TAXATION

AND

THE FUNDING SYSTEM.

INTRODUCTION.

GENERAL OBSERVATIONS ON TAXATION.

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A tax is a portion, or the value of a portion, of the property or labour of individuals taken from them by government, and placed at its disposal.

A tax may be either direct or indirect. It is said to be direct when it is immediately taken from property or labour; and indirect when it is taken from them by making their owners pay for liberty to use certain articles, or to exercise certain privileges.

A tax may be either general or particular; that is, it may either affect all classes indiscriminately, or only one or more classes.

Taxation is the general term used to express the aggregate of particular taxes. It is also the name given to that branch of the science of political economy which explains the mode in which different taxes affect the public interest, and in which the revenue required for the public service may be most advantageously raised.
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It would be superfluous to enter into any lengthened arguments to show the utility, or rather necessity, of raising a revenue for the use of the public. It is sufficient to state that the experience of all ages and countries shows that good order and tranquillity at home, security from foreign invasion, and the speedy and impartial administration of justice, are indispensable to the vigorous exercise of industry, the accumulation of wealth, and the well-being of society; and that where they are wanting the energies of the population are prostrated, industry paralysed, and poverty and barbarism universally diffused. The duty of making adequate provision for securing the means by which so much good may be realized on the one hand, and so much evil averted on the other, is, therefore, imperative: an expenditure for such objects is most profitable: it is essential, indeed, to the existence of the body politic, and, being productive of universal advantage, it should be defrayed by the joint contributions of the society. Hence the fundamental principle that, in as far as practicable, all the subjects of a state should contribute to the sums required to maintain its fleets and armies, with the various functionaries and institutions, necessary for defence against hostile aggression, for the preservation of internal peace, the promotion of prosperity, and the protection of every citizen in the undisturbed enjoyment of his property and rights. It, no doubt, frequently happens that the public has to contribute larger sums than are necessary for the ends of good government. Inasmuch, however, as all abuses of this sort obviously originate either in the misconduct of governments or in something defective in their organization, they do not come within the scope of our inquiries, and have, in fact, nothing to do with taxation. It is sufficiently clear that, so long as taxes imposed for necessary and legitimate purposes are judiciously assessed, and collected in the way least likely to be injurious, their
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payment cannot reasonably be objected to. Under such circumstances their expenditure seldom fails to secure an adequate return to the contributors. But, at all events, it is no part of our business to inquire whether the revenue raised by the state exceed its necessary wants, or whether it be judiciously expended. How important soever, these questions do not affect the principles on which taxes should be imposed, nor the mode of their imposition, and are consequently foreign to the nature and objects of this work: and, leaving them to be examined by others, we shall content ourselves with endeavouring to ascertain the influence of taxation over individual and national wealth; and, by analysing the various methods in which a revenue may be raised, and comparing them together, we shall, perhaps, be able to show which is most advantageous, or rather which is least injurious.

The scheme of taxation now in force in modern Europe had its origin in the decline of the feudal system. According to the principles of that system, lands were held as fiefs of the crown, on condition of their possessors performing certain stipulated services; of which the obligation to support the sovereign when he took the field, with a body of retainers armed and maintained at their own expense, was by far the most important. The tenants in chief of the great fiefs, or those who held directly under the sovereign, were either originally invested with, or subsequently usurped, the prerogative of distributing justice in their respective lordships; and in those days the administration of justice, instead of being a source of expense, became, in consequence of the corruption and abuses with which it was infected, a considerable source of influence and emolument. The clergy were supported partly by the produce of their own estates, and partly by a tithe levied upon the estates of others. And the labour of the peasantry, during a few days before
and after harvest, sufficed to put the roads and bridges into that state of repair which the depressed situation of commerce, and the little intercourse among the different parts of the country, seemed to require. It was not even necessary to levy a tax for the support of the monarch and his court. The rents of the crown estates, or of the royal demesnes which had not been granted to others, but remained in the immediate possession of the sovereign, and the revenue derived from wardships and other feudal incidents, were generally sufficient to defray this part of the public expenditure. When the feudal system was in its vigour, the demesnes of the crown were, in most countries, very extensive; and the alienations occasioned by the profusion and facility of some princes were compensated by the forfeitures and escheats that were always taking place.

The vicious nature of this system is too obvious to require being pointed out; and it had for a long series of years the most disastrous influence over the peace and prosperity of Europe. But the progressive though slow advance of civilization ultimately occasioned its overthrow. Money payments were gradually substituted for personal services; and the establishment of standing armies in France * by Charles VII., and their introduction into other countries, entirely broke the power and spirit of the feudal aristocracy, and enabled the different governments to introduce a regular plan of administration, and to enforce that system of pecuniary contribution now universally established.

