Mazzola, in a note to his *I Dati Scientifici della Finanza Publica*, p. 24, claims the honor for Pantaleoni, referring to an article published by him in 1883 in the *Rassegna Italiana*, entitled: *Contributo alla Teoria delle Specie Pubbliche*.

finance as to economics a principle long familiar to utilitarian, or better Hedonistic, ethics—the obtainment of the greatest possible pleasure at the least possible sacrifice.

We may for the present dismiss this theory with the remark, that while most extravagant claims are made for it (which will be considered more fully later) it correctly recognizes the fact that the satisfaction of collective and of private needs is, in a sense, mutually exclusive, or that taxes lessen the consuming power of the taxpayer. It is this fact that makes the problem such an important one. Yet it is quite as true to say that the satisfaction of collective and of private needs supplement each other, for the satisfaction of the former conditions, as we have seen, the satisfaction of the latter, thus adding to the complexity of the problem.

We can not stop to discuss this aspect of the question further. We have succeeded in our purpose if we have made clear that taxation and economics are most intimately related, and have made clear the importance, and, at the same time, the difficulty of the question involved. For it has been shown that, indispensable as they are, taxes may be so levied as to work most injurious and unjust results upon production, distribution and consumption through the operation of economic laws, thus materially affecting human well-being. We have seen, also, that the whole question revolves about the problem of shifting and incidence in taxation, which, as we have seen, is determined by the operation of the phenomenon of price, which itself is objectively determined by the law of demand and supply and subjectively by the law of marginal utility. It is, then, to these economic influences and economic results that the statesman should give careful attention if justice is to be an aim in taxation. But while very definite conclusions may not be possible, Professor Seligman has shown that substantial results may be obtained

as a guidance in legislation.¹ Without such observance of economic laws, conditions and results the first requirements of ethical taxation are put to naught.

III. TAXATION AND ETHICS

Important as is a knowledge of economic laws and forces in questions of taxation, this knowledge will not of itself determine the true principles on which taxes should be based. From such knowledge we may learn the economic results of kinds and systems of taxes, but nothing at all of principles, that is, of ethical principles. Actual results tell of conditions as they are; ethical principles of conditions as they should be. Yet, without a knowledge of the former it would not be possible to prescribe the latter. Actual economic results have also the further significance that they indicate the extent to which the ideal, contained in the principle, is realized. They are at once, therefore, a manifestation and a guide. It is, however, the ethical principle that is of real primary importance; for the ethical principle is the fundamental principle of taxation, as the ethical basis (as we shall have occasion to see) is the ultimate basis.

In thus insisting upon the paramountcy of ethical principles in taxation, that the ends of justice can not be attained by the mere play of economic forces, I am aware of running counter to a theory, implied in the doctrines of the classical economists, and expressly championed by Sax and his school.² For according to Sax, at least, economic laws are but the expression of the process of the realization of justice; or, justice is simply the realization of economic laws, particularly of the subjective law of marginal utility. In economic laws are found the *alpha* and *omega* of justice in taxation. Yet justice is not to be directly aimed at, for, so we

¹ See, *Shifting and Incidence of Taxation*, ch. viii.

² Cf. Sax, *Grundlegung*, 83, and Ricca-Salerno, *op. cit.*, bk. ii, ch. vi.

are told, ethics has no place in public finance. So far as public finance is concerned ethical ends are a consequence, not an aim.¹

To this doctrine two important objections may be opposed: It rests upon the false Hedonistic assumption that pleasure is the highest Good; it assumes that economic motives and ends are one and the same as ethical motives and ends. That the highest Good,—the ethical end,—is not pleasure, it is not our place to demonstrate here;² but it must be admitted that it is not consonant with a theory that makes the ultimate end of the state the realization, or perfection of man. Pleasure (in the sense of satisfaction, happiness—Aristotle's *Eudaimonia*³—not Hedonistic pleasure) is an accompaniment, a necessary incident, if you will, but is not itself the end.⁴ Hence economic pleasure, *as such*, is by no means necessarily identical with ethical ends. Whether or not it is so, depends upon the *idea* of the Good whose realization is sought.

However closely related, therefore, economics and ethics may be in certain phases of taxation, ethical motives and ends are entirely distinct from economic motives and ends. *Purely* economic motives are founded upon the idea of a selfish pleasure of a more or less material character, whose realization is the economic end. Ethical motives, on the contrary, are founded upon the idea of a Good of a spiritual character—the fulfilment of the possibilities of our nature. It is not a selfish Good, for it is recognized as the "good" of others as well as for the self. Its realization is the ethical

¹ This is also implied throughout by Sax in spite of his contention to the contrary.

² See Green, *Pragmatism*, bk. iii, ch. i.

³ Described by a German philosopher as "the culture, the all-sided development of all human faculties, and the satisfaction which is founded thereon." Cf. also Paulsen, *System of Ethics*, p. 49.

⁴ Cf. Green, *Ibid.*, secs. 158 and 161.

end, which involves justice in the relations of man to man, individually and collectively. And because the ethical end is the highest end it is paramount over all other ends; hence over economic ends, and thus, also, in matters of taxation. We can not, then, admit that in questions of taxation economic self-interest is the measure of the individually or the socially just, however dependent our notions of ethical justice may be upon economic results.

For insisting upon an essential distinction between economics and ethics, and that the question of taxation is fundamentally an ethical question, no apology is needed. The supremacy of the ethical element is the only logical deduction from the theory of the state and the individual presented in the foregoing chapter. Indeed, from the ethical nature of man it follows of necessity, or as the old English moralists¹ would say, it is "according to the reason of things," that the ethical element should be the ruling element in all social relations and social institutions. In fact, it is true of taxation, and of the thousand and one social questions that are agitating the world to-day, that no satisfactory or permanent solution is possible which does not conform to an ethical standard, though that standard pertains directly to economic conditions. That is, there should be an ethical standard of economic conditions, for as Mill well says: "The first thing in every practical discussion should be to know what perfection is."²

If we are at all correct in our conclusion, even more untenable than the theory of Sax is the position maintained by McCulloch: That since perfect equality is unattainable, "in laying down a practical rule that is to apply to all taxes, equality of contribution is of inferior consideration;" and that, "It is the business of the legislator to look at the practical influence of different taxes, and to resort by preference

¹ Cudworth, Clark and Price. ² *Political Economy*, v. 2, sec. 2.

to those by which the revenue may be raised with the smallest inconvenience."¹ The error of this doctrine is not so much in the premise as in the conclusion. For the doctrine erroneously assumes that the *salus populi*, which is held to be of "prime consideration," may be permanently antagonistic to ethical considerations; that policy and justice may be permanently opposed to each other. No, the truth is with Madame Royer, who places both "utility and justice above the narrow consideration of policy;" but adds, that if "justice is at variance with utility, we say that justice is preferable."² The fact is that there can be no true social policy, no true policy in any of the social relations of life, that is not based upon ideas of justice. Justice is the foundation of a permanent social order, and a permanent social peace. Only upon the grounds of a "policy" best known to the "politician," or through want of a wholesome influence at the ballot box of a powerful minority (unless, perchance, the masses are soothed by ignorance, lethargy, or hopelessness) can a system of taxes long endure, that is recognized by all competent judges as full of injustice.³

Our conclusion, then, is: That the problem of taxation is partly economic and partly (but also essentially) ethical, the two elements being inseparably related. It is an econ-

¹ McCulloch, *Taxation and Funding*, p. 18 (2d Ed.). Cf. also Schmoller, who opposes to the principle of *Beitragsfähigkeit*, the principle: "Nimm wo es geht." Quoted by Meyer, *Die Principien der gerechten Besteuerung*, p. 128. The declaration of Held, that "the practice of using those taxes over which there is the least complaint is the wisest," is not an acquiescence with McCulloch; for with Held justice is not sacrificed as end, or opposed to policy. On the contrary, it is policy to heed the "complaint" because it is the surest (negative) guide to the realization of justice, the surest measure "für die Grösse persönlicher Opfer." (*Einkommensteuer*, p. 115.)

² *Théorie de l'Impôt*, Introduction, pp. 14-5.

³ As note the tax systems in many of the American Commonwealths (See Ely, *Taxation in American States and Cities*, and Seligman, "The General Property Tax," in *Essays in Taxation*).

omic question in that it has to do with economic goods, conditions, and relations; ethical, in that it has to do with man as a spiritual and ethical entity, at once an end in himself, and the end of all social life. Each supplements the other. As Bastable says: "The important problem of justice in taxation is indeed an ethical one, but until its economic effects are known it is impossible to say whether any given form of taxation is just or the reverse."¹

In insisting so strongly upon the ethical character of taxation no pretension is made that absolute justice is attainable. In human affairs only relative justice is possible. But we can not reach the highest approximate to justice without first knowing, as Mill says, what perfection is, and the "highest approximate" is all that can be desired.

But the problem of taxation is something more than an economic and an ethical one; it is also political. For our conception of the justice in taxation is quite as dependent upon our conception of the nature of the state and of the functions of government, as it is upon economic results.² But the political conceptions, like the desired economic results, are relative to ideals of justice.

We may therefore consider taxation as having three bases—political, economic, and ethical—which though distinct are inseparably related. Upon our conception of these bases, and of their relative importance, must our principles of taxation be determined. Sometimes the one and sometimes the other is assumed as the only basis, with a consequent narrowness of views and one-sidedness of conclusions. They must be considered in their mutual relation and mutual dependence. We shall consider these bases somewhat historically and critically in the three following chapters.

¹ *Public Finance*, p. 9. Cf. also p. 273.

² La justice dans l'impôt est une conception extrêmement difficile à formuler parce qu'elle dépend de l'idée qu'on se fait des droits et des devoirs des gouvernements. Léon Say, *La question des impôts*, p. 66.

CHAPTER IV.

THE POLITICAL BASIS AND PRINCIPLES OF TAXATION

AS we have seen in the previous chapter, taxation is a contribution from the private property of the individual for the support of the government—for the satisfaction of a common need. It arises out of the nature of the state, the necessity of government, and the prevailing system of private economy. It was further shown that the tax may be regarded as voluntary or compulsory according to the point of view in question; that it is influenced by economic conditions and involves economic results; and that above all, taxation is a supremely ethical question which must be determined by ethical standards and in conformity to ethical ideals.

Now these three phases—the political, the economic, and the ethical—are not separate, but are inseparable phases of the problem of taxation. They nevertheless afford distinct bases of taxation—bases, however, that lead to false results if taken in their isolation and not regarded in their interdependence and unity. The primary basis is the political basis, since the whole problem grows out of the relation of the individual to the state. But since economic goods are necessarily involved, and so the economic relations of the individual to the state, there is, following the political basis and inseparable from it, an economic basis. And finally, because of the ethical character of the taxable subject, and of the ethical character of all social relations, there must be an ethical basis which must act as a guiding norm in the determination of the principles that should control

taxation; since because of the supremely ethical character of the problem, the highest demand is the attainment of justice.

By the 'political basis' of taxation is understood that basis which rests upon a definite theory of the state, and from which certain principles of taxation may be deduced; or it is the determination of principles of taxation in accordance with an accepted theory of the state, or is the logical outcome of such a theory. Hence the possibility of a wide range of principles, varying from those of the extreme individualist to those of the extreme socialist. These we can not attempt to consider in any detail, but must confine ourselves to a few of the more important theories—those that have the greatest influence, either theoretical or practical. Such are: the contract theory, the evolution theory, the utilitarian theory, and the social theories (as anarchism, communism and socialism).

Now in examining these views of the principles of taxation, as related to and dependent upon a theory of the state, two things must be constantly kept in mind: The deductions made by the advocates of a given theory, and the logical deductions of that theory. It is also important to note whether the question is viewed in its entirety, or whether the political basis is regarded as the only basis. Before, however, discussing the theories mentioned we may mention briefly previous conceptions of the state and taxation.

In the time of Plato and Aristotle little was known or thought regarding principles of taxation, though both Plato and Aristotle elaborated a theory of the state. Had they attempted, however, to determine principles of taxation from their theories of the state, it is certain that they would have sought principles consistent with the highest development of the individual. The principles of Plato would have

looked towards the attainment of ideal justice, while those of Aristotle would have been adjusted to a 'mean' capable of realizing an approximation to justice. But with both, ethical results, as they saw them, would have stood in the foreground, since they saw in the state the proximate, and in the individual the ultimate, good.¹ And yet with neither Plato nor Aristotle would the laws of 'universality' and 'equality' apply to all members of the commonwealth. For with Plato the burdens of the industrial life, and so the burden of supporting the government, would fall upon the working classes, the "husbandmen;" while with Aristotle the same burdens would fall upon those destined "by nature" to be slaves.

The Roman idea of the state and government likewise precluded it from forming a basis for principles of taxation. The large dependence of the government upon booty and tribute for its support, together with the exemption of the patrician—the governing—class from the tax burden, prevented taxation from becoming a serious problem whose principles needed investigation and determination.

Coming down to medieval society and to medieval thought, we find new conceptions of the state and more definite ideas concerning taxation. The system by which individuals gave up their persons and property to lesser lords for protection, and these, in turn, their persons and property to the higher nobility, and the higher nobility to royalty; the system of sub-infeudation; and, indeed, the whole feudal system, inculcated the idea of the dependence of the individual upon higher political power, and so made protection

¹ However true it may be that the Greek subordinated the individual to the state, I do not believe that any such doctrine can be found, by any consistent interpretation, in the philosophy of Plato or Aristotle, as is so often assumed. With both, the State was only a means for the fullest development of the "golden nature" of the individual.

a dominant idea of the social and political structure of society. For this protection personal service was performed. Hence, as the feudal society gradually gave way to the "status of contract," and personal service to taxation, it was only natural that taxation should have been looked upon as a payment for the protection received from the government. The tax was simply a payment to the government of the costs of its service of protection. It was the 'cost-of-service' theory of taxation. This theory, however, soon gave way, at least in part, to the 'value-of-service' theory—a theory that measures taxation by the value of the service of protection, instead of the cost of that protection. The value of the protection was then conceived to be dependent upon the amount of the property protected, the protection of the person being apparently regarded as a negligible quantity. A tax, therefore, proportioned to one's property would be proportionate to the value of the service that he had received. But amount of property protected was very early regarded as the measure of one's economic ability, or 'faculty,' and so of one's ability to pay taxes. Though 'faculty' might be considered as only another aspect of the 'value-of-service' principle, the faculty—*facultas*—of the individual to pay taxes was early laid down as a distinct measure, or canon, of taxation.¹ It was largely out of these conditions that grew the conception of the 'social contract' and the theory of taxation that evolved from it.

I. THE SOCIAL CONTRACT AND TAXATION

At the same time that historical conditions were lending much force to the conception of society as founded upon a contract, there was gradually developing out of the old Stoic conception of a "law of nature," though with considerable

¹ Cicero somewhere identifies faculty with property.

² Cf. Seligman, *Progressive Taxation*, p. 127.

transformation of ideas, a theory of a "social compact" as a complete explanation of the origin and nature of the state. Although this theory is now universally repudiated by economists and political scientists, no theory of the state has exerted a wider or deeper influence, theoretical and practical, in the fields of politics, economics and finance, particularly in England, France and the United States. The contract theory had, for example, a great influence upon Jefferson and the founders of our Republic, and has also given color to much subsequent legislation,² while its assumptions are to-day among the most commonly accepted doctrines of lawyers, statesmen, and the general public, especially in matters of taxation.³

1. *The Political Philosophers.* The theory of the Social Contract has received its fullest development in the writings of Hobbes,³ Locke,⁴ and Rousseau,⁵ although the doctrine is older than the Leviathan.⁶ The theory is so generally understood that it is not necessary to enter into a detailed account of it. In brief it is this: Prior to the existence of civic society mankind lived in a "state of nature," according to Hobbes in an un-social, even anti-social, "state of war," but with Locke and Rousseau under more or less social conditions. In the course of time the individuals composing the non-civic society became, as it were, suddenly conscious of the fact that their happiness and well-being would be furthered if they would organize themselves into a body politic and choose a common arbiter, or arbiters,

¹ Cf. for example, speech of Dallas, *Annals of Congress*, 14th C., 1st Sen., p. 1681.

² Cf. Cooley, *Law of Taxation*. Also second message of Gov. Black of New York (1896), and newspapers at the time of the Income Tax decisions in 1893.

³ *Leviathan, De Corpore Politico* and *Philosophical Rudiments*.

⁴ *Civil Government*.

⁵ *Social Contract*.

⁶ See Grotius, *De Jure Belli et Pacis*. Also, Sidgwick, *History of Ethics*, pp. 157-160.

for settling all such disputes as are constantly arising in a state of nature, and for common defense against all attacks upon life and property; thus converting the 'natural right' of the self-defense of one's person and property into the right of a legal protection guaranteed by the people as an organized whole.

As the theory is developed in detail there are considerable differences among the writers mentioned, though for our purpose most of them are unessential. We may mention, however, that with Hobbes the purpose of the compact was to avoid a state of "war of all against all" that prevails in the state of nature; that with Locke it was to avoid the "inconveniences" that naturally arise in settling any disputes where there is not a common arbiter to decide differences; while with Rousseau the compact was rather a convenient hypothesis for picturing the conditions of an ideal society. Rousseau, indeed, had little concern for the past, but believing man to be born free but everywhere in chains,¹ he sought, like Plato, to discover the nature of the ideal state where liberty and justice might be realized.² And the basis of such a state he found in the idea of a 'contract.' There is also a difference with respect to the location of sovereignty, and to the character of the protection. Hobbes emphasized the protection of life, Locke the protection of property, and Rousseau the liberty that is conditioned by the protection of both. But the more important fact is, that with all alike the idea of a *contract* best expresses the nature of the state; that, further, the state originated in the necessity of protection, or, at least, has as its function the protection of the lives and property of its citizens.

It is unnecessary to enter into a criticism of a theory now so universally repudiated by philosophers and political scientists, although the fiction is still kept up in much legal

¹ Cf. *Social Contract*, ch. I.

² *Ibid.*, Introduction.

writing. We would simply refer to the facts: That it rests upon no historical foundation; that it falsely assumes the relation of the individual to the state to be of the nature of a contract; that it makes mechanical and statical what is spiritual and dynamic, formal what is vital, external what is internal. On the other hand, the criticism of Professor Burgess, that the theory assumes a logical contradiction, since the state must exist before there could be a contract,¹ seems to us little more than a technical point of law, as by the 'contract' was evidently meant nothing more than a covenant, similar to that of the Scottish Covenanters, or of the Pilgrims in the Mayflower.

Assuming, then, the theory as understood by its promulgators, what is the theory of taxation based upon it? If its theory of taxation depended upon its theory of a contract we might dismiss it with the statement: That since no such contract ever existed, nor, in fact, expresses the true relation of the individual to the state, it can not form the basis of the rights and obligations of citizens in matters of taxation. But as a matter of fact the idea of a contract forms no part of the theory of taxation of the Contract theorists. With them the basis of both—of the state and of taxation—was found in the idea of protection. For this reason their theory of taxation, most fully developed by Hobbes, deserves more careful consideration, since protection is unquestionably an important factor both in the conception of the state and in that of taxation.

That the basis of taxation is found in the protection that the citizen receives from the state is most clearly brought out by Hobbes. Taxes, he says, "are nothing else but the wages due to them who hold the sword to defend private men in the exercise of their several trades and callings." Moreover, since the benefit that every one receives from this

¹ Burgess, *Op. cit.*, Vol. I, p. 62.

protection "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 defense of his."¹ But this equality of taxation does not mean, however, an absolute equality, for the benefit of the protection is the "enjoyment of life" as measured by material consumption; and hence taxes should be based upon what one "spendeth," or consumes, by which "every man payeth equally for what he useth."² Similarly in the *Politics*: "The burdens of the commonwealth being the price that we pay for the benefits thereof, they ought to be measured thereby." And since this benefit is the equal enjoyment of the peace and liberty to use our industry to get our living, we should contribute equally to the common charge, not as measured by the results of our industry, but by our consumption. "That seemeth therefore to be the most equal way of dividing the burden of public charge, when every man shall contribute according to what he spendeth, and not according to what he gets."³ Again in the *Philosophical Rudiments* it is declared, that taxes being "nothing else but the price of bought peace, it is good reason that they who equally share in the peace, should also pay in equal part."⁴

In brief, the position of Hobbes is this: The purpose of the state is the protection of the life of the individual that he may enjoy the peaceful pursuit of a living, and the individual should pay for the expense of this protection; the tax, which is the price of this 'bought peace,' should therefore be based upon the benefits derived from this protection; and since the value of this benefit is determined by the

¹ *Leviathan*, Part II, Ch. 30, p. 30. (All references to Hobbes are from Molesworth's edition.)

² *Ibid.*

³ *De Corpore Politico*, Part II, pp. 216-7.

⁴ *Philosophical Rudiments*, p. 173.

amount of the enjoyment, which is itself measured by the amount that one enjoys in the way of consumption under the protection of the state, the tax should be based upon the consumption of the individual; and since all equally enjoy the benefits of protection, as thus measured by consumption, all should bear equally the burden of taxation according to their enjoyment of consumptive goods, that is, in proportion to their consumption. And that this principle should govern the distribution of taxes is in accordance with the 'natural law.' "Rulers," says Hobbes, "are by the natural law obliged to lay the burden of the commonwealth equally on their subjects. Now in this place we understand an equality, not of money, but of burden, that is to say, an equality of reason [proportion] between the burdens and the benefits. For although all equally enjoy peace, yet the benefits springing from thence are not equal to all,"¹ because of differences in consumption, which is the true measure of benefits. That is, the cost of protection should be distributed among those receiving the protection in proportion to its value to them, or in proportion to the value of the benefits of protection, which is the quantity of consumption.

Are these conclusions of Hobbes a logical consequence of his fundamental premise, or the logical outcome of his conception of the state? Or, again, does the theory of Hobbes give us a satisfactory principle of taxation, grounded upon a sufficient and satisfactory basis? Both questions, we believe, must be answered in the negative. For, with respect to the first, if protection is the sole purpose for which political society exists, then the cost of that protection is the logical basis of taxation, but such a basis of tax distribution is a practically impossible basis. Or, if the tax be considered to be paid for the benefits of the protection, not for the

¹ *Philosophical Rudiments*, p. 179.

protection itself, then the value of those benefits would seem to be the true basis for the distribution of the tax burden. But, again, this is an impossible basis, for the value of these benefits is an incalculable quantity, since the protection upon which they rest is the foundation of our whole civilization and of all the benefits derived therefrom. But since a tax can not equal the benefits let us concede that it should be in *proportion* to benefits; that is, the share of each should be such a proportion of the total expense, as the benefits that he derives from the protection are to the total benefits. But this, again, is not a calculable quantity. Hobbes, however, gets around the difficulty by first assuming that the benefits consist in the peaceful pursuit of "our trades and callings," and then illogically concluding that the benefits are measured by what we consume rather than by what we produce. In brief there is no logical connection between Hobbes' theory of protection and his theory of consumption as the basis of taxation. Nor is Hobbes more satisfactory in his assumption of benefits as the true principle of taxation. Even if we concede that, in a sense, the theory of benefits is a logical deduction from the theory of protection we maintain, and shall presently show, that the theory of protection is wholly inadequate, as it expresses at best only a half truth. On the other hand the theory of benefits as understood by Hobbes is equally inadequate, since it expresses even less than a half truth. It is a grossly inadequate conception of the state that conceives its benefits to be limited to the power of peaceful industry, or to the personal consumption of economic goods. The benefits of government are manifold and are not to be limited to the enjoyments derived from the consumption of material goods. And the tax must include the whole range of enjoyments. Further, the theory of benefits is a false and impossible principle for taxation; false, because it assumes an erroneous

conception of the relation to the state as the basis of taxation; impossible, because the benefits that are supposed to form the basis of the distribution of taxes are in no way a calculable quantity.

Not only, therefore, does Hobbes commit the double error of assuming benefits as the true measure of taxation, and that these benefits are proportioned to our consumption of economic goods, but his theory altogether ignores the moral element that is involved in the relations of individuals to each other in society or the state, and hence he expressly repudiates the principle that proportions taxation to ability.² Hobbes finds the justice of his principle solely in the assumption that our benefits are proportioned to our individual economic consumption. And he finds corroboration for his principle in that it conforms to the most expedient. A tax proportioned to consumption, he says, "seemeth not only most equal, but also least sensible, and least to trouble the mind of them that bear it."³

Turning from Hobbes to Locke and Rousseau, we find that they gave little attention to the problem of taxation. Yet Locke expressly bases taxation upon protection and intimates that it should be proportioned to its cost, though it must be admitted that his statement on the latter point is not very clear. "Tis true," he says, "government cannot be supported without great charge, and it is fit every one who enjoys a share of protection should pay out of his estate his proportion for the maintenance of it."³ This is practically all that Locke has to say on the subject, so that we are left in doubt how the proportionate share of each in the tax burden is to be determined. But it suffices for our present purpose that the principle of taxation is based upon protection, each sharing his proportion of the cost.

It is interesting to note, however, that Locke emphasizes

² Cf. *De Corpore Politico*, p. 216.

³ *Ibid.*, p. 217.

³ *Civil Government*, sec. 140.

the importance of free consent in the payment of taxes, i. e., consent of the majority—since arbitrary taxation “invades the fundamental law of property, and subverts the end of government.” This is not only an emphasis upon the moral obligation to pay our share of the cost of our protection, but it follows from Locke’s theory of civil government and from his theory of property.¹ Yet Locke, himself, makes this moral obligation stand for naught by his theory that the ultimate incidence of all taxes is, by the inevitable workings of economic laws, upon land; since the merchant will not and the laborer cannot pay the taxes. “It is in vain,” says Locke, “in a country whose great fund is land, to hope to lay the public charge of the government on anything else; there at last it will terminate. The merchant (do what you can) will not bear it, the laborer cannot, and therefore the landlord must.”² The merchant “will not,” because he can shift it by raising the price; the laborer “cannot,” “for he just lives from hand to mouth.”³ Thus, the position of Locke amounts to this: We are all in duty bound to pay our share of the cost of the protection of government, yet the large merchant class will not, since economic laws enable them to shift the burden, and the large laboring class cannot, because they are already at the minimum of subsistence. That is, economic laws and conditions stand in opposition to the moral law, thus compelling one class in society—the landlords—to bear the burdens of the rest. The theory as a whole, then, is inconsistent with itself, but the fault here is with the theory of incidence rather than with the theory of protection.

Finally, in the case of Rousseau, we find no attempt to develop a theory of taxation based upon his theory of a

¹ *Civil Government*, ch. 5.

² *Interest*, p. 60 (Works, Vol. IV, Edition 1824). Cf. also p. 57.

³ *Ibid.*, p. 57.

social contract. Yet out of Rousseau's theory of 'liberty and equality,' which he made the mainspring of the contract, theories of society and taxation were developed, mainly by the French communists at the end of the eighteenth century, such as Baboeuf and Morelly. But as these theories were communistic in character we shall postpone their consideration until we take up the question of Social Theories and Taxation.

2. *The Protection Theory of Taxation.* Our preceding discussion has shown that the contract theorists based their principles of taxation solely upon the idea of protection. This doctrine we have also found to be contained in much legal thinking, as in the popular mind, and it is also found in a certain school of economists. Because, then, of its historical and practical importance it may be well to examine separately, though briefly, both the merits and the demerits of the doctrine, its truths and its limitations.

In discussing the protection theory of taxation we should carefully distinguish it from the similar economic theory, better known as the give-and-take, or the *quid pro quo*, theory of taxation. The latter will come up for discussion in the following chapter. Here we are concerned only with the protection theory as forming the political foundation of taxation and of its principles. True, the kindred economic theory rests upon the assumption that protection constitutes the true political basis of taxation, but it views the relationship that necessitates taxation more from the economic point of view and deduces its principles wholly from economic considerations, or from economic laws. But although there is a clear theoretical distinction, it would be difficult to find any treatment of the subject wholly free from the one or the other point of view. Nevertheless we shall view them separately, though recognizing their practical inseparability.

From the purely political point of view, then, I would

adduce as the most important criticisms of the protection theory: That its fundamental conception is inadequate; that the principles deduced are not consistent with its logical deductions; that it sees no ethical consideration beyond the obligation of each to pay his share for the protection that he receives.

1. We have already pointed out the fact that this theory is based upon an inadequate conception of the state, and from our point of view this statement finds sufficient proof in the theory of the state outlined in chapter II. If we are right in our conception of the state the protection theory is necessarily inadequate. It expresses, in fact, but a half-truth. For while the protection of persons and property is the fundamental basis of social order and social progress, the purpose of the state and the functions of government are altogether too large to be comprehended under the conception of protection. The true conception includes protection and admits that it is fundamental, but it does not recognize protection as exhausting all that the state stands for. The state not only represents the highest culmination in the development of the social life of a people, but it is at the same time the conditioning instrument in the totality of their development, or in the development of the individual. To this end the protection of persons and property is a necessary incident but it is only one among many incidents, though we will grant that it is the most fundamental and most important. Hence the aim of taxation cannot be limited to the one end of protection. Its range is necessarily as comprehensive as the functions of government acting as the agent of the state in the fulfilment of its purpose. This is practically conceded by defenders of the protection theory who, like Von Hock, make protection co-extensive with national well-being,¹ or who, with Sismondi, make it include

¹ Von Hock, *Die öffentlichen Abgaben und Schulden*, §§ 1-4.

all of the advantages that are derived from it, as roads, honor, justice, education, religion, etc.¹ But if protection forms too narrow a conception for the political basis of taxation, the principles deducible from this conception must likewise be insufficient, as we shall endeavor to show.

2. That the principles deducible from such a basis are insufficient is shown, among other reasons, in the fact that those who proceed upon its assumption are unable to carry the doctrine to its logical conclusions. For, logically, the theory involves the cost-of-service principle of taxation—the apportionment of taxes to the cost of the protection, whether of persons or of property. This position, however, is seldom maintained, it being usual to adopt in its place the principle that bases the tax upon the advantages, or the benefits, derived from the protection. But even if we assume that this principle is a logical consequence of its leading premise, as in a limited sense it, perhaps, is, it does not, any more than the cost theory, afford a working principle for rules of taxation; for both individual costs and individual benefits are incalculable quantities. But this apart, according to the benefit principle the tax should be proportioned to the benefits received. But this is impracticable. For on the one hand the tax should equal the costs (else the protection must cease), whether or not the costs exceed the benefits; while on the other hand the tax for the most part cannot equal the benefits, otherwise the revenue would enormously exceed legitimate expenditure. Thus, neither the principle of individual costs, nor that of individual benefits, the only logical principles deducible from a purely protection basis, are practically possible principles of taxation, since they have only a hypothetical existence.

Nor do we wholly escape the difficulty by harmonizing the two principles, as is universally done, on the basis of the

¹ Simondi, *Économie Politique*, Vol. II, p. 165 (Ed. 1827).

totality of costs and the totality of benefits, assuming as the principle of taxation that the taxes of each should be such a proportion of the total costs as he shares of the total benefits. It is true that the total taxes must equal the total expenses of the government, but the protection basis of taxation does not afford in itself any ground for distributing the costs according to the benefits received, except upon the gratuitous assumption that the costs and benefits are in every case directly proportioned to each other. But even if this were true in theory no definite result would follow, since a proportion could not be established between two unknown quantities.

The fact is that upon the political basis of protection the distribution of the costs of protection according to the theory of benefits can have validity only upon the assumptions: (1) that the idea of protection is confined strictly to the protection of the person and of property; (2) that the value of the protection of the person is precisely the same for every individual; ² (3) that the value of the protection of property bears a direct, ascertainable ratio to the amount of property protected,³ a ratio that is most commonly assumed to be directly proportional. But this limitation of the function of government we have already seen to be too narrow even for the defenders of the protection theory. They assume that protection covers all of the advantages derived from the protection, and at the same time assume that these advantages have a definite money value that is proportioned to the amount of property of the individual. But these are assumptions only; they are not logic.

The failure of this school to arrive at logically deduced principles is emphasized still more in the fact that, not con-

² Cf. Von Hock, *op. cit.*, same reference.

³ Examples are too numerous to mention. It is the almost universally accepted doctrine of those influenced by the conception of the state in question in the text.

tent with the theory of costs or of benefits, they make ability also the true norm of taxation, apparently regarding it as deducible from the theory of protection and in harmony with the theory of benefits, if not, indeed, synonymous with the latter.¹ But, as will be shown later, ability is a principle quite distinct from that of benefits, and has a foundation quite distinct from that of the protection theory of the state. The ability principle implies an ethical basis that is not to be found in the protection theory, or the theory of benefits. And in fact the inconsequences in the conclusions of this school arise very largely from the assumption of principles, in the development of their theory, that are not involved in their fundamental premise—their theory of the state.

3. Not least important among these assumptions is the assumption of ethical relations that are not involved in the theory of the state upon which their principles are based. For if protection is the sole basis of the state, originating in an actual or implied contract to that end, the tax, as we have seen, must bear a definite relation to the cost, or at best to the benefits, of that protection. There can be no escape from the tax for the protection of the person, and no escape for the protection of property, by those who may possess even the smallest amount of it. Moreover, this theory of the state does not in itself involve principles from which exceptions may be logically derived. Hence the only ground for any exception to the above rule for taxation is that of absolute necessity. Many writers, indeed I think I may say most writers, consistently maintain this position, though some would justify exemptions on the principle of ability, which involves ethical considerations.

Now it is my contention that any theory of the state is essentially defective from which practicable principles of

¹ Cf. for example Adam Smith's famous first canon of taxation, since widely accepted without qualification.

taxation cannot be logically derived, since a state implies as well as necessitates taxation. But such a theory the contract, or its counterpart the protection, theory does not afford. And this mainly because the ethical character of the state is ignored. The state is conceived of as static and as consisting of external, mechanical relations; whereas it is dynamic and its relations are essentially internal, psychical. This means also that the relations are ethical, and that ethical precepts are involved in the rules that determine the manner of the state's support. It means further, that the ethical precepts should dominate more and more in the practical rules of taxation the more a people develops its ethical consciousness; that principles and rules of taxation should not be derived from primitive conditions of society, but from the conditions prevailing in a society in the process of developing its internal relations, and with reference to its ultimate end. We may, indeed, seek to discover principles that controlled actions in the past, but in searching for principles for taxation we are searching for principles that should control the action of the future. Such principles are not mere records of past or actual experiences, but are the formulation of ideal norms for the guidance of conduct, determined by the inner nature of society and the state.

II. THE EVOLUTION THEORY OF THE STATE AND TAXATION.

The preceding discussion has shown us, at least by implication, that principles of taxation are not to be derived from specific functions of government, or from the historical origin of the state, but are to be derived from the nature and end of the state, which involves the nature and end of the individuals by whom the state is composed. Functions of government determine limits of taxation, and the actual origin of a state influences the character of its system of

taxation, but in neither case do they afford a basis for the determination of ethical principles for the distribution of the tax burden. Important as these truths are, they are frequently ignored, not only by the school of writers just considered, but among others, in part at least, by Mr. Spencer in the development of principles of taxation based upon his evolution theory of the state.

Turning, then, to the evolution theory of the state (and we shall confine ourselves to the theory of Herbert Spencer), we shall not find it necessary to trace the evolution of the modern state from the primitive horde and tribe, for the course of this development has nothing to do with Mr. Spencer's theory of taxation. Besides, in this respect the theory does not differ essentially from the historical theory of the state, except that the evolution theory assumes to discover the underlying principle that guides the course of the development. It is the principle that controls development that is the important thing in Mr. Spencer's theory of evolution, and the principle that controls social evolution is found to be precisely the same as that which determines all evolution in the plant and animal worlds—a principle that may be summarized as the survival of the fittest struggling in the direction of the least resistance, or, by co-operating forces, overcoming resistance. Hence the evolution of the social world, like that of all life, is mechanical, external; the moving power as the determinant of the "fittest" being ultimately Force—the force to resist or to subdue, the force to destroy or to utilize.

It is by the power of augmenting such forces through co-operation, that political society is made possible, and it is those peoples that possess this power in the greatest degree that are the fittest to survive and to develop. This suggests that social organization has not for its sole purpose mere survival, but has a larger, ultimate purpose in development

—the development of social organization and through it the development of the fullest life of the individual; for the development of the highest possibilities of life is the ultimate aim of all evolution. Now the all-essential to the highest development of the possibilities of individual life, that is, to the development of human nature, is the largest possible freedom of the individual in the exercise of his own powers as directed by his own nature, and so receiving “the good and evil results of his own nature and consequent results.”¹ But if this rule were without restraint in its application there would be only individual conflicts without individual development. It needs, therefore, limitation, so that with the freedom of the individual to develop himself, there must be recognized the like freedom of others. That is, “in the social state the conduct of each bringing to him these results must be restrained within the limits imposed by the presence of others similarly carrying on action and experiencing results.”² Thus is developed the fullest life compatible with equal freedom, “the ultimate end being a higher development of human nature.”³ In short, while there should be full freedom and liberty for the individual in the exercise of his powers, since his development depends upon himself, it is true that his personal interests, when unrestrained, tend to come into conflict with the like interests of his fellows, who should possess the same freedom of development as himself. And since this conflict of interests will not cease until altruism dominates the world,⁴ such freedom and liberty of each must be guaranteed by a supreme power—that is, by the state. The sanction for this interference in the conduct of the individual would seem to lie in the power of force—co-operative force—and the fact that those peoples that enforce such restraint prove themselves the fittest to survive and to develop.

¹ Spencer, *Justice*, p. 221.

² *Ibid.*

³ *Ibid.*, p. 226.

⁴ See Spencer, *Data of Ethics*, chs 11-13.

From this point of view of the state, and from what we may call its immediate and efficient cause, its chief purpose would seem to be to act as a protective agency, and hence it is that Mr. Spencer conceives of the state as a kind of a "joint-stock protection-society,"¹ whose function is to guarantee to each the fullest freedom for the exercise of his faculties compatible with the equal freedom of all others."² But Mr. Spencer rightly regards protection as only a primary, immediate function of government—a means to an end. This end, as variously stated, is to "administer justice," "to maintain the conditions under which each may gain the fullest life compatible with the fullest lives of fellow-citizens."³ Or, it is "to maintain the conditions under which individual life and its activities may be carried on,"⁴ though ultimately it is "the formation of character."⁵

But notwithstanding this recognition of ultimate ends, it is the immediate function of government that is the important thing in Mr. Spencer's philosophy of the state. Indeed, when a government assumes to do more than protect the individual in the exercise of his faculties, that is, when it assumes to participate positively in the development of human nature, or of human capacities and characters, it defeats itself and retards rather than aids the development of the 'fullest life.'⁶ And this conclusion obtains from whatever point of view we regard the state—from its immediate or its ultimate end. The state (or with Mr. Spencer indifferently, the government) must act simply as a restraining power, though the boundary line of this restraint is admittedly a difficult problem to determine.⁷

From such a theory of the state, what principles of taxa-

¹ Spencer, *Social Statics* (Abridg. Ed.), p. 122.

² *Ibid.*, p. 123.

³ Spencer, *Justice*, pp. 213-4.

⁴ *Ibid.*, p. 194.

⁵ *Ibid.*, p. 251.

⁶ Cf. *Social Statics*, p. 127. Also Ch. 26, especially 372.

⁷ *Ibid.*, p. 127 et seq.

tion follow, according to the views of Mr. Spencer? In the first place, it is to be observed that since the government must guarantee equal freedom of development, or negatively, equal conditions "under which individual life and its activities may be carried on," it is bound not only to respect a principle of equality in the distribution of the tax, but to exact only the minimum necessary for its support; since to do otherwise would be to deprive us of our liberties, or of the freedom to exercise our faculties."¹ Indeed, any tax is regarded as a curtailment of our liberty, yet necessary to the enjoyment of larger liberties, and so a necessary evil. Or, it is a necessary "sacrifice of a part to ensure the remainder of our property."²

But upon what principle is this equality to be realized and taxation confined to its proper limits? Upon Mr. Spencer's theory of a "joint-stock protection-society," the true measure of taxation would seem to be the principle that controls an insurance premium, as the state exists to guarantee our lives and property against the attacks of others, and also their free exercise and use. But with Mr. Spencer the limit of taxation is found in the actual costs necessary to guarantee the desired protection, while the principle of distribution is that of "benefits" derived from the protection.

"In the abstract," says Spencer, "the question does not appear to present any great difficulty. The amounts individually paid should be proportioned to the benefits individually received. So far as these are alike the burdens should be alike; and so far as they are unlike the burdens should be unlike. Hence arises a distinction between the public expenditure for the protection of persons and the public expenditure for the protection of property. As life and personal safety are, speaking generally, held equally valuable by all men,

¹ Spencer, *Social Statics*, p. 123.

² *Justice*, 209. Cf. also Montesquieu, *De l'esprit des lois*, bk. xiii, ch. 1.

the implication appears to be that such public expenditure as is entailed on their account should fall equally upon all. On the other hand, as the amounts of property possessed at the one extreme by the wage worker, and at the other extreme by the millionaire, differ immensely, the implication is that the amounts contributed to the costs of maintaining property rights should vary immensely—should be proportionate to the amount of property owned, and vary to some extent according to its kind.¹

Not only should taxes be proportioned to benefits, but "state burdens, however proportioned among citizens, should be borne by all. Every one who receives the benefits which government gives, should pay some share of the costs of government, and should directly and not indirectly pay it."²

In the above quotations, we have substantially all that Mr. Spencer has to say respecting principles of taxation, although the same ideas are several times repeated in his different works. And the sum and substance of the principles that Mr. Spencer finds deducible from his theory of the state are, that the tax should be proportioned to benefits, and should be universal. But since Spencer, with Von Hock, distinguishes between the protection of the person and of property, and consistently so, there must be one universality for persons and another for property.

