

## PUBLIC REVENUES AND JUST TAXATION

### Adam Smith's "Ability to Pay" Theory Examined

BY EDWIN ADAM

The natural Canon of Taxation would seem to be that each citizen should pay to the State in proportion to the benefits he receives from the State. Taxation should be payment by the citizen for services rendered by the State. But the benefits provided by the State are so numerous and so varied that the difficulty must be to find a rule by which to measure the sum of the benefits conferred on any particular citizen, for the benefits conferred are not conferred on all in equal measure. The dweller in the town enjoys benefits unknown to the dweller in the remote country-side. The dweller in one part of a town enjoys privileges which at another part of the same town he must do without. Nay, even dwellers in the same street enjoy in different degrees the benefits resulting from the presence and work of the community, and a corner lot will be far more in demand than other sites on the same thoroughfare.

The primary services of the State seem rather to confer a general benefit on all the citizens than separable benefits on each. All appear to benefit by the security provided in the defence of the country from foreign foes. Do they benefit equally, or can a measure be found whereby each may pay as he receives? Similarly, while a large revenue can be raised from litigants towards the upkeep of the courts of law, that takes no account of the benefit enjoyed by all the citizens, in the protection afforded by the existence of the courts, even if personally they never require to apply for their assistance. The existence of trustworthy courts, the possibility of applying for justice to them, benefits all the citizens, and renders industry safe and profitable. The benefit may be very difficult to individualize, but it is none the less real. All benefit, but in very varying degree. The problem therefore is, the benefit being unequal, can a measure be found by which each citizen shall only pay to the State in proportion to the benefit received by him from the State?

It is in the above sense only that Adam Smith's famous First Canon of Taxation, the Canon of Equality, can be accepted as expressing a principle just in itself. That Canon runs:—

"The subjects of every State ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the State."

This is the canon so far as it is usually quoted and adopted by economists, whether they are admitting or disputing its validity. But as thus stated it is by no means a self-evident truth. Its terms are ambiguous, if not contradictory. The "respective abilities" of citizens of a State to pay taxes are not necessarily measured by "the revenue they enjoy under the protection of the State." Accordingly some writers try to define the latter phrase as meaning their surplus income after meeting the necessary cost of maintenance; and lay stress on the word "enjoy," as implying something additional to mere income necessarily expended in maintaining life; as reaching out into the sphere of luxury, or at least of superfluous expenditure.

Adam Smith, however, does not leave his canon without interpretation, for he immediately adds an explanation which may clear up any dubiety. He proceeds: "The expense of government is like the

expense of management to the joint tenants of a great estate, who are all obliged to contribute in proportion to their respective interests in the estate."

Here we are on familiar ground, and the antecedent ambiguity seems explained. The joint tenants of an estate can only in reason be called on to pay towards the cost of management of the joint estate in proportion to the share of that estate held by each. They will each pay to the common fund in proportion to the benefit they receive from the estate.

The key-word of the canon, therefore, seems to be the word "under," which we would translate "by virtue of" or "as the result of." Each citizen should contribute to the support of government in proportion to the revenue which he enjoys by virtue of, or as the result of, the protection and activity of the State.

It is patently just and proper that any income enjoyed by the individual by virtue of something done by the State should contribute to the upkeep of the State, just as it would be right that one of the tenants of an estate should pay an increased rent proportionate to any increase in value of his holding which resulted from some expenditure, on roads or buildings or other improvement, by the management of the estate. Such an arrangement conforms to our ordinary commonsense view of what is right and proper. The improvement may have benefited all the tenants, but we should expect each to pay in proportion to the increase in value of his own special holding. In this sense, then, Adam Smith's Canon of Equality seems to be a canon of natural justice.

To interpret the canon as giving sanction to the idea that each citizen is to contribute to the State in proportion to his income would be to deprive it of all title to be considered a rule founded in justice. It would sanction the theory that the more industrious a citizen was the more the State was entitled to demand from him. This would be to fine the industrious for their industry, whilst the idle would go free.

This is quite clearly not the meaning of Adam Smith. His joint tenants would never have admitted that each was to pay as he improved his portion of the estate, while his idle co-tenant was to get off without contribution. Each would pay in proportion to the value of the opportunity afforded him by the estate. The result of his personal industry should remain to each. If the joint estate expenditure resulted in raising the value of the portion of the estate allotted to him, then he would justly be called on to pay a proportionately increased quota to the expenses of the joint estate. But if by his own energy and capital he improved the earning capacity of his portion of the estate, in all justice that increased capacity should redound to his individual benefit, and should not be made a ground for increasing the quota he has to pay to the expenses of the joint management of the estate.

That each member of the joint adventure should pay to the expenses of the management in proportion to the value of the joint estate which he enjoyed under the joint adventure; that his contributions to the joint fund should vary from year to year according as his portion of the joint estate rose or fell in value by the expenditure of the joint fund, is a commonsense arrangement. But to suggest that the more he improved his portion by the expenditure of his own labour, skill, and capital, the more, relatively to his co-tenants, he

should pay into the common purse, is, to put it mildly, not a business proposition. It would discourage industry.

Take it that the joint estate, at the partition among the tenants, is a tract of unimproved land, the natural, business-like course will be to ask each tenant to pay into the joint purse year by year the annual value of the portion allotted to him, apart from any value added by his own industry, resource, and energy. This leaves him the utmost encouragement to be industrious and improve his portion by leaving him the whole benefit of his work, while it will discourage any tenant from idly letting slip the opportunity of improving his lot, as he must still pay in to the common fund the same quota whether he is idle or industrious. Each would pay to the common fund as he had received from the general estate, and the result of his own industry would remain secured to him.

Again, to interpret the canon as if it meant that all income enjoyed by the citizen, from whatsoever source derived, were equally a just subject of taxation, is as if in the illustration of the tenants one of them were to

be asked to contribute to the joint expenses of the estate, in respect of an annuity or other allowance which he happened to enjoy from a source quite outside the joint adventure. Or as if the joint tenants of a house were to be asked to pay towards the expenses of the establishment in proportion to their salaries, although these were enjoyed quite independently of residence in that particular house. A demand for a contribution to the joint expenses of the establishment might be submitted to in ignorance of the rule by which the amount was arrived at, or under duress or fear of ejection to worse quarters, but a sense of justice could never enter into such a transaction. Such an interpretation of the canon would lack the semblance of an appeal to our sense of justice.

The only permissible interpretation of Adam Smith's Canon of Equality, therefore, must be that each citizen should pay to the revenue of the estate in proportion to the benefits he receives from the State.

*(From Chapter III of the book LAND VALUES AND TAXATION, by the late Edwin Adam, M.A., LL.B., K.C.)*