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ANSWERS TO QUESTIONS PUT BY THE LOCAL  
TAXATION COMMISSION

[THE doctrine of minimum sacrifice is restated in less technical language in answers to a question put by the Royal Commission on Local Taxation. Answers are also given with respect to the incidence of various taxes about which the Commission inquired. The answers were published in the Reprint of the Commission [C. 9528, 1899]. A copy of the Question is here affixed.]

ROYAL COMMISSION ON LOCAL TAXATION

QUESTIONS

1. Is the classification of Imperial Taxation indicated in the accompanying Table a correct classification; if not, what alterations can you suggest? (*See* Table marked A, and memorandum marked B, by Sir Alfred Milner explaining the basis of the Table.)
2. Assuming the classification, is it complete, and are the several items correctly distributed?
3. In particular should such an item as the net revenue of the Post Office be treated as a tax, and if so, under which of the heads specified in the Table?
4. In considering the equity of any tax or system of taxation what tests should be applied?
5. Can you offer any suggestions which would assist the Commission in determining the question of the real incidence of taxation as distinguished from its primary or apparent incidence?
6. Could you, for example, state your view as to the real incidence of—
  - (a) The inhabited house duty;
  - (b) Rates levied on houses and trade premises;
  - (c) Rates levied on agricultural land;
  - (d) Taxes on the transfer of property;
  - (e) Taxes on trade profits;
  - (f) Death duties?

7. Is it possible to frame any criterion whereby the purposes for which taxation should be raised locally can be distinguished from those for which taxation should be raised by the central Government?
8. Should the two kinds of purposes and the expenditure on them be kept distinct or should the expenditure for local purposes be partly borne by the central Government?
9. Should local rates be divided between owners and occupiers of real property, and if so, in what proportions?
10. Should ground values be separately rated for local purposes, and if so, on what principles?
11. Under what conditions and in what manner would the rent which could be obtained by an owner of land on rateable hereditaments be affected, if at all, by—
  - (a) The increase of an old rate;
  - (b) The imposition of a new rate;
  - (c) The reduction or abolition of a rate?
12. Under what conditions and in what manner would the rent which could be obtained by an owner of land or rateable hereditaments be affected, if at all, if an occupier by whom a rate had hitherto been paid were empowered to deduct the whole or a portion thereof from the rent in the same manner as he is now entitled to do in the case of income tax? (Schedule A.)
13. What is the effect, if any, upon rent of rating property—
  - (a) On different scales of duty according to the value of the property;
  - (b) On different scales of duty according to the character of the property or the purposes for which it is used?
14. Can you make suggestions to the Commission as to any methods of raising revenue for local purposes, otherwise than by means of rates?
15. Does any point not included under any of the foregoing questions occur to you on which having regard to the terms of reference to the Commission you wish to express an opinion?

PROFESSOR EDGEWORTH'S ANSWERS TO THE QUESTIONS SUBMITTED TO HIM BY THE ROYAL COMMISSION ON LOCAL TAXATION

1. A classification may be incorrect in two ways. It may violate the rules of formal or those of material logic. For instance, suppose taxes divided into indirect, and those which are on

commodities; or taxpayers divided into those who are at least six foot high, and those who are under six foot. The first classification is incorrect because the classes formed are not mutually exclusive; the second classification is incorrect because it sub-serves no purpose of art or science.

The proposed classification, properly interpreted, is not incorrect in either sense. If the terms "incidental to . . . property" and "in respect of commodities" are defined so as not to overlap, then the classification may subserve the purpose of enabling the various items of the national Budget to be held together in thought.

The classification might be considered incorrect, if it was designed to indicate the incidence of taxation. For, certainly, it does not fulfil that purpose, as appears from the cross-questioning to which the author of the classification was subjected by Sir Robert Giffen.<sup>1</sup> But the classification was not designed to fulfil this purpose, as appears from the answers given on the occasion referred to.<sup>2</sup>

I cannot suggest, I do not recommend, any alteration of the proposed classification. The object of such an emendation would be, apparently, to render the classification a better exponent of the real incidence. But it may be doubted whether a classification which fulfils the first purpose—to afford a comprehensive view of the receipts of the Exchequer—admits of being amended so as to fulfil the second purpose—to indicate the real incidence of taxation. It must be recognised that the points of primary percussio and final incidence are not coincident. There is the sort of difference which exists between an ordinary map divided into provinces and counties, and a map of which the divisions are designed to exhibit the variety of geological formations. There is, doubtless, a certain correspondence between the two charts; and it is not only in Greece that mountains are associated with boundaries. But query if it would be worth while to alter familiar demarcations—subtracting a district from one county, and adding it to another—in order to construct a sort of mongrel map, which should subserve at once the purposes of ordinary geography and scientific geology.

2. The questions may be understood to mean: (1) Do the items enumerated in the proposed Table together make up the total taxation raised by Parliament? (2) Is each item placed in the compartment to which it properly belongs?

<sup>1</sup> Agricultural Commission, Q. 63, 235, and context.

<sup>2</sup> *Ibid.*, Q. 63, 253; 63, 266.

(1) To the first question there can be only one answer. The only qualification to the obvious affirmative is the caution that the amount raised by taxation is not an accurate measure of the real burden. As Mill says of a tax on newspapers, it is "objectionable, not so much where it does fall, as where it does not." The principle has been generalised by Professor Marshall in his theory of "consumers' rent." For example, if the duties on some consumable articles were raised, the burden of taxation would certainly be increased, but the ordinary pecuniary measure of that burden might quite possibly be reduced.

(2) The arrangement of the items appears to me correct enough. I should add that it might have been widely different, without appearing to me incorrect. For the term "incidental to" signifying simply "with respect to"—and divorced, as I contend that it should be, from its association with *incidence*—is so vague and elastic that the compartments which it defines may be made to include more or less, at pleasure. Thus several of the items under Head 4, *e.g.*, bills of exchange and promissory notes, might as well have been, where Sir Alfred Milner was at first disposed to place them,<sup>1</sup> in the category of taxes not incidental to property, as where they are now. Distinctions which turn upon such differences seem hardly worth contending for.