We cannot stop here to enter into a criticism of Mr. Spencer's theory of the state which he assumes as the basis of his principles of taxation. For us the question is: Are these principles logically deduced, and are they consistent with the demands of justice? Or we may ask: Is this theory of the state itself capable of supplying principles that satisfy the highest demand of justice?

1. Mr. Spencer deduced his principles from his theory of

¹ *Justice*, pp. 198-9.

² *Ibid.*, p. 194.

government as a "a joint-stock ~~and~~ protection-society"—from his theory of the functions of government; not from ~~his~~ his theory of the evolution of the state—not from the nature of the state itself. And assuming the same functions, he arrives at the same conclusions as those who hold to the contract theory, or to the protection theory of the state—the theory of benefits and universality. But we maintain that neither his theory of the functions of government, nor his principles of taxation, are necessary deductions from the evolution theory of the state. For if society is a "growth" and not a "manufacture,"¹ the same must be true of the state, for Mr. Spencer does not distinguish between the state and its government, and thus to assume that the state goes on developing while its functions remain constant, is to contradict himself, and to assume for the state dynamic, and for the government static conditions. It means, further, that while evolution is recognized as the all-controlling social force, yet arbitrary limits may be assigned to it; that after all, it is the preconceived notion of what ought to be, and not the actual trend of evolution, that has formed the basis of conclusions. It is true that Mr. Spencer's individualism has given color to this theory of governmental functions, but it is not consistent with his theory of the ultimate end of the state to assign arbitrary limits to the functions of its government, the agency through which it must realize its end.

The same criticism may be applied to the principles of taxation. For if there is any truth in this theory of evolution, the principles of taxation must vary from time to time with the progress in social evolution, conforming to existing ideals and standards of society. Again, if we recall that all evolution, according to Mr. Spencer, is a product of external, material forces and laws, the *non sequitur* of his conclusions becomes even more apparent. Whether, on the theory

¹ Cf. *Justice*, p. 247.

of evolution, a tax should conform to benefits and be universal, must depend upon whether the evolution of the state is best promoted by an application of these principles. Nor does the theory of evolution, in itself, afford any *a priori* reasons in support of these principles.

For a criticism of these principles as deductions from Mr. Spencer's theory of the functions of government we may refer to the preceding discussion.¹ But to this we may also add, that however true it may be that the protection of life has an equal value for all, it is by no means self-evident that the benefits derived from the protection of property are proportional to the amount of property protected. Indeed, the opposite conclusion has more reason. Still more, the protection of property affords benefits to the propertyless as well as to the property holders, though in a less degree.

2. As to the ethical character of the principles, we may refer again to the preceding discussion,² where it is shown that while the principle of universality is true as a general principle it nevertheless requires exceptions; and that the principle of benefits is lacking in important ethical considerations. But more than this, we maintain that Mr. Spencer's theory of social evolution does not afford a sufficient basis for ethical principles of taxation. The conception of a state as composed of individuals who are little more than abstractions of the individual as he is in actual life, and of relations that are little more than artificial and mechanical, are not conceptions to give a basis for ethical principles. No theory, indeed, can meet the requirements of ethical demands that does not conceive of the individual as a self-realizing spiritual entity—a person; as also having a social nature which is such a vital part of himself that apart from it he has no reality as a person. For only with such a conception can the relations of individuals to each other in society be rightly

¹ See *ante*, p. 73 *et seq.*

² *Ante*, p. 75 *et seq.*

understood, or ethical principles deduced. Material agencies may issue in conduct, but not in moral conduct. In brief, a philosophy of taxation, like a philosophy of the state, must, as we have before observed, take into consideration the whole man.

But such is not the case with the theory of evolution in question. Principles of taxation that follow from it must result from the law of the "survival of the fittest," must be such as are best adapted to the conditions of social life, and to the economic conditions, as they at any time exist. It is true that such a result may be contained in the principle of universality; but it is equally true that those conditions might be met only by a modification of the law of universality—by means of exceptions; while under Mr. Spencer's assumption the law of universality admits of no exceptions. The benefit principle, however, cannot conform to such conditions, since it is not capable of practical realization, as there is no justification for the assumption that benefits are proportioned to the amount of property.

Finally, it may be added that Mr. Spencer's theory of taxation is not consistent with his theory of a social organism. For if the state is an organism (as he maintains in spite of his own refutation of the doctrine), taxation should be based upon the economic ability of the individual, apart from any personal needs; other, at least, than those of the necessary minimum, since as a member of the organism he must exist and act to the extent of his capacity for the whole, and not for himself.

III. THE UTILITARIAN THEORY OF THE STATE AND TAXATION.

While almost any theory of the state possesses certain utilitarian characteristics, there is nevertheless a distinctively utilitarian theory based upon utilitarian ideas; and while

utilitarian principles have been applied to taxation mainly from an ethical or an economic point of view, there is an underlying basis in a utilitarian political philosophy. It is this latter point of view, as furnishing a basis for principles of taxation, that I wish to consider here. In doing so I shall confine myself to Mill and to Sax, though the former considered the question more from an ethical, the latter from an economic point of view.

1. *The Theory of Mill.* According to Mill mankind is of such a nature that every individual seeks the greatest possible amount of pleasure and the avoidance of the greatest possible amount of pain, the ideal aim of life being "the greatest happiness of the greatest number."¹ Now this ideal is most nearly realized when every individual is given the fullest liberty to act according to his own impulses and beliefs, subject only to the like liberty of others.² It is in the maintenance of the conditions essential to this equal liberty that the utility of a government consists. That is, the utility and sanction of government consists in its usefulness to the ends of the individual, a utility, therefore, that is "grounded upon the permanent interests of man as a progressive being." And it is because these interests cannot be realized through an independent life that they "authorize the subjection of individual spontaneity to external control, but only in respect to those actions which concern the interests of other people." But such a common interest is limited to the maintenance of the conditions of the free activity of the individual, in a word, to self-protection. Indeed, says Mill, "the sole end for which mankind are warranted, individually or collectively, in interfering with the liberty of action of any of their number, is self-protection."³ With the functions of

¹ Cf. Mill, *Utilitarianism*.

² Cf. Mill, *On Liberty*, ch. 3 and 4.

³ *On Liberty*, Introduction.

government thus directed, but also thus restricted,¹ there is developed the highest individuality, and by implication the greatest happiness of the greatest number.

It will be noted that Mill arrives at the same conclusion as Spencer respecting the functions of government; and we shall see that he also arrives at essentially the same principles of taxation, derived, as with Spencer, from the relations of the individual to the functions of government, but also with the ethical ideal uppermost in mind. For with Mill the protection that guarantees equal liberty of performance, of the development of individuality, and so of the highest happiness of the individual and of mankind, is of interest to all since all are benefited by it. And hence, "every one who receives the protection of society owes a return for the benefit, and the fact of living in society renders it indispensable that each should be bound to observe a certain line of conduct towards the rest." And among other things, this "line of conduct" consists "in each person bearing his share (to be fixed on some equitable principle) of the labors and sacrifices incurred for defending the society or its members from injury and molestation."²

But how, according to Mill, is the "share" of each to be determined? It must, he says, be upon some "equitable principle," and such a principle he finds contained in the idea of "equality." Equality is regarded as the basic principle of government, whose chief function it is to maintain equal liberty in the enjoyment of pleasures,³ and equal con-

¹ In his later life Mill did not so restrict the functions of government, though he did not change his utilitarian ideas or his principles of taxation. Cf. for example, his *Autobiography* and the later editions of his *Political Economy*.

² *On Liberty*, ch. 4.

³ With Mill "pleasure" is not merely Hedonistic, sensual, but it is a "happiness" that includes intellectual pleasures, and which, indeed, with doubtful consistency, Mill makes the highest pleasure. Cf. Mill, *Utilitarianism*; and Green, *Prolegomena*, p. 168 *et seq.*

ditions in the avoidance of pains. Therefore, for the labor and sacrifices incurred in maintaining these equal liberties and conditions there should be an "equality of sacrifice" on the part of those benefited; or "equality of sacrifice" should be the guiding principle of taxation. That is, the government should "apportion the contribution of each person towards the expenses of government so that he shall feel neither more nor less inconvenience from his share of the payment than every other person experiences from his."¹

We shall postpone for future discussion the merits of this principle as an economic or an ethical principle and inquire here, as in the case of the preceding theory, whether the principle is consistent with the theory of the state upon which it is founded, and whether this theory of the state is adequate to the determination of satisfactory principles.

1. The theory of Mill, at the outset, has the advantage over either of the preceding theories in that it assumes an ethical end in the purpose of the state, and involves ethical relations among individuals as they exist in society, whatever may be said of the ethical end in itself. Granting, however, the ethical ideal, and also the assumption that the ideal is best attained by the maintenance of an equal liberty of individual action, of individual direction of one's activities—one's emotions and ideals—and equality would rightly seem to be the justly dominating principle of social life. Hence, also, it is that in the maintenance of the conditions of equal liberty there should be an equality of individual sacrifice corresponding to the equal benefits derived from the equal liberty. As individuals share equally in the benefits, so also should they share equally in the sacrifices necessary to obtain them.

It is further not only consistent with the theory of Mill,

¹ Mill, *Political Economy*, bk. v., ch. 2, § 2.

but also its merit, that it fairly solves the problem of absolute and relative equality, the absolute equality being of a subjective, the relative equality of an objective character. For with respect to the property enjoyed under the protection, or guaranteed liberty, of the government, there is only a relative equality of benefits, and so there is and should be only a relative equality in the goods given up for the support of the government; but with respect to the conditions of liberty in the free use of our faculties, so far as the government is concerned in them, there is an absolute equality of subjective interest, and hence there should be an absolute equality of subjective sacrifice for the maintenance of those conditions. Such an equality is found in Mill's subjective "equality of sacrifice" as the norm for the distribution of taxes.

(2) But apart from the question whether equality of sacrifice is the ideal norm of taxation—a question to be considered later—the utilitarian theory of Mill is otherwise defective. True, he rightly considers the question from the point of view of the ultimate, and not the immediate, end of the state, and therefore escapes the criticisms passed upon the protective theory. But the faults of the theory arise mainly from the defectiveness of its ethical standard which we shall have occasion elsewhere to criticise. Besides, the theory is further defective in that its ideals and results are essentially of a subjective character, and so are incapable of the necessary quantitative determination. Nor would it be easy to find in the Greatest Happiness principle any definite standard for deviations from the rule of universality in the tax obligation for the maintenance of the conditions of equal liberty. And there would be the same difficulty in determining these exceptions on the principle of equality of subjective sacrifice.

2. *The Utilitarian Theory of Sax and the Austrian School.*

A far more elaborate attempt to place taxation upon utilitarian principles is to be found in Sax and the Austrian school of economists.¹ But with them the theory loses its ethical character and assumes a distinctly economic form. Yet the theory is founded upon the utilitarian principle of pleasure and pain, a principle that it is assumed applies equally to the collective and to the individual life. That is to say, pleasure and pain are supposed to determine collective activity in precisely the same way that they determine individual activity. And, indeed, the collective life has the same end in view—the increase of the sum total of pleasure; and, further, it exists to promote this end wherever it is more competent than individual action.

As worked out by Sax the theory, in brief, is as follows: Man is a creature of wants—sensuous and intellectual, moral and religious, social and economic, etc., etc.—whose satisfaction with the least possible pain, or sacrifice, to himself is the aim of his life. Of these wants, infinite in their variety, some are satisfied by the individual directly, others by the associated or collective action of individuals. The former are called collective wants, the latter individual wants. Of the collective wants, which alone concern us, some are satisfied by voluntary associations within the state, others by society as a collective whole, organized as a body politic—by the state itself. But however satisfied, the ruling principle of all wants is: the greatest possible satisfaction with the least possible effort—with the least individual sacrifice.

Now this principle not only determines all collective action but also what action shall become collective, that is, the func-

¹Sax, *Grundlegung der theoretischen Staatswirthschaft*; also, *Die Progressivsteuer*; Wieser, *Natural Value*; Ricca-Salerno, *Scienza della Finanza*; Flora, *Scienza delle Finanze*. The work of Sax is profuse and difficult; that of Ricca-Salerno brief and clear. A very good statement of this theory is given by Flora in the *Rassegna*, for August, 1893, in an article entitled, *Il Concetto della Economia Finanziaria*.

tions of government. These functions extend to the satisfaction of all wants that could not be satisfied by individual effort, or if so only by a greater sum total of individual sacrifice. These wants have no absolute restriction but are relative to the conditions of a given civilization, to the convictions of a people. As Flora says, "The measure of the action of a state is a product of the wills of its members,"¹ but wills that are determined by ideals of pleasure and pain.

That is to say, collective wants of whatever kind are determined by the law of satisfaction common to all wants, a condition that follows from the nature of the individual and of society. For collective want, in its last analysis, like all want, necessarily pertains to psycho-physical organisms and not to a personified collective being that has only mythical existence. Hence, collective action, like individual action, must be determined by the law of greatest utility and of least disutility, in a word, by the law of "marginal" utility. Hence, also, the same law must determine principles, or more strictly laws of taxation.

In this simple law of the satisfaction of want Sax thinks that he has found the key to the solution of the whole problem of true principles of taxation, and, indeed, in its simplicity he finds a guarantee of its validity.² But Sax does not discover any new principle from this law of utility, for his "equivalence of burdens," which he deduces from the law of marginal utility, is in reality nothing but Mill's "equality of sacrifice," in spite of the assumption to the contrary. Indeed, Sax sums up his principle in almost the exact words of Mill; for his principle of taxation is: that "every individual should value the goods taken from him as highly as every other individual values those taken from him."³ In other words, the marginal utility of goods taken

¹ *Op. cit.*, p. 8.

² "Die Einfachheit der Lösung ist eine Bürgschaft ihrer Richtigkeit." Sax, *op. cit.*, p. 308.

³ *Ibid.*, p. 514. See *ante*, p. 88.

as a tax should produce an equivalent sacrifice. Yet in his method of treatment Sax differs quite materially from Mill, particularly in relation to collective wants and in confining himself solely to the view-point of economics. For with Sax the political basis is put into the background, while the ethical is considered as having no place in determining principles of taxation, since taxation has to do with what is and not with what ought to be.

A criticism of the theory of Sax must, therefore, be made in connection with the economic basis of taxation. But with respect to the political basis it may be observed, that if we grant the primary assumptions of Sax his conclusions would seem to follow. We cannot, however, concede that the economic law of marginal utility, based upon self-interest, determines collective action in precisely the same way that it determines the economic action of the individual; nor that economic laws take precedence over ethical considerations in the determination of principles of taxation; or that ethical principles are nothing but the results of the action of economic laws, as is virtually assumed by Sax. And because of the faultiness of these assumptions the political basis fails as a basis for principles of taxation. The theory is, further, like Mill's too subjective, too abstract. We postpone further criticism.

But whatever criticism may be passed upon the theory of Sax it must be admitted that his general views are not only suggestive but also contain much truth. The chief merits of his treatment are: Its conception of the state, as a social organization essential to the highest development of the individual, and yet not itself a social organism; its recognition of the flexibility and the relativity of collective wants, and therefore of the functions of government; its rich suggestiveness in making the philosophy of taxation a part of the general philosophy of human wants; its emphasis upon

the satisfaction of wants, rather than upon the benefits of government, as the measure of taxation; though by failing in a due recognition of the ethico-social nature of collective wants, and so of the implications involved therein, he fails to discover the true norm that should determine their satisfaction.

IV. SOCIAL THEORIES AND TAXATION

We have thus far treated of theories that pertain to historical or actual forms of state and government, and it may be well before closing the present chapter to say a word respecting the character of taxation involved in such ideal social theories as anarchism, communism and socialism. True, such theories may not be able to throw much light on principles of taxation that are consistent with prevailing notions of the political state, since the total abolition or the complete transformation of such states is a part of their scheme of taxation. And yet they are not wholly without their lessons in their conceptions of the nature of individuals, their relations to each other in society, and their mutual obligations in their associations with each other.

1. *Anarchism.* Nominally under anarchism there is no state, but only voluntary associations. Force as a coercive, collective power, is completely wanting. All association, and therefore all political association, must be voluntary, else there would be a denial of individual liberty; and for the same reason all support of these voluntary associations, of whatever sort, must likewise be a voluntary support. Membership in the association, and therefore support of it, is permanent or temporary according to the choice of the individual.

Under such a social system the conscience, or the ethical standard, of the individual must be the sole determinant of the amount of individual contributions, as no force can be applied. Should an association forbid membership to any

individual, or enforce contributions as a condition of membership, it would defeat its own purpose and repudiate its own notion of individual liberty. Yet, until the millennium appears, or so long as human nature remains as it is, enforcement of contribution, and the determination of the proportionate share of each, is inevitable. The conscience of the individual can not, as yet, be trusted to determine his share of the necessary contributions. Nevertheless, the anarchist view has its lesson in its emphasis upon the voluntary side of political society, and upon the ethical character (at least by implication) of the obligation to contribute for its support. And yet there is only a half-truth in this doctrine. There must be a social determination and a social enforcement, else the association must cease to exist.

2. *Communism.* Communism in its objective form is little more than the constructive side of philosophic anarchism.¹ As with anarchism political and industrial society are organized in one common Association, but while the association is voluntary, communistic ideals do not preclude the enforcement of its laws. Communism, further, finds a definite principle of association in the idea of the brotherhood of man, from which it deduces as a principle of collective activity: "From each according to his ability, to each according to his needs." This principle which should actuate all social effort must also control the contributions which it involves. True, technically speaking, there is no taxation in a communistic society, since the officers of the community share in the product on the same basis as the producers. But the support of the officers, and the provision of the material wants of the government from the common product is as much taxation as a direct levy upon the property or income of the individual; for in either case the support of the government comes from individual labor and

¹ See Benjamin F. Tucker, *Instead of a Book*.

effort, from the giving up of the results of one's own labor to the community. And since the common fund is the result of the combined labor of the whole, each producing according to his ability, the burden of the support of the community is necessarily proportioned to the ability of its members. Here we virtually have "universality" and "ability" as the two cardinal principles of taxation, deducible from the nature of the social organization and the ethical ideal upon which it is founded—the brotherhood of man. These principles are both consistent and sound. The error of communism lies in the assumptions which it bases upon the idea of a common brotherhood, particularly with respect to the nature and character of the collective life. It exaggerates the communal idea as anarchism does that of the individual. Its great merit is the emphasis it places upon the ethical side of social life.

3. *Socialism.* So many social ideals are included under this caption that I must confine myself to that type of socialism that is known as Scientific Socialism, or Collectivism—the socialism that would abolish political states—the *Polizei-Staat*—and establish in their stead industrial states, which are to own all the means of production and to direct and control all industries. Under such a system, it is assumed, there will be no occasion for the exercise of police powers, and the state will have only economic functions to perform. Yet every individual must be guaranteed an equal opportunity in the satisfaction of his economic wants. Such guarantee, however, is supposedly fulfilled by the system itself, which offers the same opportunity to all to make use of the means of production. That is to say, the equality, which it is assumed is the fundamental human right, and the basic principle of the state, is an "equality of opportunity," an equality of use, not an equality of possession. Hence the quantity of goods acquired by each individual for the

satisfaction of his wants should depend upon his ability and inclination to labor, as in the system of Rodbertus; but in the less just system of Marx it depends upon the "average labor time" necessary for the production of commodities. And the same principle that determines the share of each in the common product, must determine, also, the contributions of each to the common reservoir, the common fund, out of which the shares are distributed.

But the government is also maintained out of the common fund. Upon what principle, then, is the burden of supporting the government distributed? Necessarily, the share of the common burden must depend upon the portion that each contributes to the common product. In other words, the distribution of the expenses of the government will be relative to the standard of private wants and the degree of their satisfaction; or, in brief, upon the use that one makes of his opportunities. Nominally, then, the principle of sharing the common expense—for there is no taxation—is the ability to satisfy private wants, or rather to provide the means for their satisfaction. But more strictly, the principle is that of economic benefits, the contribution of each being proportioned to the actual use made of the economic opportunities afforded by the government.

Upon the assumption of the socialistic conception of the state this conclusion cannot be gainsaid. It is logical and just. But there is not the same theoretical justice in the distribution of the burden upon the basis of the "labor-time" theory of Marx, since those having less than the average capacity of production are credited with more than they actually contribute, while those having a capacity above the average are credited with less than they actually contribute. The former receive benefits that are in excess of their power of production, and so of their contribution to the common fund; the latter receive benefits that are less than

their product, or their contribution. On the other hand, with no type of collectivism is there any exemption allowed for those who are capable of producing, but only for the incapables—the physical or mental incapables. Those who are able to produce must do so or starve; and must therefore contribute to the common burden in the same proportion that they satisfy their own economic wants, whether or not these wants are satisfied according to the ability of the individual, or the average ability of individuals. So that from this point of view the contribution may be regarded as based upon the ability of the individual as measured by actual product, or by the average ability of individuals as measured by their average product. That is, the ability is determined by the power of production, and not by the necessities of consumption; and therefore there can logically be no exemption based upon the needs of the individual, apart from his incapacity.

If we consider this theory of public contributions from the point of view of benefits, we find that it is defective in that it confines benefits to the purely economic benefit of equal opportunities for production; and if we regard it from the point of view of ability we find it defective in so far as it confines ability to the ability to produce. But the real defect of the socialistic system of taxation, if we may be permitted to use the term, lies in its fundamental conception of a purely economic state, and in its conception of justice as consisting solely in the economic equality of opportunity. Its important lesson is, perhaps, its emphasis upon the social character of production, upon the joint interest of the members and of the collective whole of society in the social product, and upon the joint responsibility in the maintenance of the government. But it views the relations of the individuals to each other and to the state too entirely from an economic point of view, and, indeed, from the point of view of production alone.

With respect to the principles of taxation state and *Katheder* socialism are not essentially socialistic, as they would not wholly convert the political into the industrial state, nor equalize the burdens of government by equalizing the opportunities of production. They are specially characterized by the emphasis they give to the ethical side of social life, from which they justly deduce as a principle of taxation the ability of the individual to pay; and hence also are given a wider range in considering the problem of exemptions. The social side of their theory—the distribution of wealth—is a problem of political policy, and not of taxation.¹

V. CONCLUSIONS AS TO TRUE POLITICAL BASIS AND PRINCIPLES OF TAXATION.

In the preceding discussion of political theories relative to a political basis of taxation, we have attempted to touch only upon such theories as have exercised the greatest influence, either theoretical or practical, in matters of taxation, together with a brief reference to social theories that antagonize the existing state. Of the latter class we found that while they contain important truths, they are but half-truths at the best; and further, their lessons have little practical significance since they have not to do with actual conditions, but with ideals whose consummation must wait for the dawn of the millennium. Or again, they make false applications of principles that are true in themselves.

In the theories of the first class many important truths were also found, but we were unable to find in any of them a consistent and logical development of principles directly deducible from the political basis that formed their primary assumptions. Besides a lack of logical development we found, also, an omission of important factors in the problem. But what to our mind constitutes their fundamental defect, is

¹ Cf. Vocke, *Die Abgaben, Aufagen und die Steuern*, p. 476.

their conception of the nature and purpose of the state in its relation to the individual; together also with a deduction of principles from the immediate functions of government instead of from the ultimate ends of the state.

The political basis of taxation is simply a conception, or theory, of the state in which is found the justification and character of taxation, and from which principles of taxation logically and naturally flow. Such a theory must comprehend not only the nature and end of the state, but also the nature and end of the individual, as *person*, since each is the counterpart of the other and by itself is but an abstraction. But man, as an end in himself, is essentially and fundamentally ethical, and hence principles that govern taxation, as also all social relations, should conform to ethical standards and ideals, and at the same time should conform to the political conception upon which they are based.

The theory of the state outlined in the preceding chapter, it is believed, answers these requirements. It recognizes the obligation of the individual and the rights of the state, the voluntary and the compulsory character of taxation; it recognizes the universal dependence upon the state for the highest individual development, and thereby inculcates the principle of "universality" in taxation; it recognizes the ethical nature of the individual and the ethical nature of social relations, and thereby inculcates the principle of equity, or "equality" in taxation as its highest principle. These, Universality and Equality, are, in fact, the cardinal principles of taxation deducible from a political basis—from a true theory of the state—and may, therefore, be called the political principles of taxation. All other principles are but modifications of these. These two principles, indeed, are, with greater or less logic, found in all theories of taxation, but all theories do not find a sufficient basis in their conception of the state for the modification, of these principles that

are necessitated by economic and ethical considerations. A basis for the modification and limitation of these principles is, however, to be found in the theory of the state that we have upheld as the basis for all principles of taxation. The cardinal principles are in themselves abstract and general in character, and result from the viewpoint of the general relation of the individual to the state. But in their concrete application the actual conditions of life, with reference to ethical aims and standards, must be considered, the necessity of this consideration resulting from the ethical nature of the individual and the state, such as we have conceived them to be. In brief, the modifications of the two primary principles, universality and equality, no less than the principles themselves, are, as they must be in every consistent theory, the necessary implications of the conception of the state, and result naturally from the logical development of these implications. The main problem, now, is to determine the basis and character of the equality, and the limitations that are to be put upon the principle of universality. These can not be determined by the purely political aspect of the question, but only by the economic and ethical aspects. These aspects we shall consider in the two following chapters.

CHAPTER V

THE ECONOMIC BASIS AND PRINCIPLES OF TAXATION

AS a theory of the state implies taxation, so taxation implies the economic relation of the individual to the state. A political basis and political principles of taxation imply, therefore, an economic basis and economic principles. By an economic basis, then, is understood the economic relation that the individual sustains to the state; and by economic principles the principles that should determine the portion of private wealth that each individual should contribute to the ends of the state, or the relative satisfaction of private and collective needs. The question is not directly concerned with the economic effects of taxation, although these effects are indirectly involved. The economic basis and principles of taxation are, in part, an interpretation, and, in part, a modification of the political basis and political principles.

The economic aspect of the question is not, therefore, an independent problem, but simply one phase of the problem of taxation, though, indeed, a very important phase. Indeed, its importance has led some economists to consider the question of taxation as though it were wholly an economic one, to be determined by the simple application of economic laws. Taxation is treated as though only the economic relations of individuals to the state were involved. In the political basis they see only an economic basis, and in the political principles only economic principles. Indeed, it is expressly or tacitly implied by them that the application of

economic principles and laws will in all cases best attain the ends of justice. Taken by itself, however, this is but a superficial view of the problem. For, in the taking of economic values for its support and maintenance—the execution of its functions—the state, through its government, enters into a most vital relation with the individual; since the source of the economic values taken by the state is likewise the source of those values that go to the maintenance of life, and of the material conditions that are necessary to the development of human personality. This vital relation, then, is something more than an economic one. Because it relates to a *person*, and so to an ethical being, it has ethical as well as economic importance.

However, there is an economic side to the question which may be abstracted from other relations, just as in a theory of knowledge sensation, perception, judgment, etc., may be abstracted from the unified process that alone makes knowledge possible. The state must ultimately determine, as it is ultimately responsible for, the amount of those values that are diverted from the satisfaction of private wants to the satisfaction of collective wants—the needs of the government. It is, therefore, important that there should be a definite understanding of the economic basis and economic principles that should control this distribution.

In the present chapter we shall attempt to consider this economic aspect of the question of taxation. In doing so we shall not only review such theories as would solve the problem wholly along economic lines, but shall consider the economic side of other theories. As these theories differ, in the main, according to different conceptions of the character and importance of different departments of economics—as Production, Distribution, Exchange and Consumption; or according to different conceptions of economic theory and economic laws, we shall consider the subject under these

several heads, using different economic theories as main divisions.

I. THE PHYSIOCRATS AND THE SINGLE TAXERS.

It was the theory of the first school of scientific economists—the Physiocrats—and is the theory of their modern representatives—the Single Taxers—that the whole expense of government should be met out of the proceeds from the land, from the *produit net* or the “economic rent.” Let us attempt to ascertain the economic basis and the economic principles underlying this theory. Although they reach practically the same result we shall find that the earlier and the later representatives of this theory employ somewhat different lines of argument.

1. *The Physiocrats.* According to the doctrine of the Physiocrats land alone produces a *produit net*, a net surplus above the expenses of production; therefore upon whatever form of property or income a tax may be imposed its ultimate incidence must be upon this *produit net*, as otherwise production must cease and starvation follow. Hence, to avoid unnecessary expenses of collection and added costs due to the advancement of the taxes, all taxes should be imposed in the first instance upon the landed proprietors.¹ Moreover, as only the proprietors of land obtain a net product, they are the only class that has any interest in a stable government. Indeed, a net product and a stable government mutually condition each other.² For “without good government and tranquility there will be no net product, and without a net product no government and no society.”³ Security and tranquility increase the revenue of each. Because, therefore, of the mutual interest and mutual dependence of proprietors and the government they should share about equally in the net product.³

¹ Cf. Turgot, *Works*, vol. iv, p. 306.

² Quesnay, *Despotisme de la Chine*, ch. 8, sec. 20.

³ Cf. Quesnay, *Ibid.*

The doctrine of a *produit net* as applied to taxation is most fully developed by Turgot who assigns several reasons for a single tax on land. His argument we may summarize as follows: The object of a tax "is for the preservation of property, not to lose it,—and hence should be upon income, not upon property;"¹ but "the proprietor of land is the only one who has a true income"—a *produit net*—and therefore "he alone has an interest in preserving the permanent order of society," for to the industrial class any change of ownership would be but a change of employers.² The tax should, therefore, be paid out of the "true income," and to force it from any other income, or to make it exceed this income, would check production and so dry up the source of the revenue of the state.³ Moreover, any other tax is always shifted to the proprietor by being added to the cost of production;⁴ and to cause the laboring and industrial classes to advance the tax is to produce their ruin, since they have no disposable income.⁵ On the other hand, "it is impossible to make the consumers, who are not proprietors, pay a tax upon consumption, because from the moment it is established they are forced either to restrain their consumption or to diminish the price which they can offer for the production which they consume; and because either method will throw the tax upon the producers, or sellers, of those productions."⁶ Finally, a single tax on the produce of land is demanded because an indirect tax—that is, any tax except that upon the *produit net*—leads to frauds, condemnation of goods, loss of the labor of the great number of men who are necessary to collect it, a war of the government with its subjects, a disproportion between crime and punishment, and "attacks liberty in a thousand ways."⁷

Thus we find that according to the doctrine of the Physio-

¹ Turgot, *Works*, vol. iv, p. 215.

² *Ibid.*, p. 216.

³ *Ibid.*, p. 220.

⁴ *Ibid.*, p. 306.

⁵ *Ibid.*, p. 313.

⁶ *Ibid.*, p. 363.

⁷ *Ibid.*, p. 208.

crats the economic basis of taxation lies in the relation which a certain class of society sustains to the government. This class is that of the landed proprietors who alone can have any interest in the government, since land alone produces a net product over and above that which is necessary in order that there may be any production at all. But as the net product that attaches to land would not exist but for the government, the landlord should share it with the government in the form of a tax. Not only has no other class any interest in the government, but the net product of land is the only fund out of which a tax can ultimately be paid. As the net product is equally conditioned by landlords and the government we have, further, as the principle of its distribution, as the economic principle of taxation, that the net product should be distributed equally between landlords and the government. Or, as the basis of the tax is the economic interest which the proprietors of land have in the government, the principle of its distribution is the extent of the interest in the joint economic result—the *produit net*—which is assumed to be a half interest.

Criticism of this theory may be brief. Not only is its theory of incidence utterly erroneous,¹ but so also is its theory of a net product² upon which its theory of taxation rests. Other factors of production than land yield a net product upon which a tax may ultimately fall, and which is equally with the net product from land conditioned by the existence of government. It follows, therefore, even from the view-point of the Physiocrats, that other classes than landlords have an interest in the government, and that the government has interest in other products than the net product from land. Moreover, because a government is a condition of a net product, or for that matter of any product, it does

¹ See, for example, Hume, *Essay on Taxes*.

² See Adam Smith, *Wealth of Nations*, bk. iv, ch. 9.

not follow that the product must be distributed between the producer and the government on the basis of the share of each in its production. Indeed, if this were so the government might claim the whole product beyond the barest necessities of life. Because a government conditions production it is not therefore a factor in production in the sense that it should share in the product in proportion to its interest in it. The fact is that the income of government bears no relation whatever to its part in production. Its income, and therefore taxation, depends upon its character and upon the functions it assumes. And whether or not a tax should be determined according to the principle of interests, it certainly is not to be determined by any joint interest in an economic product. But above all, government does something more than condition production. It is the condition of the satisfaction of all of our wants, and therefore interest in it is general and not special; and for the maintenance of these general interests—the interests of civilized life—government requires economic support from every citizen of the state.

2. *The Single Taxers.*—The doctrine that the whole expense of government should be met by a single tax on land was revived in more recent years by Henry George¹ whose doctrine is now known as that of the "single tax." By its modern advocates, however, the argument for a single tax takes on a somewhat different form from that of the Physiocrats. By George and his followers the justice of a single tax rests upon the Ricardian theory of rent; only emphasis is given to the social factor as producing differential advantages that give rise to the phenomenon of rent, quite as much as do differences in natural advantages. This rent is akin to the *produit net* and is called the *unearned increment* of land. But land is the birthright of man, a "gratuitous-

¹ Henry George, *Progress and Poverty*, 1880.

gift of Nature to men, the free bounty of the Creator to his children."¹ Therefore, the *unearned increment* from land, the whole increment that is not produced by the labor of any given individual, belongs to mankind, to society, and should not be monopolized by any one or several individuals.² Indeed, the government has a double claim upon the unearned increment: both because the land belongs to society, and because a part, at least, of the unearned increment is due to society, or is produced by it. Moreover, government has no right to touch any part of the increment of production that is due to human labor, since by "natural law" the product of one's own labor belongs to himself. "Whatever a man brings forth, whatever he adds to the common stock of wealth, belongs to him alone; and it is wrong to take from him any part of it."³

According to this view of the single tax, there is in reality no taxation, as the government simply appropriates to itself the wealth accruing from natural advantages and from social growth—wealth to which the individual has no valid claim, but which of right belongs to the people as a whole, that is, to their government. But as the *unearned increment* comes first into the hands of individuals—the landlords—the taking of it from them by the government may be regarded as nominal taxation, the landlords being the natural tax collectors.⁴ The economic basis of the tax thus comes to be the relation subsisting between the government and the individual arising from the possession on the one side, and the ownership on the other side, of the source of unearned increment.

As the privilege of possessing the source of the unearned increment is regarded as an advantage to its possessor, it is laid down as a principle of taxation, that "we ought to tax

¹ George, *Single Tax Discussion*, p. 76, Saratoga, 1890.

² Cf., *Ibid.*, p. 83.

³ *Ibid.*, p. 79.

⁴ See Shearman, *Natural Taxation*. pp. 118-9.

men according to the special advantages they receive from the community, thus putting all men on an equal plane."¹ This is the principle of taxation according to benefits, and is common to all "single taxers," who repudiate the principle of ability as unjust or as an appeal "to sentiments of benevolence and philanthropy."² The principle is purely an economic one, as the "advantage" is measured by "the market value of the benefits conferred by government and by human society,"³ the market value of ground rent. As the benefit is measured by the extent of the ground rent, and is "conferred by government and by human society," the tax, according to George, should absorb the whole increment of land that is not due to human labor; but Shearman, assuming that such a tax would be in excess of the needs of government, less consistently holds that the government should take only such part of the ground rent as it needs, leaving the rest to the landlords.⁴ If, indeed, it is true that the whole ground rent, the unearned increment, belongs of right to the government, it is difficult to see the justice of any part of it being retained by any class of society. The only just method of distributing the surplus would be to distribute it *pro rata* to every member of society.

That the doctrine of the "single tax" has the merit of simplicity cannot be doubted, nor that it contains some desirable features.⁵ We must, however, discredit its claim as a *panacea* for all social ills, as the fanciful dream of an enthu-

¹ George, *Single Tax Discussion*, p. 83. "There can be but one strictly just basis of taxation, and that is the basis of benefit received from the taxing power;" Shearman, *op. cit.*, p. 228.

² George, *Ibid.*, p. 82, and Shearman, *Ibid.*, p. 227.

³ Shearman, *Ibid.*, p. 229.

⁴ Cf. Shearman, *op. cit.*, pp. 132-135; and also ch. 10.

⁵ See Prof. J. B. Clark, *Single Tax Discussion*, p. 5.

siast.¹ Nor can we grant that the "single tax," as a theory of taxation, solves the problem of justice. Granting the validity of the theory of social values, and assuming its sufficiency for purposes of public revenue, we would still have the following criticisms to offer to the theory, as a theory of taxation:

(1) It assumes as an economic basis for taxation, that only one class in society bears such an economic relation to the state that there rests upon it the obligation to support the government, to pay taxes, to wit: the proprietors of land; whereas, in point of fact, the economic relation and the consequent obligation rest upon every class of society, upon every citizen of the state. (2) Not only does the theory assume a limited economic relation, but it assumes as the basis of this relation that land alone yields an unearned increment, which, while it belongs to society, or to government, comes in the first instance into the hands of the possessors of land; whereas, land is not the only source of an unearned increment—a rent or a *quasi*-rent—that arises from social conditions, and therefore the rent of land is not the only wealth, or source of revenue, which comes into the hands of individuals, but which, according to the single tax doctrine, belongs to the government. Apart from the question of a *quasi*-rent in other factors of production than land,² there are legal and capitalistic monopolies that produce unearned increments quite as much as does the monopoly of land. Moreover, there is no form of industry that is not benefited by social growth. (3) It is further assumed that the advantages of government lie in the possession of the source of the unearned increment, and that this advantage

¹ See George, *Progress and Poverty*, B. ix, ch. 4; also, Shearman, *Natural Taxation*, ch. 13.

² On this point, see Marshall, *Principles*, B. vi, ch. 7; and Hobson, *Economics of Distribution*, ch. 5.

is the only ground for the imposition of a tax ; and therefore, that a tax according to the benefits received from the government is the true principle of taxation. But as other factors than land possess these advantages (which are made the basis of taxation) it is difficult to see by what justice the possessor of land alone should pay for the advantage of obtaining an unearned increment. Besides, there are other economic advantages produced by the state that equally demand a recompense—as the maintenance of the social conditions necessary to the pursuit of a livelihood. Moreover, in assuming that the unearned increment is the price of a special advantage it is assumed that the advantage is proportioned to the amount of the increment, a position whose absurdity is at once seen when we reflect that the ultimate advantage is confined to the privilege of gaining a livelihood. Then, too, this privilege is common to all. More than this, there is in reality no payment for any special advantages, as the government simply takes the unearned increment, and upon this the landholder has no claim. (4) In fact, it is a special feature of this theory that no individual should undergo any burden of sacrifice for the purpose of maintaining a government ; that, indeed, the government has no right to touch any part of private wealth that results from one's own labor, but should support itself on the economic values that belong to society as a whole, which is to assert that there should be no taxation. But such an assumption is opposed to any rational conception of the nature of the state, and misconceives the nature of the " natural right " to the product of one's own labor, since the payment of a portion of this product to support the government is a condition of its own existence. Yet, in the first instance, a tax is imposed upon the present holders of land who are made to pay penalty for the sin of past governments in permitting private property in land—a species of confisca-

tion, in spite of all refinements upon the word,¹ that is repugnant to all sense of justice.

Various other forms of a single tax have been promulgated by different writers, though not so much from any peculiar notion respecting the relation of the state to the economic life of its members as from the conviction that a single tax best realizes the ideal of a tax according to ability. Such theories belong to the discussion of systems of taxation, and need not be dwelt upon here. There is one theory, however, that may be briefly touched upon, as it assumes a certain economic relation between the individual and the state as its economic basis. I refer to the theory of Menier,² who would obtain public revenue by a single tax upon capital.

The argument of Menier is as follows: Capital is a national product and therefore out of it alone should the state derive its income, "the tax representing the expense of giving value to, and the exploitation of, the national capital." Moreover, since the state exists to further individual liberty and human personality—"the enfranchisement of the individual"³—it should not lay any tax burden upon the individual as such. "The tax," says Menier, "ought not to know man, but only the national fortune. But since this fortune is held by individuals they should pay a tax in proportion to what they hold."⁴

The position is not wholly unlike that of George, since he would take the tax out of the national capital upon which the state has a claim because exploited by itself, the principle of taxation being a proportion to the amount of the national capital individually possessed, no tax being imposed upon the individual, *as such*. But does not Menier

¹ See Shearman, *op. cit.*, p. 169.

² *Théorie et Application de l'Impôt sur le Capital*.

³ *Op. cit.*, p. 192.

