

TAXATION IN THE NEW STATE

Published @ 2017 Trieste Publishing Pty Ltd

ISBN 9780649361755

Taxation in the new state by J. A. Hobson

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NEW YORK
HARCOURT, BRACE AND HOWE
1920

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PREFACE

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Notes

Even before the war the growing need of large revenue in order to meet the new demands upon the modern State was bringing the problem of taxation into a place of increased prominence in the politics of every civilized nation. Non-remunerative State services were continually increasing in number, scope, and intricacy, and the annual bills kept mounting up. In some countries the increased expenditure could be largely met out of income from public properties or remunerative services. But in Great Britain and in other countries the pressure for increased tax revenue was strongly felt; and new sources of this revenue were being explored. The war, with its legacies of indebtedness and its large sudden demands of State expenditure for reconstruction, must force every intelligent citizen to consider closely how a tax-income, at least three or four times as large as the pre-war sum, can best be raised. It will be evident at once that no multiplication of minor devices can suffice, but that a thorough explora-

tion of the taxable resources of the nation must be undertaken.

These chapters are an attempt to establish and apply to the financial situation in front of us certain intelligible principles of tax policy. Recognizing that the normal annual tax-income can only be derived from the incomes of the several members of the nation, and consists of a portion of the wealth constituting the annual product of the nation reckoned in money or in goods and services, we are confronted first with the necessity of distinguishing the portions of personal incomes that have ability to bear taxation from those that have not such ability.

I have made it my first object to win, by means of a brief analysis of the various elements in income, a clear definition of 'ability to bear.' While there is nothing novel in the distinction which I draw between 'costs' and 'surplus,' I am convinced that neither in the theory nor the practice of taxation has this distinction been adequately realized. Though modern State finance has been moving empirically towards a recognition of the fundamental truth that only surplus income, *i.e.* economically unnecessary payments to owners of some factor of production, possesses a true 'ability to bear,' economists and statesmen alike still

cling to the looser and defective statement of this principle conveyed in the first of Adam Smith's four maxims of taxation. That maxim declares that "The subject 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 their revenue which they respectively enjoy under the protection of the State."

Now, theory and practice alike attest the need of amending this maxim by a recognition that such parts of the revenue of any one as are physically or morally necessary to evoke and maintain the output of productive power which serves to create this revenue, should be excluded from the purview of this test as possessing no ability to bear taxation. All taxes which fall directly or indirectly upon this part of revenue are bad taxes, impairing the sources of production if they are borne, and causing waste and confusion if, as will usually happen, they are shifted on to some surplus element of revenue.

But while it is not difficult to establish in general terms the justice and utility of confining taxation to surplus elements of income, the difficulty or impossibility of accurately ascertaining and measuring such surpluses as they emerge in

the intricacies of actual industry and commerce compels State financiers to have recourse to less direct expedients for the application of their principles. Alike in the case of the immediate taxation of income and of the deferred taxation of accumulated income through Death Duties, the two chief instruments of revenue for the modern State, the assumption is adopted that surplus wealth with 'ability to bear' varies directly with the size of the income or the estate. Our Income-Tax is thus in main outline conformable to the distinction here made between costs and surplus. The exemption limit with allowances asserts the principle that a small necessary income has no ability to bear taxation, while the progressive graduation assumes that ability rises proportionably with the dimensions of the taxable body.

But, in order to make this method of taxation thoroughly effective, certain reforms are needed. Exempted income should evidently have regard to the number of those who depend upon it for their maintenance, and progressive graduation should be more continuous and more progressive. Proposals for achieving these reforms are discussed.

Indirect taxes are generally worse than worthless for purposes of revenue, producing little,

costing much, and interfering with the general productivity of industry and commerce. In the few cases where it is desirable to retain them, considerations not of revenue, but of public order, health, or the prevention of extravagance and waste determine their retention. A tariff on imports is found to be peculiarly injurious in its incidence and shifting, for it can never be directed so as to make the foreigners pay any proportion of the tax sufficient to compensate the injuries which it inflicts upon home industries and real income.

In the first part of this volume these principles and policies of reformed taxation are set out in their general bearings. The second part treats of the financial emergency in which the State must find itself as soon as the war-borrowing ceases and annual expenditure must be met out of annual revenue. The difficulties and dangers of attempting to find the required revenue by any ordinary processes of annual taxation are discussed, and it is urged that an emergency levy upon capital is requisite in order to effect such a reduction of war-indebtedness as will bring the annual revenue within the compass of safe taxation. Two proposals for a levy are described, one confined to war-made wealth, the other of a general character,