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Taxation According to "Ability to Pay"

What It Means and What Is Wrong With It

WHEN IT IS PROPOSED that the annual rental value of land, geologically produced and community produced, be made the first source of public revenue, those who are implacably opposed to this reform present a variety of objections. Among these is the contention that such taxation would operate to the relief of the owners of capital, such as buildings, and to the relief of the recipients of large salaries, and that both classes "ought" to be required to pay appreciable—even large—sums in taxes.

Before discussing at length the major principles involved, it may properly be pointed out that to appropriate most of the rent of land to community needs does *not* necessarily mean the abolition of all other taxes. We can, therefore, combine with such heavy land-value taxation, *if we want to,* especially heavy taxes on the largest salaries, even though these are fairly earned by skill and hard work, and similar heavy taxes on the capital (or the income from it) of those who have a great deal of capital, regardless of how hard they may have worked to acquire it. We can use the revenue from an increased land-value tax, *if we want to,* for the purpose of lightening the tax burden only on the incomes of those who earn *low* wages (or "salaries"), on the capital of those who have but *little* capital and on commodities (*e.g.,* cigarettes and goods subject to a general retail sales tax) which are bought in considerable degree by the comparatively poor.

Nevertheless, it is highly important to emphasize the fact that the economic philosophy of these objectors is altogether different from that of advocates of the public appropriation, by increased taxes, of land and site rent. These objectors to the land-value tax program are little interested—indeed, one is inclined to believe that most of them are not at all interested—in the *source* from which the taxpayer's income is derived. They are much more concerned with taxing heavily *large* incomes, however fully and fairly earned by service given to those from whom the incomes, in the last analysis, are received than they are concerned with taxing incomes which are not earned at all by any service rendered in return. That some should be able to derive incomes by charging others for *permission* to work on and live on the earth, in those locations where work is relatively effective and life relatively pleasant, does not especially disturb them. What disturbs them is, rather, that some persons have appreciably *larger* incomes than other persons. And this appears to disturb them just as much when such larger incomes are received in return for equivalent service rendered as when they are purely exploitative.

I

PERHAPS IT WILL HELP to bring home to the reader the principle involved in this controversy if we suppose a country where there is private ownership of seas, rivers, lakes and air and where, therefore, a large part of the people have to pay rent to the owners of such "property" for the *permission* of the latter to *transport* goods on—and to row, fish or swim in—the seas, rivers and lakes and to *breathe* the air. Suppose, then, an effort to bring it about that the rents paid to use seas, rivers, lakes and air—which the "owners" never themselves brought into existence—should be the first source of public revenue and, therefore, used for the benefit of all. Immediately it is objected that this arrangement might relieve of taxation some persons whose incomes, though fully earned by the rendering of equivalent service in return, may nevertheless be larger than the incomes received by some of the poorer owners of sections of seas, lakes or rivers or some of the owners of small amounts of the country's air or some not very prosperous owners of very small lakes!

Such concern over the inequality of income resulting from inequality of contribution, together with comparative indifference to the problem of exploitation, is nearly identical with the attitude of those who urge charity to aid the poor but have no interest in *justice*. If, having understanding minds as well as sympathetic hearts, we were willing really to establish substantial justice—in the sense that incomes were received henceforth for services rendered and not through chicanery, monopoly, slavery *or* charging men for *permission* to use the earth—there would certainly be much less need for charity.

Those who express such great concern lest sizable *earned* incomes be somewhat relieved of taxation by making the rent of land a first source of public revenue are probably, in general, adherents of the "ability theory" of taxation. They believe that taxes "ought" to be levied on a basis of "ability to pay."

The idea of basing taxes on ability to pay grows out of the fact that a dollar has less significance to a person who has many dollars than to one who has few. To a person whose income is already large an additional dollar means only the ability to buy some inconsequential luxury. In the case of a person whose income is very small, on the other hand, the lack of a single dollar of it may mean deprivation of sufficient food, clothing or other necessity. The contention is made, therefore, that taxes on the larger incomes involve less "sacrifice" from the taxpayer than taxes of similar amounts on the smaller incomes and that taxes on the larger incomes should be greater.

But how much greater? So far, the notion that taxes should be based on "ability to pay" is vague. How much more "ability to pay" goes with a $50,000 income than with a $2,000 income?

Here we need to consider two somewhat divergent branches of the "ability" idea. One is that taxes "ought" to be so levied as to impose "equal sacrifice" on the different taxpayers. The other is that taxes should be so levied as to impose the *least aggregate* or *total* sacrifice.