⁴ *Ibid.*, p. 196.

confuse a nominal and a real tax on capital, thus leading to the untenable position that a tax on capital does not, while a tax on income or other form of wealth does, interfere with individual rights and individual liberty? Besides, income quite as much as capital is a national product, and quite as much as capital is given value by the government. Not the least error of Menier, however, is the assumption that a tax is upon property, not upon the person. Only persons can have a responsible relation to the state, or be under obligations for its support. The state, it is true, demands property, that is, economic goods, but the demand is and can be only upon persons. Then, too, Menier falls into the error of supposing that one's interest in the government and obligation to it is directly proportional to the amount of capital that he possesses.

II. THE CLASSICAL SCHOOL OF ECONOMISTS

1. *The Benefit Theory of Taxation.* The economic basis of the classical economists rests upon their theory of the state as the protector of persons and property, while their principle of taxation is that the tax should be proportioned to the benefits derived from the protection. The economic aspect of taxation, in short, is simply the economic side of their political doctrine. Hence, a tax is regarded as an economic return for a presumably measurable benefit received from the government. This conception differs from that of the Physiocrats only in the character and extent of the content contained in the idea of benefits. Here the idea is that the relation of the state to the individual is that of a protector and guarantor of liberty, and that the individual should compensate for the expense of this protection in proportion to the benefits derived from it. It is an economic relation that is the counterpart of the Contract theory of the state, and is very largely an outgrowth of it.

According to this view, then, a tax is considered as the expense of protection, while the value of the protection is measured by the amount of property protected. This is implied in the famous dictum of Montesquieu: that taxes are the payment of a part of one's property in order to enjoy the remainder in security.¹ It is expressed still more explicitly by Adam Smith, whose canon has become classic on principles of taxation. Subjects, he says, should contribute to the support of government "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, who are all obliged to contribute in proportion to their interests in the estate."² True, this conception of taxation is given as an explanation of the meaning of "ability," which is regarded as the basic principle. But it is only by a confusion of ideas, or an inconsistency of thought, that the principle of ability can be connected with the protection theory of the state. And yet this confusion or inconsistency is found in most of the classical economists. Its most extreme type is, perhaps, found in Murhard, who bases the tax upon the protection of property,³ yet would proportion the tax to "ability,"⁴ expressly repudiating a tax proportioned to the amount of income enjoying the protection.⁵

Such, in the main, is the view of most writers of this school, some, like Murhard, emphasizing the protection of

¹ Montesquieu, *Esprit des Lois*, ch. I.

² Smith, *Wealth of Nations*, pp. 414-5 (Rogers' edition).

³ "Steuern werden bezahlt zum Schutze des Eigenthums. Darum, und nur darum gebe Ich Steuern." Murhard, *Theorie und Politik der Besteuerung*, p. 30.

⁴ For taxes are "am glücklichsten gewählt, wo jeder Staatsgenosse im Verhältnis seiner Kräfte zu den Staats-Aufgaben beiträgt." *Ibid.*, p. 80.

⁵ Cf. *ibid.*, p. 26.

property, others, like Sismondi, emphasizing the protection of persons.¹ From the point of view of consistency, however, Von Hock makes a distinct advance, since he not only recognizes the protection of both persons and property, but would have an equal tax for the former and a tax proportional to the benefits of protection for the latter.² Like Sismondi, too, he places the question squarely upon an economic ground, making the tax a compensation for the services received from the state.³ Yet in the hands of Von Hock the protection principle loses much of its character, as, indeed, it does also with Sismondi, since the term is made to include practically all that is contained in the idea of national well-being (*das Wohl des Volkes*). Protection, with such an extended conception of its content, loses, too, any significance that it might have as a basis of taxation, since it is incapable of giving a principle that is consistent with itself, for the distribution of the tax burden.

We have had occasion to criticise the principle of benefits in the preceding chapter. As affording an economic basis and principles it is even more defective than it is as a political principle. To have any validity from the view-point of economics the benefits of protection must have a definite assignable value, else the tax cannot be a compensation for a value received. From the point of view of the protection of persons it cannot be said that the benefit of the protection is equal, as Von Hock assumes, nor that the benefits from

¹ "L'impôt doit être considéré par les citoyens comme une compensation de la protection que le gouvernement accorde à leurs personnes et à leurs propriétés. Il est juste que tous le supportent, en proportion des avantages que la société leur garantit, et des dépenses que la société fait pour eux." *Économie Politique*, vol. II, p. 155.

² Cf. Von Hock, *Die öffentlichen Abgaben und Schulden*, §§ 1-4.

³ "Jeder Abgabe ist eine Vergeltung der vom Staat geleisteten Dienste, und erscheint darum nur dann gerechtfertigt, wenn der Dienst des Lohns werth ist." *Op. cit.*, p. 4.

the protection of property are proportional to the amount of property enjoying the protection, as most upholders of this theory maintain. Still less is it possible to apportion the tax to benefits when, as with Von Hock and Sismondi, benefits are made to include such immaterial qualities as honor, glory, education, religion, national well-being, etc. But apart from the impossibility of determining the value of the benefits, the economic relation between the individual and the state cannot be expressed by the idea of compensation for benefits received. Nor is this due simply to the fact that the benefits are not measurable quantities. The falsity of this conception rests chiefly upon the fact that it is wholly out of harmony with the social relations that a tax involves. Indeed, the inadequacy of this conception would seem to be felt by most of its defenders, since they, following Adam Smith, interpret "benefits" as synonymous with "ability." But the two ideas are totally distinct and mutually exclude each other. As Bastable says: "So far as the 'benefits' or 'service' principle is applied, it excludes the rule of taxation according to ability."¹ Most writers, however, who accept the benefit principle (whether or not they make it synonymous with ability) find a measure of benefits in the assumption that the benefits of government are proportional to the amount of property enjoyed or consumed. As expressed by Sir William Petty: "Every man ought to contribute according to what he taketh to himself, and actually enjoyeth."² With Petty this means, as with Hobbes, that the benefit is proportional to what one consumes, and therefore that the tax should be a proportional tax on consumption. This, too, is the tendency of the classical economists, who would throw every safeguard around capital and pro-

¹ Bastable, *Public Finance*, p. 389. Gen. Walker and Mlle. Royer, also of the classical school, likewise repudiate the "benefit" principle.

² Petty, *A Treatise of Taxes and Contributions*, p. 83.

duction. But not the amount of property that one possesses, and still less what one consumes, nor any other portion of income, is an adequate measure of the benefits of government. Nor is the claim of government limited to any portion of income. As Gen. Walker has well said, "the revenue rights of the state attach equally to every portion of private revenue, irrespective of the consideration whether any such portion is to be spent or to be saved."¹ But above all this view of the economic aspect of taxation is at fault, because it assumes a relation of economic equivalence where no such equivalence is possible, and because it falsely assumes that such an equivalence is the true basis and measure of the tax.

2. *The Exchange Theory.* The same in principle as the theory of "benefits," though different in point of view, is the "exchange theory" of Bastiat and Perry. Although this view of the tax was earlier expressed by Senior in his "Political Economy," with Bastiat and Perry it was made a part of their economic theory, the collection and expenditure of public revenue being regarded as determined by the same principles of exchange that determine all economic exchanges.

The theory starts with the principle of the "division of labor."² In all departments of economic activities, so the argument runs, protection is required, and in the division of labor in social and economic life the function of protection is assigned to the government. For the "service" that the government performs in procuring the protection every economic activity owes an "equivalent" service in exchange. That is, in the "division of labor," government performs one service—protection—in exchange for another service—contribution of taxes. Or taxation, like all private economic

¹ Francis Walker, "The Bases of Taxation," in *Pol. Sci. Quart.* iii, p. 11.

² Perry, *Political Economy*, p. 516. See also, Senior, *Political Economy*, p. 74-

activity, finds its basis and its principles in a theory of exchange of equivalent economic services. As Perry puts it, taxation "finds a ready and solid justification in the common principles of exchange." Indeed, "taxes demanded of citizens by a lawful government which tolerably performs its functions, are legitimate and just on principles of exchange alone."¹ For "value resides in services exchanged; but government is an essential prerequisite to any general and satisfactory exchanges, since it contributes by direct effort to the security of persons and property; and justly claims, therefore, from each citizen a compensation in return for services thus rendered him."² The same thought is also expressed by Bastiat, who declares that when a state renders a service equal to the tax, there is only an exchange (il n'y a qu'un échange);³ and that a good or a bad use is made of the tax according as the service of the state is, or is not, equivalent to what the public gives in exchange—the tax.⁴

In other words, according to the exchange theory of taxation the basis of the tax is an economic "exchange of services" between the government and the taxpayer. That is, the government being a participating factor in all private exchanges, it should find compensation for its "service" by participating in the gains from these exchanges. Or, the "gains" accruing to individuals because of the service of the government in providing protection and security, the individuals should share their gains with the government in exchange for its service. And from these assumptions we get as a principle of taxation that individuals should contribute to the cost of the service of the government "in proportion to the gains of their exchanges."⁵

¹ Perry, *Political Economy*, p. 516.

² *Ibid.*, p. 515.

³ Bastiat, *Ce qu' on voit et ce qu' on ne voit pas*.

⁴ Bastiat, *Sophismes Économiques, Oeuvres*, iv, p. 47 (Ed. 1863).

⁵ Perry, *op. cit.*, p. 516.

As against this view of taxation we may note that the state cannot be conceived of as simply an economic agency in exchange, whose "service" in the exchange is to be compensated for according to the principles of private economic exchanges. Such a conception expresses neither the relation of the state to the individual, nor that of the individual to the state. True, the state does perform a service for the individual and receives taxes from the individual, but the "service" and the tax are not related to each other in the way of an economic exchange. Hence, the basis of the tax is not to be found in the idea of an "exchange of service." The services of the government are far more extensive than that which obtains to the individual from the "gains of exchanges." And if the basis of taxation is not to be found in the idea of an economic change, so neither can the principles of taxation be expressed in terms of an economic exchange.

But even if we assume the fiction of an exchange, the character of the "exchange of service" between the government and the taxpayer is entirely different from that involved in private exchanges. For in the former case, however voluntary may be the payment of taxes in the abstract, there is a compulsory feature in the exchange that does not attach to private exchanges, which are wholly voluntary. In the former case, too, the terms of the exchange are made by one party to the exchange—the government; while in the latter case the terms of the exchange are mutually determined through the operation of economic laws—the law of "demand and supply," or, if you will, the law of "marginal utility." Finally, in the former case the normal basis of the exchange is cost—cost of the government service; in the latter case the basis of the exchange is the value, or "utility," of the exchange to both parties to the exchange—the basis of profits, or gains. In fact, as pointed out

by Sax,² between the two types of exchange there is only a distant similarity (entfernte Aehnlichkeit). But at bottom there is nothing new in this theory of taxation, except in name and point of view. In reality it is nothing but the old benefit theory in a new dress, the benefits being regarded as measured by the "gains of exchanges," or the profits of industry—a limitation as inadequate as any of the preceding. Thus, the exchange theory contains all the defects of the benefit theory in addition to those mentioned above; not the least being the absurdity of assuming that the services of the state and the taxes are economic equivalents, indeed, as Bastiat says, must be.

3. *The Insurance Theory.* A somewhat different version of the "benefit theory" is found in the "insurance theory" of taxation. The most noted champion of this theory is Thiers,³ while it has the sanction of McCulloch⁴ and of E. Peshine Smith.⁵ It is closely allied to the "joint-stock" theory of Herbert Spencer,⁶ which is found, also, as one of the contradictions of Adam Smith.⁶ According to this theory the state is comparable to a Joint-stock Insurance Company, whose function it is to insure security of life and property. Hence, a tax rests upon the same basis and the same principles as the premium of an insurance company. "As government renders services to each and every one of its constituents," says E. Peshine Smith, "every one ought to contribute to the expense of its maintenance in the ratio that he receives advantage. It gives him security of his person and his property. So far as his property is concerned, it is apparent that his contribution should be esti-

² Sax, *Grundlegung*, p. 54.

³ Thiers, *De la Propriété*, p. 355 et seq.

⁴ McCulloch, *Taxation and Funding*, p. 17.

⁵ E. Peshine Smith, *Political Economy*, p. 264.

⁶ Spencer, *Social Statics* (abridg. ed.), p. 122.

⁶ Adam Smith, *op. cit.*, p. 415.

mated as it would be by a private insurance company, by the amount at stake." ¹ But Mr. Smith, unlike Thiers, confines the application of the insurance principle to property, rightly admitting the impossibility of making "the value of personal security a basis for taxation," since "the value of protection to the person is incapable of estimation." ²

But a moment's reflection, however, is necessary to convince us that the whole theory is even more false than the "exchange" theory. As to the person, not only is it impossible to estimate the value of the protection—the insurance—but the character of the "insurance" given by the state is entirely different from that given by a private insurance company; while with property, though its value is capable of estimation, there is a similar difference in the character of the insurance. In the case of persons the state does not guarantee a monetary compensation in case of injury or loss of life, as does an insurance company, but contents itself with punishing the aggressor if he is found; or, at best, permits you to use its courts to compel compensation from the aggressor. So, likewise, in the case of property, the insurance company guarantees to make good the whole of the insured property that is lost or damaged, but the state, as Leroy-Beaulieu says, "will repair no damages made either by natural causes or by man. If a thief steals your property—the state will pursue the thief, but if he has consumed your property the state will not restore it." ³

But above all, it is not true that the conception of insurance rightly expresses the nature of the basis of taxation. To quote Leroy-Beaulieu again, "The attributes of the state are much more extensive than they would be if they were confined to this conception."⁴ Equally false is it that taxes

¹ *Op. cit.*, p. 264.

² *Op. cit.*, pp. 264-5.

³ Leroy-Beaulieu, *Traité de la Science des Finances*, p. 116. ⁴ *Ibid.*, p. 115.

wide range of phenomena we must observe caution lest we push it too far, and neglect counteracting or modifying forces. We must beware of deceptive analogies. These cautions are particularly pertinent when we attempt to employ sensuous phenomena in the explanation and interpretation of distinctively spiritual activities and relations—the activities and relations of spiritual beings. For example, in applying the principle of utility to moral agents it is indispensable to truth that we take account of the distinctive characteristics and attributes of mind, over and above the sensuous pleasures and pains.

No better example can be given of the attempt to use one common, all-embracing principle to explain and to interpret all phenomena, to give unity to all knowledge, of the animal and human worlds, of the physical and the mental, of the individual and the social—than is to be found in Herbert Spencer's system of philosophy; but the simplicity of his principle does not prove the truth of his philosophy, and still less the truth of his special applications of his principle. There is, indeed, a unity in truth, but it is a unity in complexity; there is not always a truth in unity. In our search for knowledge we are too apt to be led astray by those Idols of the Tribe against which Bacon warned us, and our search for truth descends into a search for simplicity.

Now it is my contention, further, that the principle by which Sax seeks to interpret the phenomena of taxation is more complex than he imagines, at least more complex in its application. True, there is, and must be, an underlying unity in individual and social phenomena, since social life is, in a sense, but the larger self of the individual. But just because society is the "larger self," the common principle, when applied to it, takes on a complexity that does not exist when confined to the individual *as such*. It is operating under different circumstances and conditions in the two

cases, and, therefore, in its application these circumstances and conditions must be duly considered. Hence it is quite possible for the conclusions in one case to be quite different from those in the other. Only by neglecting important factors, and by the use of the specious argument of analogy can we conclude from the one to the other.

The fact is, that Sax is able to conceive of the simplicity of his principle only by abstracting from it some of its most important elements, only by considering it from the viewpoint of "pure economics," abstracted from all ethical considerations. But no such abstraction can be allowed; for wherever human relations are involved there are also involved ethical considerations. Human connotes ethical, and so likewise the problem of equality of taxation, as Professor Seligman observes, "connotes an ethical problem." The problem of taxation can not, therefore, be reduced to a simple problem of pure, that is, of abstract, economics. But the "simplicity" of the theory of Sax is only the simplicity of abstract economics, therefore a seeming simplicity only. These criticisms will become more apparent as we proceed.

3. *Individual and Collective Psychology.*—The theory of Sax, like the utility theory of value upon which it rests, has its foundation in what we may call a psychology of motivated action. It is, moreover, one of the fundamental assumptions of Sax that collective psychology is the same as individual psychology; that, in other words, "collective" activity for the satisfaction of common wants is directed in precisely the same way as individual activity in the satisfaction of private wants; that is, by the *intensity* of the want to be satisfied, or by the egoistic impulse to get the greatest possible enjoyment in the satisfaction of wants with the least possible sacrifice to the self. But here, again—in concluding from individual to collective psychology—there is need of

¹ *Progressive Taxation*, p. 149.

are distributed on the same principle as an insurance premium. The premium is determined not only "by the amount at stake," but by the risk—by the probabilities of life, or of loss—in each individual case; the principle of tax distribution is determined by the solidarity of interests of the whole body of citizens, without regard to length of life or the insecurity of property.

III. THE PRODUCTIVE THEORY OF TAXATION.

Conceiving of "production" as the production, by individuals, of material, exchangeable goods, and looking only at the direct factors engaged in production, Adam Smith held that all consumption of economic goods that is not directed to further production is "unproductive consumption." Hence the consumption of wealth by the government, in the form of taxes, is unproductive consumption. In this Adam Smith was followed by most of the early economists of the classical school.¹ Bastiat and Perry, however, while they regarded the government as a necessary evil, assumed that its services have an economic value in exchange, not only with relation to consumptive, but also with relation to productive goods. But it remained for Wagner and Stein to give a more exact appreciation of the function of government in production.

According to Wagner the function of government in production is to transform material goods (Sachgüter) in the form of a tax into immaterial goods (öffentliche Einrichtungen, Dienstleistungen). "Because it is indispensable to the entire economic life, and for all private activity of individuals, the services of the government (Staat), and therefore the government itself, must be regarded, in an

¹ According to Ricardo taxes may affect production through their "tendency to lessen the power to accumulate." *Works*, p. 88. (McCulloch's edition.) For views of McCulloch and others, see *ante*, p. 43 and notes.

economic sense, as eminently productive."¹ So likewise Stein, who held more to the classical notion of the importance of production, regarded the government from the point of view of its indispensableness to the building up of capital (Kapitalbildungsprozess), and therefore not as an "unproductive consumer," but as an indispensable agent in production. "In fact," says Stein, "all services and payments to the government (Staat) are, economically speaking, nothing else than an integral part of the cost of production of every economic product."² Therefore, the tax that goes to maintain the government is simply a part of the necessary cost of production.

From the view-point of Wagner, who emphasizes the social side of production, and has in mind the totality of the factors in production, without distinguishing the pre-conditions from the immediate factors, the government is viewed as a direct agent in production, and therefore the tax itself as "eminently productive." From the view-point of Stein, on the other hand, who regarded production more from the standpoint of the individual, who emphasized the importance of capital and capital formation (Kapitalbildung), and thought of government as a condition precedent, government was considered rather as an indirect than a direct agent in production, and the tax itself as "reproductive;" and reproductive in the sense that it enables the government through its administration to maintain the conditions of capital-building, and "this reproductivity of the tax is, and will remain, the absolute condition of the power to pay taxes (Steuerkraft), therefore also the condition of taxes, and so of civic life itself."

But although different in point of view, the "productive" theory of Wagner and the "reproductive" theory of Stein

¹ Wagner. *op. cit.*, i, p. 13.

² *Finanzwissenschaft*, i, p. 15.

³ *Ibid.*, ii, p. 359.

are practically one and the same—a productive theory that is nothing else than the old “give-and-take” (*Leistung und Gegenleistung*) theory of taxation; or, as Sax observes, “it is a correlate of the “exchange theory.”¹ But the field of the exchange of service is here limited to the process of production, or to capital building. Even Wagner notes the parallel, and points out that in the state giving services for taxes (*Sachgüter*) there is a kind of an exchange (*eine Art Tausch*), but that the conditions of the exchange are fixed by the state. “Thus, the services of the state and taxes,” he adds, “appear as correlates of each other.”² But with Wagner the exchange is not, as is implied in the exchange theory, an exchange of special services; but the principle of exchange is that of general compensation (*generelle Entgeltlichkeit*), no separate reckoning being made with individuals concerning the advantages they receive from the state.”³

But neither Wagner nor Stein makes use of his productive theory to furnish a basis or principles of taxation; further, at least, than to show that the taxes must be adequate to the needs of the state, and the services of the state equal to the taxes, else production must be hampered or cease entirely. Or, as is implied in the view-point of Stein, taxes must be sufficient to enable the state to attain its highest efficiency in maintaining the conditions of production, of capital building, but never in excess of the value of the services of the state in capital building. That is, they must be high enough to maintain that degree of efficiency on the part of the state that will ensure their reproduction in capital, else capital building must cease, and thus the source of the tax is annihilated, and with it also the state itself.⁴ But with Wagner the productive theory lies wholly outside of the principles of

¹ *Op. cit.*, p. 92.

² *Op. cit.*, i, p. 523.

³ *Ibid.*, i, p. 14.

⁴ Cf. Stein, *op. cit.*, ii, p. 359.

private economy, his conception of the functions of government and of a "general compensation," without individual reckoning paving the way to his social-political conceptions, in which he finds both the basis and the principles of taxation.

That, however, there is much truth in the productive theory of the state and taxation, that the state is a *conditio sine qua non* of production, is not to be doubted. But just because it is this, because it is a condition precedent, it is not a directly active force in production. A condition of production, it is true; but it does not for that reason perform any measurable economic service in production. This Wagner admits.¹ Then, too, there is much expenditure by the government that by no conceivable hypothesis could be regarded as productive, as the term is understood by either Wagner or Stein.² Moreover, this conception of the economic relations involved is too restricted in its scope to furnish a basis and principles for taxation, as it includes but a small part of even the relations that are involved in the economic life, to say nothing of the wide field of "services," other than in the strictly economic sphere, for which compensation must be made, or rather must be maintained.

These facts go to show that while the productive theory undoubtedly represents an important phase of the economic relations between the state and individuals, it is not a phase that can furnish a basis and principles of taxation. And it is to the credit of both Wagner and Stein that they made no such attempt, and that least of all did they conceive this relation to be the only relation that determines principles of taxation; that is, did not conceive taxation as a purely economic problem.

¹ "Aber schwierig ist sogar die technische und vollends die ökonomische Produktivität der einzelnen Staatsthätigkeiten zu beurtheilen." Wagner, *op. cit.*, i, p. 13.

² Cf. Sax, *op. cit.*, p. 98.

IV: THE UTILITY THEORY OF SAX.

Although the theories just discussed are based upon the conception of an economic relation between the individual and the state, they do not attempt (with partial exceptions of the "exchange" and "single tax" theories) to place taxation upon a purely economic basis, or to determine its principles by purely economic laws. It is, on the contrary, the boast of Sax that the problems of taxation are to be solved simply and solely by the application of economic principles and laws. The fundamental thought, as we have seen, is, that the collective wants of a people—wants satisfied by the agency of government—resolve themselves into individual wants in such a manner that they constitute a part in the totality of individual wants, being distributed indiscriminately in the circle (*Reihe*) of wants according to their intensity; and that all wants, collective and private without distinction, are satisfied in the order of their intensity, the final test always being the marginal utility of goods relative to the wants satisfied by them.¹ Collective and private wants are upon precisely the same plane, and in a conflict between them it is the relative intensity of wants that decides the competing claims. Precisely in one case as in the other, in taxation as in economics, it is a question of the intensity of wants on the one side, and of the marginal utility of goods on the other—the utility itself being determined by the psychological law of "greatest satisfaction with the least possible sacrifice," or effort. In brief, laws of subjective value, themselves rooted in sensation, are the alpha and omega of problems of taxation, as, indeed, of all financial problems.²

Not only have we here an economic basis and an economic principle, but we have in them the fundamental basis and principle of taxation. Economic laws become the in-

¹ See Sax, *op. cit.*, § 31.

² Cf. *ibid.*, § 52.

terpreter of both the political and ethical side of taxation. Indeed, according to Sax, taxation is not an ethical problem, the principles of taxation having nothing to do with ethical considerations. The problem is one of economics, and only by a strict adherence to economic laws is justice in taxation possible. The ethics of taxation is simply the inevitable consequences of the economics of taxation.¹

That this theory, thus briefly and inadequately stated, contains the simplicity that is claimed for it cannot be denied. But to Sax this simplicity is a guarantee of its truth (*eine Bürgschaft ihrer Richtigkeit*). Indeed, the simple law of value, the solvent of every financial, as of every economic problem, is comparable in its importance to the law of gravitation.² This simple law, so it is exultingly and triumphantly claimed, is the "light which, like the electric flames of the sun, clears up, all at once, the hitherto dark, confused province (of taxation)."³ We are told, too, and repeatedly with much apparent self-satisfaction, that in this law the difficult problems of taxation for the first time find a solution; and for the first time a definite meaning is given to the idea of justice in taxation. The law, in short, explains everything—benefits, exchange, sacrifice, ability, justice, etc., etc.⁴

In this estimate of the merits of the theory, and in the axiomatic character of the proof of its validity, Sax has support in the able Italian economist Ricca-Salerno. With such able defenders it is with not a little diffidence that we venture to question some of the pretensions of this theory and to offer some criticisms upon it, at the same time acknowledging its many merits. Because of the exalted claims for this theory, and in form, at least, its comparative newness, we may be justified in giving to it a somewhat

¹ Cf. Sax, *op. cit.*, p. 524, and *Die Progressivsteuer*, p. 89.

² *Grundlegung*, p. 308.

³ *Ibid.*, p. 444.

⁴ Cf. *Die Progressivsteuer*, p. 90.

more extended consideration than we have given to any of the preceding theories discussed.

1. *Its Originality.* Reflection must, I think, convince us that, with all of its claims, the theory of Sax does not differ in essence from some of the older theories that it so vigorously combats. It differs from these only as the utilitarian theory of value differs from that of the classical economists—in being more fundamental in its analysis. True, this difference is important, and to Sax all-important. Like them all, the theory of Sax, from one point of view, is a theory of benefits, of exchange. But while they emphasize the objective side of the exchange, Sax emphasizes the subjective character of the exchange. Or if Adam Smith emphasizes the “protective service” of the exchange, Bastiat and Perry the fact of the exchange, Thiers the element of insurance, George the service of the government in creating “land values,” Wagner and Stein the productive service of the government, Sax emphasizes the subjective motives that determine the character and amount of the exchange—the ultimate fact of the exchange.

In another respect, also, there is an important difference. For, whereas, in the other theories the “exchange” suggests the idea of the state standing over against the individual as a separate entity, as an independent party to the contract, the theory of Sax more correctly regards the whole phenomenon as proceeding from the individual, and determined by the individual; collective life and collective economy being but a separate phase of individual life and individual economy.¹

But notwithstanding these and other differences, the basic idea of the tax and of tax principles is essentially the same with Sax as with his predecessors. As previously pointed out,² the practical rule that Sax deduces from his theory is

¹ *Cf.*, § 31.

² *Ante*, p. 92.

the same as that previously expressed by Mill, as the result of his theory of "equal sacrifice," which itself may be considered as the subjective side of the theory of benefits and of exchange. At best the "equivalence" theory of Sax differs from the "equal sacrifice" theory of Mill only in giving an ultimate and more definite measure of the sacrifice, and we may add, too, of "benefits" and "exchanges." This ultimate measure he finds in the "marginal utility" of goods, applying to finance the economic "utility theory" of value.

But Sax is not, as he would have us suppose, the first economist to make this application. As pointed out by Professor Seligman, "the formulation of the whole doctrine had been developed by Meyer without any suspicion on his part that he had thereby made any specially new discovery."¹ One emphasizes the marginal want satisfied because of the tax, and the other the marginal want unsatisfied; a distinction without a difference. But the honor of first applying the utility theory of value to finance is credited by Mazzola to the Italian economist Pantaleoni.²

2. *Simplicity and Truth.* There is, indeed, a fascination in simplicity. But we ask: Is simplicity a guarantee of truth? And is the theory of Sax as simple as it seems?

It is no doubt true that only as we discover unity in social as in natural phenomena, do we get an *interest* in them (as distinct from a curiosity), because only then are we able to comprehend them in all of their relations, only then intelligently understand them. Such a unifying principle we have in the idea of utility, and this principle bids fair to become still more important in the future than it has been in the past; both in the interpretation of the philosophy of history, and in the evolution of political, social and economic institutions.³ But in the application of this principle to such a

¹ *Progressive Taxation*, p. 148.

² See *ante*, p. 53, note.

³ This was emphasized by Prof. Giddings in his lectures on Sociology at Columbia University, in 1890-91.

the greatest caution. Similarities and analogies will not suffice.

It is true, as Sax very correctly shows, that "collective needs" do not pertain to the Collectivity—the state—as an independent entity, but are ultimately resolvable into the needs of the individuals that constitute that Collectivity, and true, therefore, that in the satisfaction of these needs individual psychical relations and activities are involved. But more than this fact is necessary to prove a psychical identity in the two cases. The psychical activity of the individual may be the same when he is acting for himself or the collective whole, but the condition, motives or impulses that determine the activity may not be, and we contend are not, necessarily the same. The highest good for the Collectivity may not be the highest good for the individual. It is in the neglect of these dissimilarities that Sax, to my mind, makes his greatest mistake. The Idols of the Tribe prove false guides.

What the psychological differences are will appear presently, but that they are important to the question at issue cannot be doubted. For the point at issue is whether the principles underlying utilitarian economics are so far applicable to public economy as to be able to furnish an all-sufficient basis, as also principles of taxation, solving the problems of equality, exemptions, proportions, etc., apart from any ethical considerations. Hence, it is important to ascertain how far the primary assumption, that individual and collective satisfaction of needs obey the same law, is true. The question may be considered subjectively, or psychologically, and objectively, or empirically. At present we are concerned with the psychological question: Whether the psychology of the individual, *qua* individual, is the same as that of the individual as participating in the Collectivity—is the same, that is, as collective psychology. We may note the

difference by first calling attention to certain facts of individual, then of collective psychology.

(1) *Individual Psychology; or the Psychology of Individual Satisfaction of Needs.*—In the first place, individual psychology has to do with sentient, self-conscious, self-determined organisms; that is, with persons whose peculiar nature it is to have “ideals, feelings and sensations”¹ that pertain to them as individuals, and others that pertain to them as social beings, that is, spring from their membership in political society. The former (we confine ourselves to the economic) are induced by a conception of certain psychical states, certain conceptions of the self, that the individual desires to attain for himself, while they involve the relation of external objects to the sentient self. By changing the objective relations he changes the subjective state of feelings and sensations—satisfies his needs, his ideals. By controlling the former, therefore, he controls his own psychical states, his own satisfactions. Ideas, feelings and sensations that a given order of things may induce are compared with the ideals, feelings and sensations that another possible order may induce, and the individual decides for himself (conditioned by external limitations) which order of things shall prevail by deciding which order will give him the greatest satisfaction on the whole, thereby satisfying his highest need as he sees it for the time being. For example, he may decide to exchange a given sum of money for the necessities of life, or for a work of art, thus effecting a subjective satisfaction in accordance with an ideal that he has formed of himself, an ideal that is peculiar to his own psychical nature.

Again, it may be noted that private economic needs are subjectively ideas, feelings and sensations that pertain to and are felt directly by the individual, but objectively they pertain to “goods” by which the needs are satisfied, the goods

¹ Cf. Sax, *Grundlegung*, p. 574.

themselves belonging to and being under the control of the same individual. By a subjective comparison of needs, as actually and as ideally satisfied by the goods in question, the subjective value, or marginal utility, of the goods is ascertained, relative to the intensity of feeling of the needs compared; and hence, again, since the goods are under the control of the individual, he may satisfy his needs in the order of their intensity so far as he is in possession of the necessary economic goods.

Expenditure of goods—satisfaction of needs—will, of course, be influenced by habits, by the circumstances of social and industrial conditions; but intensity of individual feeling, relative to the ideal the individual has of himself, will determine the order of the satisfaction of needs whatever the conditions; but because of the consumer's rent,¹ or surplus, there is not necessarily an equality between the objective value of the goods, the price the consumer must pay, and their subjective utility for the satisfaction of needs, or the price which he would be willing to pay. Or, rather, because there is not an equality between the objective value and the subjective utility of goods, there arises a consumer's surplus. Or, more correct still, a consumer's surplus arises because the marginal utility of goods to the consumer, measured by the sacrifice which he is willing to undergo in order to obtain them, is greater than their "social marginal utility," as Professor Seligman very aptly puts it, or "the sacrifice which the members of society as a whole are willing to make."²

(2) *Collective Psychology; or the Psychology of the Individual in Collective Life.* Thus far students of psychology have given but slight attention to the psychology of

¹ See Marshall, *Principles*, p. 181.

² Seligman, "Social Elements in the Theory of Value," in *Quart. Journ. of Econ.*, vol. xv, p. 332.

collective life, and we have not, therefore, a systematized knowledge concerning it. As I do not pretend to be a psychologist I shall not presume to elaborate such a theory. Nevertheless, I believe that a little reflection must convince us that "ideals, feelings and sensations" have quite a different significance according as they have reference to the individual, *qua* individual, or to the individual in his social activities—to the satisfaction of private, or to the satisfaction of collective wants.

That the psychical phenomena in both cases centre in the individual there can be no doubt, for there is no psychical "collective entity" in which psychical phenomena may centre. Nevertheless, the two classes of phenomena have distinctive characters. The "ideals, feelings and sensations" that actuate the individual, *qua* individual, may lead to a quite different course of conduct from that to which they would direct if they actuated the individual as representative of the "collective whole." It is nothing to our purpose that there is no psychology of the individual worth speaking of, except of the individual participating in social life. The point is that he is actuated differently when acting for himself and when acting for the "whole," because actuated by a different conception of the "good," in the one case a good for the self, in the other a good for the whole—a "personal" good and a "common" good. And it is the conception of the "good" that is the fact of importance. Intensity of feeling may be the immediately controlling force in both cases, but it is the conception of the "good" that one forms for himself that determines the direction of that intensity. Sax may find in *intensity* of feeling—in sensation—a *tertium comparationis* to explain demand and supply, sacrifice, differences in needs, etc.,¹ but he fails to see that there is a still more fundamental *tertium comparationis* that

¹ Cf. Sax, *Grundlegung*, p. 176.

explains and interprets the intensity of the sensation, to wit. : the conception of the ideal that one sets for himself to attain.

From these facts it would seem clear that "ideals, feelings and sensations" partake of a different character according as they are concerned with the satisfaction of private, or of collective, wants; that, therefore, we cannot safely conclude from rules of private satisfaction to rules of collective satisfaction; that the fact that intensity of desire is an immediately controlling force in both cases is not, as previously pointed out, a sufficient fact for comparison. In fact, it is only as the individual in acting for the whole differentiates his motives and actions from what they would be if he were acting for himself alone; only, that is, as he differentiates his conception of the good of the whole from his conception of the good for self, is his action likely to be directed to the attainment of the "common good." On the other hand, so far as the individual in his capacity of acting for the whole is dominated by the impulse that would guide him if acting for himself, irrespective of others; so far, that is, as he is guided by a conception of his own "personal good," and not by a conception of the "common good," the tendency of his action will be to thwart the attainment of the "common good." This latter case is well illustrated by the "professional" office seeker, with whom the interest of self dominates his every action, and who thereby, paradoxical as it may seem, assumes a different character, a different personality, when acting in the two capacities¹—for the self and for the whole; for when acting for the whole he does not make its good his good as he would if the whole were himself. He rather assumes that he is the whole.

¹ There is, indeed, much apparent truth in the semi-serious suggestion of Prof. Giddings, that the "politician" at least, has a double consciousness, a dual personality, assuming one in his private capacity and another in his public capacity. Notes from lectures on Sociology, Columbia, 1890.

From the above considerations, inadequate as they are, it is apparent that private and collective needs are distinct in their character, their point of view, their aims, and may be in their subjective results. Private needs are felt by the sentient self to whom they belong, their interest is solely for the self, they are directed by the self for its own "good," and are measurable by the self by comparison with felt needs. Collective needs, on the contrary, are *conceived* by individuals, but as belonging to the whole; are indirectly controlled and satisfied by representative agents, pertain not to the individual, but to the common good, and are only remotely capable of measurement by comparison, if, indeed, they are not immeasurable. The former are *felt*; the latter, as Mazzola¹ points out, are distinctively "reflexive needs," needs related to thought rather than to feeling.

4. *Collective Needs Empirically Considered.*—That the satisfaction of collective needs is not wholly determined by the same rule, or law, that determines the satisfaction of private needs will appear still more evident by a few practical observations of objective facts; facts, however, that are determined by and are illustrative of the psychological differences already mentioned. We need to note only differences in the character of the problems of satisfactions, and the political facts relative to collective satisfactions.

(1) *Differences in Character.*—It is, as we have seen, one of the errors of Sax that his economic theory is too abstract; that he assumes economic action to be determined solely by the intensity of economic want, whereas there are many influences that go to shape economic action, as ethical, social,

¹ Mazzola, *op. cit.*, p. 73. While Mazzola makes some good criticisms of the theory of Sax, he seems, on the whole, to accept the theory; but thinks that the highest utility of the tax can be determined only by differential calculus, since there are various factors involved in the problem, and not one factor, as Sax assumes. This, he says, "is the limit to which financial economy can go," p. 149.

etc.¹ The error is aggravated when economic law is applied to financial problems, such as taxation, since here these modifying influences become of even greater importance. With this correction there is, under ideal conditions, a degree of similarity between the satisfaction of private and public needs, between private and public economy. Still, even then, we are compelled to assume that the individual in his public capacity seeks to change the objective relations of things with respect to an ideal standard for the whole body politic; just as the individual seeks to change the relations of things with respect to an ideal standard of objective relations that he forms for himself. But these conditions are ideal and imply ideal conditions of human nature. They are yet far from attainment.

But even if the ideal conditions prevailed there would yet be an important difference; for although ethical relations are involved in both cases, they are or should be the determining force in all action directed towards public ends, since every public act, particularly in matters of taxation, involves the rights and duties of every member of the state in a manner that is out of all proportion to that of private economic action. If this were not so a government might well adopt the advice of McCulloch and let expediency determine its tax system.² Then, too, the fact that action in the one case is directed with reference to self, and in the other case with reference to others, puts a wide chasm between them. Intensity of feeling may control both sets of actions, but not all public action is controlled by the need most felt by the public, because the individual in his capacity

¹ See last note, and Zorli, *La Scienza dei Tributi*, p. 17, where he mentions cosmological, anthropological and sociological elements. Cf., also, Cohn, *Science of Finance*, sec. 195.

² See *Taxation and Funding*, p. 161. Cf., also, Held, *Einkommensteuer*, p. 115, and Newcomb, *Political Economy*, p. 493. Newcomb relies upon shifting of taxes to effect justice in the long run.

as a public agent is too often actuated by motives that are relative to purely private ends. These facts may be illustrated by the political factors in the problem.

(2) *Political Factors.* According to Sax the method by which we satisfy our collective wants, by the same rule that we satisfy our private wants, is through the agency of representative government by means of our vote. (He does not pretend that his theory applies to any other form of government.) But is this anything more than a pleasing fancy? True, we voluntarily consent to be taxed—to make expenditures for our “collective” needs; but the tax is pre-eminently compulsory and must be paid whether we, as individuals, will or no. Nor does our consent carry with it the amount of the tax nor the purposes for which it will be used. It is true that we consent to leave this to the discretion of our representatives, but their judgment is not necessarily our judgment, for they are more inclined to be dominated by their needs than by our needs,¹ and their needs take on a new form and variety as they become public agents.

Without doubt, much of the public expenditure is in the interest of the common good, but there is no less doubt that no inconsiderable part of it is spent to satisfy the private needs of our “representatives,” rather than the common needs. Legislators will vote for expenditures that they know will enrich themselves, their friends, or their constituents, well aware that its ultimate utility to them will far exceed their share in the burden of the tax, while for the

¹ Sax's error, when considering the cause that determines taxes, is in giving excessive importance to the needs of those who pay them and too little to the needs of those who make them pay." Zorli, *op. cit.*, p. 55. This little book contains a very good criticism of the theory of Sax. The spirit of the criticism is very similar to that which will be found in the text. As our own criticisms were made before we knew of the work of Zorli, we have not made as many references to it as we should otherwise have done.

great mass of the taxpayers there would be far greater utility in private expenditure. The public good is made to give way to the selfish interest of the individual or a class.¹ Surely there is little here that is common between private and public economy!

But says Sax,² this state of things cannot always endure, for in the course of time—it may, indeed, be a generation or more—the wrongs will be righted, if needs be by revolution. Indeed, a whole generation or more pilfered, deprived of the fullest satisfaction of both their collective and their private needs, and the wrong to be righted, adjustment of expenditures in accordance with needs to be re-established only by some future generation, perchance at the expense of a costly and bloody war, perchance, too, with a repetition of the same order of events! And this is satisfying our collective needs on the same principle that we satisfy our private needs! Could the infatuation for a theory go further?

But apart from all corruption, the individual has a very indirect and very inadequate control over the public expenditures for collective needs. In the first place a majority vote in the legislature may represent a minority of the voters.³ Then, again, it is seldom that the policy of expenditures or taxes is submitted to the voters before the majority in the government have entered upon it, and which, perhaps, as in

¹ Note, for example, our corrupt city governments. It is, however, not confined to them. Speaking of Italy, Pareto writes: "Up to the present time the governing class has not opposed the increase of expenditures, because they have the means of enriching themselves, and at the same time satisfying their vanity. If they had to pay for this indulgence they would be inclined to renounce it. This, contingency, however, seems far off. The example of Spain and Portugal shows that a Latin country may approach the verge of ruin before the governing class renounces the policy which has brought it there." "Parliamentary Government in Italy." *Polit. Sci. Quart.*, vol. viii, p. 717.