(3) What is the best definition of a tax is an interminable inquiry. There is a whole literature on the subject on the Continent. It may be true, as a French writer has observed, that all this dialectic never brought an additional franc into the Treasury. Yet the discussion exercises speculative faculties which are demanded by some problems in taxation. It will not be expected, however, that this academic exercise should be performed here.

For the present purpose we may accept Professor Bastable's definition of a tax, and understand with him that "when ordinary profit is exceeded, the monopoly possessed by the [public] office is employed for taxation."<sup>2</sup> Or, in Professor Sidgwick's words, "Government avoids interfering with distribution"—whether in the way of tax or bounty—"if it sells the commodity at the price at which it would be sold if provided by private industry."<sup>3</sup> But "we can only conjecture roughly" what that price would have been.<sup>4</sup> We do not know to what extent

<sup>1</sup> Memorandum B., p. 4.

<sup>2</sup> *Public Finance*, Book II. ch. I. § 4.

<sup>3</sup> *Political Economy*, Book III. ch. viii. par. 4.

<sup>4</sup> Note to first edition, *loc. cit.*

the service would be monopolised in the absence of Governmental interference. The calculation is further complicated by the possibility that, whether in a regime of perfect competition, or more or less imperfect monopoly, there might be different prices, varying with the cost of service in different localities. It has further to be considered that the burden imposed on the public by the Government monopoly of the post is not to be measured simply by the rise in price which it may occasion. Professor Marshall, in a letter to *The Times*, of April 6, 1891, estimated the loss to the public in the way of "consumers' rent," consequent on the prohibition of private enterprise in postal services, as amounting to some four and a half million pounds sterling annually. It seems to follow that the "net revenue of the Post Office" is a very inaccurate measure of the fiscal burden imposed by the Government monopoly.

4. The equity of any particular tax must be judged by reference to the system of which it forms part. That the same tax may or may not be inequitable, according as the payer is or is not otherwise burdened, is an acknowledged principle.<sup>1</sup> We may go on then to consider the equity of a system of taxation. The following is a summary of views expressed fully in the *ECONOMIC JOURNAL* for December 1897.<sup>2</sup>

In considering the equity of any political system, the test which should be applied is the greatest happiness principle.<sup>3</sup> From this principle it follows that *ceteris paribus* the sum of privation or sacrifice caused by taxation should be a *minimum*. Therefore, if a certain amount of taxation has to be raised (for purposes of which the benefit cannot be allocated to particular persons), the *prima facie* best distribution is that the whole amount should be paid by the wealthiest citizens. The incomes above a certain level should all be reduced to that level; the incomes below that level should be untaxed, the level being determined by the amount which it is required to raise.<sup>4</sup>

This levelling principle requires to be corrected by several prudential considerations.<sup>5</sup> There is the danger of driving the rich, or at least their riches, from the country, and checking accumulation; there is the danger of awakening the predatory instinct of the poor, and precipitating revolution. When tempered by ordinary prudence, the suggested rules of equity deduced

<sup>1</sup> See Fawcett, *Manual of Political Economy*, Book IV. ch. i. Bastable *Public Finance*, 2nd edition, p. 300 and p. 555, note 1. Seligman, *Progressive Taxation* (on the principle of *compensation*).

<sup>2</sup> "Pure Theory of Taxation," above §, p. 100 *et seq.*

<sup>3</sup> *Loc. cit.* p. 101.

<sup>4</sup> *Loc. cit.* p. 103.

<sup>5</sup> *Loc. cit.* pp. 104-5.

from the principle of *least* sacrifice are not, in practice, very different from the received rules which are deduced from the principle of *equal* sacrifice. But there is an important theoretical difference between the two first principles.

I maintain that the principle of equal sacrifice derives its acceptance from its similarity in conception and dictates to the principle of least sacrifice: that the former has no authority independent of the latter. J. S. Mill, the leading authority on the subject, confuses the two principles. In the same breath he enounces the principle of equal sacrifice and identifies it with that of least sacrifice. "Whatever sacrifices it [Government] requires of them [persons or classes] should be made to bear as nearly as possible with the same pressure upon all, which, it must be observed, is the mode by which least sacrifice is occasioned on the whole."<sup>1</sup> The association in Mill's thought between *equal* sacrifice and equality—an inference from *least* sacrifice—is apparent in his method of advocating the limitation of inheritances,<sup>2</sup> and in the juxtaposition noted by Professor Sidgwick,<sup>3</sup> between the first clause above quoted and the dictum in the same section that "the true idea of distributive justice consists . . . in redressing the inequalities . . . of nature."

Many distinguished foreign authorities also seem to hover between the two principles, having "equal sacrifice" on their lips, but using arguments which are germane to "least sacrifice."

The principle of equal sacrifice has sometimes been clearly distinguished from that of utilitarianism pure and simple, and preferred to it as being free from the dangers which, as above admitted, attend the working of the latter principle. But in order to deduce any rule of distribution from the principle of equal sacrifice, there is needed some assumption as to the degree of slowness with which utility tends to increase with the increase of means. Upon a very probable assumption as to that slowness, the principle of equal sacrifice would lead to a progressive taxation almost as drastic as that which has been above described. This is admitted by Professor Sidgwick when he says, "If equalisation of burden were the sole consideration, the equity of a graduated rate of taxation, rapidly increasing as incomes rise, could hardly be denied."<sup>4</sup>

It should seem therefore that, as a working principle, equal sacrifice has no great advantage over least sacrifice.

<sup>1</sup> *Political Economy*, Book V. ch. ii. § 2.

<sup>2</sup> Above, §, p. 115.

*Political Economy*, Book III. ch. viii. par. 7, 1st edition.

<sup>4</sup> *Politics*, p. 182. Cp. *Political Economy*, Book III. ch. viii. par. 7, sub.