The amount of a tax is not to be estimated by the bulk or species of the produce which it transfers from individuals to government, but exclusively by its value. A heavy taxation consists in the abstraction of a large value, and a light taxation in the abstraction of a small value. When a fall takes place in the cost of producing

* Hallam's 'Middle Ages,' vol. i. p. 118.
any article, its price necessarily declines in an equal degree; and if the value of money continue stationary, its producers are obliged to dispose of a proportionally larger quantity to obtain the means of paying the same amount of taxes. But it is an obvious error to suppose, as is very commonly done, that the burden of taxation is consequently increased. The value paid by the contributors remains the same; and it is by values, and not by quantities, that the weight of taxation is to be measured. If, through improvements in agriculture, machinery, or any other cause, two quarters of wheat, or two yards of cloth, were produced with the same expenditure of capital and labour that is now required to produce one quarter or one yard, it would be no hardship to give double the present quantity of wheat and cloth in payment of taxes.

The want of attention to this principle has led to much erroneous reasoning on the subject of taxation. Even Smith made no sufficient allowance for the influence of improvements in enabling a country to bear additional taxes. Nothing, however, can be more obvious than that the share of the products of its subjects taken by government as revenue may be regularly increased in every country in which the arts are progressive, without really adding to their burdens. Every invention and discovery by which the production of commodities is facilitated, and their value reduced, enables individuals to spare a larger quantity for the use of the state. The sacrifice made in paying taxes consists in the labour, or in the cost of the money or produce required to pay them, and not in the amount of such money or produce. To pay 100. or 1000. to government at this moment will require a cotton-manufacturer to sell not less, perhaps, than fifteen or twenty times the quantity of cottons that would have sufficed to make the same payment in 1760. But as this diminution in the value of his
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goods has been occasioned by an equivalent diminution in the expense of their production, he is not thereby placed in any respect in a worse situation; nor is he making any greater sacrifice now than formerly. Governments have, therefore, precisely the same interest as their subjects in facilitating production; inasmuch as its increased facility affords the means of adding to the quantity of produce at their disposal, without really adding to the weight of taxation; whereas, on the contrary, a diminished facility of production must either diminish in an equal degree the produce appropriated by government, or compel it to lay heavier burdens on its subjects. Public wealth, in short, is merely a portion of private wealth transferred to government; and the greater the amount of the latter, the greater, of course, will be the magnitude of the portion that may be conveniently spared for public purposes.

Though taxation be necessary, it should always be kept within the narrowest limits. The best taxes, provided they produce the necessary supplies, may, speaking generally, be said to be the lightest, or those of which the pressure is least felt. But how light soever, all taxes necessarily at first encroach somewhat on the means of enjoyment or of accumulation possessed by the parties by whom they are paid; and whatever may be their amount, and however imposed, they must necessarily fall either on the revenue of the contributors or on their capital or stock. Perhaps, indeed, there is no tax the produce of which is not partly derived from both these sources. It is, however, abundantly certain that all taxes, when judiciously imposed, and not carried to an oppressive height, occasion an increase of industry and economy, and but rarely encroach on capital. Under these conditions they operate as motives to restrain expense, and as incentives to labour and ingenuity, frequently occasioning the production of more wealth
than they abstract. But the power to make increased exertions, and to save from expense, though not easily defined, is not illimitable. And whenever this limit has been attained—that is, whenever the burden of taxation is not fully compensated by increased production or increased saving—it must encroach on the means of future production, and the country will then begin to retrograde. Taxation, when carried to this extent, is one of the severest scourges to which a people can be subjected. By diminishing capital, or the funds destined to support productive industry, it lessens the national revenue, the only fund out of which taxes can be permanently paid; and lays the sure foundation of public poverty and disgrace, in the destruction of individual fortunes. Like falling bodies, which are precipitated with a constantly and rapidly increasing velocity, a system of taxation acting on capital multiplies pauperism and distress in a geometrical proportion, and destroys alike the desire and the means of reproduction.

It would, however, be an error to suppose that a tax necessarily falls upon capital because it is laid on capital, or on income because it is laid on income. A moderate tax laid on capital may be, and generally is, defrayed out of a saving of income; whereas an oppressive tax laid on income has in most cases to be partly paid from capital. But of all species of taxes, those would seem to be among the worst which necessarily fall on capital, without giving the contributors an opportunity to defray them from revenue. By diminishing the means of reproduction, they in so far diminish the future taxable income of the country. The legacy duty, as will be afterwards seen, has been objected to, though perhaps without much reason, on this ground.