² *Grundlegung*, pp. 517 and 522.

³ Note also approvals and vetoes by presidents elected by a minority vote.

the case of war, is practically irrevocable. The subsequent "approval" at the polls may mean but little, since the appeal "to support the party" has a stronger influence upon the voters than the real merits of the tax or the expenditure.

Nor do we find it at all more satisfactory if we turn from the "representatives" to the voters, as is illustrated by the almost universal tendency, if not to evade taxation, to escape a just proportion of its burden. Says Pareto, in the article referred to above: "The landed proprietors are powerful to resist any increase of taxation upon their property; they have even been able to get the land tax reduced two-tenths, and this at the very time when the expenses of the state were increasing in an extraordinary degree and taxes on consumption were being increased in consequence."² Nor is this condition exceptional with Italy. Satisfying our collective needs at the expense of others by evasion of taxes is by no means uncommon.

Thus, from whatever point of view we consider the question, we cannot find that Sax and his disciple, Ricca-Salerno, find much proof for their theory in representative government.³ The prevalence and power of an egoism of the individual, or of a class, in a representative government prevails against the practical application of the theory only in less degree than it does in a despotism, where the theory is not assumed to apply. But Sax evidently shares in the sanguine expectations of Pantaleoni—that eventually all lower forms of egoism will give way to the "egoism of the species"³ to an altruism that for rulers as well as for the ruled enforces the sacrifice of self to promote the general happiness.

That such a condition does not yet prevail; that public assessments and disbursements are not yet wholly determined on the same principles as private economy; that there is a

¹ *Op. cit.* 717.

² *Cf. Zorli; op. cit.*, p. 62.

³ Quoted by Nitti in *La Scuola Positiva*, Sept. 1891, p. 491.

discrepancy between the theory and practice, Sax virtually admits. But, so it is argued, any unjust distribution of the tax is not the fault of the theory. It is due rather "to error or to ignorance of actual circumstances; but more still to the class egoism of the ruling element of the people which seeks to throw the tax burden as much as possible (überwiegend) upon the governed."¹ Yet this condition can not long endure, since such a government would be eventually overthrown by the votes or by the guns of the people.

But this admission, I maintain, is not to be so easily reconciled with the contention that in the economic actions pertaining to the fulfilment of the ends of collective life, "men are guided by the same psychical acts, ideas and sensations which a comprehensive analysis shows to be the guiding elements of all economic action, but which until now [*i. e.*, until this great discovery brought truth to light] was able to explain only individual economy."² The fact is, that there has not been sufficient discrimination between "the psychical acts, ideas and sensations" *as such*, and the difference of circumstances and conditions under which they are produced; or between them and the standard, or ideal, in accordance with which they are interpreted—between the conception for *self*, and the conception for *others*. Hence the error in the analogy that forms the basis of the theory.

Upon the whole, then, we cannot think that Sax has added anything of great importance to an economic basis and economic principles of taxation. We would summarize as its more important defects: that it is a pure abstraction; that it errs in its analogies and in its theory of their realization; that its validity, at best, rests upon ideal conditions that nowhere exist, and that, therefore, it is wrongly assumed that ethical principles will be realized through the working

¹ *Grundlegung*, p. 521.

² *Ibid.*, p. 574.

of economic law—the law of “greatest intensity,” or marginal utility. But after all, the “equivalence” of intensities of needs sacrificed because of the tax, which to Sax is “the whole problem of tax distribution in a nutshell,”¹ is, as we have seen, only a special phase of the sacrifice theory. But “equality of sacrifice” is fundamentally an ethical principle.

IV. CONCLUSION AS TO TRUE ECONOMIC BASIS AND PRINCIPLES

From the preceding review of economic bases and principles of taxation we are forced to conclude, for reasons given: that an economic basis and principles do not stand apart, but are closely correlated with a political and an ethical basis and principles; that neither the idea of “protection,” of “service,” nor of “exchange” forms a competent basis for economic principles of taxation, because, among other reasons, the economic basis must be in perfect harmony with the political basis—with the relations between the individuals and the state—and this basis is not properly expressed by these conceptions, because they do not properly express the true nature of the state. Moreover, we have seen that these ideas have no practical significance, since neither the “protection” nor the “service” exchanged, has any assignable economic value such as the theory implies.

And yet there must be an economic basis from which economic principles may be drawn, and this basis must have definite reference to the relation between the individual and the state; more specially to the economic relation. According, then, to our conception of this relation—of the nature of the state—the real economic basis of the tax is the collective needs that result from the political organization of

¹ *Die Progressivsteuer*, p. 90.

society—the state; the necessity for the tax being due to the régime of private property. But private property must also provide for the satisfaction of private economic needs, and, therefore, the real economic problem of taxation is to satisfy the collective needs in a manner proportionate to the satisfaction of private needs; or so to distribute private property—really the income from it—between the satisfaction of private and collective needs as to produce the highest economic efficiency, the highest economic development, and the most complete satisfaction of needs. The point of view is that of the individual, and the real question is one of the distribution of his income between the satisfaction of his private and his collective needs. But since the collective needs must be satisfied through agents, there is a seeming opposition of interests, which, as Schäffle says, occasions a perpetual strife.¹ This conflict will never wholly cease, but with a due regard of economic principles by the agents of the state it may be greatly alleviated.

What, then, are the economic principles that should guide the agents of the state in matters of taxation? Briefly, the primary principle is precisely that of the problem just stated: That individual income should be so distributed between private expenses and taxes—between the satisfaction of private and collective needs—that both the highest efficiency of the state and the highest efficiency and development of the individual will be thereby attained. In the words of Stein:

“The ruling principle of Finance is that, in covering the needs of the State, a due proportion be maintained as compared with the proportionate covering of those needs not represented by the State. . . . Neither public nor private economy presents, of itself, a final

¹“Er ist Befreiungs- und Freihaltungskampf auf Seite der Steuerträger dem Staate gegenüber.” *Grundsätze der Steuerpolitik*, p. 164. Cf. also, Cohn, *Science of Finance*, sec. 208.

end. To pamper the one and starve the other, to over-nourish the one and stunt the other, appears, upon its face, without warrant, since an effective State and a strong people are alike essential elements in national life. Both public and private needs are integral parts of a common necessity, and the one as well as the other must finally be determined according to their relative importance for the maintenance and development of society as a whole. . . . To provide for the public necessities as well as for private wants, in the ratio of their importance, is the manifest, self-apparent demand which the theory of finance that holds itself within the circle of economic vision asserts as its own, and which may be successfully opposed to the parsimonious citizens as well as to the spendthrift State."¹

It is admitted that this economic principle is very general in character, but it is sufficiently objective and definite to be capable of practical application; yet the extent of its practical realization will depend upon the extent that conscientious and enlightened statesmen hold the reins of government—ultimately upon the moral status of the community. But this principle obtains definiteness by the corollaries, or secondary principles, that flow from it, and through whose application alone the primary principle obtains practical significance. The secondary principles relate to the economic effects of the tax upon the individual and thereby upon the sources of the national income, and involve such questions as those touched upon in chapter II. For without a careful observation of the effects of a tax a due distribution of income between private and collective needs cannot be effected.

It may be noted in conclusion, that "Equality of sacrifice," or "Equivalence," cannot be the economic principle, since

¹Quoted by Adams, *Public Finance*, p. 28. "Oberstes Princip der Finanzwissenschaft ist die wirtschaftlich verhältnismässige Deckung des Staatsbedarfs gegenüber einer nicht minder verhältnismässigen Deckung aller nicht-staatlichen Bedarfe." Schäffle, *Grundriss der Steuerpolitik*, p. 17. Cf. also, Held, *op. cit.*, p. 106.

these involve comparison with others and have, therefore, an essentially ethical connotation. Nevertheless, economic principles are not entirely distinct from ethical principles any more than an economic basis is wholly distinct from an ethical basis. As an economic basis and economic principles result from a political basis and principles—from a political conception of the state—so the realization of economic principles is one of the essential conditions of the realization of an ethical standard of taxation.

It may be noted also, that because of the relation of the economic to the political, the principles of "universality" and "equality" are also economic principles. That is, the economic principles must be applied to every member of the state, and applied equally, or in the same manner, since every citizen stands in the same relation to the state. The terms have not here any specially ethical import, but result simply from the relation of the economic to the political aspect of taxation. The ethical character of taxation will be discussed in the two following chapters.

CHAPTER VI

THE ETHICAL BASIS OF TAXATION

IT has been implied throughout the preceding discussion that justice is the supreme end and the supreme test in the distribution of the tax burden, and that, therefore, there must be an ethical basis on which principles of justice may rest, and from which they flow as a necessary consequence. Indeed, no notion is more fundamental to our conception of the nature of the state, or to our conception of the political basis of taxation. The realization of justice as a condition of the highest individual development being a supreme end of the state, justice in the distribution of the burden for the maintenance of the state becomes imperative. No social relations involve more fully the relations of individuals to each other, or the common relation of all individuals to the whole body politic, than do the relations that are involved in taxation. Hence no social relations are more deeply ethical in their character and requirements. Here as elsewhere, wherever the relations of man to man are involved, the ethical end becomes supreme—in conception if not always in fact.

But the ethical problem, or the problem of justice in taxation, is as difficult as it is important. That what is ethical is just is conditioned by circumstances, *i. e.*, by the working of economic forces and laws, by economic conditions and results, by ethical standards and ideals—has been already admitted; but the fact has been equally insisted upon, that purely “economic” results are not a test of the

ethical, but rather that ethical considerations and ethical standards are the test of the justice of economic results. But this granted, it is by no means a simple problem to determine what is the ethical standard, or the ethical basis of taxation; still less simple the determination of the principles that should control taxation.

The problem of determining an ethical basis is rendered all the more difficult from the lack of a common agreement in primary conceptions; for our conception of an ethical basis is very largely determined by our conception of the state. Since, then, the conception of the state assumes a variety of forms we have also a variety of conceptions of the nature of the ethical basis of taxation. Nevertheless, this variety may be reduced to two fundamental conceptions—to “benefits” and to “ability.” Into one or the other of the ideas connoted by these terms every ethical basis of taxation may be resolved, though each assumes several forms of expression. In the earlier period of taxation and of economic thought, “benefits” was the more commonly accepted basis of taxation, but in recent years the “ability” basis is more widely accepted. Let us consider each of these in turn.

I. THE BENEFIT THEORY OF TAXATION.

The benefit theory of taxation is, in part, an outgrowth of earlier political and social conditions, particularly feudal conditions; and, in part, is a natural consequence of the contract theory of the state, or of the conception of the state as a protective agency, thereby conferring benefits upon individuals. This fact has already been adverted to,¹ as also the fact that the doctrine is still widely accepted, and is a commonly adopted legal fiction.² It is now generally discarded by economists, about the only modern school of economists

¹ *Ante*, p. 63.

still upholding this doctrine being the "Single-Taxers"¹ who, like their predecessors, the Physiocrats, uphold the benefit principle of taxation.²

The general idea underlying this theory is that political basis which assumes that a tax is a payment for a service rendered by the state to the individual. That is, the basis of the tax is assumed to be a "service" or the "benefit" from a service; and hence it is concluded that the tax payment should be made in accordance with the "service" or the "benefit" received. This basis of taxation we have already considered from both the political and the economic points of view. The question now is: is this a just basis of taxation? This question may be best answered first by briefly considering the different forms which this basis of taxation has assumed. But in the first place it may be observed that the "service" is ultimately resolvable into the service of protection, or the benefits derived in consequence of the protection; while the different forms that the basis has assumed are resolvable into either the *cost* of the service or into the *value* of the service.

1. *The Cost-of-Service Theory.*—The idea underlying this theory, or at least implied in it, is that every individual should pay to the state the exact cost of his protection. It has its root, we think, in the conditions that prevailed under the feudal régime, and has a show of validity in the poll tax and in the modern fee system. The idea is that of special services, whereas the chief services of the state are general in character, though it does perform services that are special to individuals or to classes of individuals. For the latter fees are exacted, for the former taxes. There is, then, an important difference between fees and taxes,³ and the principle that applies to the latter is not applicable to the former.

¹ Cf. *ante*, p. 109; also, Louis F. Post, *The Single Tax*, p. 14.

² See Seligman, *Essays in Taxation*, pp. 274-282, for clear distinctions.

Taxes have no relation to cost, while fees do "not normally exceed the cost of the particular service to the individual."¹

Not only is the "cost" theory based upon a wrong conception of the services of the state, but even if the service be regarded as a service to the individual, the individual cost of that service is beyond all possibility of determination. Indeed, even in the case of special services for which "fees" are exacted, the cost of the "special service" cannot be determined; that is, cannot be exactly determined for every individual. But even if the individual cost could be determined, it is more than questionable if the expense of such special service should be wholly covered by fees; for the state should perform no service that is wholly special to an individual, or in which there is not *some* common interest; and wherever such common interest exists some part of the expense, at least, should be met by a tax without reference to the individual cost.² The expense should be met by a combination of fees and taxes, and theoretically the proportionate amount of the fee should depend upon the relative importance of the special and the common interest. For special reasons, it is true, as for sumptuary or police purposes, or as a means of taxation, fees may equal or exceed the cost. But the question of fees apart, the cost to the individual, or on account of the individual, of a common service is not a calculable quantity. Cost of service cannot, then, be a just basis of taxation, both because taxes are paid for a common service without reference to the cost on account of any individual, and because, even if there were such reference, the cost could not be determined.

If, now, we turn to the logical consequences of this theory we shall not find it any more satisfactory as a basis of justice.

¹ See Seligman, *Essays in Taxation*, p. 276.

² Cf. Sidgwick, *Political Economy*, p. 563. Sidgwick inclines to the cost-of-service principle, but thinks "this principle can rarely be applied."

The "services" of the state, according to this theory, we have seen to be the protection of persons and property. Now as a general rule there is no difference, to speak of, in the cost of protecting persons, considered wholly apart from their property. Nevertheless, the expense is greater for those subject to criminal assaults. Strictly, therefore, according to the theory of costs, those who are so unfortunate as to be subjected to assault should pay a penalty for their misfortune by a tax in excess of that imposed upon those fortunate enough to escape assault. It is, indeed, a question if they should not even pay a larger tax than the criminal who committed the assault. But on the whole, however, an equal poll tax, so far as it should be based upon the cost of protecting the person, would not be greatly at variance with justice. But the problem of costs in the protection of property is by no means so simple. The question is complicated by being dependent in part on the kinds of property and in part on the amount of individual holdings. It costs more, for example, to protect property in buildings, in money or other tangible forms of property, than to protect property in land; and, other things being equal, the tendency would be for the protection of a million dollars' worth of property in the hands of a thousand individuals to cost more than the protection of an equal amount of property owned by one individual. The same tendency is true in the case of property that is widely distributed, compared with property of equal value that is greatly concentrated. On the other hand, it costs but little if any more to protect a home and contents costing one million dollars than to protect one costing one-tenth of that sum. Thus the cost basis would lead us into interminable and insoluble difficulties, in some cases leading to proportional or to progressive taxes, in others to regressive taxes. Justice would have no place in such a system.

But the most important reason why cost of service is not

a just basis of taxation is because the state is necessary to the highest development of the individual and must be maintained regardless of the cost entailed on account of any individual member of it; because the bond of membership is not a cash nexus, but a spiritual bond; because the obligation to support and maintain the government of the state rests upon a common, or general, interest (whose costs, as we have seen, cannot be individually determined), not upon a special interest; because, in fine, tax obligation rests upon membership in the state, not upon the cost of any individual to the state.¹ Briefly, cost of service is not a just basis of taxation since it rests upon a false political basis, for the ethical basis, as we have seen, must be in harmony with, as it is dependent upon, the political basis. The total tax must, indeed, equal the total cost of the government, but this cost cannot be individualized.

The same general result appears in whatever aspect we consider the cost-of-service principle. Take, for example, the insurance theory of taxation. Here it is held that a tax is based upon the same principle as the premium of insurance, and this is assumed to be the cost of the insurance. But no insurance premium corresponds to the cost of the insurance, except, possibly, in rare cases in life insurance. As a rule, any particular insurance premium is much greater or much less than the cost. Besides, the premium takes account of the element of risk; but it is manifestly impossible for a government, in its protective "insurance" to take account of differences in risk, just as it is impossible to take account of differences of cost. The cost and the risk must be averaged.

Take, again, the "productive" theory of taxation, where

¹ "Die Nation giebt als Ganzes die Mitteln für ihren Beruf als Staat und jeder Einzelne muss geben weil er Glied der Nation ist." Helferich, *Schönberg's Handbuch*, iii, p. 139.

the tax is regarded as a necessary part of the cost of production. Here the cost of the "service" of the government on account of any particular industry cannot be determined. What is determined is the cost of the service to the industry, which cost is equal to the tax imposed upon it, but this cost to the industry has no definite relation to the cost of the government on its account. For the government only the total cost is determinable. The productive basis, as an exclusive basis, would, therefore, be an unjust basis on the cost theory. But it becomes still more unjust when we consider that the cost of its service for protection is only a part of the cost of the service that it renders. However, this basis has never been assumed as a basis for the distribution of the tax.

2. *The Value-of-Service Theory.* Value of service as a basis of taxation has been much more generally accepted than cost of service. Indeed, it has been widely accepted by those who advocate "ability" as a basis of taxation, the presumption being that ability to pay taxes is determined by the service of the government to the individual. But in all such cases, as, for example, with Adam Smith, the real basis of the tax is the value of the "service," ability and value of service being expressions of the same thought from different points of view.

What, then, is meant by value of service as a basis of taxation? It is, that the tax of every individual should be based upon the value of the service of government to him; or that the individual should share in the total costs of government in proportion to the value of the benefits that he derives from government. The basis of the tax centers in the individual, while in the "cost" theory the basis centers in the state. It is the value of the "service" to the individual instead of its cost to the state.

What, now, is to be said of value of service as an ethical

basis of taxation? That, like cost of service, it cannot be a just basis because it is an impossible basis. The value to the individual of the service of government is just as indeterminable as the cost of the service to the government on account of the individual. True, no one contends that the tax should equal the value of the service of government. To do so would, to say the least, make the tax enormously exceed the cost, for the absolute utility of government bears no relation whatever to the costs of government. Every taxpayer, no matter how large his tax, receives a "consumer's rent" that is out of all proportion to his tax. Between the individual tax and the value of the service that is given in return by the government, there is no comparison. We may say, indeed, with Léon Say, that taxes are the price of the total advantages derived from the government;¹ but this price is not determined by the value of the service to the taxpayer, as, in fact, it includes a large "consumer's rent," if we may use this figure in this connection.

But value of service is an equally impossible basis when understood to mean that the costs of government should be proportioned to the value of the service received from it, for this "value" is practically an unknown quantity, and between the known and the unknown no ratio can be established. Nor are we any better off if we suppose that the tax of every individual should be such a portion of the total costs as the value of the service that he receives is of the total value of service, for here we have a ratio between two unknown quantities, and the determination of the known by the unknown.

These theoretical difficulties, however, have been evaded by advocates of the value-of-service theory by the assumption of different methods or standards of determining the value of the "service:" as objectively by the amount of ex-

¹ Léon Say, *La Question des Impôts*, vol. i, p. 119.

penditure, the amount of property, or the amount of income; subjectively by the law of marginal utility. The briefest consideration, however, must convince us that in none of these do we find a satisfactory measure of the value of the service of government.

(1) *Expenditure*.—It was a favorite thought of Hobbes that expenditure, or consumption, is the surest test of the benefits of government. One of the conditions of maintaining peace, says Hobbes, is "to divide the burthens and charges of the commonwealth proportionably." He then adds; "Now there is a *proportionably* to every man's ability, and there is a *proportionably* to his benefits by commonwealth, and this latter it is which is according to the law of nature. For the burdens of the commonwealth being the price that we pay for the benefit thereof, they ought to be measured thereby. And there is no reason when two men equally enjoying, by the benefit of the commonwealth, their peace and liberty to use their industry to get their livings, whereof one spareth and layeth up somewhat, the other spendeth all he gets, why they should not equally contribute to the common charge. That seemeth, therefore, to be the most equal way of dividing the burdens of the public charge, when every man shall contribute according to what he spendeth, and not according to what he gets."¹

So likewise Petty: "It is generally allowed by all that men should contribute to the public charge but according to the share and interest they have in the public peace; that is, according to their estates and riches: now there are two sorts of riches, one actual, and the other potential. A man is actually and truly rich according to what he eateth, drinketh, weareth, or any other way really and actually enjoyeth; others are but potentially or imaginatively rich. . . . Con-

¹ *De Corpore Politico*, pp. 216-7.

cluding, therefore, that every man ought to contribute according to what he taketh to himself, or actually enjoyeth."¹

It will be noticed that with both Hobbes and Petty the measuring of benefits, and therefore taxation, by consumption is assumed to conform with justice, as is implied in the use of the moral concept "ought." But, in fact, what we personally expend upon ourselves is a very inadequate measure of the benefits we derive from government. To have the means of potential consumption is a "benefit" little, if any, less than actual consumption. Mere possession, however little one may expend upon himself, gives power and influence that are decided assets in the list of benefits. Equal consumption is not a test of equal benefits. But above all, the benefits of governmental protection cannot be reduced to any such material standard. Consumption alone, therefore, is not a just standard for taxation, even from the point of view of benefits.

(2) *Property*.—McCulloch follows Thiers in making property the measure of the benefits of the "insurance" guaranteed by government. Government being "established for the common benefit of all . . . it necessarily follows that every individual should contribute to its support according to his stake in the society, or to his means."² This notion that property is the measure of the benefits that we derive from government is closely allied with the insurance theory of taxation—that taxes are paid for the insurance of our property by the government. But this conception wholly neglects the benefits derived from the "insurance" of our persons. Moreover, as already pointed out, there is no analogy between the "insurance" of government and the insurance of a private corporation. The character of the benefits is entirely different; but in neither case are the benefits wholly measured by the amount of property. In

¹ Petty, *op. cit.*, p. 83.

² McCulloch, *op. cit.*, p. 17.

the case of the benefits of government the amount of property represents but a fraction of those received, even when we include, as we should, the advantages directly derived from property.

(3) *Income*.—A far more common standard for measuring the benefits of government, than either expenditure or property, is found in income. With the Physiocrats only the income derived from the *produit net* of land was regarded as a measure of benefits, because only the holder of land enjoyed the benefits of government; and similarly, the modern "single taxers" confine such income to "economic rent," and for the same reason as the Physiocrats. But most advocates of the benefit theory have followed Adam Smith in making the benefits conditioned by the revenue enjoyed under the protection of the state. And from a purely economic point of view of benefits, income would seem to be a truer measure than expenditure or property, for it represents the means of both actual and potential enjoyment. Property, may, indeed, also represent potential enjoyment, but if it becomes actual it can only be at the expense of future enjoyment, in a sense that the use of income is not.

Nevertheless, income no more represents the value of the benefits than does either of the other objective standards. As with them, too, the enjoyment of income is only a small part of the benefits of government. The fact is that each and all of these objective standards beg the whole question by assuming that the benefits are limited to the enjoyments from expenditure, from property, or from income, yet expressly or tacitly the benefits in question are admitted to be far more extensive. No such objective economic equivalent of the value of the service is possible. They do not, therefore, lend any support to the view that value of service is a just basis of taxation.

(4) *Marginal Utility*.—Although Sax claims for his theory that it holds the key to the solution of all the problems involved in other theories of taxation, it properly belongs to the value-of-service theory; only with Sax the value is subjectively determined through the operation of the law of marginal utility. That is, the value of the service is determined by the marginal utility of the tax, which is itself determined by a comparison of the collective needs satisfied with the intensity of private needs that might be satisfied but for the tax—by the relative intensities of collective and private needs.

Now if the satisfaction of collective needs were determined in every respect in the same manner as private needs, much might be said for this subjective valuation of public services. But, in the preceding chapter, we have seen reasons for holding that what is true of private needs is not necessarily true of collective needs. The marginal utility of the goods that would be enjoyed in the satisfaction of private needs may, indeed, express the subjective value of those needs, but this marginal utility does not express the value of the collective needs. This value cannot be determined subjectively any more than it can be determined objectively. It cannot, therefore, form a basis for taxation, still less an ethical basis.

So far we have only negative proof that value of service is not a just basis of taxation. But there is even stronger disproof of this theory, which may be stated in a word. It is, that the whole theory is based upon an entirely false conception of the relation of the individual to the state, and so upon an entirely false conception of the nature of the obligation of the individual to support the state. The ethical basis must connote a more distinctively ethical idea than is contained in the principle of *quid pro quo*, of an economic exchange of service for service.

II. ABILITY AS AN ETHICAL BASIS OF TAXATION

Whatever the accepted basis of taxation, it is always, directly or indirectly, implied that the ultimate end sought is "distributive justice." But more and more the conviction has gained prevalence that this end cannot be attained by a purely political, or purely economic basis, but only upon a basis of distinctively ethical connotations; and hence the more and more is it realized that "benefits," at bottom an economic conception, does not meet this requirement. On the contrary, the term that is universally used to express the basis of the ethical idea of distributive justice in taxation is "faculty," or "ability," with the Germans "ability to pay" (*Leistungsfähigkeit*).

The term ability (*facultas*) is not, however, new to financial science, as Bodinus, as early as the sixteenth century, declared for a universal tax based on ability. We have seen, too, that economists who have accepted the benefit principle have followed Adam Smith in making it equivalent to ability. That is, ability is determined by the benefit received, the benefit determining the ability, not the ability the benefit. But this view of ability begs the question; it gives a new term but not a new basis. But what we want is a change of ideas—a change of basis—since the benefit principle no longer satisfies the moral sense. The best term, as also the common term, for expressing this new basis is "ability"; but whatever its former associations, it must be wholly freed from any alliance with the benefit principle. This is the present tendency, the benefit principle and the ability principle being regarded, as they should be, as two entirely distinct conceptions, and not merely different names for the same thing.

But although the term "ability" is the best expression that we have of the ethical basis of distributive justice in taxation, it is not altogether satisfactory, because of its vague-

ness and indefiniteness of meaning. No single term, however, can express fully all of the principles demanded by justice, though it may contain them by implication, as the logical result of the development of its own content. It is because the term "ability" does meet this requirement that it is, upon the whole, a satisfactory basis of taxation. The ultimate basis of taxation, which we have all along contended is ethical, must carry with itself grounds for the modification and limitation of the two cardinal principles—universality and equality—which is not the case with the political or the economic basis. With these the principle of universality has no exception, and the principle of equality no definite content. The content of "ability," when its implications are fully developed, provides for both. It is, therefore, a distinctively ethical basis. Or ability is the ideal ethical basis of taxation. Its full significance, however, can appear only as we proceed with the development of our thesis in this and in the following chapter.

But there are other reasons why "ability" constitutes the ethical standard of taxation. It is not a mere, vague sentiment, but is the direct expression and outcome of the ethical nature of the individual and of the ethical relations of individuals in the state and to the state. As more fully stated by Cohn: "The demand of equity that individuals are to pay in proportion to their varying pecuniary ability, is accepted so unresistingly within the field of the public economy for the reason, in the first place, that a computation of proportional cost and benefit is, in regard to many very essential services, impossible; and in the second place, and more especially, because the more fundamental phases of the public activity in some degree condition the very existence of the individual in society, so that it appears right and just that these fundamental conditions of human social life should be intimately bound up with the total personal and economic

strength of each individual. The appeal to the principle of the pecuniary ability of the individual in matters of national concern touches our sense of equity so directly and irresistibly because it is a principle of wider scope than that of the economic field alone, and is but a special application of the broad principle of moral solidarity."¹

This view is not only in harmony with, but it is the direct logical consequence of, the conception of the state outlined in the second chapter. The importance of society to the individual that he may become truly a *person*, the paramount importance of the political organization of society—of the state—to the development of the highest social relations and the fullest realization of the ends of social and individual life, the spiritual and ethical nature of these relations growing out of the spiritual and ethical nature of man; in a word, the conception of *man* in society and the state makes it a demand, both of the reason and the ethical sense, that every member of the state should contribute to its support and maintenance in proportion to his *ability to pay*; or the full implication of such a conception carries with it the obligation upon every member of the state, that he *ought* so to contribute—that is, according to his ability. It is not enough that there is a solidarity of interests—a community of interests—but because there is a "moral solidarity"—a community of interests of ethical beings—that ability is so "irresistibly" accepted as the ethical basis of taxation.²

However vague, then, the term "ability" may be, it is clearly the one term that most fully expresses the tax obligation that rests upon the citizens of a state. For a tax according to ability, as a universal proposition, implies just that relation to others that is implied in a moral solidarity. Further, ability to pay implies that the ability is relative to persons, and thereby gives emphasis to the fact, already

¹ *The Science of Finance*, p. 297.

² Cf. Adams, *Public Finance*, p. 330.

pointed out, that the tax obligation can rest only upon persons, since only *persons* can have a membership in and are capable of obligations to the state. True, a tax involves property, but property as incidental to a person. Property, we have said, is the person objectified, and a tax upon property is, therefore, a tax upon persons. But the obligation is not upon the property, but upon the person, as the term ability implies. The term "ability," moreover, has the merit of implying more than personal obligation. Its content is positive in character, and carries with it the idea of *active* participation in the support of the state, corresponding with active participation in the general ends of the state.

But after all that is said, ability to pay is a relative conception. In the first place, it implies relativity to the ability of others; a relativity that follows from the recognition that the tax obligation that rests upon self, likewise rests upon others because it rests upon persons, and because others, equally with the self, are recognized as persons. In the second place, the term is relative to personal wants, for ability to pay taxes has no meaning, or at least lacks in significance, except with reference to the relative ability to satisfy collective and personal wants. For, unless the paramount personal wants are satisfied, there can be no tax for the satisfaction of collective wants. Besides, the person must be given first consideration, since the whole exists for the sake of the person—for the individual. Ethical considerations, in other words, re-enforce the economic.¹ In the third place, since the tax and the satisfaction of private wants require economic goods, ability to pay is relative to some form of material wealth. In brief, "ability," as a basis of taxation, involves the relation of one's economic wealth to his personal and collective wants, compared with the similar relation of every other member of the state.

¹ Cf. *ante*, p. 143 *et seq.*

It is around these relations involved in ability—relation to others, to self, and to economic goods—that the whole problem of just distribution of the tax burden revolves. Only as the content of ability in these relations is gradually unfolded are we able to get at the full meaning of ability, as only in their development are we able to discover the just principles of taxation. For if ability be the true ethical basis of taxation it must contain within itself the ethical principles of taxation, just as the acorn contains the oak; so that in developing its meaning we are developing the principles involved, or implied, in it. Principles of justice are, as it were, attributes of the basis of justice.

It is in the development of these principles that consists the most important and the most difficult part of the problem of justice in taxation. For although the principles must have their root in the basic idea—ability—and be developed logically from it, differences of point of view or of interpretation may lead to opposing or conflicting results. We shall, nevertheless, attempt to develop these principles as they appear to us as the logical consequences of the ideas most naturally connected in the term "ability." The remainder of the present chapter, however, will be devoted to a review of opinions respecting the relation of ability to property, to income, and to subjective sacrifice, at the same time indicating the limitations of each.

1. *Ability and Property.*—The most natural, as also the most obvious, test of economic ability is the amount of property possessed. Ability—faculty (*facultas*)—has throughout the centuries been associated with the idea of property—economic wealth. Cicero somewhere makes *facultas* synonymous with wealth, or possessions, and Coulanges points out that in the ninth century *facultas* signified one's entire property.¹ So again in the sixteenth century, Bodinus,

¹ Coulanges, *The Origin of Property in Land*, p. 72.

in opposing the privileges of the upper classes that then prevailed, declared that taxes should be universal, and should be borne equally by all classes of citizens according to their ability, or faculty (*quae in omnes ordines pro singulorum facultatibus exaequantur*), which he explains to mean according to their wealth, or fortune (*pro cuiusque opibus ac fortunis*).³

Thus ability—faculty—and property had long been interchangeable terms when ability was first made a basis of taxation; so that it was one and the same thing whether the basis was considered to be property or ability. Still, the root idea was that the tax should be based upon ability to pay, but that this ability was measured by the amount of property or fortune possessed. Now there can be no doubt that fortune, or property, was a fair representation of ability, and so an approximately fair basis of taxation, under the primitive economic conditions that prevailed in early industrial society; when there were no great inequalities of fortune, industries were little diversified and wealth consisted almost wholly of property in land, social wants were few, and social conditions were upon an approximate equality. But under the conditions of modern industrial and social life, where these relations no longer hold, and where there is a growing class of propertyless producers, or, at least, productive agents without capital, it must be clear that property alone affords a very inadequate test of ability; for the ability to satisfy wants—the real test of ability—and, therefore, the ability to contribute to the support of the state, is not conditioned by the personal ownership of property. Besides, even where property is the source of the means of satisfying wants there is not necessarily the same proportionate power of satisfaction, since the means are not necessarily proportionate to the amount of property. For not only is some

³ Quoted by Meyer, *op. cit.*, p. 4.

property unproductive of further means, but productive property is not always equally productive.

Nevertheless, property is an index of ability, even "unproductive" or consumable property; for the amount and character of the property that we possess indicates to a very large extent our power of satisfying our wants, and, therefore, our tax ability. It is, indeed, as an "index," not as an absolute measure, that property is regarded by those who hold it to be synonymous with ability, though the index is necessitated more from practical than from theoretical grounds. Baer, for instance, would base all taxes upon property,¹ because property is a measure of ability. To get at a more accurate relation between property and ability, however, he divides property into three classes—productive property, unproductive property and property whose destination is not yet determined upon.² For each class there is an index, or indices, since the amount cannot be accurately determined directly. For example, the index for productive property is capitalized interest, while for unproductive property the indices are the articles of common consumption, the "ability" of this class of property being reached by consumption taxes—on wines, spirits, tobacco, etc.

But even as an index the property test is wanting in important particulars. It is true that property as a basis of taxation does not mean that the tax should be paid out of property, otherwise the property, and with it the ability, would soon be exhausted. The tax is presumed to be only nominally upon property; in reality it is upon income. That is, the "index" is an index of income, and the real basis of ability is thereby assumed to be income, and not

¹ "Il criterio per giudicare della parità delle condizioni o di loro rapporti in più o in meno non può essere altro che quello dell'importanza delle sostanze, dell'averne, dei beni che si posseggono." *L' Avere e l' Imposta*, p. 19.

² *Ibid.*, p. 32 et seq.

property. But for practical reasons Baer and others would base the tax upon property as the best means of ascertaining income, it being a practical impossibility to determine real income by direct methods. This, too, is the common practice and is a necessity for many forms of income. But it is not less true that many forms of property are, in practice, very imperfect indices of income, or ability; as note, for example, the universal failure of personal property taxes. For income not derived from property a more accurate test is consumption, and consumption taxes, such as those on spirits, tobacco and other luxuries, are a more accurate test of ability.

However important, then, property may be as an index to income, and therefore of ability, it needs to be supplemented by other tests to reach the full tax ability. It is theoretically defective because, being indirect, it affords only a proximate test of the power to satisfy wants; it is practically defective because many forms of property cannot be discovered by the tax assessor. We cannot, therefore, subscribe to the contention of Menier, that the state has no right to inquire into what one makes or does, but only into the share of the national fortune that he possesses.¹

2. *Ability and Income*.—Since Adam Smith first published his famous canons of taxation, property, as a measure of ability, has been commonly interpreted to mean revenue, or income. That there is, indeed, some doubt what was in the mind of Smith when, in explaining the term "abilities," he wrote: "That is, in proportion to the revenue which they respectively enjoy under the protection of the state," may be admitted.² But however this may be, it has generally been understood to mean that ability is measured by income, and it is with this meaning that the first canon has been so

¹ Cf. Menier, *op. cit.*, p. 196.

² *Op. cit.*, p. 414.

universally accepted, it being assumed that Smith stood for the principle of "ability" rather than that of "benefits."

However true it may be that there are circumstances when it is necessary to use property as a measure or index, of income, there can be no doubt but that income is a truer measure of ability than is property. For in income is represented the actual earning power of the individual, the realized capacity of providing the material means for the satisfaction of wants. Moreover, income as a measure of ability is in harmony with the fact we have so often emphasized, that the tax is a tax upon the person—upon his ability to satisfy his wants.

But after all, income is a very vague and indefinite measure of ability. If we are to measure ability by income we must know what is meant by income; also, the character of the income that determines the tax ability, that is, what portion of the total receipts of the individual constitutes his taxable income.

(1) *Meaning of Income.*—By income is generally understood the returns that come in to the individual as the result of his economic activities, or from his control of the economic activities of others. It does not, however, include the total receipts of an industry. These are known as "gross incomes." Income, properly so called, is the "net income" that results after deducting from the gross income the costs of production and the maintenance of the plant. That part of the gross income that is absorbed in costs and maintenance is not a return that is at the disposal of the individual. The expenditure is essential that there may be any return, but it does not of itself add anything to that which was already possessed. Income, in an economic sense, implies an increase of wealth in addition to that which is already possessed, and which comes in within a definite period of time, giving an increased power of satisfying wants.

within that period of time. Only net income is such an income.

But the term "income" has been given a more extended meaning, and has been made to include the indirect income from enjoyment, or use, of so-called "unproductive" property, thus giving emphasis to periodic enjoyment rather than to periodic new acquisitions. All income, indeed, is valuable only as it affords means of enjoyment, to the satisfaction of wants. Income is a means, satisfaction the end. Hence possession of property is by some regarded as an addition to the money income derived from gainful occupations, for its possession enables a given money income to satisfy the wants that otherwise remain unsatisfied. Such possessions are houses (occupied by the owner) and their furnishings. Take, for example, A and B, having equal money incomes, but A owning his house, while B rents a house of equal value, say at five hundred dollars per annum. Clearly, five hundred dollars represent the excess of A's income over B's, as measured in the satisfaction of wants. That is, A has five hundred dollars to spend for satisfactions that B cannot enjoy, has five hundred dollars more to dispose of than B has. His "ability," therefore, is greater than B's to the extent of five hundred dollars, other things being equal.

That the same is true of household furnishings, paintings, or other "unproductive" property of this class, is not equally clear. True, if enjoyment is the test of income, such property is an advantage to income, just as is the ownership of a home. Yet the two cases appear to us to be quite different, particularly in the case of luxuries. The enjoyment of these is not income in the sense that house rent saved by ownership is income. They are enjoyments procured by means of income, but are not an addition to income—do not save income—in the sense that this is true of house rent saved.

As a rule (where not from gift or inheritance) they are an index of income, but not themselves income. They do not increase ability; on the contrary, they decrease it. Necessary household furniture should, perhaps, be excluded from this class, but from the practical impossibility of determining where the necessity ends and the luxury begins, no distinction should be made. If, however, with Cohn we regard luxuries as "income consumed in kind,"¹ we must admit with Meyer that its value "is impossible to reckon."²

The mistake, we are inclined to think, lies in making enjoyment the sole criterion of income. Because income has value only as it is a means of enjoyment, it does not follow that all means of enjoyment are income. If such is the test of income, then there is little that is not income. All consumable goods would be income—food, clothing, shelter, etc., etc. Yet how small would be the income of the miser, however large his hoardings.³ This is a needless confusion of ideas. For our purposes, at least, luxuries should not be regarded as income, but only as indices of income, and this is really the way in which Cohn regards them.⁴ The income that we are seeking is the income that brings in annually positive acquisitions of material goods, disposable for the satisfaction of wants, and whether the acquisition is direct or indirect. Luxuries, we repeat, do not constitute such an income. They do not increase the sum of disposable goods in the sense that this is true of the ownership of a house. They represent satisfactions enjoyed—income expended—but they add nothing to ability, but only indicate its extent.

¹ Cohn, *op. cit.*, p. 359.

² Meyer, *op. cit.*, pp. 327-8.

³ Cf. Rogers' criticism of Adam Smith's first canon in note to his edition of *Wealth of Nations*, p. 414. Much of this criticism is strained, particularly where Rogers concludes that if the emphasis of Smith is on "protection," then women and children should pay heavier taxes. The protection clearly refers to "revenue," not to persons.

⁴ Cf. for example, *op. cit.*, pp. 360-1.

(2) *Taxable Income*.—If we are right in our determination of the nature of income, we have next to inquire what is the character of taxable income, the income that determines tax ability. Evidently this cannot be gross income; for this would be, in effect, a tax upon the source of income, whose tendency would be the gradual extinction of income, of satisfactions, and thereby of ability. Costs and maintenance should, therefore, be rigidly excluded from taxable income.¹ (This is not saying that for practical reasons there should not be nominal taxes on gross income or capital.) What is left after these deductions is a net income. This, or some part of it, must then be the taxable income, the income that determines tax ability. Whether it is the whole or a part only of the net income that is the taxable income, economists do not agree.

With the earlier economists, following the English school, the taxable income was held to be the "pure" income—the net income minus the necessary cost of subsistence. That is, there was assumed to be no ability to pay taxes until the income exceeded that required to supply the necessaries of life, since in the satisfaction of wants there is no "clear" income until the stage of enjoyments is reached.² This view of income, it is true, is peculiar rather to the benefit than to the ability theory of taxation, it being assumed that there can be no benefits of government until after the means of subsistence are provided for. But it has its advocates also in those who accept the ability basis of taxation, and, as we shall see later, not without much show of reason.