For further defence and qualification of the views propounded the reader is referred to the article already cited. The main result of that investigation is somewhat to weaken the prepossession in favour of taxation proportional to incomes (above a certain minimum), and somewhat to strengthen the arguments in favour of progressive taxation. It may be added that there does not seem to be much weight in the common objection to progressive taxation: that if the proportion payable continually increases, it must ultimately reach 100 per cent., or at least a ratio such that the taxpayer would have no interest in increasing his income. For, first, the point at which these consummations would be attained may well be far above the highest existing incomes, as happens in the case of some progressive systems in Switzerland. And secondly, the dictates of the least sacrifice principle might be approximately satisfied by a law of progression which ultimately, for high incomes, converged to a simply proportional rate of taxation.\* If the ultimate ratio was very high, the initial ratio might be very low.

5. I have elsewhere<sup>1</sup> suggested four distinctions which may be of assistance in determining the real incidence of taxation.

There is first the distinction between a regime of monopoly and one of competition. The laws of incidence are not the same for these two cases. Thus it is rightly argued that rates in respect of railways and canals fall upon the shareholders who own the property, while rates in respect of mines and quarries fall upon the consumers of the products;<sup>2</sup> it being understood that monopoly prevails in the former case, competition in the latter. A less familiar inference is that, even if a canal or quarry is monopolised, a rate would not fall entirely upon the monopolist, but partly on the consumer; supposing, as is usual, I believe, that the rate is proportioned to the output.<sup>3</sup>

The second distinction is between products which obey the law of "diminishing returns" and those which do not. This distinction is relevant to the weight rather than the point of incidence. The burden of a tax on products obeying the law of "increasing returns" is apt to be greater. It may be observed that the articles with which the Commission is specially concerned,

\* Even this degree of proportionality is not necessary as shown below.

<sup>1</sup> Above, §, p. 65.

<sup>2</sup> See Memorandum by Sir Edward Hamilton, p. 55.

<sup>3</sup> See Marshall, *Principles of Economics*, p. 462, and above, §, p. 91.

lands and houses,<sup>1</sup> seem mostly to belong to the category of diminishing returns.

The third distinction is between cases where there exists mobility between different industries and cases where this mobility does not exist. One important case of immobility is that of capital fixed during a "short period"<sup>2</sup> as distinguished from "the long run." Thus there is an essential difference between the incidence of a new house rate, according as it affects the owner of a house already built, or as it enters into the calculation of an intending builder.

The fourth distinction is between a tax which varies with the amount of article (including money) produced or dealt in, and one which is irrespective of that amount. A *specific* and an *ad valorem* tax belong to the former category; to the latter, a poll tax and a payment for a licence. Consider, for example, different modes which might be imagined of taxing the production of barley—I say barley, not corn, to avoid the complication attending the taxation of labourers' necessities.<sup>3</sup> Mobility between the farming and other industries being supposed, a tax proportioned to the amount of output falls upon the consumer; since before, as after, the impost the "final" increment of product must just repay the producer.<sup>4</sup> By a parity of reasoning a tax under the form of a licence to grow barley will presumably fall on the landlord; supposing that he has no mobility and must either let his land for the cultivation of barley or not at all. It must be supposed also that he can bear it, that his rent *minus* the licence is a positive quantity. Theoretically it would seem that, in general and when the demand for the commodity is not perfectly inelastic, the consumer would, in the long run, only be affected when the licence exceeds the rent. Nor even then is the operation of the licence quite so simple as it is sometimes taken for granted in the books.<sup>5</sup> More practical

<sup>1</sup> As to lands, see Mill's *Political Economy* passim; as to houses, Marshall's *Principles of Economics*, sub voce "Margin of building."

<sup>2</sup> Professor Marshall's useful phrase.

<sup>3</sup> In this hypothetical analogy the effect of foreign trade on price may be left out of sight as an incident not relevant to the building industry.

<sup>4</sup> In the case of agricultural produce, as Mill points out (Book V. ch. iv. § 3, par. 1), if the tax diminishes consumption, "it to that extent contributes to throw back agriculture upon more fertile lands or less costly processes and to lower the value and price of corn; which therefore ultimately settles at a price increased not by the whole amount of the tax, but by only a part of its amount." There is, theoretically, an analogous diminution of the expenses, with the rise of the "margin," of building (the law of diminishing returns prevailing); but it may be doubted whether this effect is considerable.

<sup>5</sup> See above, p. 78.



exemplifications of these theories will be given in subsequent answers.

6. In the answers which follow relating to imposts on houses, I shall suppose, when the contrary is not expressed, that the so-called "London leasehold system"<sup>1</sup> prevails. Statements made with special reference to that system can easily be adapted to other circumstances.

(a) To determine the incidence of the inhabited house duty is a problem so complicated that it is expedient to break it up by first considering an ideally simplified case, then introducing one by one the concrete complications.

(1) First let us suppose the inhabitants of a town to deal with the owners of houses already built, abstracting the competitive influence exercised by new houses and other towns. For periods and circumstances which permit this supposition a tax such as the Inhabited House Duty will, theoretically, fall entirely on the owners on the expiry of each occupant's lease (that is, on an average, in less than three and a half years after the imposition of the tax, supposing that the term of the occupation-lease is sometimes seven years and sometimes three). For, the supply of houses being perfectly inelastic, the owners have no choice but to throw these their wares upon the market without a reserve price; they must accept that price which just carries off the supply. Since the imposition of the duty does not increase the demand of the occupants, the payment per house which they can be got to make will not be increased. The payment now made by the occupant, consisting of rent *plus* tax, will be the same as the payment made before by him, consisting of rent alone. The payment received by the owner will be less than before by the full extent of the tax.<sup>2</sup>

(2) Now, let us take into account the circumstance that houses are not eternal. First, let us suppose the town, or other circumscribed region, to be renewed without being enlarged, new houses from time to time being built on old sites, but not on new sites. If the average duration of a house is 50 or 100, or generally  $n$  years, then an  $n$ th part of the total number of houses in the town will be yearly produced, and offered for occupation by building entrepreneurs. These entrepreneurs, being free to apply their capital otherwise than in building, will require as

<sup>1</sup> There is a good description of the system in the final report (1892) of the Select Committee on Town Holdings, p. vi.