Individuals differ in needs, tastes and desires, and so we cannot be certain that two persons of equal incomes will be undergoing equal sacrifice if they are equally taxed. However, it is evidently assumed by those who hold the "equal sacrifice" philosophy that for practical purposes we are not to bother with individual tastes and habits but only with differences of income and of relatively necessary expense (such as the expense imposed by dependents). Then, presumably, a rough guess would be made regarding "equality" of sacrifice. Such a guess might be, for example, that an annual tax contribution of $15,000 from a person with a $50,000 income involves a sacrifice "equal to" that imposed on the recipient of a $2,000 income by an annual tax of $10!

But the question inevitably obtrudes itself whether anyone, anywhere, at any time, has worked out or could possibly work out cogent evidence to show what *would* be "equality" of sacrifice. Might it *possibly* be the case that the phrase "equality of sacrifice" is just a slogan used to persuade an unanalytical public to accept the policy of those who use the expression?

But why should we want taxes levied so as to make the "sacrifice" of different taxpayers precisely *equal?* Is the word "equal," in this connection, anything more than a euphemism? Why not claim that the *amount* contributed by different taxpayers should be "equal"? Or that each should contribute an "equal" per cent? Is there any reason from the point of view of logic, ethics or the welfare of the social group why the thing to be made "equal" in the case of different taxpayers should be their "sacrifice"? Indeed, why not make the "sacrifice" very *unequal* in order that the magic word "equal" may be applied to the net income remaining to taxpayers after tax contributions are subtracted? Is there, in short, any really *convincing* argument for having the word "equal" apply to sacrifice rather than to *amount of tax contribution* or *per cent* of income taken or *amount of income left* for individual spending, *except* that some economists *intuitively feel* that way about it? Are not some of our mentors, in fact, giving us a mumbo-jumbo economics?

If there is nevertheless some sort of case for taxing the larger incomes more heavily so that sacrifice between different taxpayers is "equal," may there not be a still more plausible case for so levying taxes as to produce the *least possible aggregate* sacrifice? In this view, if $15,000 has been taken in taxation from a $50,000 income and still more revenue is needed, whether $10 more or $100 more or even $32,000 more, this additional amount should still be taken from the $50,000 income *before anything at all* is taken from the $2,000 income. Indeed, even if $47,000 ($15,000 plus $32,000) has been taken in taxation from the $50,000 income, there still remains $3,000, and so a dollar still has less utility (or importance) to such a taxpayer than to the recipient of an annual income of $2,000. Therefore, if (say) another $900 is needed by government, there will be *less sacrifice* imposed *in the aggregate* if this, too, is taken from the $50,000 income, bringing the recipient's net income down to $2,100, than if it is taken from the $2,000 income. And likewise if still another $99 or even $100 is needed by government, less aggregate sacrifice will be imposed by taking it also from the larger income, reducing this to a net of $2,001 or $2,000, than by taking it from the smaller income of $2,000 and so reducing the smaller income to a net of only $1,901 or $1,900.

But what if the expenses of government do not require so much revenue and such high taxes as we have just been assuming? And what if, therefore, the recipients of the initially larger incomes still have more left, *even though they pay all of the taxes,* than have the recipients of smaller incomes?

The logical answer, from the point of view of one who favors taxation to impose least aggregate sacrifice, would be that, since additional wealth has greater utility to the recipients of the smaller incomes than to those whose incomes are large, *i.e.,* since their *need* is greater, therefore government should increase its levy on the larger incomes and spend the resulting additional funds mostly in providing services gratis for the needy. In other words, the only logical stopping place for the advocate of taxation according to least aggregate sacrifice is the communistic terminus of equal incomes for all,—or, perhaps, "from each according to his capacity, to each according to his need."

But any such scheme of taxation and public expenditure, it will be said, would largely weaken the motive to efficiency. If the more competent and efficient worker, who earns more by virtue of his superior efficiency, is to have all—or even the major part—of such additional earnings taken from him, is it equally likely that he will work thus efficiently? And is it equally likely that he will spend the time and effort to become thus competent? If the benefit of his extra effort is to flow, not to those of his own family, for whom his affection is presumably the strongest, but to the entire community in larger tax revenues, is it humanly likely that he will feel the same incentive to effort? If to undergo an extended period of training for a difficult profession is to add little or nothing to the trainee's income, can we be confident that men will be as eager as now to undergo such training? Under the direction of Nicolai Lenin, even the communistically-minded Russian Bolsheviks abandoned their earlier communistic ideal of equality of incomes and began to pay more to the skilled and efficient than to the inefficient, the unskilled and the untrained.

But to say all this is to admit that "ability" or "sacrifice" should, at most, not be our only basis for the apportionment of taxes. And we may find, as we go on with our inquiry, that not only the matter of incentive to efficiency but also other important considerations have been and constantly are being overlooked or ignored by the tax theorists who prate so earnestly of comparative "sacrifice" and of "ability to pay."

II

ONE CONSIDERATION which certainly ought not to be overlooked is the possible effect of taxation on saving and, therefore, on the available total of capital. Inadequate capital means less and poorer equipment for a country's working force. It means lower productiveness of labor. And so, other things equal, it means lower wages.