But largely through the influence of the German economists, the net income is now far more generally accepted as the true taxable income; at least nominally so. That is, it

¹ "Man darf die Henne nicht schlachten welche goldene Eier legt." Schäffle, *Grundsätze*, p. 57.

² *Cf.* Stein, *op. cit.*, p. 230.

is considered as the theoretical ideal, but is negated as an ideal by the admission of exemptions. According to Wagner, the "net" income theory is the logic of the financial view-point, while the "clear" income theory is the logic of the social-political view-point.¹ The chief defense of the net income theory is found in the indispensableness of the state to the individual. Being a necessity, it should be placed upon an equality with other necessities in respect to satisfaction. This would seem to follow, too, from the nature of the state as we have regarded it; also from both the political and the economic basis of taxation. That is, from the universal obligations of citizenship, and from the seemingly relative importance of collective and private wants.

When, however, the taxable income is viewed from the standpoint of ability it is not so self-evident that it is represented by net income; unless, indeed, we assume that net income measures ability, in which case we have but a vicious circle. If, as we think Schäffle justly says: "Ability is an expression for how much a taxable unit can give up to the support of the state without injury to his own relative support,"² it is questionable if there is a taxable income—ability—until a "clear" income appears—an income over and above the necessities of life. Whether, however, the taxable income is a "net" or a "clear" income; whether, that is, ability is determined by net or clear income, is a question that involves political and ethical considerations that are inseparable from the problem of the exemption of the minimum of subsistence. In other words, it involves the problem of the justice of exemptions. We may, therefore, postpone further discussion of this question until we take up the problem of exemptions in the following chapter. But it is a question, also, whether or not ability is affected by source, permanence, and size of income; but this is a

¹ *Op. cit.*, p. 330.

² *Grundsätze*, p. 23.

question of rates, which like that of exemption, is a question of principles, and will, therefore, also be deferred to the following chapter. Here, we wish only to emphasize the fact that a prime condition of "ability" is a net income. That it is not the only condition we shall see later.

A somewhat different criterion of ability-determining income was advocated by the late President Walker. According to him ability is determined, not by actual income but by the capacity, or *faculty*, to produce income; not by realized but by realizable income. Accordingly he defined ability (he used the term *faculty*) as the "native or acquired power of production," a tax on this basis being the "most equitable form of public contribution."¹ Property, expenditure, and revenue all come in for criticism as a basis of taxation. Property, because a tax on property "constitutes a penalty on saving (p. 3); expenditure, because "the revenue rights of the state attach equally to every portion of private revenue, irrespective of the consideration whether any such portion is to be spent or saved" (p. 11), and because any exemption of expenditure, "on the ground that it is to be used for the public good," involves the right, which may become a duty of the state, "to see that such wealth is, in fact, in all respects and at all times put to the best possible use;" and it is added: "If this is not socialism of the rankest sort, I should be troubled to define socialism" (p. 12); revenue, because "the revenue tax lays the heavier burden upon him who most fully and diligently uses his abilities and opportunities. It even accepts indolence, shiftlessness and worthlessness as a sufficient ground for excuse from public contributions" (p. 14). Indeed, "to tax wealth instead of revenue is to put a premium upon self-indulgence, in the form of expenditure for present enjoyment," while "to tax revenue instead of faculty is to

¹ Francis A. Walker, "The Basis of Taxation," in *Polit. Sci. Quart.*, vol. iii, p. 14.

put a premium upon self-indulgence in the form of indolence, the waste of opportunities, the abuse of natural powers." Hence, "a faculty tax constitutes the only theoretically just form of taxation, men being required to serve the state in the degree in which they have ability to serve themselves,"¹ any departure from this rule constituting a departure from justice.

As a purely theoretical ideal this view of the tax basis is, perhaps, sound. It has the merit of emphasizing the necessity of positive effort; it justly expresses the moral obligation resting upon every citizen to put forth his fullest energies and powers to the support of the state on whose maintenance depends his civilized existence; it justly emphasizes, also, the moral obligation resting upon the individual because of his ethical relations to his fellow men, growing out of his and their natures as spiritual beings—as persons—and the identity of their mutual relations to the state.

But if this is the ideal, it is an ideal to be realized only in the millenium. Under existing conditions of society it cannot be admitted that departure from it is departure from justice. From the practical viewpoint the chief objections to this theory of ability are: it is utopian; it necessitates most arbitrary powers of government; it is too objective. (a) It is utopian since there is no way of determining whether the "native or acquired powers of production" have been exercised to their utmost capacity, if material results are not be taken as the expression of the potential capacity under existing social and economic conditions (as no doubt in many cases they cannot be). (b) The only other alternative is the determination of these powers by the government. But this

¹ *Ibid.* p. 15. To the same effect Mill. Royer writes: "Nous devons contribuer de nos personnes, de nos facultés intellectuelles et de nos forces physiques, comme de cette extension extérieure de notre être que nous appelons nos biens, nos propriétés." *Théorie de l'impôt*, p. 24.

could not be except by most arbitrary methods and with most indifferent results. Besides, such a method of determination would defeat itself, since the highest productive efficiency would not be obtained under such a system of governmental slavery. Moreover, when a government assumes the function of seeing that every individual develops his latent power, and that no one be allowed to shift his burden upon others by "indolence, shiftlessness and worthlessness," logically and justly it will be compelled to guarantee the conditions of their exercise, just as the logic of the Elizabethan Poor Laws was the public workhouse; for these powers cannot be exercised where the means are wholly wanting, any more than the "vagabond" could work without tools and materials. Still more, with such functions it would "unmistakably be the right, and it might even become the duty of the state to see that such powers are, in fact, in all respects and at all times put to the best possible use. But, "if this is not socialism of the rankest sort I should be troubled to define socialism." In fact, no action of the government could be more paternal or more arbitrary.¹ (c) Finally, this view of the ability is too subjective, too indeterminate, to be of practical value. In determining the ability of the taxpayer, the government is bound of necessity to measure his ability by objective, not by imaginary results. In short, we must, as Spinoza would say, deal with adequate ideas of the understanding, not with confused ideas of the imagination. Or actual income, not the theoretical possibilities of income, is the safest guide to real tax ability.

Yet it must be admitted that the mere objective fact of income is but one factor in the determination of tax ability.

¹ Neumann opposes to the basing of the tax on the ability to produce the following objection: "Die Ermittlung darüber wie viele Jemand nach seiner körperlichen oder geistlichen Fähigkeiten noch erwerben könnte, dürften schwer zum Ziele führen und entsetzlichster Willkür Thür und Thor öffnen." *Die Progressive Einkommensteuer*, p. 172.

Not only must we take account of income, but also of the legitimate demands upon that income. Or, from a different point of view, it is a question of the effect upon the taxpayer of the deprivation of a part of his income for the support of the state—the effect of contributions for his collective wants upon the satisfaction of his private wants. This suggests a negative and subjective determination of ability: That it is not income that determines it, but the sacrifices endured by the taxpayer in the way of the non-satisfaction of private wants, of the loss of personal enjoyments. This view has suggested the sacrifice theory of taxation, or ability.

III ABILITY AND SACRIFICE

1. *Mill*.—The first writer clearly to substitute subjective sacrifice for objective ability, as measured by revenue, as the basis of taxation, was John Stuart Mill.¹ With Mill the basic idea in the distribution of taxes is *sacrifice*. The aim of justice in taxation is to effect an “equality of sacrifice;” not the giving up of equal shares of the means of enjoyment—revenue—but the giving up of equal enjoyments. “The true principle of taxation I conceive to be, not that it shall be equal in proportion to means, but that it shall, as far as possible, demand an equal sacrifice from all,” *i. e.*, a “proportional sacrifice of enjoyments.”²

This is Mill's substitute for taxation “according to ability.” In a sense it is his explanation of the meaning of ability, though to Mill the idea of sacrifice is not so much an interpretation of ability, as it is a new principle of taxation. For with him the fundamental idea of justice is to be explained, not in terms of ability, but in terms of sacrifice. The ideal is, “equality of sacrifice;” that each person

¹ *Political Economy*, bk. v, ch. 2, § 2.

² *Report of the Tax Commission of 1852*, Mill's testimony, pp. 286, 312.

“shall feel neither more nor less inconvenience from his share of the payment than every other person experiences from his.”¹

This view of the basis of justice in taxation is the natural result of the reflections of a philosophic mind on the obligations of the citizen to the state, and is no doubt influenced by a utilitarian ethics whose highest principle is the greatest possible sum of pleasure to each consistent with the like pleasure of others. It emphasizes the idea that the obligation of the individual to the state calls for a sacrifice, a giving up, rather than an active, positive effort, and in this respect is directly opposite to the theory of Walker. From the viewpoint of Mill, “equality of sacrifice” is clearly the best expression we have of the theoretical ideal of the obligation resting upon the taxpayer; but, to our mind, this negative conception of our obligations does not bring out so clearly and fully our relations to the state as does the positive conception that calls for effort, activity, the fullest exercise of our faculties—taxation according to ability. We are inclined to think, too, that, theoretically at least, the two conceptions are quite distinct, representing distinct bases of taxation.

Practically and objectively, however, there is no difference. For we find that Mill, in his testimony before the Tax Commission, is compelled to appeal to an objective standard—income or property—for the determination of the equal sacrifices. Ideally, he thinks, that equality of sacrifice is a proportion to what one is able to spend—his income; but for practical reasons—the low state of morality—there should be an “equal sacrifice according to means,”² which is just what Mill has said is not the true principle of taxation. In short, viewed with respect to their objective expression, ability and sacrifice are but two aspects of the

¹ *Political Economy*, v. 2, § 2.

² See *Testimony*, p. 301 *et seq.*

same idea, the *tertium quid* being income, by which Mill means a "clear" income, including in the deduction not only the necessities but also the lesser comforts, the taxable income being that part of income that is spent upon luxuries. So that equality of sacrifice comes to this: That each should "pay a fixed proportion, not of his whole means, but of his superfluities,"¹ just what taxation according to ability means to the advocate of the clear income theory.

2. *Wagner and Neumann*.—Since the time of Mill "equality of sacrifice" has come to be very generally accepted as expressive of the basis of just principles of taxation, but it is not considered as a distinct principle, but only as the subjective form of ability. Yet, while some, like Mill, find in the conception of sacrifice the true basis of justice, others find that this basis is best expressed in the conception of ability. Wagner, for example, accepts the sacrifice theory of Mill but thinks that the true norm of taxation is the economic ability to pay (*wirtschaftliche Leistungsfähigkeit*), but that the sacrifice theory shows more definitely how equality in taxation—taxation according to ability—is to be accomplished,² or the meaning of ability. So likewise Neumann: "It is through a consideration of the sacrifice imposed that the measure of ability acquires definite form and becomes useful for a system of taxation."³

That is, both Wagner and Neumann find in the idea of "taxation according to ability" the real norm or demand of justice, but hold that the attainment of this norm is best accomplished in terms of sacrifice. This, I think, is the more usual form in which the ability and sacrifice theories

¹ *Political Economy*, v. 2, § 3.

² "Hier dient diese Theorie [Opfertheorie] dazu, genauer den Weg zu weisen wie die Gleichmässigkeit der Besteuerung durchzuführen ist." Wagner, *Finanzw.* ii, p. 349.

³ Neumann, *Progressive Einkommensteuer*, p. 62.

are held. And it has the merit of at once emphasizing the fact that in the positive idea of ability—effort—is the real basis of the tax obligation; and at the same time, also, that every tax necessarily involves the sacrifice of personal satisfactions, the degree of the sacrifice marking the degree of ability, while the relative sacrifice of each to the sacrifice of others, marks the relative tax ability. Hence, accordingly, equal taxation according to ability is theoretically attained by effecting an equality of sacrifice.

In determining the equality of sacrifice, however, Wagner, Neumann, and others are compelled, like Mill, to revert to objective standards. Indeed, with most the practical standard is one rather of objective than of subjective sacrifice—the effect upon objective economic conditions, rather than upon subjective feelings. But Wagner and Neumann go even farther than does Mill in making allowances for the external circumstances that affect the sacrifice and thereby determine the ability; for they consider not only the source, size and character of the income, but also the circumstances and condition—health, indebtedness, etc.—of those dependent upon it. By considerations such as these, it is assumed, an equality of sacrifice may be attained, or, that “taxes will occasion equal efforts and sacrifices over against other needs.”¹

3. *Meyer*.—Nominally opposed to the theory of Wagner and Neumann, and in form more nearly akin to the view of Mill, is the theory of Meyer, who insists that equality of subjective sacrifice is the true tax basis, but admits that this equality can be effected only through a consideration of the “ability to pay.”² The difference, however, is more in seeming than in reality, except in the emphasis given to the central idea that lies at the basis of a just distribution of taxes, the emphasis being given in the one case to ability,

¹ Neumann, *ibid.*, p. 63.

² *Cf. Meyer, op. cit.*, §§ 50 and 53.

and in the other to the idea of sacrifice. But there is no difference with respect to the objective and practical standard of ability, or sacrifice.

The theory of Meyer, however, is not a mere restatement nor a mere expansion of the theory of Mill. It is peculiar to the theory of Meyer, as distinguished from the preceding views of sacrifice, that he gives greater definiteness to the meaning of the subjective sacrifice occasioned by the tax, by connecting it with the intensities of our "marginal wants," the intensity of the marginal wants occasioned by the tax, measuring the degree of the subjective sacrifice. But Meyer understands by the marginal want affected by the tax, not the last want unsatisfied because of the tax, but the last want attaining satisfaction.¹ In this view of the marginal want effected by the tax Meyer seems to think that he has discovered some new principle, but we fail to see what possible difference it can make, in measuring the subjective effect of a tax, whether we consider the effect upon the intensity of the last need attaining satisfaction, or upon the intensity of the first want given up—unsatisfied—because of the tax. If equality of sacrifice is the aim, what possible difference can it make whether the equality is established between the last want attaining satisfaction, or the want unsatisfied because of the tax—the first want that would be satisfied if the tax were removed? If there is an "equality" in the first case, there is, of necessity, equality in the second case. The distinction is without a real difference.

That Meyer has given us a more definite conception of the nature of the sacrifice occasioned by the tax, and a more

¹ "Das Opfer nicht in der Intensität der in Folge der Steuer unbefriedigt bleibenden Bedürfnisse, sondern in dem Masse erblicken in welchem die durchschnittliche Intensität der letzten zur Befriedigung gelangenden Bedürfnisse in Folge der Steuer erhöht wird." Meyer, *op. cit.*, p. 332.

definite standard for measuring the subjective equality, than did Mill, must be admitted, though in result there is no real difference. The equality in the intensity of the last need attaining satisfaction is precisely the equality of Mill—that one person should *feel* the tax no more than every other person feels it. In neither case is the equality thought of as an absolute equality, but only that the “feeling” or the “intensity” is for each person, under the circumstances in which he is placed, exactly what it is for every person other under the circumstances in which he is placed. That is, it is a purely relative equality.

Has Meyer, then, added anything to the solution of the problem of justice in taxation by his reduction of “equality” to a comparison of “marginal wants,” or rather of the intensities of marginal wants? True, as a purely theoretical conception, it would be difficult to find a more exact, or more precise, conception of the idea of “equality of sacrifice” than is to be found in the conception of a relative equality of intensities—*i. e.*, of sacrifices—of marginal wants (of either margin) as occasioned by the tax. And true, also, that the conception of “ability” finds, perhaps, its most perfect subjective expression in the idea of a relation between the intensity of collective wants and the intensity of marginal personal wants; while relative ability finds its most perfect subjective expression in the idea that tax contributions should produce the same relative effects upon the satisfaction of the marginal, personal wants of every taxpayer. We cannot, therefore, agree with Leroy-Beaulieu that the sacrifice theory is a piece of pure sentimentality.¹

On the other hand, it must be admitted that this subjective comparison of marginal wants is of little or no practical importance, since in either case, as we have seen, they can be interpreted only by reference to objective facts—to economic

¹ “Cette théorie est simplement sentimentale.” *Op. cit.*, i, p. 140.

conditions and personal circumstances. But if, however, we retain the idea of sacrifice along with that of ability, it can be of little consequence whether we consider "equality of sacrifice" as explaining "ability," or ability as explaining equality of sacrifice; although, as we have pointed out, the conception of "ability" best expresses the ideal of justice. Yet in either case or whether, with Professor Ely and others, we regard "equality of sacrifice" and "ability to pay" as but different expressions of the same fundamental idea,¹ we are involved in a vicious circle. The solution of this circle, according to Sax, is to be found in his great discovery—the Theory of Equivalence.

4. *Sax*.—From the fact that Sax disclaims ethics in finance, and believes that the whole problem of taxation is a purely economic problem, it might seem, at first thought, that a discussion of his theory is out of place in a discussion of the ethical basis of taxation. But in spite of any disclaimer, the fact is that Sax, equally with every other writer on the theory of taxation, has in mind as an ultimate end an ethical basis and ethical principles; only with Sax, as we have previously seen, the fulfillment of the ethical end is to be attained by the free play of economic forces. It is proper, therefore, to examine his theory of justice and to inquire whether he has made any real contribution, in the solution of the problem, to the thought of his predecessors.

We have already sufficiently discussed the general features of the theory of Sax, and have found that his theory, like that of Meyer, is founded upon the intensity of marginal wants as resulting from the tax. It is, however, to the merit of Sax that he emphasizes rather the "satisfactions" than the "sacrifices,"² thus calling attention to the positive,

¹ Cf. Ely, *Taxation in American Cities*, pp. 80 and 237.

² Sax, "Die Progressivsteuer," in *Zeitschrift für Volkswirtschaft, Socialpolitik und Verwaltung*, Erster Band, I Heft, p. 87.

instead of the negative, relations of the individual to the state. In the scale of wants, too, Sax brings out more clearly the inclusion of collective wants, the taxpayer, theoretically at least, making his comparisons between his marginal collective and marginal private wants; whereas with Meyer the comparison is virtually between the marginal private wants before and after the tax; or, when relatively considered, it is between the marginal want (as affected by the tax) of different taxpayers—a comparison impossible to make except through objective standards. In reality, however, with Sax, no less than with Meyer, the comparison is between the intensities of marginal private wants as they are affected by the tax, and he gives to these wants, also, the same objective reference.

What, then, according to Sax, is the standard of justice? In the first place, Sax makes no effort to refute the ability and sacrifice theories, further than to maintain that in themselves they explain nothing; just as, to the utilitarian economist, the law of "demand and supply" is an explanation of economic facts that does not explain—the ultimate, efficient cause being wanting, and there being no third term of comparison, other than that of "general feelings." What Sax seeks to do, then, is not to overthrow "ability" or "sacrifice" as a basis of taxation, but to supply the *tertium comparationis* that gives them meaning, makes them intelligible. This "*tertium*," as we saw, Sax finds in "sensation." For the determination of ability or sacrifice lies in a comparison of the intensities of marginal needs, before and after the imposition of a tax; and "all needs have, without distinction of ends to which they are referred, a *tertium comparationis* in sensation."¹

Hence, therefore, the problem of tax distribution—taxation according to ability, equality of sacrifice—revolves

¹ *Grundlegung*, p. 194.

about sensation, and when "reduced to a nutshell," we find it to be, "that our tax payments should be equivalent,"¹ *i. e.*, should effect equivalent sensations. And when this is accomplished distributive justice will be attained, because it will be the fulfilment of economic laws.² Moreover, it is in the "equivalence" of sensations resulting from the imposition of a tax that ability and equality of sacrifice for the first time find a complete, ultimate explanation.

But in what respect does this "equivalence of sensations" differ from "equality of sacrifice" as understood by Meyer—the equal sacrifice of enjoyments as measured by the intensity of feeling (of sensation) of the marginal wants attaining satisfaction after the payment of the tax? The great discovery of the *tertium comparationis* is not, therefore, the discovery of Sax. In short, with Sax, equally with Meyer, the standard of justice in taxation is equality of sacrifice—the production of an equal (= equivalent) increase in the intensity of feeling of the marginal want satisfied, or of the marginal want unsatisfied, because of the tax. Thus, that "equivalence of sensations"—*i. e.*, of sacrifice—is only "equality of sacrifice" in a new dress is clear; also, from the fuller statement of the law of "equivalence:" that "every individual shall value the goods taken from him just as highly as every other individual values those taken from him, their respective stations in life being taken into consideration,"³ a formula given by Mill forty years previously as expressing the meaning of "equality of sacrifice."

Yet Sax, himself, does not admit that his theory of sacrifice is at all in agreement with that of Meyer. He points out that Meyer regards the wants within each group of wants as having the same intensity, and insists, no doubt more correctly, that they have varying intensities. Accordingly, he accuses Meyer of making equality of sacrifice mean

¹ *Die Progressivsteuer*, p. 90.

² *Ibid.*, p. 89.

³ *Grundlegung*, p. 514.

a loss of equal utilities; whereas, says Sax, "equal sacrifice is not the dispensing with equal enjoyments, but with equal parts of respective enjoyments [within the different groups]. That is, by equal sacrifice is not meant absolutely equal, but relatively equal sacrifices;" or, "that the enjoyments that each person loses by means of the tax shall stand in the same relation to the total enjoyment made possible by means of his income."¹ But the difference is purely verbal so far as it has reference to the character of equality. Absolute equality is, no doubt, just as "unthinkable" to Meyer as it is to Sax. Nevertheless, we may agree with Sax that "equivalence" is a better term than "equality," as being less ambiguous; and that "equivalence of sensation" expresses with greater definiteness than "equality of sacrifice" the ideal of distributive justice.

It is the further boast of Sax that equivalence of sensation for the first time also explains the meaning of justice in taxation. But it is rather a definition than an explanation. Still, the claim is not wholly without its reason. Not only because ability and sacrifice, subjectively considered, are ultimately resolvable into sensation—ability having reference more to the sensation of satisfaction, and sacrifice to the sensation of non-satisfaction; but also, from the viewpoint of Hedonistic ethics and utilitarian economics, between which sensation—the ultimate fact of consciousness—constitutes a uniting bond; a *tertium comparationis*, pleasurable sensation—*i. e.*, satisfaction—being the ultimate end of both. Still more, because of this reference of the economic and ethical to sensation, and because of the competition resulting from the fact that every individual is actuated by the same motives, the same sensations, it is assumed that each individual determines for himself the realization of the ethical

¹ *Die Progressivsteuer*, p. 55.

ideal—equivalent sensations = equality of sacrifice = taxation according to ability.

But all this is ideal. The individual does not impose taxes upon himself, but through his representatives, and these representatives can interpret the sensations of their constituents only through objective signs, through the objective conditions that produce the sensations. It is these objective signs, which are not a whit different with Sax from what they are with Wagner or Meyer, that constitute the objective, practical *tertium comparationis* between ability and sacrifice and explain their meaning, that gives the practical solution to the riddle of the circle. However indefinite this solution may be, it is the only practical one. While, then, Sax may have added to the definiteness of the theory of subjective sacrifice, he has added nothing to the practical solution of the problem of justice.

5. *The Dutch Economists.*—Accepting “equality of sacrifice” as the ideal of justice in taxation, the mathematical economists of Holland have gone farther than any other economists in their attempt to give to the idea—equality of sacrifice—precision of meaning. They apparently start from the position of Meyer, that within every group of needs there is the same intensity throughout, together with the fact that the order of the satisfaction of needs varies inversely with the means of their satisfaction—with income. That is, only those with the larger incomes can satisfy the least intensive group of needs; so that that group of needs affected by the tax is necessarily the most intensive of unsatisfied needs, or the least intensive of satisfied needs.

Assuming, then, decreasing groups, or grades, of needs

¹ Pierson, Cohen-Stewart and Mees. I regret that my knowledge of this school of economists is only second hand, my acquaintance with them being limited to the exposition of Sax in *Die Progressivsteuer*, already referred to, and to Professor Seligman's account in his *Progressive Taxation*, pp. 137-144.

with each decreasing grade satisfied by correspondingly increasing incomes, we have the fact that the marginal utility of incomes decreases as the incomes increase, since less intensive needs are satisfied by them. Again, with incomes equally increasing the difference between the intensities of the unsatisfied needs (or the last satisfied), on account of the tax, grows constantly less as the incomes increase; or the difference between the intensities of unsatisfied needs is less with the larger incomes than it is with the smaller incomes. Hence, every increment of tax, corresponding to an increment of income, has a less marginal utility than the next preceding increment.

With these facts before us the problem of determining equality of sacrifice is apparently very simple. For all that is now necessary, is to *assume* a fixed gradation in the decrease of the marginal utility of every increment of income, and a corresponding decrease in the marginal utility of every increment of tax. Then the sum of the marginal utilities of the different increments of income and of the tax will represent respectively the total utility of income and of the tax. If, now, we divide the total utility of the tax by the total utility of the corresponding income we shall ascertain the per cent. that the total tax is of the total income upon which it is assessed. In the same way percentages may be found for every grade of income. In every case this percentage will be the percentage that any given tax bears to the total utility of its corresponding income. The series of percentages thus obtained would measure the sacrifice that a proportional tax would occasion for every grade of income.

Now it must be very clear, as indeed Cohen-Steuart himself points out,¹ that the gradation in the series of percentages must depend entirely upon the numbers *assumed* to

¹ See Sax, *Die Progressivsteuer*, p. 76.

represent the marginal utilities of the increments of income and of the tax. Only, however, when the tax is exactly the same per cent. of the total utilities of the different grades of income can equality of sacrifice be attained. To produce this equality, therefore, all that is necessary is, to find such a tax rate as will yield a tax whose total utility divided by the total utility of the income paying the tax will be the same quota for every income. In brief, the tax should be such that the total utility of the tax of every individual will be the same per cent. of the total utility of his income as the total utility of the tax of every other individual is of the total utility of his income. Or, "Tax quota and income reduced to units of utility must show the same relation to every tax-bearer, since herein consists the equality of sacrifice."¹

The problem of effecting an equality of sacrifice is, then, the problem of finding such a tax rate for every income that the tax will take the same quota of the total utility of every income. Clearly everything depends upon the series of numbers taken to represent the marginal utilities of the increments of tax and of income. But whatever series we may choose, any other series, as Cohen-Steuart admits, would be equally legitimate. Hence, accordingly, it is possible, by a clever manipulation of an arbitrary series of numbers representing utilities, to prove that almost any system of tax rates is necessary to produce an equality of sacrifice—as constant, increasing or decreasing rates.

But this fact does not shake the faith of Cohen-Steuart in the possibility of a mathematical determination of equality of sacrifice. He therefore thinks to avoid the dilemma by assuming two, instead of one, series of decreasing marginal utilities with increasing incomes; also that the truth lies somewhere between these two series, which are supposed to

¹ Sax, *Die Progressivsteuer*, p. 57.

represent the two extremes of possible decreasing utilities. In the series that decreases more slowly the rate of increase is assumed to be inversely proportional to the cube root of the fourth power of the amount of the income; while in the other series—that having the more rapid decrease—the decrease is assumed to be inversely proportional to the second power of the amount of the income. From these two rules is deduced the following formula for equalizing the sacrifice of total utilities in the imposition of a tax: “An arithmetical increase of the tax rate with a geometrical increase of income.”¹

Here, indeed, we have the problem reduced to mathematical exactness. But unfortunately Cohen-Steuart proceeds upon assumptions equally arbitrary and equally imaginary with those of the other Belgian economists, whose theories he rejects. All alike, as Sax says, attempt to prove a truth by groundless assumptions. But, in fact, assumption lies at the basis of every theory of sacrifice, and we may, therefore, conclude with Sax that the sacrifice theory in itself is insoluble.² As to his own theory, Sax, of course, believes that he has avoided all assumption, and it must be admitted that his theory contains no such wild assumptions as are found in the Belgian economists. Indeed, his whole theory is based upon one of the most ultimate facts of conscious life-sensation. It is in the development of his thesis that what appears to us unwarranted assumptions make their appearance, particularly with reference to the assumed power of the individual over the satisfaction of his collective wants. At any rate, after all the elaborate development of his subjective theory, Sax is compelled to conclude that “justice merely forbids that a tax be imposed upon any one that is in contradiction with his economic relations;”³ in other words, with his “ability.” The prevention of this “contra-

¹ Quoted by Sax, *ibid.*, p. 81.

² *Ibid.*, p. 83.

³ *Ibid.*, p. 63.

diction" must be left to the officials of the government—to their "sensations" quite as much as to the "sensation" of the taxpayer. This conclusion is that of every sacrifice theory.

6. *Edgeworth.* Another interpretation of the sacrifice theory is given by Professor Edgeworth in his able article on "The Pure Theory of Taxation."¹ Sacrifice is accepted as containing the true principle of taxation; but it is maintained that neither "equal" nor "proportional" sacrifice—as held respectively by Sidgwick and Cohen-Steuart—correctly expresses the fundamental idea which the principle involves. The true notion of equity in taxation finds its more correct expression in the term *like sacrifice*, which constitutes the common genus of which "equal" and "proportional" sacrifice are but species.² But "like sacrifice," otherwise expressed, is an *equi-marginal sacrifice*, which we take to mean an absolute equality of the marginal utilities sacrificed—the marginal disutilities occasioned—on account of the tax. That these marginal sacrifices, or disutilities, should be at a minimum is an imperative demand of utilitarian ethics. Hence, an "equi-marginal sacrifice" finds its most perfect expression in a *minimum sacrifice*, to which principle the true basis of taxation is ultimately reduced. It is not claimed, however, that there is any real opposition between this view and that of "equal" or "proportional" sacrifice. On the contrary, it is intimated that both equal and proportional sacrifice are notions that show a confusion in the minds of their advocates for *equi-marginal sacrifice*, itself leading to *minimum sacrifice*.³

Like other utilitarian economists Professor Edgeworth assumes as the basis of his argument "the greatest happi-

¹ *Economic Journal*, vol. vii. This article did not come to my notice until this and the following chapters were written.

² *Ibid.*, p. 557.

³ *Ibid.*, pp. 564-5.

ness principle," though in a "slightly modified" form. That is, in its application to social phenomena, which are not determined by competitive action, the principle must be interpreted to mean: not the greatest sum of happiness for each of the two or more parties concerned, taken individually; but "that arrangement which conduces to the greatest sum-total welfare of both parties, subject to the condition that neither should lose by the contract." In other words, in its application to political problems the greatest happiness principle must be understood to mean the greatest sum-total of utility for the community—*i. e.*, of collective utility—not the greatest sum for each individual; though "in the long run of various cases, the maximum sum-total of utility corresponds to the maximum individual utility." For, "of all principles of distribution which would afford him now a greater, now a smaller proportional sum-total utility obtainable on each occasion, the principle that the collective utility should be on each occasion a maximum is most likely to afford the greatest utility in the long run to him individually."¹

Applied to taxation the principle means that taxes should be so distributed that the maximum total net utility will be realized, or the minimum of total disutility. For "the condition that the total net utility procured by taxation should be a maximum reduces to the condition that the total disutility should be a minimum." Hence "it follows in general that the marginal disutility incurred by each taxpayer should be the same." But to produce such an equality would be to level all fortunes, which would produce the result: that "the richer should be taxed for the benefit of the poorer up to the point at which complete equality of fortune is attained." This is, indeed, the acme of socialism, "but it is immediately clouded over by doubts and reservations."²

¹ *Economic Journal*, vol. vii, p. 552.

² *Ibid.*, p. 553.

These "doubts and reservations" that stand in opposition and modify the logical execution of the minimum principle, are such as have been noted by Mill, Sidgwick and others: That there would result a lessening of the amount to be distributed, since such a system would inculcate a tendency to leisure rather than to industry; that it would result in an increase of population, which would ultimately reduce the amount of wages, both by the increased competition of numbers and by a decrease of efficiency. But further (except upon the false assumption of an equality of natures), there are different capacities for happiness, which, on the principle of minimum disutility, involves an unequal distribution of the tax. Still further, a progressive rate, which the unmodified principle implies, would produce a check to saving, and so "would check the augmentation of the community's wealth," though this loss is "to be set off against a probable increase of saving among the poorer classes." So likewise the principle of minimum sacrifice justifies differential rates on account of the size and permanence of incomes, the number of children, age, etc. But with such reservations as the above in the practical application of the principle, it still remains true that *minimum sacrifice*, the direct emanation of pure utilitarianism, "is the sovereign principle of taxation."¹

And yet this principle affords us no definite data for the determination of rates. The rate must depend upon the relation existing between the decrease of utility and the increase of income. According to Cohen-Steuart the rate of the decrease of the utility is proportional to the increase of the income. Professor Edgeworth, on the other hand, maintains that the decrease of the former is at a more rapid rate than the increase of the latter.² But the exact ratio is theoretically indeterminate. And hence from the view-point of

¹ *Economic Journal*, vol. vii, p. 556.

² *Ibid.*, p. 560.

pure theory it cannot be determined what rate of taxation would effect a minimum sacrifice. About all that can be said is that the tax rate should be progressive within the limits of the above reservations.

Such, in brief, are the main points in Professor Edgeworth's interpretation of the "sacrifice theory" as a basis of taxation. And in this restatement important modifications of the theory are made. It is to us, indeed, of no little significance that we have the weight of Professor Edgeworth's authority—himself a utilitarian economist—in support of the contention of the preceding pages: that the principles of private economic activity are not, as supposed by Sax and others, applicable to the economic activity of political or collective life.¹ As Professor Edgeworth points out, the true analogy is not that of economic bargains governed by competition, but that of economic agreements between associations of employers and employées; "where the action of self-interest being suspended by mutual opposition, the more delicate force of amity, which even in economic man is not entirely wanting, may become felt."²

Yet even in its modified form we are not convinced that the sacrifice theory affords a better statement of the basis of taxation than does the ability theory; nor do we see any reasons for changing our previous criticism of the former theory. In fact, Prof. Edgeworth does not claim to do more than to bring out a little more definitely what was already implied in Mill, Sidgwick, Meyer and others. At any rate, as we have understood these authors, the marginal sacrifice occasioned by the tax has meant an "equi-marginal" sacrifice; one in which the tax imposes exactly the same sacrifice upon every taxpayer, though not of absolutely equal amounts, viewed objectively. Yet "equi-marginal" has the merit of giving us a more definite expression of the idea in-

¹ *Economic Journal*, vol. vi, p. 551.

² *Ibid.*, p. 552.

volved. But whether viewed as "equal," "proportional," or "equi-marginal," the conception of sacrifice affords but a most intangible basis for taxation—a basis, as Professor Edgeworth admits, that is hedged by "doubts and reservations."

Again, it may be admitted from a certain point of view that the procurement of the greatest amount of happiness—or the greatest sum-total of utility, or the minimum of disutility—is the true aim of all collective action; but it is by no means self-evident that this "sum-total" or "minimum" pertains to the collectivity irrespective of the distribution of the "utility" or "disutility" among the individuals that constitute the collective whole. Such a principle is not wholly dissimilar from that which determines monopoly prices, the sum-total of a few utilities of large amounts offsetting a large number of utilities of individually small amounts. True, it is admitted that "in the long run" there is probably the greatest amount of individual happiness when there is the greatest sum-total of happiness; and so in the long run it is of no practical moment which point of view is considered to be the correct one. Nevertheless, from the point of view of "pure theory" it is by no means clear that the largest sum-total of utility is the true aim of political action. Not only does such a view savor of a collective entity, but it assumes as a basis of action a principle that is quantitatively as indeterminable as anything that is to be found in the sacrifice theory of Mill, Sax, or Meyer. A sum-total of utilities has no meaning apart from individual utilities; and to us a principle that looks merely to the sum of happiness and not to its extent, that permits the large total of the utilities of a few to be set off against the large total of the disutilities of many, is not the ideal of social justice. It is not sufficient that the largest sum-total *may be* consonant with the largest extent of individual happiness.

It may *not* be so. For neither logically nor practically is what is true of the whole necessarily true of the units. The ideal, then, would seem to be the minimum of sacrifice to the greatest number, which in the long run may produce the minimum of total sacrifice. No other supposition is consistent with the ideals of democratic institutions, or in harmony with the conditions of social content.

That the principle of *equi-marginal*, or *minimum*, sacrifice does not, as we have seen, afford any definite rule for taxation is not perhaps of any importance in itself. But it seems a little strange that one who is *par excellence* a mathematical economist should find satisfaction in a theory based upon a principle that does not permit of an exact mathematical expression, since "the reasoning from the principle of minimum sacrifice assumes no exact relation between utility and means."¹ Nor is it without significance that he is compelled practically to abandon the subjective principle and to find the determinants of rules of taxation in objective standards—in the economic effects of the tax upon individuals and in the economic conditions of the taxpayers. But in this respect the position of Edgeworth is similar to that of Mill, Meyer and Sax. And finally, it is not without interest that in recognizing that there is no exact ratio between utility and means, Edgeworth has given the weight of his authority against the futile attempts of the Dutch economists to reduce taxation to an exact science.

IV. CONCLUSION: ABILITY VERSUS SACRIFICE

The preceding discussion on the basis of taxation has throughout implied the fact that the tax obligation rests upon persons, not upon property; that, therefore, the basis of taxation has specific reference to some fundamental principle that attaches to the person, not to his property. Hence,

¹ *Economic Journal*, vol. vii, p. 567.

therefore, the basis of the tax involves two fundamental ideas: the idea, or principle, that expresses the character of the tax obligation of the individual; and, secondly, the principle of the universal application of the basis, or the relative obligation of taxpayers. It is the first idea that has been the chief subject of our attention in the present chapter; the second will be the subject of the following chapter.

The first of these principles—the basis of the idea that expresses the character of the tax obligation—we have found to be comprehended and expressed in two different ways—from the view-point of the ideas contained in the term “ability,” and from the view-point of the ideas contained in the term “sacrifice.” That there is significance in both of these conceptions of the tax basis is not to be denied; but at the same time we have seen reasons for holding that the idea connoted in the term “ability” more fully expresses the ethical basis for the imposition of taxes, since it is the relation that most fully comprehends, not only the true relation of the individual to the state, but also the ethical relations of the individuals in the state; is most expressive, that is, of the fact that the obligation rests upon *persons*. Ability, as we saw, is expressive of the idea of positive, active participation in the expenses of the state, corresponding to the positive, active participation in the ends of the state. It is expressive, too, of the voluntary character, or aspect, of tax contributions; of the idea of duty, not of compulsion.

On the other hand, we have seen that sacrifice is a negative concept; that it expresses a denial, a sacrifice of personal satisfactions, though, it is true, for higher satisfactions that are common with self and others. It also contains more the idea of compulsion—the compulsory aspect of taxation. Undoubtedly there is truth in this view of the tax, for every tax necessarily involves a sacrifice—a com-

pulsory sacrifice—of personal satisfactions for the sake of the realization of collective satisfactions. And it is true, too, that this idea of sacrifice is of a distinctly ethical character; of a character, too, that is complementary of the ethical idea contained in "ability."

But while all of this is true, the idea of sacrifice does not so clearly and fully represent the nature of the ethical basis—itsself based upon the nature of the state—as does the idea of ability; for while it is true that from the view-point of individual wants a sacrifice is involved, from the larger view-point of the complete whole of the individual there is no sacrifice in taxation, but only effort towards the fulfilment of the conditions of the more perfect realization of self.

But, again, equality of sacrifice is a refinement of justice that it is inconceivable the state should ever realize; for equality of sacrifice—relatively equal loss of enjoyments, = equivalent painful sensations—are conditioned not only by property conditions, but by individual character, habits, sensibilities, ideals, etc. Equivalence of sacrifice—of feelings, of sensations—is an ideal conceivable only from the view-point of individuals as a whole, in their ethical relations to each other. For ourselves, we cannot conceive it as an ideal which it is any part of the duty of the state to fulfil.² The ends of justice are satisfied when the objective economic conditions, or the objective effects, are made relatively the same by the tax. Or, again, when the tax is adjusted to the ability to support the state relatively to the ability to meet the demands of the wants of the self.

Accepting, then, ability as the best expression of the ethical basis of taxation, though at the same time recognizing the truth contained in the idea of equality of sacrifice, we have next to inquire what principles flow from this basis.

² "In framing an ideal," says Aristotle, "we may assume what we wish, but we should avoid impossibilities." *Politics*, ii, pp. 6, 7.

That is, since the primary element in the determination of ability (as, indeed, also, of sacrifice) is property, or more strictly, income, we have to inquire into the nature of the qualifications and limitations of the taxation of income that are demanded, in order to meet the requirements of taxation according to ability; or, again, what principles should control the taxation of income so that the tax may meet the demands of justice. It is not simply or chiefly the ability of income to pay taxes relative to its ability to satisfy personal wants, but it is a question of the relative ability of different incomes under different conditions and circumstances; hence, of the principles that should determine the taxation of income under these different conditions and circumstances. Most important among the conditions determining the ability of income, that is, the ability of its possessor, is the character, source, and size of income; and, therefore, whether the income should be taxed at different rates according to these circumstances in order to meet the just requirements of taxation according to ability. Finally, whether under any circumstances consideration should be given to the needs of the individual as against the demands of the state. That is, whether there are circumstances in which exemptions may be allowed without infringing upon the principles of ability and universality.