<sup>2</sup> The matter is put more technically in my study on the Pure Theory of Taxation (above, S).

good profits in that industry as in any other not subject to a special tax. Whence it follows, by familiar reasoning, that the duty, being an *ad valorem* tax on the price paid for a consumable article, falls entirely on the consumer—the occupant. The occupants of new houses then pay the entire duty. But it is not theoretically possible that, in the same market, similar articles should be obtained for different prices: old houses for the same rent as before the imposition of the tax, new houses for that rent *plus* the tax. If, as a first approximation, we ignore the difference in the demand for new and for old houses, the pressure exercised by the builders of new houses will, in the course of less than seven years, result in imposing the tax<sup>1</sup> on the occupants of the old as well as the new houses.

(3) A similar conclusion is obtained when we take into account the circumstance that where the population is increasing new houses will be required in new sites as well as old ones; still assuming that new and old houses are exactly similar articles. But, of course, this is a very inexact assumption. New and old houses are not interchangeable like sovereigns of different dates; urban and suburban residences are not identical articles, but more or less perfect *substitutes* for each other.

(4) Account being taken of this relation between new and old houses, we shall find that the effect exercised by the new buildings upon the house-market is similar in kind, but not in general equal in quantity, to that which was described under heading (2). In the limiting case, when the rivalry between the new and old houses is null, the whole tax falls on the owner, as in case (1). In general it may be supposed that the case lies between (1) and (2); that the occupier of an old house pays a part, but not the whole, of the tax. But this natural supposition is not quite correct. The extra payment imposed on the occupants of old houses in consequence of the tax is not limited to the extent of the tax. Zero is, indeed, an inferior limit, but there is no definite superior limit. The imposition of the tax may so disturb the delicate balance of demand for the rival articles, central and suburban—or, more generally, old and new—houses, that in the new equilibrium the occupants of old houses pay a rent increased by more than the tax, the owners of old houses positively gain by the tax.<sup>2</sup> This *curiosum*

<sup>1</sup> The whole tax, if we admit what may be called the classical assumption that the expenses of building are not sensibly altered by the diminution of demand for houses which may be caused by the rise of the price paid by the consumer—the occupier. (See the penultimate note to Q. 5.)

<sup>2</sup> Above, S, p. 81.

in the theory of value seems only to be of importance as it tends to confirm the conclusion that the occupier will bear a considerable portion of the tax.<sup>1</sup>

(5) There is next to be introduced the competition between different towns. Residences in different places constituting rival commodities, we may see, by an extension of the analysis above employed, that a uniform tax may so disturb the balance of complex demand as to cause a certain rush of inhabitants to one town from another. The owners of houses already built may gain more rent by the increase of demand consequent on such disturbance than they lose through that more immediate action of the tax which was indicated under the preceding head. Conversely, they may lose rent through the competitive action referred to under the present head. As regards the distribution of the burden between owner and occupier, the competition between towns does not tend, on the whole, to alter the proportions.

(6) Lastly, account is to be taken of "friction." With respect to the distribution of the burden between owner and occupier, friction acts in two opposite ways. It obstructs that transference of the tax from the occupier to the owner which was indicated under head (1), and that transference from the owner to the occupier which was indicated under heads (2), (3), and (4).

In the first case, the process by which the burden tends to be shifted from the occupiers to the owners is as follows:—If, before the imposition of the rate, each occupier had as much house accommodation as he wanted at the old price (the rent of occupation), thereafter he will have more house accommodation

<sup>1</sup> The eminent Mr. N. G. Pierson, of Holland, in his noteworthy discussion of this subject (in the second edition of his *Leerboek der Staatshuishoudkunde, eerste deel*, p. 166 *et seq.*) has come to a different conclusion, namely, that the occupier of a house with a high ground rent, as in a central region, will, at most, pay only as much tax as what is paid by the occupier of an exactly similar house with [little or] no ground rent, as in a suburban poriphery. Mr. Pierson deduces this conclusion from the assumption that the difference between the rents of the two houses may be expected to be the same after and before the imposition of the tax (or, at least, not greater after than before). This assumption would be appropriate if two similar houses dissimilarly situated [*"twee huizen van ongelijke ligging en alleen daarom in huurwaarde verschillend,"* loc. cit. p. 178; *"twee getijksortige percelen,"* p. 171] could be regarded as two units of the same commodity, analogous to two quarters of barley grown on a highly rented site and at the margin of cultivation respectively. But I submit that the two houses ought rather to be regarded as *different quantities of commodity*, analogous to the quantities of barley produced by the outlay of the same capital at the margin and on a highly rented site. There is no "anomaly" (loc. cit. p. 179) in the supposition that the difference between the prices paid for those two quantities of produce should be increased by a tax. It is the received theory, as stated, e.g., by Mill (Book V. ch. iv. § 3, pars. 2, 3, 4).

than he demands at the new price (the rent *plus* the rate). Accordingly, he will seek to disembarass himself of this superfluous housing by moving, or threatening to move, to less extensive premises. But this action is much clogged by friction. The gain in utility (or "consumers' rent") which is effected by taking just as much as he wants at the new price may well be over-balanced by the expense and trouble of moving.

Case (2), at first sight, does not seem to admit of as much friction. As the owner of a new house will not pay the rate, the occupier must undertake to pay it; but he will not do so while equally good old houses are obtainable at the same rent and less rates. As Mr. Cannan says: "Who will stand up and confess that he took 76 — Street at £100 a year, and subject to £20 of rates, when an exactly similar house next door . . . was to let at £100 a year, and only £12 of rates?"<sup>1</sup> However, in the case before us, it may well be that the paucity of new houses is a circumstance favourable to friction. That *nth*<sup>2</sup> part of the town or region which is yearly renewed may not be sufficient, so to speak, to leaven the whole region with the effect of the tax. It is, perhaps, significant of the preponderance of friction—the impotence of what may be called the normal forces—in this case, that Mr. Pierson, in his discussion of a rate on houses in a circumscribed region, such as *The City* in London,<sup>3</sup> considered as unaffected by the competition of extra-urban houses, has taken no account of the competitive influence exercised by *new houses within the region*. The action of friction in favour of the occupier in case (2) may be enhanced by the characteristic of case (4), the imperfect capacity of new houses to act as substitute for old ones.