If capital is very heavily taxed or if the income which it yields is very heavily taxed, there is at least some basis for doubting whether the amount of saving and, therefore, the amount of capital equipment will not be less. Certainly this possibility should not be completely ignored in planning a system of public revenue. If those who save are allowed to gain but a tiny share of the extra wealth the capital they have saved makes possible, they may have less motive for saving. And certainly the ability to continue to save and to save increasing amounts, on the part of those who have acquired the habit of saving, is lessened by such a tax.

But even though some refuse to admit that taxation of capital may tend to reduce saving and investment and thus involve a decreased total amount of capital, there is still the question of the effect such taxation may have in reducing the available amount of capital in a particular state or nation. For if in one jurisdiction or state, capital is very heavily taxed, whereas in another jurisdiction it is taxed less or not at all, investors will certainly prefer, with other conditions anything like equally favorable, to send their savings for investment into the jurisdiction where capital is not taxed or is taxed but lightly. (If necessary to avoid future taxation on the income from such investment, they may themselves move.) For investors, like other men, *prefer more to less!* Thus the people in the state or jurisdiction where capital is heavily taxed may come to be less well provided with the capital needed for effective production.

What sort of economic "science" is it which bases its tax theory on intuitive slogans such as "equal sacrifice," which ignores the possible effect of taxation on thrift and the aggregate amount of capital, which ignores the effect of taxation in any given community in causing those whose saving makes capital possible to invest in *other* communities, and which ignores entirely any bearing taxation may have on the incentive to efficiency?

III

BUT THIS IS NOT ALL. Everyone who is acquainted with the facts knows that very considerable quantities of land are held wastefully vacant for years in the hope of a rise in the price at which they can be sold or, sometimes, in the determination not to sell for less than the potential seller has paid. This tends to crowding and slums in the cities, to lower productiveness of labor (*e.g.*, because much land near cities and, therefore, well located for truck farming and dairying, remains vacant and unused awaiting a hoped-for suburban residential use which may be delayed for decades or never materialize at all), and to various other wastes. Taxation according to "ability to pay" or according to any system of equal or least sacrifice means that these considerations also are altogether ignored. In fact, there is a tendency to commiserate with the speculative holder of vacant land and assess his property for taxation at a relatively lower per cent of its actual value than other property, despite his being a cause of waste and of loss to the community. "Poor chap!" it is said. "He certainly shouldn't be taxed much on his vacant land since he isn't making anything on it. He hasn't really much 'ability' to pay taxes on it."

But taxes ought to be levied with a view to *promoting the common welfare*. And a heavy land-value tax, as a result of which men *could not afford* to keep others—by high prices for land—from using land they themselves do not use, would definitely promote the common welfare.

Not rightly to be ignored, either, is the question of tenancy. High land-value taxation would make the price of land low. It would make possible great reduction in the burden of other taxes as well as increased productivity of labor and higher wages. The would-be owner of his home or farm could earn more, save faster and buy land far more cheaply. His rise from tenancy to independent ownership would be far easier. *And the social consequences of this might well be profound.*

Yet all this is entirely ignored by those who, when questions are raised regarding taxation and the tax burden, are able merely to mouth such phrases as "ability to pay" and "equal sacrifice."

"The educated classes," said a distinguished sociologist of an earlier generation,[1] "are victims of the phrase. Phrases are rhetorical flourishes. They are artifices of suggestion. They are the same old tricks of the medicine man adapted to an age of literature and common schools."

The one tax which can be urged most consistently with a defense of "capitalism" (the system of free enterprise) is a tax which appropriates practically all of the annual rental value of land. Such a tax does *not* discourage efficiency. It does *not* penalize thrift and the construction of capital. It does *not* impose a burden on so-called "venture capital." It penalizes only the *interference* with production which comes from holding good land out of use.

The "system of free private enterprise," *if so reformed as to make it consistent with the principles on the basis of which it is commonly defended,* would be definitely preferable, I believe, to any system of regimented socialism. But the adoption of a socialistic economy seems *less unlikely* than it did only a few decades ago. And I am inclined to think that this is, in part at least, because most protagonists of our so-called free enterprise system do not really understand it and do not see—even when they are not unwilling to see—how it must be reformed if it is to operate really as in their defenses of it they say it does. Land-value taxation is, indeed, not the only reform needed. All forms of monopoly and monopolistic conspiracy must be adequately dealt with. Our monetary and banking system must be such as to make for stability in the general price level, to the end that inflation shall not enrich borrowers at the expense of lenders nor deflation bring ruin to borrowers and widespread unemployment to wage earners. But unless our reforms encompass land-value taxation, and, therefore, a practical recognition of the right of all to use the earth, they will not be enough.

[1] William Graham Sumner, "Folkways," Boston, Ginn, 1907, p. 179.