CHAPTER VII

ETHICAL PRINCIPLES OF TAXATION

BY the ethical principles of taxation I have in mind those principles that are deducible from the ethical basis of taxation; the principles in accordance with which the tax burden must be distributed to meet the highest requirements of justice. It is the problem of determining the principles that will give realization to the ideal of taxation based upon ability. These principles should not be based upon mere sentiments, or upon mere abstractions. To have consistency and value they must be developments, not only of the implications contained in the idea of "ability to pay," but must be developments, also, of the theory of the state, on which is based the whole theory of justice in taxation. Or these principles, again, should be developments of the meaning of "ability," whether they take the form of positive principles, or of exceptions to general rules. Exceptions to general rules there may be, but not exceptions to the fundamental idea—taxation according to ability. The exceptions, as well as the rules, or principles, must be logically contained in this idea. This distinction is important, but is almost universally overlooked, thereby leading to inconsistent conclusions, as we shall have occasion to see.

The development of these principles, which involves the development of the principles of a just distribution of the tax burden, is one of the most difficult problems within the whole field of taxation, and one upon which there is, perhaps, the most diverse opinion. But notwithstanding these differences of opinion, there is common agreement among all

schools of economic thought that justice demands that the tax should be distributed equally and universally. These two principles—Equality and Universality—, which are recognized as logical deductions of both the ethical and the economic basis of taxation, are regarded even more as the two cardinal principles of justice in taxation—of taxation based upon ability to pay. For, since the ends for which the state exists are common to all, justice requires that every member of the state, indeed every person that participates in its ends, should contribute to its support to the extent of his ability, relatively, of course, to the ability of others. The same conclusion is reached if the obligation to pay taxes is considered from the viewpoint of the ethical relations of the membership in the state, of the character of the members as *persons*. For this ethical view of the question demands above all “equality” of taxation, but equality implies universality.

These conclusions are not new. But what we wish to call attention to here is that the principles of Equality and Universality as ethical principles, being viewed from a different standpoint from what they are as political or economic principles, lead to different, and, indeed, to more definite conclusions. Politically, for example, the meaning of “equality” is vague, while the principle of universality stands unqualified. Ethically we find that both principles are conditioned by “ability,” and that, therefore, they may need qualification and limitation. In other words, the ethical contents of these principles supplement and complete their political and economic contents. Indeed, we might say that they are political and economic principles only because of the ethical implications involved in the political and economic bases of taxation. At any rate, it is in the development of the content of these principles that we develop the content of the ethical basis of taxation—taxation according to ability.

I. THE PRINCIPLE OF EQUALITY

That equality in taxation means a relative equality few will deny.¹ It means that there should be the same relative economic conditions after as before the tax. Viewed with respect to ability to pay it means that there should be the same relative economic ability after as before the tax for the satisfaction of personal wants. Subjectively considered—as equality of sacrifice—it means that there should be the same relative intensity of feeling of wants unsatisfied because of the tax; or, if you will, of the wants last attaining satisfaction. Or, again, since income is the primary factor in the determination of (objective) ability, equality in taxation means that the tax should take such portions of income as will leave the same relative amounts for the satisfaction of private needs, their objective importance, or their subjective intensity being considered; or it means that income should be so distributed between the satisfaction of collective and private needs—between public and private expenditure—that there shall be the same proportional satisfaction, the same proportional expenditure, for each when viewed with reference to their relative importance, or their relative intensities.

The problem of realizing equality in taxation, therefore, is a problem of the just distribution of taxes, or of the just distribution of income between collective and private wants. The question, then, resolves itself into this, What proportions of different incomes must be taken so that the tax may be proportioned to ability, and thereby a relative equality be established? In other words, in distributing the tax so as to

¹ Von Hock, as we have seen, makes exception of the tax for the protection of the person, which he thinks should be absolutely equal. The tendency of communism, too, is to make the burden of the government absolutely equal. And even such an individualist as the late Thomas Davidson once questioned, in conversation with the writer, whether all taxes should not be absolutely equal.

realize a relative equality according to ability, Should there be the same rate, the same proportional tax, for all incomes? Or, Does the "equality" necessitate different rates according to the size, character, and amount of income? For if these affect the ability they must likewise affect the rate.

1. *Rate and Source of Income.* It is the belief of many writers on taxation that the ability to pay taxes is very largely affected by the source of income, and that, therefore, there should be differential rates according as the income is "funded" or "unfunded," is derived from inheritance, from monopoly, from "quasi-rents," or from speculation. In practice, however, but little consideration has been given to the source of income.¹ Let us examine briefly the grounds for such distinctions, that we may see to what extent ability is affected by the source of income, and -thereby differential rates are justified.

(1) *Funded and Unfunded Incomes.* According to Mill, funded income, or income from property, has a greater taxing ability than unfunded, or personal income, because of its greater permanence.² Wagner assigns two reasons—because funded income leaves the entire labor power wholly, or for the most part, free for other acquisitions; and because personal income has more necessary expenses to meet, such as provisions against sickness, old age, etc.³ With Meyer the only basis of distinction is, that "property is not only and not always a source of income, but it may be immediately applied for the satisfaction of needs"⁴ in emergency cases.

As to the argument of Mill, it contains only a partial truth. For, as far as life incomes are concerned, the economic necessities of the business world and the growing

¹ The Italian income tax is a partial exception. Cf. L. Say, *op. cit.*, ii, p. 152.

² Mill, *Polit. Econ.*, v. 2, § 4.

³ *Op. cit.*, ii, p. 56. Cf. also Neumann, *Die Progressivsteuer*, p. 178.

⁴ *Op. cit.*, p. 326.

Civil Service provisions of governments tend to a permanency of salaried positions that makes unfunded incomes not a whit less permanent than funded incomes. In fact, many personal incomes are more permanent than property incomes; and besides, there are degrees of permanence in both.¹ So far, then, as the difference is due to a difference in the permanence of income it is a question pertaining to the character, not to the source, of income.

The second argument of Wagner is but a fuller statement of the argument of Mill, for it is the assumed temporary character of personal income that necessitates a larger outlay to provide against future needs.² So far as this argument relates to perpetual family income it contains, indeed, much force of reason; for of two equal incomes there is undoubtedly greater tax ability in the perpetual, than in a life, and still more than in a temporary, income. But this, again, is a question of the character, not of the source of income.

As to the first argument of Wagner, the primary contention is true, but the conclusion unwarranted. If, for example, A and B have each a personal income of \$1000, and A has in addition a funded income of \$1000, it is no reason in itself why A should pay a higher rate on his funded income. He simply has twice the income that B has, and if his ability is more than proportionately increased thereby, it is due to the size of his income relatively to his needs, as compared with the size of the income of B relatively to his needs. In determining A's ability it is of no importance that he is free to earn a personal income in addition to his property income, unless, indeed, we accept Walker's theory of potential ability. So far as this particular argu-

¹ Cf. Meyer, *ibid.*, p. 327.

² To Sax this is the only ground for a differential tax on funded incomes. Cf. *Grundlegung*, p. 514.

ment is concerned—*i. e.*, leaving aside other characteristics of funded incomes—the question is simply one of the size of A's income as compared with B's, and consequently of his relative ability. This question will be considered presently.

The position of Meyer is equally untenable, and, besides, if it is not inconsistent with the declaration of the preceding page, that as there is practically no difference in the permanency of funded and unfunded incomes there is in this respect no difference in ability, it represents, at least, a confusion of ideas. For the real comparison is between different sources of income, whereas with Meyer it is virtually between income and property. Or, more strictly, his comparison is between those who have property but no income, and those who have neither property nor income. Be this as it may, it is quite true that as between the possessor of a funded and the possessor of an unfunded income, the former can continue satisfying his needs, presumably also his collective needs, after income ceases, while the latter can not. But this advantage is in the possession of property, not in a particular kind of income; since the incomes being assumed to have equal permanence represent, as incomes, equal ability. But if the mere possession of property gives greater ability to pay taxes, it must exist whether or not the property is yielding an income, and must exist so long as there is private property; and at the same time differ in degree among different property holders according to the amount of property possessed. But this "ability" could be reached only by a real tax on property, and by such differential rates that it is difficult to see where they would stop short of confiscating all private property, or equalizing its possession—as compared, of course, with the non-income receiver.

Upon the whole, then, we must agree with Sax, that the only reason that a funded income gives a greater ability than an unfunded income is, because it does not necessitate the

same saving to provide against future needs.¹ The possession of property may, indeed, have this same advantage, but only in a very limited way, since in most cases it would soon be exhausted. It is not a taxable advantage. Property itself gives a tax ability not because it may be used to satisfy future wants, but because it has the power of yielding a future income to satisfy future wants. This advantage, however, is limited in scope, and has special application only to perpetual incomes, for reasons previously given.

(2) *Inheritance and Gifts.* That inheritance of property (including bequests) and gifts tend to increase the tax ability of the recipient no one can safely deny. . At the same time it must be admitted also, that there are many cases where an inheritance, or a bequest, carries with it a decrease of ability, if we consider the family as the taxable unit; for with the inheritance or bequest there is a loss of the salary of the head of the family.² But so far as there is a real addition to the tax ability of the recipient it is not to be measured by the amount of the inheritance as in itself an additional income, for I cannot regard an inheritance as a true income. It may be a source of new income to the inheritor, but it is not itself income. The ability, therefore, is increased only to the extent of the income-producing power of the property inherited. This ability is not confined to the year of the inheritance, but lasts as long as the income from it lasts. In fine, the increased ability resulting from an inheritance is confined solely to the effects of the inheritance upon the income of the inheritor, either with respect to its annual increase in size or to its funded, or perpetual, character.

The same holds true of gifts, particularly of productive property. In the case of money gifts for defraying living

¹ Cf. also Cohn, *op. cit.*, p. 359.

² Cf. West, *The Inheritance Tax*, p. 118.

expenses, whether occasional or continuous, the gift is justly a part of the annual income. This is true, also, of inheritances or bequests in the form of annuities, or life incomes. If B receives from A \$100,000, his ability is increased just to the extent that A's decreases—to the extent of the income-producing power of the \$100,000, no more, no less. The ability that centered in the personality of A now centers in the personality of B.

That the increased ability comes gratuitously is not a matter that can have any weight, so long as the present property relations are sanctioned by the law of the land.¹ All that justice requires is that the government should ascertain the existing tax ability of every taxpayer. To tax the inheritance or gift, other than as specified, is to put a tax upon capital, though not, it is true, upon the national capital.² The tax should be on the income, not on the property, if it is to be a tax on ability. That an inheritance tax may be justified for other reasons, as compensatory for evaded taxes, payment for special services, etc.,³ we would not deny, but we cannot agree with Meyer that a tax on inheritance is justified on the ground of greater tax ability,⁴ for this ability is amply reached, to the ends of justice, by taxing the income from the inheritance, the income being the only ground of the increased ability.

(3) *Monopoly and Quasi-rent Income.* At first thought it might appear that a differential tax rate would be justified on monopoly incomes on the ground that such incomes have a special tax ability, relatively to other incomes, since they result from special advantages in income-earning power.

¹ Cf. Wagner, *per contra*, ii, p. 588.

² As clearly demonstrated by Mill. Cf. *Polit. Econ.*, v, 2, 7.

³ For a good summary of arguments for special tax on gifts and inheritances see Max West, *op. cit.*, ch. v.

⁴ Meyer, *op. cit.*, p. 359.

On account of these advantages, whatever their source, the tendency is to give the holder of the monopoly an additional income above the average of non-monopoly incomes, and so to increase his ability to the extent of the monopoly increment of his income. All this may be true. But this does not give A, with a monopoly income, a greater ability than B has with an equal but non-monopoly income, their conditions being otherwise the same. Both A and B, with respect to C with his smaller income, have the same relative advantage, the same relative increase of ability. It is simply a question of the size of the income. On the mere ground of ability, therefore, the tax rate on A's income should be the same as that on B's income. The fact that it is a monopoly income does not in itself give it greater tax paying ability.

However, a special tax on monopoly incomes may be justified on other grounds. All monopolies, whether natural or capitalistic,¹ are at bottom legal or social creations, and society has, therefore, a peculiar claim upon the increased ability resulting from the monopoly increment of income. Particularly is this the case where the monopoly utilizes public property, such as streets, or is in any sense a legal creation (which includes capitalistic monopolies).² It is only justice that incomes due to special privileges of government should compensate the government for them. That society should absorb the full monopoly increment of income cannot be granted, for it receives back indirectly many advantages from the monopoly, as, for example, from the private ownership of land, or, in the case of capitalistic monopolies, from the concentration of productive wealth

¹ Such we understand to be those huge corporations where the concentration of enormous wealth under one management makes possible a control over prices. Examples: The Standard Oil Company, the United States Steel Corporation, though both are partly, also, natural monopolies.

² Which, by their incorporation, become, in a sense, legal monopolies.

under the management of the most efficient and competent *entrepreneurs*.

The case is very similar where the income is due to social conditions more than to personal effort, as is the case with "unearned increments." Of this class "ground rent" is the best example. Here the "unearned increment"—rent—is peculiarly a social product, and society has, therefore, a peculiar claim upon it. We are not prepared, however, to concede that society should claim the whole of the unearned income—the "ground rent;" both because society indirectly receives many advantages from this private "monopoly," and because it would tend, in many cases, to discourage the most efficient use of the land. But, in any case, society cannot justly absorb the "unearned increment" of the past, or its capitalized value; for in most cases the rent, to the present holders, is not an "unearned increment," but interest on capital invested. Still, it must be admitted that society has a special claim to this class of income, not only because largely a social product, but because society, as Henry George rightly claims,¹ has a just claim upon the soil. But a differential tax is not justified on the ground of a peculiar ability, other than that which comes from the size of the income.

Much the same conclusions follow with respect to "*quasi-rent*"—to *quasi-monopoly* income. To the extent that income is increased by means of these "rents" there is an increase in tax ability, but the ability to pay taxes is not increased by the mere fact that any part of the income has its source in a "*quasi-rent*." But on the other hand, there is not the same ground for a differential rate, or a special tax, upon the income of "*quasi-rents*" as there is upon pure monopoly income, both because it results more from per-

¹ Cf. *Progress and Poverty*, B. vii, ch. i.

sonal efficiency than from social causes,² and because such a tax would have a more immediate and more direct effect upon production and consumption. As Professor Ross holds, a tax on the "consumer's rent" would tend to lessen consumption and thereby work injuriously. But the contention of Professor Ross that the "producer's rent" is a specially good subject for taxation, since such a tax would curtail production least,³ can be accepted only with qualification. It may be true with respect to monopoly rent, but a special tax upon the "producer's rent," as "profits"³ of the *entrepreneur*, would be in effect a penalty upon individual capacity and efficiency in production, and would tend to curtail production.

(4) *Income from Speculation.* We need not stop to dwell on the income from speculation. It does not differ from other income in its ability-giving power. It involves large risks and may result in large returns, and it is the size of these returns that determines the tax ability, so far as this is effected by income. But there are different kinds of speculation, and the question whether there should be a differential tax upon speculative profits must be decided in each case according to circumstances. In some cases, as in illegitimate speculation, a special tax may be demanded for police purposes, but in no case does speculative income carry with it any special tax ability. On the contrary, such income tends to give less ability on account of the possibility of its loss in the immediate future.

Upon the whole, then, we find no reason for holding that the ability of any person to pay taxes is affected by the source of his income. The mistake of those who hold to the contrary is due, we think, to their attaching ability to the

² The "quasi-rent" of capital would be a partial exception.

³ Ross, "A New Canon of Taxation," in *Polit. Sci. Quart.*, vol. vii.

³ See Walker, *Political Economy*, bk. iv, ch. 4.

object of the tax—the income—rather than to its subject—the person. As Vocke says, “The tax on the basis of real ability knows no object, but only a subject and a measure. The subject is constantly changing, let the source of the income be where it will.”¹ In other words, income determines ability only so far as it relates to the satisfaction of wants—future as well as present. This satisfaction is not influenced by the source of income, but only by its character and size, or by source only as character and size of income are reflected in the source.

2. *Rate and Character of Income.* By the character of income is understood, whether it is permanent and secure, or temporary and precarious. Do, now, these characteristics of income produce differences in tax paying ability that justify differential rates? Not, it may be answered, the characteristics *per se*. From the viewpoint of income alone it is of no consequence to ability whether the income be permanent or temporary. If permanent it pays taxes permanently, if temporary it pays taxes temporarily.² These characteristics assume importance only because of their influence upon the satisfaction of future wants. Mill, for example, held that permanent incomes should be taxed more highly than temporary incomes, and temporary more highly than precarious, for the reason that temporary, and still more precarious, incomes have to make larger outlays to provide against future wants—sickness, old age, etc.³ This is a very commonly accepted doctrine, and is, as we have seen, the only ground for the assumption that funded incomes give a greater ability than unfunded incomes.⁴

This position we believe to be theoretically sound, for since the taxpayer is a *person* it is necessary and just that his future needs be taken into consideration in relation to

¹ *Op. cit.*, p. 465.

² *Cf. Vocke, ibid.*

³ Mill, *Political Economy*, v. 2, § 4.

⁴ See also Vocke, p. 466.

the probabilities of this future means for their satisfaction. Practically, however, allowance for future demands on present incomes leads to grave difficulties. To begin with, the theory assumes that every person who receives a temporary or precarious income saves a part of his income and invests it in insurance, or otherwise, to provide for future wants. Or, if actual saving does not take place, it is presumed that it ought to take place. But admitting that a part of the income is saved to provide for future wants, it follows that there is proportionately less income to satisfy present wants, and therefore less tax ability. This is too self-evident to need illustration. If, then, such 'savings' are justified it follows, on the ground of tax ability alone, that they should be exempted from taxation; or, what amounts to the same thing, that temporary incomes, from which savings are made for the future, should be favored by differential rates. But it is believed, that not only is such saving justified from the viewpoint of the individual, but that it is sound political policy to encourage it, lest the receivers of temporary incomes (still more of precarious incomes) may become future public charges.

But upon what basis of savings should such differential rates be established? To base them upon actual savings would admittedly be a most difficult problem in practice. Accordingly, Mill thinks that "the next best thing in point of justice" is "to take into account in assessing the tax, what the different classes *ought* to save."¹ This we believe to be a very questionable solution of the difficulty. It opens up at once most perplexing problems. Unless what is exempted is actually saved there results the injustice of what is virtually regressive taxation, equal incomes being taxed at different rates. But above all, it raises the query, How much "ought" one to save from a temporary and a

¹ *Political Economy*, v, 2, § 4.

precarious income for future needs? It must, of course, bear some relation to the amount of the income and to the accepted standard of life. But whatever the amount presumed to be saved, no government could consistently, or justly, exempt from taxation what "ought" to be saved unless the saving was enforced by compulsory insurance, or in some other manner. To exempt any portion of a temporary income, on the assumption that it is saved to provide for future needs, would be grossly unjust if the exempted income is squandered on present pleasures. No! To accept what ought to be saved as the standard makes it obligatory upon the government to see that the actual corresponds to the ideal.

Nevertheless, admitting the justice and right of "savings" from temporary incomes, we believe that the theory of economic ability requires that there should be differential rates in favor of those incomes from which savings are actually effected. But we cannot agree with Mill, that the basis of such rates should be what one "ought to save." Not that we fear any bugbear of "paternal socialism," nor because we think the government would thereby overstep the limits of its functions (for these we have seen to be relative¹); but because consideration of the actual savings is not only all that is required by theoretical justice, but because, in spite of the practical difficulties, rates based upon actual savings, we believe, would approximate most nearly to the ideals of justice. Nor is it any argument against differential rates on temporary incomes that they pay taxes only temporarily, while permanent incomes pay taxes permanently.² The argument rests upon the old fallacy that a tax is upon the income, or property, not upon the person, and that mere income is the measure of ability—a fallacy that is at the

¹ See *ante*, pp. 26, 27 and 52.

² See, for example, Perry, *op. cit.*, p. 519.

root of many false solutions of tax problems. Once comprehend that only the individual, the person, can be the subject of a tax and the way is cleared to a more easy solution of many tax problems.

But differential rates, or exemptions, on account of the savings from temporary incomes for future needs, involves or implies an important consequence: That it is the right of the individual to provide for his future, and therefore, also, of necessity, his present, necessary needs before he is under obligation to contribute to the support of the state. Though a debatable question I believe the conclusion to be sound, but we may best discuss this phase of the question when we come to tax exemptions.

3. *Rate and Amount of Income.* Of far greater importance than the source or the character of income, in the determination of the ability of the taxpayer, is the amount of the individual income received. Normally income is both the means by which we satisfy our economic wants and the source of our tax contributions. The ability to pay taxes is, therefore, conditioned by the ability to satisfy our personal wants, but this latter ability in turn is necessarily conditioned by the amount of income at our disposal. Clearly, then, the amount of taxes that one can pay is conditioned by the amount of his income, other conditions remaining equal. This no one will deny. But we have found that justice requires that taxes should be based upon relative ability, that the burden should be equal; or that such portion of each income should be taken for taxes as will leave the same relative ability to satisfy wants after as before the tax. Hence the first principle of justice in the distribution of the tax is that taxes should be imposed in proportion to the ability to pay. But ability, we have said, is relative to the amount of income. The question before us, therefore, comes to this: In what ratio must incomes be taxed, with respect

to their size, in order that the tax may be proportional to ability—that a relative equality in taxation may be established?

The answer to this question is by no means a simple one. Indeed, to determine what portions of incomes of different sizes must be taken as a tax, in order to effect a true proportion according to ability, is perhaps the most difficult problem within the whole field of tax distribution. It is certainly a crucial problem, and its answer supplies the basic principle of just taxation—the just rate of taxation on income. This has no reference to an income tax. By income we mean the total income of the individual, whatever may be its source. There may without any injustice be different rates on different species of income, or property, either for administrative purposes or otherwise. The question, however, is: What should be the average rate for the total income if taxation is to be according to ability? In other words, In what measure does ability vary with the size of the income? The idea of absolute equality in taxation being excluded, except in communistic or socialistic societies, we have left the possibilities that ability varies regressively, proportionally, progressively, or degressively with income. But regressive taxation—an increasing rate with a decreasing income—is not less absurd than the idea of absolute equality, and, in fact, is contended for by no one; though particular forms of regressive taxes are found in all countries, and are not necessarily inconsistent with justice. Degressive taxation—proportional on all income above a fixed limit, progressive backwards from the same limit—is, in effect, a mild form of progression, being a decreasing progression on the total income until the rate becomes practically, though never theoretically, proportional. It rests, however, upon somewhat different grounds from the progressive tax and arises from exemptions, and may, therefore, better be considered in connection with universality in taxation.

We have left, therefore, proportional and progressive taxation, and the problem is to determine which of these plans most fully realizes equality in taxation—taxation proportional to ability. It will not be necessary, for our purpose, to go into an extended discussion of every phase of proportional and progressive taxation, but we may say in general, that conclusions respecting either system depends upon our theory of the state, our conception of the ethical basis of taxation, and not less upon consistent and logical deductions.¹ In general, those who uphold the protective theory of the state and the benefit theory of taxation advocate proportional taxation, while supporters of what has here been called the ethical theory of the state, and of the ability theory of taxation, tend to the advocacy of progressive taxation.² To the former class belong the English, the French and the earlier German economists; to the latter, the later German economists and those who have come under their influence.

(1) *Proportional Taxation.* Proportional taxation is, I think, the logical tendency of the protective theory of the state and of the benefit theory of taxation, for these theories put a property value upon the protection and assume that the benefit of the protection is proportional to the property, or revenue, "enjoyed under the protection of the state." At the same time the conclusion is little more than tautological. If, however, we assume as would seem to be quite as true, that the benefit of the protection has a proportionately greater value for the poor than for the rich, relatively to their incomes, regressive taxation would be the logical

¹ For a careful review of the relation of tax rates to the basis of taxation, see Seligman, *Progressive Taxation*.

² Exceptions are, in the main, due to a confusion, or to an unconscious identification of the ability and benefit theories, or to considering the tax from the viewpoint of income instead of the person.

consequence.¹ If, on the other hand, we regard the benefits of government as measured by the subjective sacrifice occasioned by the loss of satisfactions on account of the tax, progressive taxation would seem to be the logical result, since the intensity of the unsatisfied wants would decrease as incomes increase. If cost of service, instead of value of service were considered as the basis of the tax, I am inclined to believe that regressive taxation would be logically demanded.² But the fact is that the benefit theory affords no fixed basis for determining the rate of taxation. The advantages of government are qualitative, and therefore, as Professor Seligman says, "quantitatively immeasurable."³

But we have already discarded the benefit theory of taxation, and have, therefore, to consider proportional rates only in their bearing upon the relative "ability" of taxpayers. The question, therefore, is, Is ability proportional to income? But few economists of note answer the question in the affirmative.⁴ With those who do, either the benefit theory is lurking in the background, or else ability and income (or property) are assumed to be equivalents⁵—income, not the person, being regarded as the subject of the tax. Marzano, for example, writes: "I firmly maintain that the proportional tax is consonant with justice, for the simple reason that the contributive faculty, of which income is the concrete and actual expression, does not increase otherwise than in proportion" (*i. e.*, to income).⁶ This, indeed, is

¹ Cf. Roscher, *op. cit.*, p. 191; Mill, *Polit. Econ.*, v, 2, § 2; Parieu, *Traité des Impôts*, i, p. 87; Menier, *op. cit.*, p. 215.

² Cf. Madam Royer, *op. cit.*, pp. 36-7. *Per contra*, Sismondi, *op. cit.*, p. 155.

³ *Progressive Taxation*, p. 85.

⁴ Cf. Seligman, *ibid.*, pp. 150-3.

⁵ See, for example, Parieu, *Traité des Impôts*, vol. i, p. 134, for both defects. The same errors, I think, are also found in Léon Say and Leroy-Beaulieu.

⁶ Marzano, *Compendia di Scienza delle Finanze*, p. 122. So, likewise Baer: "Il criterio per giudicare della parità delle condizioni, o di loro rapporto in più o meno, non può essere altro che quello dell'importanza delle sostanze, dell'avere, di beni che si posseggono." *Op. cit.*, p. 19.

really the only logical argument for a proportional tax, from the view-point of ability. But it is either a *petitio principii*, or it is tautological. Income and ability are made interchangeable. No consideration is given to the personality of the taxpayer, to the relation between income and wants.

This criticism is seemingly forestalled by Marzano in the further argument, that, since the demand of advancing civilization increases wants in the same proportion that income increases, the tax should be proportional.³ By implication the satisfaction of wants measures ability, but the wants are assumed to increase proportionately with income, and so, also, is ability. The argument is specious, but not sound. It is far truer, I believe, that with advancing civilization wants increase at a more rapid rate than income or wealth increases. Wants increase directly with education and culture, with moral and spiritual growth, but while it is true that the development of these is very largely conditioned by the growth of wealth (and so of income), it is not true that their development is necessarily directly proportional to the growth of wealth. Rather do they develop progressively. Hence, wants thus viewed in their relation to income would seem to demand regressive rather than proportional taxation.

But if by "wants" Marzano means "efficient wants" his argument is not less ineffective. It is true, in that case, that the power of satisfying our personal wants increases proportionately with income, but ability is not merely a question of the relation of income to the satisfaction of personal wants. Ability to pay taxes has reference to the relative ability to satisfy personal and collective wants, as compared with the like ability of others. Because, then, if there were no taxes our ability to satisfy our increasing personal wants would be proportional to our increasing income, it does not

³ Cf. Marzano, pp. 124-5.

follow that our ability to pay taxes maintains the same proportion. For, while wants increase with advancing civilization, and "efficient wants" with increasing income, collective wants—the demand for efficient government—increase in even greater proportion, become of their relatively greater importance. Hence, from this point of view the tendency would be towards a progressive, rather than a proportional tax. However, the question of ability is not a question of increasing wants with growth in civilization, and consequent increase of incomes, but whether, under existing conditions, ability increases proportionately with income. This can be maintained only by the first argument of Marzano, the invalidity of which we have pointed out above. Besides, though our individual wants increase with the increase of our individual incomes, or our wealth, our collective wants increase in an even greater ratio. Or, apart from the question of the value of life, which may be assumed to be the same for all, our wants, deprived of satisfaction on account of the tax, become of relatively less importance as our wealth increases, as compared with the wants of government. Hence, from this view-point the relative ability of large and small incomes is evident. We shall, however, consider this phase of the question more fully in connection with progressive taxation,

The weakness of the argument for proportional taxation, as a logical deduction of the theory of ability, is brought out very clearly in the fact that the most influential, and to their advocates the most decisive, arguments result from inconsequential reasoning, or specters of the imagination. For the most part these arguments take the form of objections to a progressive tax; on the ground that it is, "inquisitorial," is "robbery," is "socialistic," is "inhuman," is "sentimental," is "arbitrary," etc., etc. With such an abandonment of reason argument is impossible.

There is, however, one argument that perhaps deserves

more consideration. It is not the result of fright at a "specter," but is nevertheless a clear type of the inconsequences of reasoning by a complete shifting of premises. I refer to the leave-them-as-you-find-them argument for proportional taxation—*noli me tangere*. This is one of the most common, and has been, perhaps, the most telling, argument for proportional taxation, but it has nothing whatever to do with the theory of ability. If the argument has any application at all it is, as Neumann says, in the give-and-take theory of taxation,¹ and only in the persistence of the benefit theory does it find any place in the theory of ability. The argument, too, presumes that property, not income, is the source of the tax, and is closely allied with the economic doctrine of *laissez-faire*. Moreover, the primary premise is itself false. *Noli me tangere* is no more a function of government in taxation than it is to level all fortunes. A tax necessarily affects the distribution of wealth through its influence upon the savings from income, and the cessation of taxes (assuming that government would still exist) would favorably affect, upon the whole, the accumulations of the rich more than of the poor. A government, then, has done its duty when it distributes the tax according to the ability to bear it, although it incidentally and indirectly affects the distribution of wealth even though this end is not directly aimed at.² Still, a government may not overlook the economic effects of a tax, for when these become ruinous it is evidence that the tax is not based upon ability to bear it, and is therefore unjust.³ But proportional taxes may affect the distribution of wealth in the same manner as progressive taxes, though by no means in the same degree.

Passing over these irrelevant arguments for proportional taxation, the question whether a tax proportional to income

¹ Neumann, *Die Progressivsteuer*, p. 101.

² Cf. Neumann, *ibid.*

³ See chapter iii.

is a tax proportional to ability may be considered from two points of view—objectively and subjectively. Objectively, it is a question of the relative importance of public and private needs satisfied by increasing incomes; subjectively, it is a question of the relative sacrifice endured by the possessors of large and small incomes through the payment of the tax. In the former case, relative ability is determined by the relative importance, objectively considered, of the needs unsatisfied because of the tax; in the latter case, relative ability is determined by the subjective intensity of the same marginal, unsatisfied wants. As the question leads at once to progressive taxation, it will be considered in that connection. The disproof of proportional taxation based on ability is the proof of progression.

(2) *Progressive Taxation.* That the principle of taxation according to ability leads logically and inevitably to a progressive rate is recognized by most economists who accept ability, or its assumed equivalent—equality of sacrifice—as the just basis of taxation. Some, however, like Mill and Vocke, accept the principle of progression only in its modified form of degression—a proportional rate on the “clear” income.¹ Others, like Seligman, Pescatore and Walker, while accepting the principle of progression theoretically, as the only logical outcome of the ability basis of taxation, question whether it can be justly applied in practice on account of the practical difficulties in the way of its execution.²

Upon what, then, does this consensus of opinion rest? In brief, upon the conviction that ability to pay taxes increases faster than income increases. But what is the ground of this conviction, if it is anything more than a mere sentiment, or an

¹ Mill, *Polit. Econ.*, v, 2, 3; Vocke, *op. cit.*, pp. 472-9.

² Seligman, *Progressive Taxation*, p. 199; Pescatore, *La Logica delle Impost.*, pp. 23-5; Walker, *Political Economy*, p. 500.

ipse dixit? It rests upon both objective and subjective considerations. Let us note the latter first.

Subjectively, then, a tax is assumed to be proportioned to ability when it effects an equality—"equivalence"—of sacrifice; when the holder of a small income feels the sacrifice occasioned by his tax just as much, but no more, than the holder of a large income feels the sacrifice occasioned by his tax. But, so it is maintained, such an "equality of sacrifice" is not obtained by the giving up of proportional parts of incomes of different sizes. For, in satisfying our wants the most intensive wants are always the first to be satisfied, and with increasing incomes wants will be satisfied of ever decreasing intensity; so that the marginal utility of the want satisfied with the last increment of a large income has a less intensity than the marginal utility of the want satisfied with the last increment of a small income. Or, what amounts to the same thing, the wants sacrificed on account of the tax are always the least intensive wants, but the marginal wants sacrificed on account of the tax increase in intensity as incomes decrease in size—the obverse of the fact that with increasing incomes wants of decreasing intensity are satisfied. Hence, the taking of proportional parts of unequal incomes necessarily does not effect a proportional sacrifice. Therefore, a progressive rate is essential to realize a true proportion, the rate gradually increasing as incomes increase.

As put by Meyer the argument is, that "the proportional tax (*Der gleiche Steuerbetrag*) occasions a so much larger sacrifice the smaller the income from which it is borne, because the smaller the income the more intensive are the needs which are deprived of the means of satisfaction, and the average intensity of the needs attaining satisfaction is put off to an ever greater distance."¹ Hence to equalize

¹ Meyer, *op. cit.*, p. 331. Meyer advances another argument for progressive taxation that is closely allied with his argument for differential rates on funded

the intensities there must be a progressive rate. So, likewise, it is held by Wagner: "That it is statistically probable that ability increases faster than income, because with increasing income there is an ever larger quota of free income left over, which is not held for the satisfaction of subsistence needs, therefore for needs satisfied with much greater difficulty,"¹ larger portions of small incomes and smaller portions of large incomes being used to provide for the necessities—food, clothing, shelter. Hence the necessity of a progressive rate. So, too, Neumann reaches the same conclusion from a slightly different point of view. In the first place ability is identified with sacrifice, since, like sacrifice, it increases either as one imposes labor upon himself or as he denies himself enjoyments and satisfactions—"the sacrifice of toil and of renunciation."² Such sacrifices are imposed by taxes. Nevertheless, ability to pay taxes is not proportioned to income, as there are other sacrifices that must be taken into consideration—expenses for food, clothing, culture, care and support of the family, etc., etc. These latter sacrifices increase progressively as incomes decrease. Hence, a progressive rate with increasing incomes is necessary in order that the tax may "occasion equal efforts and sacrifices over against other needs."³

In spite of the weight of authority in its behalf and the dictum of Neumann, "that it is only through a consideration of the sacrifice imposed that the measure of ability first contains definite form and becomes useful for a tax system,"⁴

incomes. It is, that with larger incomes there is greater power of accumulation of property; that, therefore, they should be taxed more highly, the property adding to the ability as in the case of funded property. The argument contains the same fallacy as that for a differential rate on funded incomes. (*Ante*, pp. 213-216.) Or, if it be presumed that the accumulation of a large property increases the income, the argument is not to the point.

¹ Wagner, *op. cit.*, p. 457.

² *Die Progressive Einkommensteuer*, p. 62. ³ *Ibid.*, p. 63. ⁴ *Ibid.*, p. 62.

the sacrifice theory of progression is not to us, we confess, altogether convincing. Indeed, the argument appears to be a *non sequitur*. Because we satisfy our wants in the order of their decreasing intensity, or with large incomes satisfy less intensive wants than with small incomes, and in the case of a tax sacrifice the least intensive of our wants, it does not follow that proportional parts of incomes of different sizes will not effect equivalent sacrifices; that, for example, a 3 per cent. tax on A's income of \$10,000 is not felt by him exactly the same as a 3 per cent. tax on B's income of \$1,000 is felt by him. If the income of A were suddenly reduced from \$10,000 to \$1,000 and the income of B raised from \$1,000 to \$10,000, then A would feel a 3 per cent. tax on \$1,000 proportionately more, and B a 3 per cent. tax on \$10,000 proportionately less than they felt the 3 per cent. tax on their former incomes. But this does not follow when the state of mind of A is compared with that of B, for what is to A a necessity is to B a luxury. Really, comparison between them is impossible.

Above all is our contention true if, with Mill and Vocke, we exempt the necessities—the minimum of subsistence—and apply the rate only to the clear income; an exemption, as we shall show later, is the logical consequence of the ability theory. Moreover, necessities are in a class by themselves. Comparison between them and other wants is on a par with a comparison between the indefinite and the definite, or in their extremes, between the infinite and the infinitesimal.² Apart, then, from the question, whether the ideal aim of taxation is the production of equivalent intensities of feeling on account of the tax (a somewhat questionable ideal), there can be no subjective proof of the realization of this equivalence. Subjectively, we cannot tell whether it would be attained by a proportional, a progres-

² Cf. Sax, *Die Progressivsteuer*, p. 85.

sive, or a degressive rate. We are dealing with the "quantitatively immeasurable."

In spite of this difficulty both Wagner and Neumann, while accepting ability as the true basis of taxation, find their proof for progression only by interpreting ability in terms of subjective sacrifice. On the other hand, Meyer, who makes sacrifice the basis of the tax, determines the rate (which he finds should be progressive) by interpreting the sacrifice in terms of objective economic conditions—of objective ability. So, likewise, Sax declares that no definite results can be attained by the sacrifice theory, as all we can say of feelings is that one is greater or less than another, but not how much greater or less.¹ But Sax does not himself escape the difficulty as easily as he imagines. He prides himself, as we have seen, upon escaping the dilemmas of the sacrifice theory (and also of the ability theory) by his theory of marginal utility, applicable alike to collective and to private wants. From the fact that as incomes increase there is both a decreasing utility—a decreasing intensiveness—in the wants satisfied, and at the same time an increasing utility, with respect to their extensiveness, it is concluded that finally the extensiveness of the utilities becomes so great that their decreasing intensiveness is practically in inverse proportion to the increase of income; and that, but for their extensiveness it would be more than an inverse proportion.² But in changing from the conception of sacrifice to that of marginal utilities, Sax has not changed the principle in the least. He is still dealing with subjective states of feeling. These marginal utilities are precisely what the sacrifice consists of. To effect an "equivalence" of these utilities—these subjective feelings—is not a whit different from effecting an "equivalence" of sacrifice.

Hence, in the determination of the question of rates, the

¹ Cf. Sax, *Die Progressivsteuer*, p. 83.

² Sax, *ibid.*, p. 86.

theory of Sax has to meet with practically the same difficulties that are to be met with in the sacrifice theory, and he solves the problem exactly as Meyer solved it—by an appeal to objective standards, to the general agreement among men, and to the observation of the effects of feelings in economic exchange.¹ True, the objective conditions are supposed to be the expression of the subjective feelings, or subjective feelings to be induced by objective conditions; so that in determining the tax rate the government has but to observe the effect upon feelings of objective conditions and relations, and then so arrange the rate that these relations will produce the desired subjective effect—equivalence of feelings = equivalence of sacrifice.

But with all of the "observation" of the effect of feelings upon economic exchange, no government can tell whether a tax proportional to income will produce equivalent feelings; not only for the reason already given, to wit: that the fact that with increasing incomes the marginal utilities satisfied are of constantly decreasing intensity—of constantly decreasing utility—is no proof that the loss of a portion of these utilities to A, with a large income, would not be the same to him as the loss of the same proportion would be to B, with a small income; but also from the fact, as well pointed out by Sax, that we must take account of the extensiveness as well as the intensiveness of the marginal utilities sacrificed. Even if a "more or less" could be determined, the theory affords no way of determining how much more or less, or the rate of the progression; for I cannot agree that collective wants are determined in exactly the same way as are the private wants.²

It has remained for the Dutch economists, firmly adhering to the sacrifice theory, and to progression as its logical con-

¹ Sax, *Die Progressivsteuer*, p. 85.

² Cf. Neumann, *Die Steuern und das öffentliche Interesse*, pp. 190-200.

sequence, to reduce the rate of progression to a fixed rule—to a mathematical formula—but their scientific exactness is purely an affair of the imagination. As we have seen, they attempt to solve the problem by the ingenious but deceptive device of taking two series of numbers and assuming that they correspond respectively to the decreasing utility of increasing increments of income, and the decreasing utility of increasing increments of the tax, such as would result from proportional taxation. This, it is assumed, would show an unequal, or a disproportionate, sacrifice. All that there is to do then is to so change the series as to produce a rate that will equalize the marginal utilities of the tax on different incomes, or equalize the sacrifice occasioned by the tax. But as there is absolutely no reason for choosing one series rather than another, any result, any rate of taxation, is theoretically possible according to this theory. This Cohen-Steuart admits, but his own attempted refinement of the theory by assuming that the truth lies in the mean between two extremes, is, as both Professors Sax and Seligman have shown,¹ equally groundless, equally imaginary. It is all guess work, all groundless hypothesis. Hence the rule for progression: "Arithmetical increase of the rate with geometrical increase of the income up to a definite point when progression is replaced by proportion,"² is purely chimerical, and therefore wholly without value.

Upon the whole, then, the sacrifice principle does not appear to throw much light upon the theory of rates. Inevitably appeal must be made to *objective* standards, to objective economic conditions and relations. Even if "equivalence of feeling" is the ideal of justice in taxation, it is a purely abstract ideal. A government has fulfilled its obliga-

¹ Sax, *Die Progressivsteuer*, p. 59 et seq.; Seligman, *Progressive Taxation*, pp. 184-5.