Case (3) is affected less by the circumstance of paucity, and more by the circumstance of imperfect substitution.

The principal forces, normal and frictional, which are at work have now been analysed. But I have not sufficiently accurate knowledge of the facts to determine in concrete cases the resultant of all the forces. Doubtless, in virtue of friction, it may be expected that more or less of the tax will stick where it hits. But whether this expectation is greater when the tax is imposed on the occupier than when it is imposed on the owner, I am unable to say.

So far as to the incidence of the inhabited house duty on occupiers and owners. There is still to be considered its incidence on the ground landlord. This action is, of course, very slow, making itself felt immediately with respect only to the small

<sup>1</sup> *History of Local Taxation*, p. 135.    <sup>2</sup> Above, p. 134.    <sup>3</sup> *Loc. cit.* p. 178

proportion of sites for which new leases are being created at any time, with respect to the average of sites not until after many years—perhaps 40 or 50.<sup>1</sup>

Theoretically, a house being regarded as a sort of product grown upon the land,<sup>2</sup> a house tax paid by the occupier tends to diminish the ground rent through the diminution of the demand on the part of building entrepreneurs for sites. The limiting case is when the demand for houses is quite inelastic. Then the same amount of house accommodation is demanded before as after the imposition of the tax. The occupier pays the same rent as before *plus* the duty; the builder obtains the same profits; the ground landlord the same rent. In general, the imposition of the tax causes a diminution of demand for house accommodation; intending builders divert their enterprise to other investments; the ground landlord suffers through slackened demand for sites. But what the Exchequer loses through the diminished use of houses is not, in general, equal to what the ground landlords lose through the diminution of demand for sites.<sup>3</sup> Nor would the equality be of any fiscal significance, since what is lost by the ground landlords is not gained by the Exchequer. Indeed, the question has been raised whether an effect of this sort—detrimental to a certain class, without any corresponding benefit to the Exchequer—can properly be described as the *incidence* of a tax.<sup>4</sup>

(b)—(1) The principal difference, with respect to incidence, between the inhabited house duty and house rates is that the former is uniform, the latter may vary<sup>5</sup> from place to place. So far as such variation does not occur, the preceding analysis holds good of house rates. Where one locality is more heavily rated than another, the excess of rates may or may not correspond to extra advantages offered to occupants. For instance, a municipality may give more service in the way of lighting and cleansing than others in return for an equivalently heavy rate, or it may give

<sup>1</sup> Supposing the average term of a building lease to be 80 or 100 years.

<sup>2</sup> See answer to Question 5, last paragraph. Compare Mr. Goschen (*Local Taxation*, p. 164):—"The inhabitant of the house is, in reality, the consumer of the commodity produced by the builder."

<sup>3</sup> Compare the formulæ given by the present writer in section 1 of the article on the Pure Theory of Monopoly (E).

<sup>4</sup> A dictum carrying the combined weight of Ricardo's and Adam Smith's authority can be quoted on the affirmative side of this verbal question. "The payment of this tax, then, would ultimately fall on the occupier and ground landlord, but 'in what proportion this final payment would be divided between them,' says Adam Smith, 'is not, perhaps, very easy to ascertain.'"—Ricardo, *Political Economy*, ch. xiv. (Taxes on Houses).

<sup>5</sup> Dudley Baxter has pointed out this difference very clearly.—*Taxation of the United Kingdom*, p. 65.

the same service, *e.g.*, in the way of drainage, at a heavier rate corresponding to disadvantages of situation.<sup>1</sup>

To begin with the second case, the differential rates will tend to divert demand from the locality, with the following results to occupiers and superior interests. The occupiers who are not driven away suffer the aggravation of rates; the occupiers who are driven away suffer a loss of *utility* (or "consumer's rent"). The owners during the remainder of their terms, and the ground landlords ultimately, suffer a loss of rent consequent on the slackened demand for houses in the locality.

These results are counteracted when the extra rates correspond to extra benefit. If that benefit is immediate, none of the parties need suffer. Demand is not slackened; rents do not fall. If the benefit is a future result of present outlay, both occupiers and owners will suffer temporarily in the ways above described. It is not true of differential rates that the occupier bears all the cost of improvements by which the owner is ultimately benefited.

(2) As pointed out by numerous authorities,<sup>2</sup> a rate on trade premises falls partly on the customer, partly on the trader, partly on the owner, in proportions difficult to determine: *ceteris paribus*, more upon the customer the greater his preference for dealing in the particular locality; on the trader the greater the loss incurred by him in moving to another place (or business); on the owner the longer his term. The only remark not quite familiar which occurs to me is that the owner of old premises is not quite so defenceless as might be supposed, since he benefits by the competitive action which is propagated from new premises in the manner indicated under head (a) 2.

(c) According to Ricardo, "a tax on rent" [in the proper sense of the term] . . . "would fall wholly on landlords." But "a tax on rent, as rent is constituted" [*i.e.*, true rent *plus* "quasi-rent," as we might now say] . . . would be a tax on the profits of the landlord." "The capital expended on these buildings, etc. [the buildings and the improvements which are made by the landlord's stock], must afford the usual profit of stock; but it would cease to afford this profit on the land last cultivated, if the expenses of these buildings, etc., did not fall on the tenant, and if they did, the tenant would then cease to make his usual profits of stock, unless he could charge them on the consumer."

<sup>1</sup> Compare Mr. Cannan's valuable analysis of the causes of inequality in local rates.—*ECONOMIC JOURNAL*, Vol. V. p. 31.

<sup>2</sup> *E.g.*, Professor Sidgwick, *Political Economy*, 2nd edition, p. 575, note; Professor Bastable, *Public Finance*, 2nd edition, p. 421; Mr. Blunden, *Local Taxation*, p. 55.