Most of the writers on finance, patronized by European governments, have laboured to show that taxation is never a cause of diminished production; but that, on
the contrary, every new tax creates a new ability in the subject to bear it, and every increase of the public burdens a proportional increase in the industry of the people. The fallacy of this opinion, when advanced thus absolutely and without reservation, has been ably exposed by Hume in his ‘Essay on Taxes.’ It is true, however, as has been already stated, that the desire to preserve their fortunes unimpaired, and to improve their condition, stimulates most men to endeavour to discharge the burden of moderate taxes by increased industry and economy, without allowing them to encroach on their fortunes.

The operation of this principle has been strikingly evinced in the financial history of this country since the commencement of the American war. That contest, and the more recent struggle with revolutionary France, occasioned a vast increase of taxation, and an expenditure that has no parallel in the history of the world. The public debt, which amounted to about 145 millions in 1772, amounted to about 841 millions in 1817; and, in addition to the immense sums raised by borrowing, the gross produce of the taxes levied in the United Kingdom during the late war exceeded the enormous sum of 1300 millions sterling! And yet the rapid increase of population—the wonderful progress and improvement of agriculture, manufactures, and commerce—the extension and embellishment of towns and cities—the formation of so many new docks, roads, and canals—and the infinite variety of expensive undertakings entered upon and completed in all parts of the country during the continuance of hostilities—show clearly that the savings of the mass of the people greatly exceeded the warlike expenditure of government and the unprofitable expenditure of individuals. It may be safely affirmed that no other country could have made such extraordinary exertions without being ruined; and we owe the power to make them to a variety of causes, but chiefly,
perhaps, to that security of property and freedom of industry which we enjoy in a greater degree than any other European nation, and to that universal diffusion of intelligence which enables those who carry on industrious undertakings to press all the powers of nature into their service, and to avail themselves of productive energies of which a less instructed people would be wholly ignorant.

Speculative inquirers have sometimes indulged in conjectures as to what would have been our present situation had the wars which have occasioned the contraction of so large a debt, and the expenditure of such vast sums, not occurred. Dr. Smith appears to have concluded that, in the event of our having enjoyed perpetual peace since the Revolution, almost the whole sums that have been since laid out on warlike enterprises would have been added to the national capital, and that we should in consequence have been incomparably richer, more populous and powerful. “Had not these wars,” he observes, “given the particular direction to so large a capital, the greater part of it would naturally have been employed in maintaining productive hands, whose labour would have replaced, with a profit, the whole value of their consumption. The value of the annual produce of the land and labour of the country would have been considerably increased by it every year, and every year’s increase would have still more augmented that of the following year. More houses would have been built, more lands would have been improved, and those which had been improved before would have been better cultivated. More manufactures would have been established, and those which had been established before would have been more extended; and to what height the real wealth and revenue of the country might by this time have been raised it is not perhaps very easy even to imagine.” *

* See the edition of the Wealth of Nations by the author of this work, in one vol. 8vo. p. 158.
But this, though a popular, is a very doubtful conclusion. A speculation of this sort is necessarily, indeed, encumbered with so many difficulties as to admit of little else than probabilities; though these, we think, go far to warrant the belief that, but for the contests in which we have been engaged since the Revolution, the greater portion of the wealth expended in carrying them on would never have existed. Smith forgot that an increase of taxation has the same powerful influence over a nation that an increase of his family or of his necessary expenses has over a private individual. The constantly increasing pressure of taxation during the war begun in 1793, was felt by all classes, and gave a spur to industry, enterprise, and invention, and generated a spirit of economy that we should have in vain attempted to excite by any less powerful means. Had taxation been very oppressive, it would not have had this effect; but it was not so high as to produce either dejection or despair, though it was at the same time sufficiently heavy to render a very considerable increase of industry and parsimony necessary to prevent it from encroaching on the fortunes of individuals, or, at all events, from diminishing the rate at which they had previously been increasing. Man is not influenced solely by hope, he is also powerfully operated on by fear. Taxation brings the latter principle into the field. To the desire of rising in the world, implanted in the breast of every individual, an increase of taxation superadds the fear of being cast down to a lower station, of being deprived of conveniences and gratifications which habit has rendered all but indispensable; and the combined influence of the two principles produces results that could not be produced by the unassisted agency of either. Without the American war and the late French war there would have been less industry and less frugality, because there would have been less occasion for them. And we incline to think that those who inquire dispassionately into the matter will most probably see reason to conclude that the in-