² Quoted from Seligman, *Ibid.*, p. 188.

tions in the just distribution of the tax burden when it has proportioned the tax according to the ability of the taxpayer, as this ability is determined by objective facts, objective economic conditions of the taxpayers. We may grant that such a tax may, and in a very general way will, produce an equivalence of subjective feelings. But the fact remains that the point of view of the government is that of relative objective ability; that is, ability as determined by the economic means for the satisfaction of public and private needs, their relative importance being taken into consideration. Such a conception of ability and our obligation to pay taxes is founded upon the nature of the state. It is, as we have seen, of a distinctively ethical connotation. This granted, What rate of taxation follows as a logical consequence? That is, A and B having incomes of different sizes, what portions of their incomes ought each to contribute to the support of the state, on which their social and civilized existence depends? If A has ten times the income of B, ought he to contribute ten times as much? Is his ability ten times as great? To me the question is essentially, at least fundamentally, ethical. But it is a question of practical ethics. It involves, nay it cannot escape, consideration of the relative economic conditions of A and B; nor, again, the effect of a tax upon their relative economic conditions. Immediately the problem has an objective reference; ultimately, a subjective reference. That is to say, immediately it is a question of the true relation between economic means and objective economic conditions; while ultimately it is a question of the relative importance, or character, of the wants satisfied by the economic means, or the relative importance of the needs of which the economic conditions are the expression. Immediately and objectively it has to do with economic conditions; ultimately and subjectively with the importance of these relations in their bearing upon the pur-

poses of life. A government, however, must find its rules for guidance in the objective conditions, in accordance with a standard that represents the consensus of opinion as moulded by the moral sense of mankind; by the habit, customs, and ideals as reflected in social institutions; by the degree of culture and civilization attained and by the economic status of the society in question.

Now by common consent wants are divided, in a very general way, into necessities, comforts and luxuries, and by common observation we learn that there is a certain correspondence between the satisfaction of each of these grades of wants and the amount of disposable income; or, that with different amounts of income we provide ourselves with different classes of economic goods, and thereby with the correspondingly different grades of enjoyment, of which the economic goods afford the means. By common consent, too, the necessities are deemed of the most, the luxuries of the least relative importance, not alone from the viewpoint of the subjective value to the individual, but also from the viewpoint of the progress and development of mankind. The comforts stand between the two. Therefore, the extension of the scope of the necessities is of more importance than the extension of the comforts, while the extension of the latter is of more importance than the extension of the luxuries, and this importance could be shown to extend both to our economic and our spiritual well-being. Hence, considered from the viewpoint of the realization of the ends of man, in which is found the ultimate end of the state, it is of more importance that those who are confined to the necessities of life extend the scope of their satisfactions, than that those who enjoy the luxuries should extend theirs.

At the same time it must be admitted that the comforts and luxuries are as positive factors in human development as are the necessities. Indeed, in a sense they are much

more significant. Necessities, when confined to absolute necessities, are a pre-condition to any development. Development begins only when the stage of necessities is passed, when the stage of comforts, or of "culture" begins. And progress is marked by the gradual merging of comforts into culture necessities, and the conversion into luxuries of what has been regarded as superfluous. But the order of their importance remains unchanged. From the ethical standpoint, both of man and of the state, it would seem, then, to be a logical deduction, that the deprivation of a portion of the luxuries would be of relatively less importance than the deprivation of a similar portion of comforts, and, still more, than that of necessities. Or, what amounts to the same thing, it is of more importance that there should be the means of satisfying the latter than either of the former.

Briefly, then, we are forced to the conclusion that ethically considered, that is, from the viewpoint of the ethical conception of man and of the state, wants of relatively decreasing importance are satisfied with increasing incomes, so that the taking away of a part of a small income (as by a tax) necessitates the giving up of wants of relatively greater importance than would the taking away of equivalent parts of large incomes. In other words, considered with respect to the importance of wants there is proportionately more disposable for taxes in large, than in small, incomes—proportionately greater ability. But there is no difference in the importance of the state to the person, as such. The difference of interest is indistinguishable. Yet regarded from the point of view of the totality of satisfactions, and, therefore, of the means of these satisfactions, the importance of the state to the individual would seem to increase with the increase of income; and because of the indispensableness of the state to this increase of income, its importance might well be regarded as increasing in greater proportion than

the increase of income. Hence, also, the obligation for a more than proportionate share of the tax burden as measured by income. But this view merges into the benefit theory; it does not directly determine ability, or the obligation resting upon it. Confining ourselves, then, to the view of the equal importance of the state, the above argument leads inevitably to the conclusion that ability increases in a greater ratio than income, thus necessitating a higher rate on large than on small incomes in order that the tax may be proportional to ability. In brief, a progressive rate on increasing incomes is essential to a proportional tax on ability, if by ability is understood the relative satisfaction of wants with respect to their importance.

This view of progression is not, I think, altogether different from that of Schäffle, who conceives of ability as determined by the amount which one can contribute in taxes without crippling the same relative support of himself; and who concludes that this principle leads to progression, on the ground that as incomes increase in size relatively larger portions may be contributed to the state without detriment to a relative satisfaction of personal wants. But Schäffle also thinks that the idea of progression is itself "instinctively correct," "it being only the manner of carrying it out that is false in the theory of progressive taxation."¹ This is specially true if we give emphasis to the difference in the importance of wants, which appears to be implied in the theory of Schäffle. It is questionable if based on the sacrifice theory. But progression is "instinctively correct" only because it is based upon ideas that conform to the common judgment of mankind, with respect to the relativity of wants and their comparative importance to individual and social well-being.

That there is an indefiniteness in this theory of progres-

¹ Schäffle, *Mensch und Gut*, p. 49. Cf. also, *Die Grundsätze*, p. 23.

sion, and that it affords no definite ratio, or rate, of progression, is not to be denied.¹ But this is inevitable in any theory of progression, and it does not prove that the principle itself is not correct. It has, at least, the merit of conforming to the sound principle of Vocke (though differently applied by him), that the principle of progression must proceed from its own fundamental thought,² which we take to be the principle of relative ability as determined by income and by the relative importance of wants.

But though vague and indefinite, must it be admitted that this theory of progression affords absolutely no principle for determining the rate and the limit of the progression? We think not. Vocke solves this question easily by assuming that the "fundamental thought" is the primary right to the needs of subsistence, and therefore the right to the exemption of the minimum of subsistence, by which both the rate and its limit is fixed by the amount of the exemption, the only indefiniteness being in the amount of the exemption. That is, the limit of progression is degression.³ The difficulty with this view, as it appears to me, is this: What Vocke considers to be the "fundamental thought" of progression—that is, of the principle of equality—is in reality, the fundamental thought of exemption—that is, of the principle of universality. The degressive principle is, indeed, incidental to exemption, but it has no direct bearing upon the question of progression, except upon the questionable assumption that ability is proportional to "clear" income.

Schäffle, without reference to any "fundamental thought" of progression, but upon mere grounds of policy, would have the rate and limit of the progression indirectly deter-

¹ See Seligman, *Progressive Taxation*, for criticism of Schäffle.

² See Vocke, *op. cit.*, p. 477.

³ Vocke, *ibid.*, pp. 477-9.

mined by the taxpayers themselves, through a tax upon consumption.² But this would be very uncertain in its effects on account of the shifting and incidence of taxes. Still, we may admit that the tendency of such a system would be to impose the tax "according to one's dynamic ability;" also to tax the "economic personality," and at the same time put a limit upon the progression.³ So likewise, Held would also indirectly attain the same result by imposing taxes so that they will occasion the least complaint, this complaint being considered as the best index, or measure, of sacrifice, or ability.³ This view has much in common with the theory of Sax, already sufficiently discussed, that the "equivalence" of the burden, and therefore, also, the just tax rate, is determined by the people through their representatives in the government.

But while these views contain much truth, I believe that we can find in the principle of progression rules that determine and limit its rate. Theoretically, if the principle of progression is based upon comparative ability, as we have understood it, there must be the same relative means of satisfying wants, according to their importance, after as before the tax. This is a mere truism. But it follows, also, that there should be the same relative ability to exercise one's faculties, to the end of larger satisfactions, as existed prior to the tax. Otherwise progressive human development will be checked, and the purpose for which the state exists be negated. Nor is this mere abstract theory. The same objective signs, by which the principle of progression is objectively determined, will aid, also, in determining the rate and limit of the progression—the effects of a tax upon the relative economic means of satisfaction. Above all is

² Schäffe, *Mensch und Gut*, pp. 168-9.

³ *Ibid.*, p. 168.

³ *Einkommensteuer*, p. 115.

the limit reached when the rate is such as to prevent that 'saving' that provides for future production."¹

That this whole view of progression—of equality in taxation—is vague and arbitrary, must again be admitted. But so is every other theory of progression. Here everything depends upon the determination of the relative importance of needs, which is a purely relative conception. But it must be borne in mind that our viewpoint is ethical—the ethical ideal in taxation. Nevertheless, this conception of progression is not altogether impracticable. It is capable of practical application within certain limits, and, therefore, of realizing an approximation to justice, which is all that any theory of progression can claim. And the higher the moral standard of mankind the more nearly will the approximation attain to the ideal.

But in spite of the justice of the principle of progression, there are practical objections of another character that deserve, perhaps, some consideration. That progressive taxation would prevent the growth of capital, or cause it to emigrate, is true only if the rate of progression be excessive. It would not follow moderation, or a wise conservatism, in the application of the principle. This is attested by the results of its practical application in Switzerland, Saxony, or wherever else applied. The same is true of the objection that, logically carried out, a progressive tax would confiscate wealth and equalize fortunes. Besides, logically carried out progressive taxation does not lead to confiscation. Progression may lead to infinity, but progressive taxation is limited in its application by the principle by which it is itself determined, as we have already seen. Hence, Wagner's social-political theory of progressive taxation is in direct conflict with his theory of taxation according to ability. Again, that

¹ The theory that a progressive tax necessarily prevents "saving" is based upon the erroneous assumption that what is paid as a tax would otherwise be "saved."

progressive taxation would stimulate money lenders to encourage the increase of public debts is no truer than in the case of proportional taxation.¹ Nor would it necessarily imply undue interference with personal rights and liberties. This results more from the kind than from the rate of taxation.

Upon the whole, then, I believe that if progression is just in principle it should be applied in practice; but moderately applied. Even a conservative attempt to realize a principle of justice that is felt to be "instinctively correct" would go far towards mitigating the social discontent of the masses, and would tend to their rise by peaceful, instead of by revolutionary, methods. Or, as Held says: progressive taxation "is a social need and a means of peaceful progress."² "A social need," I take it, in the sense that I have understood the principle of progression, as largely conditioned by the relative importance of the intellectual and social development of the poorer classes, upon which in great measure depends the progressive development of mankind; "peaceful progress," since every recognition of justice towards the masses, on the part of the government, tends to kill the revolutionary impulse.

"If that organization of society and political life which we call aristocratic in the best sense of the term," says Cohn, "is to survive (and it is indispensable for the progress of civilization that it should survive), the corresponding aristocratic attitude of the upper classes must come up to the demand made upon it. They will, among other things, have to fulfil this requirement also in the way of accepting an adequately developed system of taxation. Their degree of readiness will make up in quality for what the democratic masses would otherwise demand, some day, in quantity. The voluntary acceptance of an increasing burden will serve

¹ Cf. Adams, *Public Debt*, pp. 39-41.

² Held, *op. cit.*, p. 172.

to strengthen their traditional influence and is indispensable to the best civilization, as well as to the existence of the higher classes themselves. On the other hand, the more an increasing progression comes as the result of the importunate demands of a discontented populace, the more reckless will it be, both in the new demands which it embodies and in its changes of the old order of things.”¹ In brief, if the practice of progression by those upon whom it would apply creates a possible danger, it averts the possibility of a far greater danger.

II. THE PRINCIPLE OF UNIVERSALITY

That the principle of “universality,” like the principle of “equality,” follows from the nature of the state, the nature of the individual, and from the relation of the individual to the state, we have already seen. Thus viewed there would seem to be no ground for any exception to the rule. Universality would seem to be an unconditional principle of taxation. This, in fact, is the view of most writers on the theory of taxation. It is the common idea that because of the indispensableness of the state to the individual, the universality of interest in the state, there is no exception, in principle, to the obligation to contribute to the state’s support. If exception is allowed, it can be only upon the ground of absolute necessity—the non-existence of means above the necessary minimum of subsistence. For to tax this “minimum” would necessitate an equal return from the taxes, which would occasion a net loss to the government, because of the increased cost of the collection and dispensation of this part of its revenue without any net return to itself.

But this view of exemption from taxation appears to me to be entirely wrong. It overlooks important factors in the

¹ Cohn, *op. cit.*, pp. 324-5.

problem. It is consistent only with the protective theory of the state and the benefit principle of taxation.¹ For since every individual receives protection, and thereby derives a benefit, every individual, without exception, should contribute to the cost of that protection. In the case of property there could be no tax for protection if there was no property to protect.² But for the protection of the person there could be no exception, other than that of absolute necessity. For every "benefit" there must be a corresponding tax. If we consider the benefit to consist in the gains from "exchange" there could be no tax where such "gains" did not exist, but there are certain benefits that are immaterial gains, common to every member of the state, and for these gains every citizen should contribute a tax in exchange.³

Again, we may regard the benefit as consisting in the service performed by the state in production. In this case, if we look at results only, there could be no tax if the "service" was not utilized—if there was no production. But, on the other hand, if, more properly, we regard the state as the condition precedent to all production, in which every one is privileged to participate, there would seem to be no ground for exemption.⁴ At any rate, Stein considers it to be just to tax labor on the ground that it is only by the administration of the state that its acquisitions are made possible.⁵ In reality, however, the problem of exemption is not consistent with Stein's theory of "diffusion," since, according to this theory, the burden of the tax is, in the main, justly distributed through the influence of price.⁶ Or, again, if the benefit consists in the possession of a portion of the "national capital," and the tax is distributed in proportion to the amount of this capital held, then there can be no

¹ Cf. Murhard, *op. cit.*, p. 90.

² Cf. Perry, *op. cit.*, p. 515-8.

³ *Ibid.*, ii, p. 251.

⁴ Cf. Sismondi, *op. cit.*, p. 164.

⁵ Cf. Stein, *op. cit.*, p. 496.

⁶ *Ibid.*, i, p. 494.

exemption except where there is no possession of the national capital. "The minimum of needs is spared by force of necessity, not by virtue of a false principle."¹

Much the same conclusion results when exemption is considered from the viewpoint of "equality of sacrifice;" for if "equality of sacrifice" is the true principle of taxation any exemption must appear as a contradiction of the principle, and is to be justified only on grounds of absolute necessity.² For where there is no tax there can be no sacrifice, and hence no "equality" in taxation. Exemption is an exception to the principle, not a logical consequence of it.³ Nevertheless, Sax attempts to deduce exemption as a consequence of the principle of subjective sacrifice, and his explanation is, perhaps, the best that has been given from this standpoint. The thought is, as with Mill,⁴ that the physical necessities are incomparable in their intensity with all other classes of needs, comparison being possible only between those needs that are satisfied after the physical minimum is passed, the comparison including all collective needs. But no needs above the physical minimum (which includes the collective needs) can be satisfied until the needs below the minimum are fully satisfied. Hence, sharing in the expense for the satisfaction of collective needs can take place only where the means exceed the requirements of the minimum of subsistence.⁵ The exemption is a matter of necessity, not of principle. "On grounds of absolute necessity the pure minimum must be exempted, but justice does not demand any exemption so long as there is an income equal to the minimum plus the tax."⁶

But exemption on the ground of necessity is confined to the bare physical necessities of life. If exemption is to be

¹ Menier, *op. cit.*, p. 221.

² See, for example, Wagner, *op. cit.*

³ Cf. Meyer, *op. cit.*, p. 294.

⁴ Mill, *Political Economy*, v, 2, 3.

⁵ See Sax, *Grundlegung*, pp. 509-13.

⁶ Sax, *Die Progressivsteuer*, p. 69.

justified on income that exceeds the requirements of these bare necessities, it must be justified upon some fundamental principle, be the logical outcome of the "fundamental thought" that lies at the basis of the ethical idea of taxation. Such I believe to be in accordance with the real facts of the case. We have, then, two problems before us—the justification of exemptions and the limitations of exemption.

1. *The Justification of Exemptions.* Accepting the ability basis of taxation, exemption of the minimum of subsistence follows as a necessary consequence. For if taxation according to ability is the true principle of taxation, it is a mere truism to say that where there is no ability there can be no obligation. It is not merely that there can be no tax if there is no ability, but where the ability does not exist the tax obligation does not exist. The obligation begins the moment that the ability is manifest. To tax where there is no ability would be a violation of the principle that taxes should be proportioned to ability. Exemption, where there is no ability, is but the fulfilment of the implications of the principle which is assumed to be the just basis for the distribution of the tax burden. It is not, as in the preceding theories, a *necessary* exception in contradiction with the principle that is assumed as the basis of taxation.

It is true that the exemption of any person from the payment of taxes is in contradiction with the principle of universality. But this principle is a relative, not an absolute, principle of taxation. Or, if politically and economically it is absolute, ethically the principle of universality extends only so far as there is ability. Within this limit only is it a universal principle. Hence, while exemption is an exception to the general principle of universality, it is in harmony with the qualified form of the principle—the form in which it is a true principle of taxation. True, exemption of the minimum of subsistence is a necessity, but this is not its only justification. It follows, as we have seen, from principle.

But the real justification of exemption rests upon a basis that is more fundamental than the idea of taxation according to ability. It rests, indeed, upon the same "fundamental thought" as does the idea of ability itself. Both are developments of the same fundamental idea—human personality in its relation to the state. It involves both the relations of the individuals to the state and their relations to each other, and not simply, as Meyer holds, their relation to the state; nor, as Wagner seems to hold, simply their relations to each other.³ Particularly is this true if the exemption is to extend beyond the bare necessities for physical existence.

What, then, is the fundamental ground of exemption, or of exceptions to the principle of universality in taxation? The more common idea is that since every individual participates in the ends for which a state exists, every individual, without exception, should contribute to its support. But this we have found to be conditioned by the further principle, that the support should be proportioned to ability; by implication there being no obligation where there is no economic ability. But we have now to inquire why this obligation does not exist when the importance of the state to every individual is admitted. Those, for example, who hold that the obligation never ceases base their conviction upon the idea that the state, if not of first importance, is, at least, of equal importance with physical subsistence, to every member of civilized society. This is the view of both Held and Cohn. Held, for example, in declaring against the exemption of the wages of labor, says: "The state is for all a need; its existence for the whole is more necessary than the life of the individual."⁴ So likewise Cohn: "Plainly, as viewed from the standpoint of the latest theory of the state, there is no room for the doctrine which admits the state and its demands only as second to the necessities of life. The

³ See Meyer, *op. cit.*, pp. 293-4.

⁴ Held, *op. cit.*, p. 105.

state, above all things, is part of these necessities and its demands are therefore part and parcel of the demands of subsistence."¹ Hence, theoretically, or in principle, there is, according to this view, no justification for exemption.

But the view of Held and Cohn appears to me to be a mistaken one. It is based upon, or at least it implies, the erroneous conception of the state as a "social organism," the individual being a means, the state the end. But according to the view that the state exists for the highest development of human personality—the individual being the end, the state a means—"the latest theory of the state," the effect of the tax upon the person becomes of first importance. If the state is a necessity to this development, it is quite as true that there must first be the existence of the person. Moreover, the right to provide the means of subsistence is a fundamental right, and is prior to every other right. Even Held admits this. He goes even farther, and, in spite of his theoretical objection to exemptions, would exempt not only what is necessary for the physical needs of self and family, but also what is necessary for their spiritual life.² Vocke, too, recognizes the right to the necessary needs of subsistence as prior to any claims of the state, but he limits this right to the bare minimum of subsistence.³ It must be admitted, however, that with Held the exemption which he

¹ Cohn, *op. cit.*, p. 331. Cf. also, p. 354.

² "Den Jeder hat vor Allem das Recht zu leben, und es ist wohl die schreiendste Ungerechtigkeit von dem zum nothdürftigen Unterhalte erforderlichen Einkommen noch öffentliche Abgaben für den Staat zu fordern." Held, *op. cit.*, p. 451.

³ "So wahr aber der Mensch ein Vernunftwesen ist, muss einem Jedem nicht bloss es verlassen werden, was ihm zum sinnlichen, sondern auch Das, was ihm zum geistlichen Leben unentbehrlich ist." *Ibid.*, p. 452.

⁴ "Der Staat nur solche Ansprüche als seinen eigenen vorgehend anerkennen darf und kann, welche älter und naturgemäss noch berechtigter sind als er selbst, nämlich das Recht auf die Selbsterhaltung und auf die Erhaltung der Familie, bzw. in diesen auf die Erhaltung des Menschengeschlechts. Ein älteres, unbedingteres Recht gibt es nicht." Vocke, *op. cit.*, p. 480. See also pp. 463-4.

would allow is not a right, but only a social need that is necessary to the highest efficiency of labor.¹

That exemption of the minimum of subsistence is a necessity, as is so universally emphasized, goes without saying; but the above considerations show, I think, that the exemption is also justified in principle, and is not, as Von Hock claims, "a simple act of benevolence."² I do not see how any other conclusion is possible when we reflect that the ultimate end of the state is the developed personality of the individual. For the first condition of this development is an economic personality, an economic freedom, which involves above all the necessary means of subsistence. And, therefore, to tax the "minimum" is to nullify or retard the very development which it is the purpose of the state to promote. This is even more patent if the tax necessitates a public charity.

The economic and social importance of an "economic personality" was clearly recognized by Held, who deemed it a sufficient ground for the exemption, not only of a bare minimum, but of a sufficient minimum to enable the poor to rise to a higher economic order.³ Stein goes even farther and justifies exemption because of its bearing upon the total personality of the individual. True, Stein regards the state as an "organism" whose personality is to be realized, the tax being a necessary means to this end. But this "organic" view adds nothing to the theory. For the fully realized personality of the state is marked by the realized personality of the individual, or the highest form of personal life—"personal freedom." Indeed, the realization of "personal freedom" is regarded as the ultimate end of the state, and this realization is effected by the realization of its own personality. But the first requisite is "economic freedom."

¹ Held, p. 118.

² Von Hock, *op. cit.*, p. 173.

³ Held, *op. cit.*, p. 118.

Hence, the exemption of the minimum of subsistence.¹ The same conclusion is reached by Schäffle, though from a different point of view. Emphasizing the fact that the tax obligation rests upon personality—upon the person—it is justly held that there can be no obligation where the personality has not realized itself in property, in an economic personality (eine Vermögenspersönlichkeit), since what the state requires is economic goods.² That is, while the tax obligation rests upon personality it is only potential until there is realized an “economic personality.”

While there is much truth in these different views of the relation of exemption to personality, the question of real importance is the effect of a tax (upon the minimum) or of an exemption, upon the personality of the taxpayer.³ Where this is endangered there can be no obligation; and it is endangered when it has not so far developed as to have realized itself in objective goods sufficient to meet the needs of subsistence; to have realized itself, that is, in economic freedom, in economic personality. In brief, the obligation begins when “economic” or “personal” freedom begins. The first claim upon property, which we have seen to be the objectified self, and therefore, in a sense, a “natural right,” is subsistence of the self, of the physical person; but since the state is a condition of the development of the personality of self, the obligation to use the property to support the state, and the right of the state to demand this support, begins after the needs of physical subsistence are met.

But this right to exemption, on the part of those who have incomes at or below the minimum of subsistence, involves a corresponding obligation, on the part of those who have incomes above the minimum, to meet the full demands of the

¹ Stein, *op. cit.*, section, *Die Steuer*.

² See Schäffle, *Grundzüge*, pp. 14 and 169.

³ Cf. Schäffle, *ibid.*, p. 170.

state for economic goods. Nor does this obligation rest simply upon the nature of their relation to the state as alone possessing economic ability, but it has its basis also in the nature of the ethical relation of man to man, of man as a spiritual being—an end in himself. Indeed, from no other point of view is exemption to be justified in principle, whether considered with respect to the relation of the individual to the state, or with respect to the relation of individuals to each other as persons. Directly and immediately, however, the basis of exemption is the principle that the burden of taxation should be proportioned to ability. Even the social-political argument of Wagner assumes to be based upon this principle. But in making social-political ends the only justification of exemptions,¹ Wagner diverts his argument from the main point at issue. For the real social-political end of exemption, like that of progression, is not to distribute the tax according to ability, but by equalizing property to equalize ability. But the attainment of such a result is not a problem of taxation.

There are, however, various other arguments for the exemption, which do not involve the question of principle, but are of a practical nature. Such, for example, is the argument based upon an assumed analogy between capital and labor and the necessity of maintaining their highest efficiency. As developed by Luigi Rameri it is, that income consumed for subsistence is a species of recuperation of capital, "being spent to maintain the productive force of labor;" that, therefore, such income should be exempt from taxation for the same reason that the taxable income from any industry excludes that part of the product that goes to pay current expenses and to keep up the plant.² Hence, only the clear income is a taxable income. This is the same

¹ See Wagner, *op. cit.*, ii, § 167.

² Luigi Rameri, "Per la Proportionalita delle Imposte," in *Rassegna* for Oct. 1891.

economic argument as that used by Held who justifies exemption on the ground that to tax the "minimum" would lessen the efficiency of labor.¹ While the argument has directly only an economic bearing it is nevertheless of considerable importance, since to curtail labor efficiency is to check economic progress and thereby to lessen the means and with it also the efficiency of the state. It is given an added weight when we reflect that the evil influences would be cumulative in their effects. But indirectly the argument bears also upon the principles previously discussed. For in lessening labor efficiency by a tax upon the "minimum" we check the development of "economic personality," and with it also that social development that leads to the development of the larger personality of man.

Passing over the "compensatory" argument, which is a question of special and not of general exemption, we may note the argument based upon Adam Smith's fourth canon of taxation:² the argument that there should be an exemption of small incomes on the ground that the cost of collection of the tax would be in excess of the receipts. The effect of such a tax would be, not only to work economic injury to those having small incomes, but also to those having large incomes, by unnecessarily and unjustly increasing their tax burden. From this point of view exemptions would be justified even though they were not justified in principle. Nor would the exemption necessarily be limited to the minimum of subsistence, but should extend to the point where the receipts from the tax would just exceed the cost of its collection; just as in the preceding economic argument the exemption should extend to the point where the tax would not cripple the efficiency of labor.

¹ See Held, *op. cit.*, p. 118.

² For this argument see, for example, Mlle. Royer, *op. cit.*, pp. 23-7.

³ Adam Smith, *op. cit.*, p. 416.

But while such arguments as these have their weight, and should be considered in any practical application of the principle of exemption, the real justification of exemption must be found, as we have seen, in the nature of man, the nature of the state, and the relation of man to the state. The importance of the state to the individual cannot be ignored, but at the same time the supreme importance of the individual should be recognized. This is brought out very well by Vocke, who of all writers has most clearly stated the true principle of taxation. His statement is a good summary of the whole argument. "Man," he says, "lives and moves in the state and for the state, but not alone that, for he is an end in himself; if he exists for the state the state exists for him. And if man lives through the state he does not live alone through the state, but also, and indeed in the first instance through himself. Man, generally speaking, is before the state, and if the state takes from him his existence it puts itself in contradiction with its function and its purpose,"¹ for the first duty of the state is not to endanger the existence and the support of man.² And it is claimed with much truth, that if we remember that the subject of the tax is persons, not things, the problem solves itself.³

2. *The Limitation of Exemptions.* The argument has thus far assumed that the exemption should be confined to the "minimum of subsistence." But is this "minimum" limited to the absolute necessities of life, or should it extend to a

¹ "Der Mensch lebt und webt zwar im Staat und für den Staat, aber das alles nicht allein, sondern er ist auch Selbstzweck; er ist nicht nur um des Staats willen, sondern auch der Staat ist um des Menschen willen. Ebenso lebt der Mensch durch den Staat, aber das ebenfalls nicht allein, sondern auch, und zwar in erster Reihe, durch sich selbst. Der Mensch ist überhaupt vor dem Staat, und wenn hiernach der Staat den Menschen in seiner Existenz angreift, so setzt er sich in Widerspruch mit seiner Aufgabe und seiner Bestimmung." *Op. cit.*, p. 459.

² *Ibid.*

³ *Ibid.*, pp. 471-2.

"culture minimum"? In other words, Does the obligation to contribute to the support of the state begin the moment that income exceeds the necessary means of physical subsistence, or is the obligation relative to an arbitrary standard of life?

In the first place the "minimum" must be sufficient, not only for the subsistence of the person but also for the maintenance and support of the family. Without such an extension of the "minimum" the race could not be perpetuated, at least under the conditions that promote the highest civilization, the highest development of individual personality. Moreover, the family is the natural economic unit—the unit of economic personality, of economic freedom. And without the economic freedom of the family the first important step towards realized personality must remain untaken, the first important step towards the fulfilment of the ends of the state unattained. The family as much as the individual precedes the state—conditions the state. Provision for its subsistence is, therefore, not only a right, but is a "natural right," that the state is in duty bound to respect. To quote Vocke, "The state has the same obligation to recognize the necessary care of the family as a duty prior to its own claims, as it has to recognize that of self-maintenance."¹

In the second place, there can be no permanent economic freedom—requisite to permanent economic personality—until the income is sufficient to provide not only the absolute necessities of physical existence, but also to provide for the maintenance of labor power and for times of sickness,² for the family as well as for the self. For a state to levy a tax that would be prejudicial to either of these conditions would be to weaken the source of its own support; and besides, it would be as much a contradiction of its own purpose as to

¹ *Op. cit.*, p. 467.

² *Cf. Vocke, ibid.*, p. 460.

tax the absolute necessities of physical existence, differing only in degree. On the other hand, until the "minimum" is sufficient to meet these requirements there is no real tax ability, and therefore no tax obligation.¹

But when these requirements have been met, when, that is, there is a "clear" income above the minimum of subsistence as above understood, the obligation to aid in the support of the state begins. Or the obligation that was before potential, because of the importance of the state to the individual, now for the first time becomes actual. If exemption is extended beyond this limit it cannot be as a right, but only on grounds of policy—political, social, or economic. It is true that the limit is somewhat arbitrary, for it is difficult to determine exactly how much should be set aside as necessary for the support of the family or to maintain the labor power of the taxpayer. In fact, the limit is a purely relative one, the standard for exemption necessarily depending upon the accepted standard of life, which is itself conditioned by the customs, habits, social ideals and degree of culture attained; and, above all, by the conditions of individual and national wealth. Practically the standard must be determined by the same principles that determine the rate of progression.

Still, it should be remembered that purely on grounds of theoretical justice only provision for normal support, and normal efficiency, should be allowed. For example, allowance cannot, or should not, be made for abnormally large families,² since this would be to put a premium upon thriftlessness and irresponsibility, and thus to encourage an increase of population where most detrimental to society, and to the highest individual development. On the other

¹ "Die Leistungsfähigkeit aber ist das notwendige Korrelat der Leistungspflicht, welche ohne jene nicht denkbar ist." Vocke, p. 284.

² See, *per contra*, Wagner, *op. cit.*, ii, 447.

id, if more than the normal efficiency of labor is allowed in the exemption, it must be because of the retroactive effects of the exemption, or because of the disproportionate cost of the collection of the tax. But with advancing wealth, advancing culture, and advancing civilization the standard of exemption should be raised in conformity with the ends for which the state exists—the progressive development of mankind.

CHAPTER VIII

PRACTICAL JUSTICE IN TAXATION

IN the preceding study of the principles of justice in taxation, we have not wholly lost sight of the fact that theoretical ideals are not always, nay are seldom, fully realizable in practice. Nor have we been unmindful of the fact that economic and social conditions must enter largely into our determination of the ideal. For since the ideal in taxation must necessarily have as its objective point the effects, or results, of this or that system or method of taxation, the nature of the effect must be a controlling influence in determining the character, or the justice, of our ideal. But while we have recognized the relative nature of the ideal of justice in taxation it must be admitted that we have not developed this aspect of the question, but have given our attention almost entirely to theoretical principles. And yet, we insist, not to theoretical principles that are purely visionary in the sense that they are applicable only to ideal beings, but principles that are founded upon the ethical nature of man and upon moral and social facts and forces. Nevertheless, the fact that the dominant thought has been that of the morally right—of justice—has led us to ignore for the most part the possibility of the practical realization of our ideal. So true is this, indeed, that there will be a seeming justice for the critic who urges that our theoretical principles afford no solution to the apparently insoluble problem of practical justice in taxation. Moreover, since the theoretical principles are unrealizable in practice, the critic may further

urge that there can be no value in these theoretical discussions.

But before we concede the truth of these criticisms let us consider for a moment whether theoretical principles that cannot be fully realized in practice may not after all have some practical value; indeed, whether the principles themselves are not to some extent, at least, practicable. In the first place, there is always a practical value in determining a norm for the guidance of real life, or for the guidance of action in the actual happenings of life. Human action unguided by an ideal can be but irrational, purposeless, and without significance or achievement. This is as true in matters of taxation as in the purely moral life. Indeed, since human action is necessarily social action, a norm of conduct becomes indispensable, for otherwise there could be only the self-seeking of the individual which would be destructive of social life, and so ultimately also of any truly human life.

But again, Is there nothing practicable in the theoretical principles we have discussed? The answer to the question must depend upon the meaning we give to the "practicable." But the practicable must mean one of two things: Either a system which is so in harmony with prevailing sentiments and convictions that there is a possibility of its immediate adoption; or a system of which there is a reasonable hope of adoption by a change in the prevailing thoughts and ideals. Now we maintain that there is something practical in our principles from both points of view. In fact, there is no principle that we have advocated that cannot be found in actual practice in one country or another, so that the problem is not so much one of a practical application of new principles as an extension, or fuller application, of accepted principles. But though there may be some principles not in harmony with the sentiments of a

particular people, there may yet be some practical value in their discussion; for a nation, like an individual, can progress only as its thought and ideals move ever upward to higher and truer standards.

But there is yet another point of view from which we may consider the practicability of theoretical principles of just taxation—that of their implications. That is to say, if the principles involve consequences that are impossible to be realized in practice it would seem to be a just charge that the principles are themselves impracticable. What, then, are the implications involved in our principles, if these principles are to be fully realized? Undoubtedly the student of finance will say: A single tax on incomes. Nay, more, an income tax with progressive and differential rates together with a broad application of the principle of exemptions. Nor can one deny the justice of this judgment. More than this, however, is true; for there are not a few economists and students of finance who will grant that under ideal conditions of human life and human relations—when a sound social ethics dominates human affairs—such a system of taxes would most nearly realize the ideal of justice. But we are not dealing with such ideal conditions, and taking the facts as we find them—the sentiments, prejudices and convictions of the people—there can be no doubt but that a single progressive tax on incomes is one of the most visionary of all possible forms of taxation, particularly with respect to the people of the United States.

But after all, is such an implication, or such a consequence, involved in our theory? The main burden of our whole thesis has been to show not only that the tax burden should be distributed according to the ability to bear it, but to show the grounds upon which such a principle rests. True, it was found that the ability is determined in part by income and in part by the needs which that income must satisfy, and

that, therefore, a tax in proportion to ability is necessarily based upon income, though it may be with progressive and differential rates. Yet the fact is recognized (if not before, it is now) that the tax could not be assessed directly upon income for the reason that only under ideal conditions could the income be ascertained. Nay, to attempt to do so under existing standards of social ethics would be to defeat the end sought by imposing, in many cases, regressive burdens. We have before insisted that the principles of justice are relative, in the sense that they must be tested by results. In the same way must we determine their implications. Because under ideal conditions the implications involve certain results it by no means follows that under actual conditions the same results must occur. In other words, because under ideal conditions our principles involve a single tax on incomes, it does not follow that they involve such a tax under the social conditions as we actually find them to be. The main thing is to tax ability by taxing income, which is the only ultimate source of ability; but if this income can be reached and ascertained by the indirect method, this method is the one demanded by our principles. Or if the sentiment of the people is against the direct ascertainment of ability the same conclusion follows. In fact, if we could reach the full income by either method it would matter little which one was employed. We must then employ the one that will give us the most accurate results, the one that will most nearly ascertain the true income. Under present conditions this is believed to be that of the indirect method. Indeed, with a proper system it is believed that ability, so far as it is determined by income, can be ascertained with a fair approximation to justice, and such an approximation is all that can be hoped for in human affairs. And yet the ideal—a tax on income—is not without its value, since it serves as the goal for every indirect system of reaching the income ability of the tax-

payer, for every tax, however assessed, is ultimately a tax on income.

Assuming, then, the above conditions, it remains to indicate the character of a practicable tax system that will most nearly realize the principles for which we have contended. Nor can I do more than to "indicate" such a system. I cannot stop either to elaborate or to defend it. It is believed, however, that the system which we shall propose is not only perfectly consistent with our principles, but is one of which there is hope for its gradual adoption; and when adopted will give a realization to justice in taxation such as has never yet been realized in this country, if, indeed, in any country. It is not maintained that all of the principles would be fully realized, as, for example, the principle of progressive taxation, but that we should attain the nearest attainable approximation of those principles, and at the same time go a long way towards removing the gross inequalities in the tax systems of our several States.¹

Our present thesis, then, is to outline a scheme of taxation that will most nearly reach the full income of the taxpayer and most equitably distribute the tax burden—most nearly and most equitably, I mean, under existing conditions. And this method is believed to be that of the indirect one of reaching income through some index, or through indices, of income. Such an index is to be found in property which, as we have seen, may be regarded either as the source or the consequence of income. And by taking different forms of property we may get several indices, which if wisely selected will constitute a fair basis for the determination of income.

But the problem of an equitable system of taxation is something more than this. It is necessary not only to select such indices as shall be fairly representative of in-

¹ For an outline of a rational system of taxation, see Adams, *Public Finance*.

come, but such as may be most easily and most fairly assessed—perhaps the most difficult problem in the whole field of practical taxation. For if property is to be made the basis, or measure, of income, an honest assessment becomes fundamental to an equality of taxation. And, therefore, very much depends both upon the character of the property taxed and the method by which it is taxed. Moreover, much depends also upon the character of the political unit that taxes the different forms of property. Or in other words, the problem is also one of a distribution of the tax system among the different political units in such a way as to realize the best economic and ethical results.

In brief, then, the problem before us is one of the assessment of property, of the methods of taxation, of the kinds of property to be selected for taxation, and the proper spheres of state and local taxation. We cannot stop to discuss the question of rates or of exemptions. Not the question of rates, because it is admitted that only the proportional rate is feasible for the present; not exemption, because the principle is universally adopted in practice, and we do not feel it necessary to add to what has already been said on the subject. And yet we must acknowledge, that the principle of exemption is not carried out in practice to the extent that our principles would demand, not to the extent that we believe to be justified. Still, as previously pointed out, it must be admitted that the limit, or rather the extension of exemption, is relative to the prevailing economic and social conditions of the people and to the economic needs of the state. But assuming the question of exemptions to be on the whole fairly settled, and the question of rates to be for the present outside of the field of practical discussion, let us attempt to portray in some detail, though briefly, the system of taxation indicated above.

I. ASSESSMENTS

That equitable assessment is one of the most difficult problems in practical taxation is admitted on all hands. It is the crucial point in the investigations of all tax commissions and in all practical plans for the reform of our present methods and systems of taxation. And yet if property is to be made the measure of income—the index of ability—equal assessment is indispensable to justice. Indeed, given an honest assessment of property and the battle for justice in taxation is as well as won. Whether such an assessment may be approximated will depend very largely upon the character of the property taxed and the method by which it is assessed. What, then, are the conditions that are essential for the equal assessment of property?

1. *Declaration versus Doomage.*—Much has been written concerning the relative merits of a declaration by the taxpayer, and doomage by the government. Theoretically the principle of declaration is no doubt the correct one. This follows inevitably from the voluntary character which we found in the relation of the citizen to the state. Yet we found at the same time that there is also a compulsory feature in this relation, which is founded upon the necessity of the state's existence. From the character of this compulsion, founded upon a political necessity, it follows that the declaration should be supplemented by the doomage power of the government. This double feature—declaration and doomage—is the prevailing system of our several Commonwealths, though with some the "declaration," with others the "doomage" is made the key-note of the system. But however much the principle of declaration may conform to the highest ideals of taxation, experience shows that it is not a principle that can be relied upon to attain justice until there prevails a higher standard of social ethics.

No system can be just, either in theory or in practice, that

puts a premium upon perjury by ignoring facts of human nature; that induces perjury on the part of some because of the well-known fact of the perjury of others, perchance with the connivance of officials; that induces perjury because honesty would invite upon one's self a penalty in the form of an assumption of a part of the tax burden that rightfully devolves upon those who have escaped by an act of perjury. It is, for example, within our personal knowledge that an aged widow whose sole means of support is the income from nine thousand dollars loaned on mortgages at five per cent. (a small part at six per cent.), pays a tax of three per cent. because she insists upon an honest declaration; thus paying in taxes more than fifty per cent. of her small income! And this is but one of hundreds of similar instances fostered by the perjury systems of taxation in our various Commonwealths. The iniquity and injustice of such a system cannot be too strongly emphasized. These iniquities should be removed by the adoption of some system that will reach the income and distribute the burden according to the income ability of the taxpayer, and not according to the conscience of the individual.