This general theory must be applied with caution to the present circumstances. It may be doubted whether English landlords expect their outlay on their estates to afford "the usual profit of stock"; the supply of such expenditure follows a special law, not that of the general investment-market. Moreover, with respect to produce for which there is a world market, such as wheat, the effect of agricultural rating in one country upon the price must be insensible. From the first incident it is deducible, I think, that the landlord will bear some part of the tax on the quasi-rent; from the second incident, that he will bear the greater part. On the other hand, as Mr. Blunden has ingeniously observed,<sup>1</sup> the farmer will not be able to shift on to the landlord any burden which is common to other industries, in particular that part of the rate which falls on his dwelling-house, say 5 per cent. of the total agricultural rate. Altogether, theory leads to the conclusion that the greater part of an agricultural rate falls on the landlord.

These theoretical tendencies are masked by friction, the action of which seems to vary with the conditions of supply and demand. Under the conditions which prevailed when Mr. Goschen wrote his classical report on local taxation, it may have been true that a farmer could not insist on his landlord's reducing the rent in consequence of the imposition of a rate. Dudley Baxter may have been right when he wrote: "On all the evidence that I can collect, I have little doubt that, although in theory the rates are paid by the landlord, yet in practice and on the average of tenancies, a portion of the rates does fall upon the tenant."<sup>2</sup> This portion was estimated by him as one-fourth. But under the present conditions, the "pull of the market" being against the landlord, "friction" seems to favour the tenant. I know of a case in which a set of agricultural tenants, threatened with a school board rate, declined to trouble themselves about the matter, averring their confidence that the whole rate would virtually have to be borne by the landlord. I know of many cases in which the tithe rent-charge was transferred from the tenant to the landlord, according to the Act of 1891, without any concomitant increase of the rent. Friction, as well as theory, seems now to make against the landlord.

(d) Taxes on the transfer of property fall indifferently on both parties, now on the buyer more, now on the seller.<sup>3</sup> Adam

<sup>1</sup> *Local Taxation*, p. 41.

<sup>2</sup> *Taxation of the United Kingdom*, p. 62.

<sup>3</sup> Cp. Professor Bastable, *Public Finance*, p. 547, and the present writer, above, §, p. 68.

Smith's *dictum* that "taxes upon the sale of land fall altogether upon the seller," for that "the seller is almost always under the necessity of selling," cannot be predicted generally of the sale of land including hereditaments.<sup>1</sup> But it is true wherever the proprietor has no use for the property except to sell it. One important application of this theorem is that a tax on the sale of urban sites, like a tax on ground rent, falls altogether on the ground landlord.

(e) As to the incidence of a tax on trade profits, I have only one remark to add to the received theories on the subject. The difficulties which I have elsewhere raised<sup>2</sup> as to the mode in which a tax on the profits of a particular trade is compensated by a rise in price seem to strengthen the probability of the tax acting as a preventive to improvements of production which would otherwise have been adopted.<sup>3</sup>

(f) Adam Smith's *dictum* that taxes on inheritance "fall finally as well as immediately on the persons to whom the property is transferred" is substantially incontrovertible. But there is much to be said for the view<sup>4</sup> that in propriety of speech such taxes fall immediately on the persons *from* whom the property is transferred. It is they who have the power of evading the tax (by donation to the living); it is they who bear the burden of that evasion when they forgo the luxury of bequest. Nor is Adam Smith's "finally" to be interpreted so strictly, but that this tax, like all taxes, will have diffused effects upon accumulation and production.<sup>5</sup>

7 and 8. *Primâ facie* some purposes may be distinguished as purposes for which taxation should be raised locally, namely, those of which the benefit accrues to the inhabitants of the locality exclusively; for instance, amenities which conduce to pleasure rather than efficiency. Conversely the taxation should be raised by the central Government for certain other purposes, such as national defence. But there is a large intermediate class where the benefit cannot be altogether allocated either to the part or the whole, *e.g.*, local police and education.

The criterion thus afforded by the proportion in which the

<sup>1</sup> *Cp.* Mill, *Political Economy*, Book V., ch. v. par. 1, note.

<sup>2</sup> Above, §, p. 78.

<sup>3</sup> This preventive action is indicated by J. S. Mill, *Political Economy*, Book V. ch. iv. par. 2, *sub finem*.

<sup>4</sup> As suggested by Sir Robert Giffen in Q. 63,281 of the Royal Commission on Agricultural Depression.

<sup>5</sup> See Professor Bastable, *Public Finance*, Book IV. ch. ix. par. 9; and compare the present writer, *Economic Journal*, Vol. VII. p. 57, par. 2.



benefit is divided between the locality and the nation does not suffice to determine the proportions in which the expenditure should be borne. Where indeed the benefit accrues wholly to the locality, perhaps the expenditure should be wholly borne by the locality. But the converse does not hold, for it seems to be requisite for the sake of economical administration that some expenditure which is chiefly in the interest of the general public—for instance, the maintenance of the poor—should be largely borne by particular localities. *A fortiori*, the criterion is not available where the proportions in which the benefit is divided cannot be ascertained.

As Mr. Cannan says, "the expenditure does not fall into two clearly defined classes, and even if it did, the most consummate statesmanship would find it difficult always to reconcile the extension of the area of chargeability with economy in administration."<sup>1</sup> I am prepared to think that here, as in some other subjects, no principle is available except the general one which justifies the method of comparing, and in some sort averaging, the unanalysable judgments given by competent authorities conversant with the circumstances of each case.

9. It is convenient to answer this question after Question 10, and along with Question 12.

10. Ground rents should be specially rated, when newly created, in localities where an "unearned increment" has accrued to landlords. A contribution may thus be obtained from a source which would not otherwise be tapped.

This conclusion is at variance with reasoning which many experts have put before the Town Lands Committees.<sup>2</sup> It has been argued that as a rate on the occupier's rent ultimately burdens the ground-landlord, so a rate on the ground rent ultimately burdens the occupier. This reasoning seems to be incorrect in that it ignores what may be called the *marginal* character of economic transactions. If to each site there corresponded a building of a certain invariable cost, then it might be true that, if the rate is added to the occupier's payment, an equal amount must be subtracted from the ground-landlord's receipts; and, if the rate is subtracted from the ground-landlord's receipts, an equal amount must be added to the occupier's payment—the builder's profits being constant. But, theoretically, in general the cost of

<sup>1</sup> *History of Local Rates*, last page.

<sup>2</sup> See Evidence, 1887, Qs. 3,360 and 11,285; 1888, Qs. 2736, 2837, 3188, 4442, 9355; 1891, Q. 1969 *et seq.* (particularly lucid); see also Mr. Sargent's evidence before the Town Holdings Committee and his *Urban Rating*, pp. 45–52.

the building on each site is not to be considered as fixed beforehand. The builder will push his expenditure up to the point at which his last or "marginal" increment of outlay is likely to be only just compensated by the increase in the rent which he is to receive from the occupier. Accordingly, where there is a virtually *ad valorem* rate, the addition to the rate due to the last increment of value added to the house must be paid entirely by the occupier. Therefore, if we may treat house accommodation as a commodity sold in a market,<sup>1</sup> the rate, not only on the marginal increment but on the whole value of the building, will be paid by the occupier.

It may be objected that if the rate on the ground rent is applied to relieve the occupier, then the demand for houses being thereby increased, occupier's rents and ultimately ground rents will go up; the last state will be no better than the first.

This objection would have weight if it were proposed to apply the rate on each site to relieve the occupiers of that site. This proposal will be considered below as a case of division between the occupier and superior interests (see answer to question 12). But here we are entitled to assume that the proposed ground rate is applied to the relief of occupiers generally, or, what comes to the same, to the execution of improvements for which otherwise additional rates would have been imposed on the occupiers. No doubt the improvements tend to increase demand for residences, and this increased demand will tend to increase the occupiers' rents. But this tendency would equally have operated if the improvements had been executed at the occupier's expense, and the occupiers are gainers, by having them executed at the expense of the ground-landlords. No doubt the increased demand for residences will tend to increase ground rent; but the occupiers will gain by having these fresh accretions of ground rent in part applied to further improvements.<sup>2</sup> It would be a strange com-

<sup>1</sup> Compare Marshall, *Principles of Economics*, third edition, Appendix, Note XIV.

<sup>2</sup> The theory, as here stated, is not touched by the examples which Mr. Sargant has adduced in his *Urban Rating* (p. 47 *et seq.*) to prove that rates fall upon ground rent. His arguments are, perhaps, not aimed at, at any rate they do not hit, the position here taken up; that a special rate on the ground rent falls altogether on the ground landlord.

A case which has been confidently appealed to (by the writer of the *Digest of Evidence*, given before the Town Holdings Select Committee, Vol. II. p. 200), adduced by Colonel Sackville West, agent for Lord Penrhyn, in his evidence before the Town Holdings Commission (1888, Q. 11,560 *et seq.*). Of two parishes in the neighbourhood of the Penrhyn quarries, the rates of cottages were paid in Llandegai parish by the lessor, Lord Penrhyn; in Llandechid parish by the lessees, his workmen; and the ground rent per house in Llandegai was greater than the ground rent in Llandechid by almost exactly the amount of the rate per house,

plaint against a newly discovered source that, after it had been tapped, it was apt to be replenished.

While thus holding that the proposal to rate ground rents is theoretically sound, I hesitate in such a matter to follow pure theory very far without the support of specific experience. Possibly a rate of so much per cent. on ground rents generally—or on any other scale that could practically be employed—would prove *differential* in the sense which has just been explained.<sup>1</sup> Perhaps the market for house accommodation is not so perfect as the theory requires. Probably there are serious technical difficulties in the way of applying the theory. It may be difficult to distinguish true ground rent, which is the object of the proposed rating, from returns which the landlord may receive for the execution of improvements preliminary to building—for instance, drainage or road-making. It may be difficult to prevent the ground landlord from evading the proposed rate—for instance, by accepting a fine from the building lessee in lieu of a portion of the ground rent. It may be difficult to define the region in which ground rents, having received an “unearned increment,” are a fit object of special taxation. Moreover, the immediate relief to be obtained from this new source of contribution is small; since ground rents form only a fraction of occupation rents, and new ground rents are created infrequently in the situations where the higher ground rents mostly occur, that is, on sites which have already been built on. However, the source is likely to become more considerable with the growth of population.

It will be remarked that the special rating of ground values is here based solely on the presumption that an unearned increment has accrued to the landlord. The proposal is not applied to “improvements” in the ground rent due to the landlord’s outlay. It is not applied to ground rents already created. As pointed out by numerous expert witnesses before the Town Holdings Committee, such ground rents are fixed charges, which have not experienced any unearned increment.<sup>2</sup> They have been largely

viz. 9s. This case is somewhat peculiar, in that the ground landlord appears to have been virtually a monopolist. However, the general principle that taxes on rent are borne by the landlord does not entirely fail on that account. If the authorities had seen fit to impose a special rate on the ground rent in these parishes, the landlord would probably have had to pay it all in Llandeochid. (Theoretically, indeed, he could shift a part of it by restricting the amount of land offered.) In Llandogai, he would certainly have the resource of putting the ground rent on the same footing as that in Llandeochid. But where the interests are divided by competition there could be nothing analogous to this latter adjustment.

<sup>1</sup> *Cp.* Answer 12.

<sup>2</sup> I should be prepared to modify this statement upon obtaining evidence that

bought by insurance companies and other prudent investors as specially safe securities; and they would seem to be very unsuitable objects for special taxation.

11. The laws which have been enunciated in Answer 6, for the imposition of a new rate, apply equally to the increase of an old rate. The laws for the reduction or abolition of a rate are given as the negative case of the former. The chief difference—beyond the change of *sign*—between the positive and negative case is due to friction. There is some reason for believing that friction resists an increase less than a reduction of rates. For one of the chief processes by which a change of rate is propagated is the competition between new and old houses, described in sections (2) and (3) of heading (a) in Answer (6). In the case of a new rate being imposed, intending occupiers of new houses bid against actual occupiers of old houses whose leases are expiring. In case of a rate being reduced, actual occupiers of old houses whose leases are expiring bid against intending occupiers of new. The competition is naturally keener in the former case. A slight difference of rate may decide an intending owner to apply for an old rather than a new house. But a considerable difference of rate may be required to determine an actual occupier to incur the trouble and expense of a move.