Such a system, however, is not to be found in the way of a premium upon honest declarations in the form of a lower tax rate on certain forms of intangible property, such as mortgages—a method practiced in Pennsylvania and partially approved by the Massachusetts Tax Commission.¹ For such a method of evoking honest declarations is a species of class legislation that purposely relieves a part of the taxpayers from their proper and just share of the tax burden, only to impose it upon those whose visible property prevents their evasion. True, such a method may evoke a

¹ *Tax Commission Report*, 1897, pp. 88-9. Connecticut has adopted a similar device which the Michigan Tax Commission deems "worthy of most serious consideration." *Report*, 1900, pp. 18-9.

larger sum of taxes upon a given form of property—intangible personalty—than would result from the normal rate upon the declaration (with implied oath¹) of the individual. But such a concession, or purchased honesty, is quite as unnecessary as it is unjust. For if such property must be taxed there are simpler and more rational methods of reaching it. What these methods are we shall presently consider. Here we wish simply to emphasize the fact that equal assessment is the foundation of justice in matters of taxation, and that that system is inherently wrong and unjust that seeks honest declaration by a veiled method of bribery.

2. *Taxable Property.* Before discussing the proper methods of assessments it will be well to consider the kinds of property that should be taxed as most nearly and most adequately representing income, the ascertainment of which is the real aim of the government and the real purpose of the assessment. It follows, therefore, that in the selection of property for taxation two conditions are essential: First, the property selected should be fairly indicative of income, and, secondly, it should be such that its value may be easily ascertained with some degree of truth; for while income is not always proportionate to the value of property, it nevertheless remains true that upon the whole the value is a fair index of income. At any rate the value of property is about the only standard, or measure, of income that we have, so long as it is not feasible to ascertain the amount of income directly. But the justice of such a standard of income depends more than all else upon the equality of the assessment. And this equality, again, depends both upon the kind of property taxed and upon the method by which it is assessed.

As to the kind of property that best measures tax ability, it is the common theory and practice of our several States

¹ The actual taking of an oath is, I believe, rarely required.

that every variety of property is equally indicative, and that, therefore, no form of property should escape assessment. Wagner's devices for reaching every form of property give sanction to this theory. In practice, Ohio has carried the doctrine to very near its extreme limit. The experience, however, in all of our States is a clear demonstration of the utter failure of the attempt to reach ability by any such method. This, indeed, is recognized by most Tax Commissions¹ as one of the most patent evils of our tax systems. The fact is that no form of property can be considered as indicative of income, or ability, of which it is morally certain that only a small fraction can be reached. Hence, for purposes of taxation, only such forms of property should be assessed whose value can be determined with some degree of accuracy; or, better, perhaps, property should be assessed only in such form as lends itself to the determination of its value. This leads us to remark that we believe the principle of multiplicity of taxes to be entirely erroneous, both in theory and in practice. For apart from the impossibility of determining all forms of property, as mentioned above, there are certain types of property that are more accurate measures of income than other types, and tax systems should seek such types if such property can be found and its value can be ascertained. Without stopping to develop this feature, it may be remarked that a "habitation tax," or a tax on house rent, affords an excellent example of what is meant. Such a tax, too, has the advantage that it can be easily ascertained. That, within certain limits, such a tax is a fair measure of income will be generally conceded, since the amount paid for house rent is, in general, proportionate to income. So true is this, that it is recommended by many French writers and by the Italian econo-

¹ As Massachusetts, Ohio, Wisconsin and Michigan. For the opposite view see minority report of Geo. E. McNeill in *Mass. Tax Com.*, 1897.

mist Baer.¹ It is also recommended in the majority report of the Massachusetts Tax Commission.² Still, it must be admitted that house rent as a measure of incomes must be confined to moderate incomes. For the income of the multi-millionaire house rent would be no measure whatever. Such a tax must, therefore, be used with caution. As a single tax, except upon small incomes, such a tax would be most unjust. Indeed, any form of a single tax must work injustice, largely in consequence of the differing effects of shifting and incidence, but partly because of the differing opportunities for evasion.

The multiple tax is also objectionable because of the cost of assessment and collection, thus violating one of the cardinal principles laid down by Adam Smith, and since accepted by all students of taxation. Because, then, of their double injustice—evasions and unnecessary costs—multiple systems of taxation should be avoided. But we have seen that the single tax is also objectionable. Hence a wise system will consist of such a selection of plural taxes as can be based upon forms of property at once indicative of income and of easily ascertainable value. What these forms are will appear a little more in detail as we proceed. But after all, it is, perhaps, not so much the form of the property to be assessed as the method of its assessment that is important.

3. *Methods of Assessment.* The problem of equitable assessment involves two difficult tasks: The discovery of property, and uniformity of valuation. Though a constitutional requirement of most of our states, it is a notorious fact that, with the comparatively few exceptions of "widow's mites," there is not only no pretense at a full valuation, but hardly a pretense at a valuation at a uniform rate. But

¹ Baer, *L'aver e l'Imposta*, p. 32.

² *Report*, 1897, pp. 104-9. In opposition see minority report of McNeill, pp. 153-4.

whatever the "pretense," it is the universal verdict of Tax Commissions, tax officials, and of students of our taxing systems that uniformity of assessments is an unrealized dream, an ideal of the imagination, to say nothing of the total escape of certain forms of property from all taxation. Lack of uniformity of assessment applies to all forms of property, though to some more than to others, depending in part upon the successful intrigue and deception of owners, in part upon the intelligence and honesty of officials; but the complete escape from assessment pertains essentially to intangible property. Let us consider, briefly, each of these problems—the discovery of property and the uniformity of its assessment.

Concerning the discovery of real estate and tangible personal property little or no difficulty arises. The problem, as we have seen, attaches to the discovery of intangible personal property. How, then, is this to be reached? Two methods are possible; Either the compulsory recording of all possessions of intangible property—of mortgages, bonds, stocks, etc.—similarly to the recording of deeds, in order that they may have legal validity; or the taxing of such forms of property by taxing their visible representatives—lands, corporations, etc. With respect to mortgages either method is applicable; only care should be taken to avoid the injustice of double taxation by taxing both the land and the mortgage. If the land is taxed to its full value the mortgage is indirectly taxed and should not, therefore, be taxed directly. But if it is deemed best to tax the land at its full value, less the value of the mortgage, and to tax the mortgage directly, then the mortgage should be recorded that its full value may be ascertained without difficulty, and with only a nominal expense. Other credits could be treated in the same manner, though some forms of personal notes it would seem to be advisable to exempt from taxation and to use other indices of income.

For the taxation of stocks and bonds the only rational and effective method is that which taxes them by taxing the corporation or other property which they represent. Viewed as a tax upon income, as in effect it is, it is the principle of taxing income at its source—a principle extensively practised in the English Income Tax. The extent to which such forms of property escape assessment is too notorious to need specific proof, there being, as a rule, from 80 per cent. to 90 per cent. that wholly escapes taxation.¹ Nor has any effective method yet been adopted, other than the English method, by which the income from such property can be reached for purposes of taxation. The compulsory recording of stocks and bonds would be a decidedly objectionable method, both on account of the expense attending the recording, assessment and collection (the stocks and bonds constantly changing hands), and on account of the practical difficulties of the enforcement of such a method; as where the owner of the stock or bond resides in a State other than that where the corporation is situated, or the stock or bond recorded. On the other hand, it is a simple matter to obtain from corporations the amount of their earnings, of their capital, or of stocks and bonds; and the collection of the tax directly from the corporation has the merit of involving the minimum of expense. It is the absence of a rational system for the taxation of this form of property—the mere pretense of its taxation—that has given to the tax systems of the American States their well-earned opprobrium—begetters of perjury, fraud and injustice. But by the simple expedient of taxing at the source, order and justice may come out of the present chaos and injustice. We shall return to this subject later in another connection.

¹See, for example, Ely, *Taxation in American Cities*; Seligman, "The Personal Property Tax" (in *Essays*); and the Reports of the Tax Commissions of Massachusetts, Pennsylvania, Ohio, Michigan, Wisconsin and Colorado.

We have said that the assessment of tangible personal property and of real estate affords but little difficulty. This, however, is true only theoretically. Being tangible, it is true, indeed, that it is theoretically, nay, in a sense, practically possible to discover these forms of property; yet it is a notorious fact that both forms are very unequally assessed. Particularly is this true of tangible personal property in the form of household goods, but a small fraction of which is reached by the tax assessor. The chief difficulty of reaching this form of property lies in the fact that every home is felt to be sacred from the intrusions of government officials, a sentiment respected by the officials themselves. The result is that the official assessor must rely upon the taxpayer's declaration, a very unsafe criterion as we have seen. Only injustice can result from such a method. The only feasible solution would seem to be the total exemption of this form of property from taxation. And this suggestion will appear all the more rational when we consider that the purpose of taxing any form of property is to reach the income of which the property is but a symbol. True, household goods constitute such a symbol, or index, but only in a very general way, and then only for moderate incomes. But there are other and more certain indices of income which will serve the purpose far more satisfactorily. To obtain substantial justice it is not necessary to seize upon every possible index of income; but, as we have seen, only such as are at the same time most indicative and most easily applied.

The case is quite different with real estate. This is upon the whole (though there are exceptions) a just index of income, and there are neither sentimental nor technical reasons against its assessment. The problem here is essentially one of the intelligence and honesty of the assessor, his ability to estimate the value of property and to withstand the

temptations of bribery. Nor is this difficulty confined to real estate. Precisely the same difficulties are to be met with in the assessment of corporations, particularly railroad corporations.¹ In the case of real estate, it is the requirement of most of our States that it shall be assessed to the full extent of its value, though it is not uncommon to find it assessed, even within the same city, anywhere from 40 per cent. to 75 per cent. of its value.² Such an inequality of assessment is most unjust in its effects, being equivalent, in extreme cases, to the imposition of a tax upon some greater by 100 per cent. than the tax upon others. And, by the way, we need only to call attention to this intentional undervaluation of real estate to emphasize the gross injustice of taxing the poor widow's mortgage or bond to the full amount of her honest declaration. And yet there is a rational ground for the sixty per cent. valuation—that by decreasing the amount of the tax valuation, with a consequent increasing of the tax rate, there will result a tendency to check extravagant appropriations and squandering of the public funds. But whatever the basis of the assessment it should be uniform. The real difficulty, however, is to obtain an equal assessment of all property on any accepted basis, of real estate as well as of other forms of property. Yet the taxation of real estate is demanded on political, economic, and ethical grounds.

¹ In the decennial appraisalment of Ohio in 1900 the railroad property in many counties was assessed at about 12 per cent. of its value. Notably was this so in Cuyahoga county (Cleveland). This condition was made possible by a vicious system of appraisalment (by county auditors) which lent itself to a system of indirect bribery through the grant of railroad passes to the assessors—the auditors.

² Such was the fact in the appraisalment of real estate in Cleveland in 1900, as the writer was reliably informed by a real estate owner who made personal inquiries of the different assessors. It was within the personal knowledge of the same authority that in the assessment of 1890 large owners of real estate got low assessments by bribing the assessors through a third party.

What, then, is the solution of the problem—*i. e.*, of uniform and honest assessments? The remedy lies very largely with the taxpayers themselves. For first and foremost is the necessity of honest and efficient assessors,¹ without which any system of taxation may be made to work injustice, while with them any systems in themselves defective may be made to realize substantial justice.² But while very much depends upon the character of the assessors, the methods of assessment are also of much importance. For however honest and intelligent the assessors, there can be only a chance equality of assessment, unless there is some common basis for the determination of values and some common agreement for the percentage of valuation. What method will best accomplish the desired result we cannot stop to discuss. We may note, however, that it lies in the direction of a more centralized control of assessments, the degree of centralization being determined by the character of the property assessed: the taxing area for real estate being the township, county or city; that for railroads and other corporations the state. There should also be fixed and uniform rules for determining values and a rigid enforcement of some fixed percentage of valuation. But so long as the matter rests very largely upon the judgment of individual, local assessors, the pretense of justice becomes a farce. With some such system as suggested, and with intelligent and honest assessors, a fair approximation of justice may be attained. But the methods of assessment are closely allied with a system of taxation, to which let us next turn our attention.

¹ See last note.

² Cf. Report of Professor Bolles in *Report of Pennsylvania Revenue Commission of 1887*, p. 157.

II. THE TRUE TAX SYSTEM

In the preceding discussion it has been pointed out that a just system of assessment involves a direct assessment by the taxing authorities, a consequent wise selection of the kinds of properties to be taxed, and methods of assessment that shall reach all assessable property equally. Without stopping to discuss these methods in any detail it was indicated that they should be such as to eliminate, as far as possible, any personal factor within the same taxing political unit—eliminate, that is, the individual judgments of different assessors as well as the personal declarations of the assessed; thus diminishing, on the one hand, bribery and corruption, and, on the other hand, deception and perjury. It was also pointed out that in the choice of taxable property three things must be considered: The indicativeness of the property as a measure of income—the ultimate source of all taxes; and the readiness with which the taxed property lends itself to equitable assessment; and finally, that this readiness, or equality of assessment (and, we may add, of taxation), depends very largely upon the tax system; or, in other words, upon the kind of taxes and the methods of taxation, and the distribution of the different taxes among the different political taxing units.

With, then, a wise system of taxation—a proper choice of subjects and methods, and a proper distribution—it is believed that much would be accomplished in the way of removing the glaring absurdities and inequalities of present methods, and for the practical introduction of the principle of "equality of burden" as based upon "ability," so far, at least, as ability is measured by income. A brief consideration of such a system, which we must confine to the barest outline, will supplement our remarks upon assessment, and at the same time point out what we believe to be a rational system of taxation that will at once realize substantial jus-

tice in taxation and come within the realm of the practicable—essentially conform to the ideals of justice and to the requirements of practical application. Let us consider, then, the outline of such a system.

1. *Subjects and Methods of Taxation.* We have already indicated the principles that should determine the choice of subjects—*i. e.*, of property—for taxation, and also the relation which this choice bears to equitable assessments, which will appear further as we proceed. Our present purpose is to give an outline of the more important subjects for taxation that will realize the requirements of these principles. No attempt will be made to weigh the pros and contras of different kinds of taxes. Our aim shall be positive and constructive, rather than negative and by elimination. Yet we may again emphasize the fact that no rational system of taxation can contain a “general property tax” which treats alike taxes on real estate, on tangible, and on intangible property. Nor is it necessary to add to what has already been said in justification of this conviction. We shall, therefore, assume the abandonment of the “general property tax,” as such, in compliance with the logic of experience and the all but universal opinion of expert testimony.¹ This, however, does not imply that some forms of property are to escape taxation altogether. On the contrary, so far as they are proper subjects for taxation they will be taxed equally (at least more equally), and will be taxed in fact and not merely in name, but under a different name and by different methods than those now in vogue.

The system of taxes which we have in mind may, perhaps, best be outlined by a consideration of taxes on consumption, on real estate, on personal property (tangible only), on mortgages, on corporations and on inheritances; though special assessments, fees and fines should have their place

¹ As Dunbar, Tansig, Seligman, Adams and Ely.

in the system. These, however, have for their purpose local improvements, special benefits, or penalties and must, therefore, be passed over in a scheme for general taxation based upon ability.¹

(1) *Taxes on Consumption.* If it were true that all incomes are spent in personal satisfactions and enjoyments there would be much to be said for the contention of Sir William Petty: that "a man is actually and truly rich according to what he eateth, drinketh, weareth, or in any other way really and actually enjoyeth;" and that, therefore, "every man ought to contribute according to what he taketh to himself, and actually enjoyeth."² But such a condition of things would be true only under the circumstance that the total income was spent in this manner, a circumstance that, as a rule, would happen only with moderate incomes. Indeed, with the enormous development of savings banks and other means for making small investments—stocks, bonds, etc.—it does not apply universally to even moderate incomes. And yet with moderate incomes (especially with the more moderate incomes) expenditure is a very fair index of income, and a tax on expenditure a very fair approximation to justice. But such a tax would reach only a fragment of the larger incomes, and hence is objectionable as a single tax; and, besides, has the further objection that there are many technical difficulties in the way of its execution, so far as there should be an attempt to reach every possible form of consumption.

But while there should be other forms of taxes to reach the parts of income that do not find their way to personal "enjoyments," a tax on consumption is a legitimate and

¹ For a full report of these sources of revenue see Seligman, *Essays*, ch. ix. For criticism of Prof. Seligman's "special assessments" and "fees," see Bastable, *Public Finance*, pp. 153-6.

² Petty, *A Treatise of Taxes and Contributions*, p. 83.

necessary part of every tax system that seeks to reach income by the indirect method, since in all cases consumption does afford some index of income; in many cases a fairly perfect index. But such a tax should be applied indirectly, as by customs duties, taxes on manufactures and corporations, and taxes on real estate—lands and houses—not only to realize economy in assessments and collections and the Smithian canon of “convenience” in time of payment; but also to avoid any possible antagonisms that might arise on account of the strong popular sentiment against personal inquisitions on the part of the government, as a violation of individual liberties. Such a tax, too, lends itself very fittingly to the higher taxation of larger incomes by means of heavy taxes on articles of luxury. To carry out this purpose, however, would require the non-taxation of articles of necessity with a constantly increasing rate for articles of decreasing necessity. But it must be admitted that no such scientific system is possible with protective tariffs.

But though it may not be possible to realize the ideal system of consumptive taxes, they should form an essential feature in any tax system; not only for the reasons given above, but also for political reasons. For though a direct tax is important as tending to stimulate an active interest in the government, and to check extravagance in expenditures, an attempt to raise all public revenue from direct taxation would result in social revolution, or a niggardliness that would effectively cripple the government in the performance of its functions. For, however much we may philosophize about taxes, there is much truth in the statement made by Mr. Buck, of Kentucky, in the early debates in Congress on the subject of taxation: That “taxes are always disagreeable, and it is with reluctance that people consented to pay any, except they saw advantage arising from the payment of them greater than to counterbalance the evil of pay-

ing." ² Hence the importance of supplementing direct taxes with indirect taxes, particularly in the taxing system of a national government. It is not less true that the indirect tax should be supplemented by direct taxes; in part to offset the uncertainty of the incidence of indirect taxes, in part because of their greater certainty and economy, and in part because of their direct relation to the government. Most important among these are property taxes and taxes on inheritances. We omit the income tax because of its admitted impracticability. Let us briefly consider the property and inheritance taxes viewed as essential parts of a good tax system.

(2) *Taxation of Real Estate.* The taxation of real estate is theoretically simple enough. It is one of the oldest, as well as the most universal, of all taxes. Indeed, the fact that real estate is a source of income, cannot be hidden from the assessor, and has an immediate relation to and dependence upon the expenditures of government, makes it a peculiarly fitting subject for taxation. And yet, as we have seen, under present systems there is no guaranty of an equality of assessments and of burdens, either between individuals or between different political units. Nor, for the former inequality, is there any effective remedy other than the adoption of a uniform basis for assessments, a larger use of official records—deeds, bequests, mortgages, etc.—and the choice of men of character and intelligence for assessors; while the remedy for the latter inequality—that between different political units—is to be found very largely in an entire rearrangement and readjustment of the tax system, on the basis of greater fiscal independence of the different political divisions within the same system of government—a question which will come up for consideration later.

Upon the justice of levying upon real estate for purposes

² *Annals of Congress*, 4th Cong., 2d Sess., p. 1862. Cf. also speech of Mr. Richardson, of Tennessee, 14th Cong., 1st Sess., p. 84.

of public revenue there is no difference of opinion. It conforms to the ideal of taxation according to ability, since the value of real estate is determined very largely by its income-producing power, if we omit the exceptional cases of the speculative holding of land. With this exception, it is in the main true that land, buildings and machinery, and dwelling houses have their value fairly represented in the capitalized amount of the income derived from them. Hence, omitting as we do in the present discussion the question of progressive and differential rates, a tax based upon the valuation of such forms of property is a fair approximation of a tax based upon the derived income, and so likewise a fair approximation of justice. That such taxes may and do become, in part at least, taxes upon consumption does not lessen their effectiveness or their justice. With a rational and stable system of taxation, the burden will adjust itself fairly in the long run. To this end, however, it is important that other forms of property should be reached.

(3) *Taxation of Personal Property.* A sound and just system of taxation must include taxes whose ultimate incidence shall bear upon productive personalty, as well as those that bear upon productive realty. To reach personal incomes it may be necessary, also, to tax some forms of unproductive personalty; unproductive, that is, to the consumer in the sense that Adam Smith used the term. Indeed, such taxes are taxes upon consumption, which have already been sufficiently considered. Yet we may perhaps add, that to us there is some question whether household goods should not be exempted from taxation; not only because they are at best but very roughly indicative of income, but because such a tax must always be upon but a nominal part of the total amount, and that, too, in very unequal portions; must, that is, so long as public sentiment remains as it is concerning the sacredness and privacy of the home.

Moreover, there is little of a scientific character in a system of taxation that places unproductive personalty, which is only roughly indicative of income, upon exactly the same basis as productive property.

On the other hand, such forms of tangible personalty as farming implements and live stock may well be included in the tax system, not only as indicative of income but as also productive of income; while they are at the same time easily assessable; in fact, for the reasons just given, tangible personalty in general should be included in any well rounded system of taxation, and taxed in the same direct manner as realty. The same cannot be said of intangible personalty. As already sufficiently shown, every attempt of this nature leads to the grossest inequalities (to say nothing of perjuries), while its enforcement is a practical impossibility; this impossibility, indeed, being the occasion of the inequalities. Some other method than the direct one must, therefore, be found for reaching the income that has its source in this form of property; or, rather in the forms of property that stand back of and are represented by the intangible forms—mortgages, stocks, bonds, etc. Such a method, and indeed the only practicable method, is to be found in the taxation of this class of income at its source. In this way alone can evasion be avoided and the burden equitably distributed. As the form of property under consideration is most largely represented by mortgages and by stocks and bonds, we may consider briefly the best method of taxing these at their source, which will indicate the true method of taxing the income from all forms of intangible personal property.

(4) *Taxation of Mortgages.* The proper method of taxing mortgages has, perhaps, been sufficiently indicated in our discussion of methods of assessment. Either the real estate, which is represented by the mortgage and is the source of its income, should alone be taxed, leaving mort-

gagor and mortgagee to make the proper adjustment of interest; or, if the mortgage is taxed, the tax should be based upon a compulsory court record, similar to the recording of deeds. At the same time, the amount of the mortgage should be deducted from the value of the real estate that is back of it, according to some such methods as those in vogue in Massachusetts and California.¹ There is but one source of income, and therefore but one source of ability. Hence, to tax both the land and the mortgage is to inflict the patent injustice of a double taxation on that part of the income from land that goes to pay the interest of the mortgage. The better method would seem to be to tax the land and exempt the mortgage, since the land is the direct source of the tax-paying power. Certain it is, at any rate, that the present methods of taxing mortgages are open to so many possibilities of evasion that only the most flagrant inequalities can result, the amount of the mortgages taxed being directly proportional to the sensitiveness of the consciences of the mortgage holders.

(5) *Taxation of Corporations.* A still more important form of intangible personalty is to be found in corporate stocks and bonds, whose income-producing power is to be found in the corporation. In fact, the net earnings of corporations are, in the main, distributed to the holders of these stocks and bonds. If, then, we levy a tax upon the net earnings of a corporation, we thereby impose a tax upon the incomes of its stocks and bonds at their source. The ease with which the imposition of such a tax may be effected, and the unquestioned impossibility of reaching this class of income by the direct method, make the method of taxing at the source the only rational and scientific method of taxing income of this character.

¹ See *Report of Massachusetts Tax Commission, 1897*, p. 7, and Plehn, *The General Property Tax in California* (Economic Studies of Am. Econ. Ass.), pp. 126-7 and 142.

The principle of taxing incomes at their source is now very generally recognized by economists to be the only sound principle of public finance. This is done in the case of real estate, and it is believed that the same principle should be applied in the taxation of intangible personalty. Not only is this the most practicable and most effective method, but it is the most economic, entails the least inconveniences, and is the most equitable in its results. By eliminating the intangible forms of property and the personal equation in assessments, evasions would become practically impossible; while by reaching the whole income there is secured a uniformity in the distribution of the tax burden. And since such a tax necessarily bears upon individual incomes, it meets the ethical requirement of the imposition of a tax upon the source of ability.

Granted, then, the principle of taxing the incomes from stocks and bonds at their source, and that individual tax ability—so far as conditioned by such holdings—is reflected in the corporate ability—*i. e.*, in the corporate net income—the question arises: How, or in what manner, may this corporate ability be most effectively and most efficiently reached? Our answer to this question must be very brief, and somewhat dogmatic. The problem of the taxation of corporations is too large and too complex to be treated with any fulness in the closing chapter of a treatise on the principles of justice in taxation.¹

Thirteen different methods are given by Professor Seligman for taxing corporations.² These are reduced to three by Professor Adams: as based upon property, upon the volume of business, or upon earnings.³ Both, however,

¹ For a thorough treatment of the subject see Seligman, "Taxation of Corporations," *Essays*, ch. 6, 7 and 8. For an excellent brief statement see H. C. Adams, *Public Finance*, pp. 446-466.

² Seligman, *op. cit.*, pp. 177-9.

³ Adams, *op. cit.*, p. 454.

agree that the true measure of corporate ability is to be found in the net income of the corporation; and it must be evident that there can be no other standard. The limitation made by Professor Adams in the case of railroads: that the tax should be based upon the net "income from operation," is important only in calling attention to the fact that double taxation should be avoided in the case of leased corporations.¹ Undoubtedly, if the leased corporation is taxed, the basis of a corporation tax should be the "earnings from operation;" but if only the operating companies are taxed, the basis of the tax should be based upon the total net income. In any case the taxable net income should include the gross earnings, minus operating expenses; but not deducting the outlay for interest, rent, taxes, or improvements.²

Accepting, then, corporate net income—not the net income to stockholders and bondholders—as the true basis of corporation taxes, it does not follow that the desired end can be reached best, in all cases, by imposing the tax directly upon the net income. Whether or not this is the best method must depend upon the practical possibility of uniform and fixed rules of accounting. But according to Professor Adams,³ such a system of accounting is practicable. We may, therefore, accept the net income basis as, upon the whole, affording both the best theoretical and best practical basis for corporate taxation. But if in any particular case such a method is not practicable, we must agree with Professor Seligman that a tax based upon the market value of stocks and bonds will most nearly realize the ends of justice, being, besides, "certain and simple of enforcement."⁴ It is only, or chiefly, because the market values of stocks and bonds are not always determined by their net

¹ Adams, *ibid.*, pp. 460-1. Cf. Seligman, *Essays*, p. 199.

² Cf. *ibid.*, p. 461.

³ *Ibid.*

⁴ *Essays*, p. 212.

incomes, that this method of taxing corporations is not always the most just, as it is the most simple.

The correct determination of the basis of assessment, however, is by no means the least difficult problem in the taxation of corporations. There would, indeed, be little difficulty if the tax were aimed at the corporation *per se*, or if stockholders and bondholders lived wholly within the tax area of the corporation. But from our present view-point, the subject of the tax is not the corporation, but its individual stockholders and bondholders; who, moreover, are scattered throughout various areas of taxation. Yet theoretically, at least, the problem is easy of solution. For all that is necessary is that there should be, among the different commonwealths concerned, a uniformity in the methods of taxation, based upon a common agreement respecting the taxation of resident holders of stocks and bonds of foreign corporations, and of foreign holders of the stocks and bonds of domestic corporations.

The only ethical or logical basis for such agreement is, that each commonwealth should tax only such portion of the net profits as are earned within its borders; this portion being determined, for practical reasons, on the basis of mileage, gross earnings, amount of business, or capital within the commonwealth, according to the nature of the industry. In other words, the net income taxed within a given commonwealth should bear the same proportion to the total net income that the mileage, gross earnings, etc., within the commonwealth bears to the total mileage, or gross earnings, etc. The assumption here is, that the net income within any area is proportional to the mileage, earnings, business or capital within the same area; and if the choice of these methods is wisely made, according to the character of the corporation, substantial justice will be attained, though only if there is uniformity throughout all of the commonwealths.

Such, in brief, is the ideal of corporate taxation, as a means of reaching the individual abilities of stockholders and bondholders. Practical obstacles in the way of state constitutions, and the uncertainties of "politics," do not, however, promise a speedy realization. Nor does this doubt grow less when we contemplate the fact that not one of the American States has ever adopted the recommendations of its various expert Tax Commissions. Nevertheless, the practice in some of the states is evidence of a tendency in the right direction.¹ But for some time, at least, we shall have to put up with the injustice of double taxation; an injustice that is, perhaps, very largely nullified in the fact of extensive evasions under present methods of taxing stocks and bonds.

(6) *Taxation of Inheritances.* Concerning the inheritance tax we may be very brief. It is now very generally justified and very generally adopted. We may consider it from two points of view: That of the decedent and that of the heir. Viewed with respect to the ability of the former, a tax upon the inheritance must find its justification in the assumption that past taxes have been evaded, but have held a permanent lien upon the property. While there is much ground for this theory,² it applies only to personal property, and even then is but the crudest approximation to justice, since the amount of the evasion is an incalculable quantity.³

The more correct point of view, however, is undoubtedly that of the heir, or legatee. And from this viewpoint the justice of the tax is to be found in the increased ability arising from the inheritance, or legacy. According to both

¹ For examples and a fuller discussion of the interstate taxation of corporations, see Seligman, *Essays*, pp. 223-254.

² A lady in New York, the sole heir to her father's estate, told the writer that her father never paid a personal property tax, though at the time of his death he held stock in ten different banks.

³ Cf. Seligman, *Essays*, p. 131.

Professor Seligman and Doctor West, this ability arises from the fact that the inheritance should be regarded as an "accidental income"—measuring ability like other incomes—and the tax as an "accidental income" tax.⁴ This is no doubt the true attitude to take in the case of small inheritances that are spent in the manner of regular incomes. But to us the argument is not so evident with respect to the inheritance of productive property, from which there is the enjoyment of only the annual income. From the viewpoint of income, the ability of the heir is increased, practically at least, only by the amount of the increase of his annual income; and, theoretically, this increased ability should be reached by progressive rates, if not also with differential rates on account of the source. Certainly, from the viewpoint of the government, there has been no increase of social ability, because no increase of social income; but only a transference from decedent to heir.

True, there is a sense in which the whole inheritance may be regarded as a gratuitous and "accidental" income, therefore increasing by its full amount the ability of the heir. If this is the correct view, then, logically and justly, this income should be treated like other incomes of the same class. If this is the only basis and justification of the tax, there should be the same principle of rates that is applied to other incomes, no allowance being made for degrees of relationship. But this is seldom advocated in theory, and is nowhere applied in practice. If, indeed, this theory be true, then are the existing arbitrary rates and distinctions of relationship both illogical and unjust. The fact that they are both justified and practiced is evidence that the "accidental income" theory is, at least, not the only consideration in the inheritance tax. The theory at least assumes that the true tax principle should here be deviated from on grounds of policy or

⁴ Seligman, *Essays*, p. 132, and West, *The Inheritance Tax*, p. 118.

sentiment. Whatever truth, therefore, there may be in this theory of the inheritance tax, it is not a theory that permits of logical application in practice. It needs, too, to be supplemented by other considerations.

We shall not attempt, however, to discuss the various theories of the inheritance tax—cost of service, value of service, co-heirship, escheat, etc. All of them, as Dr. West says, contain some element of truth, and therefore to that extent afford some justification for the tax. Not only is this tax justified on theoretical grounds, but it has also the practical merit of being difficult to evade, and of occasioning little disturbance of industry; besides being less oppressive and less reluctantly paid than most other taxes. Viewed in all of its aspects it forms a necessary adjunct to any scientific system of taxation. We cannot, indeed, quite agree with the implication in the statement of Dr. West that "no tax is better adapted to replace the antiquated personal property tax,"¹ since this implies substitution. The true substitute for these *antiquated* taxes lies, as we have seen, in the direction of a tax on corporations, though the inheritance tax (on personal property) may well be used as supplementary to the corporation taxes.

In the above outline of a system of taxation no attempt has been made to exhaust every legitimate source of public revenue, but only to indicate the main features of a scientific system that will most nearly conform to the theoretical principles of justice—a tax based upon ability, so far as this ability is measured by income. We have omitted a discussion of rates, because, as we have said, we believe that under the prevailing sentiment on this subject this is not, in this country at least, a practical question, though without the progressive rates the highest ideals of justice in taxation must remain unattainable. Of the principle of exemptions

¹ West, *op. cit.*, p. 132.

we need only to say that it is fairly well realized in practice, though, as previously pointed out, we believe that there should be further extensions of the principle, at least in some cases, in order to correspond to the progressively higher standards of living. There is, however, another question of great practical importance, which, because of its immediate bearing upon the execution of such a system as that outlined above, is, indeed, an essential requisite to such a system, and therefore should constitute a vital part of it. I refer to the separation of state and local taxes, which let us in conclusion briefly consider.

2. *State and Local Taxation.* The importance of the separation of national, state, and local taxation is another of those financial questions upon which there is now very general agreement.¹ This granted, the question arises: On what basis should the distribution of taxes be made? According to Professor Bastable it cannot be made on the ground of a difference of governmental duties, since there is no correlation between these duties and tax systems. Hence the distribution must be made on financial and economic grounds.² This is, no doubt, in part true. But in this country, at least, it should be modified by the more correct view of Professor Adams: That "a government should select for purposes of taxation those industries with which it holds some fundamental or constitutional relations."³ In other words, while financial and economic conditions are important factors in determining the political distribution of taxes, the governmental relation to the industry taxed is, perhaps, of prime consideration. Indeed, it is this relation that very largely determines the financial conditions. The principle may be best illustrated by calling attention to the

¹ For a very good treatment of this question see Adams, *Public Finance*, ch. 7. Cf. also Bastable, *Public Finance*, iii, 6.

² Bastable, *op. cit.*, pp. 367-8.

³ Adams, *op. cit.*, p. 493.

more important taxes that should be assigned to national, State and local revenue.

(1) *National Taxes.* The revenue system of our national government is so thoroughly established that there could be only a speculative interest in a discussion of possible reforms. At the very outset the policy was adopted of relying solely upon indirect taxes, leaving all direct taxes for the States. At first it was thought that sufficient revenue could be obtained from customs duties, but it was very soon learned that they would be inadequate, and so excise duties were added. Only twice have direct taxes been resorted to, and with the exception of war periods customs and excises (on spirits, malt liquors and tobacco) have been, and promise long to remain, the chief source of national revenue. Nor is this without much reason. For, as Professor Adams shows, not only do they meet his requirement in the governmental selection of taxes, but they also give realization to the important fiscal principle of *permanence* of government revenue. To realize the other important principle—that of *elasticity*—Professor Adams would have a national tax on interstate commerce. However desirable such a tax may be, there would seem to be little chance of its adoption in the near future.

The national system of indirect taxes is not without other important merits. For, however desirable it may be, from a theoretical point of view, that the citizen should pay a direct tax, in order to emphasize his responsibility to the government and make him watchful over expenditures, there can be no doubt, as we have seen, but that a dependency upon a direct tax would greatly cripple the efficiency of the government. Moreover, the rather indirect relation of the citizen to the national government, at least his remoteness from its operations, goes far to justify the indirect tax for national purposes. Again, if we suppose the tax to retain anything of

permanency it will be found, in the long run, fairly to distribute the burden according to ability; so far, at least, as ability is determined by consumption.

(2) *State Taxes.* For the same reason that customs duties and excise taxes were assigned to national revenue—that of the peculiar relations of the industry taxed to the government—there should be assigned to State revenue the taxation of corporations and quasi-public monopolies. Being dependent upon, and under the regulations of, the State governments, there is a peculiar fitness in their taxation for the purposes of State revenue. Such a tax would be difficult to evade, and would have the fiscal importance of being easily and economically collected. At the same time it would meet the requirements of permanence and elasticity. Moreover, under conditions similar to those assumed in the case of customs and excises, there would be a fair distribution of the burden.

To these taxes might also be added the inheritance tax. Certainly, upon the principles set forth above, the inheritance tax does not properly belong to the system of national taxes. So far as the inheritance tax is regarded as a fee for cost or value of service in the transference of property, it belongs more properly to county taxes; but so far as regarded on the principle of escheat, of co-heirship, or of guaranteeing the right of inheritance, it is very properly a State tax. As grounded upon the idea of compensation or of ability, it should be distributed between State and local governments. On the ground of the dependence of the inheritance upon, and its control and protection by, the government, the inheritance tax belongs, again, more properly to the system of State taxes. On fiscal and economic grounds there is also reason for this disposition of the inheritance tax. Upon the whole, the inheritance tax should go into the State revenue, except, perhaps, such portion as might be necessary for the

probate fees, or other expenses incidental to the conveyance. But we fail to see any good reason why this tax should be assigned to any specific purpose, such as State education, as suggested by Professor Adams.¹

With these two sources it is believed that ample revenue would be supplied for all of the necessary expenses of the State governments. As Dr. West says: "The experience of New York with the inheritance tax and the experience of a number of States with corporate taxes show that by these two methods of taxation alone most, if not all of the State governments, could pay all of their expenses, leaving all taxes on property to local political divisions."²

(3) *Local Taxes.* We have left, then, for local taxation, land, houses, manufacturing plants and real estate generally; also tangible personal property and municipal licenses and franchises. Since county expenses are mainly devoted to the improvement of roads and bridges, which add materially to the value of the surrounding lands, it is very fitting that a land tax should constitute the chief source of county revenue. For township purposes there is the tangible personalty and real estate, including the real estate of corporations. While for municipal expenses we have, in addition to the property taxes of townships, municipal licenses and franchises—such as those of street railways, water works, lighting plants, etc. A special justification for this assignment of local taxes is not needed, since it is directly involved in the principles of distribution of national and state taxes. If further justification were needed it might, perhaps, be found in the fact that in local taxation, as distinct from national or state taxation, there is some justification in the application of the benefit principle as a basis of taxation. It may be added, too, that with such a system of local taxes, where each political unit is fiscally inde-

¹ *Op. cit.*, p. 505.

² *Op. cit.*, p. 132.

pendent, there will be an end to the evil of political units shifting their burdens upon each other by undervaluations.

The above outline of what is conceived to be a rational system for the political distribution of taxes, it must be admitted, is not wholly free from arbitrariness. For in spite of the more or less clearly marked political divisions, the parts of our federal system are so intimately connected, and so closely interdependent, that the relationship of the citizen to one of the units involves his relationship to each higher and lower unit in the system. There is, nevertheless, a difference that is substantial enough for forming a legitimate basis for a political division of taxes. If our division is in contradiction with any of our previous principles, it is with that principle which declares that ability is the only true basis of taxation, for the division is apparently very largely based upon the principle of benefits. As to local taxation, it is admitted that there is some validity in the benefit principle. But carefully examined it will be seen that the contradiction is little more than an apparent one.

There can be no doubt but that it is the fundamental thought in taxation that every individual should contribute towards the support of the political units with which he stands in some direct relation, and should contribute according to his ability. That such a result would follow from such a system of taxation as that outlined in the present chapter, taken in connection with its political distribution, we believe that a careful analysis of probable results would make sufficiently clear. But even though it may not give realization to theoretical principles in every particular, it offers so many practical advantages—realizing uniformity and equality, as well as having political, economic and fiscal advantages—that it may well be considered as offering the highest form of the practical ideal; at the same time that it conforms substantially to the theoretical ideal. The effect

of such a system ^{629]} in the ~~elimination~~ ^{PRACTICAL JUSTICE IN TAXATION} of those personal and political factors that are the source of so much inequality—fraud, corruption, undervaluations, evasions, etc.—would go far to promote the conditions of an ideal equality, the ends of a complete justice.

Finally, there are hopeful signs that such a system is not always to remain a mere fiscal ideal. The abuses and inequalities of present methods are becoming so flagrant that political parties are being forced to take cognizance of them and to consider remedies for the solution of the evil.¹ Normal schools in the United States and other countries.

The second group hold that the most effective results are Nevertheless, the ideal is far from attainment. This is made inevitable on account of the great number of our states, their varied economic conditions, and the natural conservatism of political parties. But until some such system as that outlined in the present chapter is put into practice, we can hope for only makeshift reforms. With such a system once in operation we shall, at least, have taken a long step toward realizing the ideal ends of justice in taxation, and shall have attained a close approximation to justice, which is all that can be hoped for in human affairs.

¹ In the State campaign in Ohio, in the fall of 1901, Mr. Tom L. Johnson, in behalf of the Democratic party, made the issue upon the equalization of taxes. The present writer took occasion to write a letter for a Cleveland paper, briefly advocating the system set forth in this chapter. In reply, letters were received from the leader of the Republican party and from Mr. Johnson, while a Demo-

ERRATA.

Page 97, Note 1, for 73 read 86. Note 2, for 75 read 88.

Page 104, Note 3, for 88 read 101.

Page 131, Line 15, for "change" read exchange.

Page 134, Note 1, for 43 read 56.

Page 140, Note 2, for 92 read 104.

Page 141, Note 2, for 53 read 66, note 2.

Page 160, Note 1, for 63 read 77.

Page 161, Note 1, for 109 read 121.

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