12. Division of rates between owner and occupier, whether by deduction or otherwise, profits little theoretically. If there is a perfect market in any commodity—it may be house accommodation, or it may be tea—the imposition of an ordinary tax (or rate), disturbing the balance of demand and supply, results in a rise of the price paid by the consumer. But it makes no difference to the result, theoretically, whether the tax collector takes his share of the price from the hands of the buyer or those of the seller.

The exceptions to this general proposition are principally due to friction. But there are some exceptions valid even in theory. A tax by way of licence to produce is, under certain circumstances, borne entirely by the producer, as pointed out in the answer to Question 4. If, then, a tax of this sort is commuted in part for an ordinary tax on the consumer, the producer will, theoretically, gain by the division. A consumer's licence presents a similar incident. "In Holland," says Adam Smith, "people pay so

the capital value of such fixed charges is generally and materially raised by an increase in the value of the houses on which the ground rent is charged. I am assuming (1) that, as Mr. Sargant says (*Urban Rating*, p. 101), "if it [the charge] is well secured, the addition can be but trifling," and (2) that it generally is well secured.

much a head for a licence to drink tea." If the licence was so much, irrespective of the quantity of tea drunk, and not large enough to deter many from becoming tea-drinkers, then, the "final utility" of tea not being sensibly affected, the tax would be borne altogether by the consumers. Accordingly, they would be permanently gainers by the division of the impost with the producers.

I don't know that this theory has much bearing on house-rates in this country. Abroad, perhaps, some exemplifications could be found. In Austria the "house-class" tax is proportioned to the number of habitable dwelling-rooms irrespective of the style of architecture. "The wealthy owner pays no higher rate of taxation on a marble edifice . . . than the owner of a common brick tenement with the same number of rooms."<sup>1</sup> If this tax was not large enough to cause a material reduction of the number of rooms inhabited, the burden would stick where it hit; a division of the tax between owners and occupiers would be effectual.

The following theory is more germane to the purpose in hand. If the occupier of a new house be entitled to deduct a portion of his rent from the ground rent, then, for reasons above assigned,<sup>2</sup> the ground landlord will be unable to shift this charge. Thus the occupier of a new house will experience a real relief which will be propagated, by the influence of competition, to old houses in the neighbourhood. The rents of those old houses will be reduced, the rates remaining the same; so that, even without division, the burden would, *pro tanto*, be shifted to the owners. Division, thus fortified, would be even theoretically effectual.

The buttress thus afforded to the project of division is itself liable to give way. It is threatened by the competition with houses on cheaper sites. The ground rents in such situations will not be large enough to afford substantial relief to the occupiers. Intending occupiers of such houses will therefore, according to the theory stated in Answer 6 (a) (3), press in and compete against the occupiers who are obtaining substantial relief by the deduction of ground rents. The advantage promised by reduction to the occupiers of houses with expensive sites will thus be shifted back to the owners and, ultimately, the ground landlords. Things will come round again, after much wasted trouble, to the *status in quo ante*.<sup>3</sup>

<sup>1</sup> O'Meara, *Municipal Taxation*.

<sup>2</sup> See Answer 10.

<sup>3</sup> *Op. Answer 10*, p. 143.

However, it is a tenable supposition that residences in neighbourhoods where the ground rent of new houses is high and those in which it is low are very imperfect substitutes for each other; that, even in the absence of friction, competition between them is feeble. Accordingly, the relief of occupiers by a certain percentage, say, 30 per cent. of the ground rent, though it would amount to different percentages of the occupiers' rent in different localities, say 12 per cent. in central and 6 per cent. in peripheral neighbourhoods, yet would fail to disturb the balance of demand for houses in those respective situations. On this supposition the division of rates between owner and occupier, buttressed by deduction from the ground rent in new houses with newly created ground rents, might stand. As conducive to the working of this arrangement the deduction of a moderate proportion only, say a third, of the occupier's rent may be recommended. Presumably this proportion should be deducted from the owner in the case of old houses, in the case of new houses with newly created ground rents from the ground landlord up to a certain proportion of the ground rent, say a third, and the remainder from the owner.

It will be remarked that in this reasoning, as throughout the answers, it is presumed that in the case of a new house the owner does not pay the rate, since he expects the ordinary profits on his investment—a circumstance which removes the case from the analogy of the income tax (referred to in Question 12), since the income tax, not being special to investment in building, cannot be shifted by the building owner.

Apart from the special arrangement which is here propounded as even theoretically defensible, I think it probable that in virtue of *friction*, if an occupier by whom a rate had hitherto been paid (Question 12) were empowered to deduct part of the rent from the owner, part of the burden would be thrown on the owner.

Altogether I am disposed to recommend that "local rates should be divided between owners and occupiers" (Question 9) as a means to that end; which appears to me desirable so far as owners are, or are about to be, in the enjoyment of unearned increment.<sup>1</sup> But, before pressing this recommendation, I should require to be satisfied that the principle of taxing unearned increment would be fairly applied. Perhaps some sort of court to make allowance for hard cases would be required. It should be observed that exemptions granted to individual owners would be ineffectual, since no individual could stand out for better terms than would be current in the neighbourhood. Exemptions could

<sup>1</sup> *Cp.* above, p. 142.

only be granted in favour of (the owners in) regions or zones practically isolated from external competition. As an additional precaution it might be recommended that the rule should not come into force until after the expiry of the occupier's lease; or at least not within some three years after the enactment. With these precautions the division could do little harm; it might do some good, and seem to do more. What seems may be as important as what is for the political purpose of appeasing discontent and getting municipal improvements adopted.<sup>1</sup>

Friction is most likely to be effective when the effect required of it is not very great. Friction may resist the force of gravity on a slope of 30 degrees, but fail to do so on a slope of 60 degrees. On the score of friction, therefore, as well with reference to the special deduction from ground-rent above proposed, it may be recommended that the deduction should not be very large; say, a third of the occupiers' rent. This proposal may square with the fact that it is difficult to give the owners a voice equal to that of the occupiers in the imposition of rates.

13. (a) The effect of a *progressive* rate would be to lighten the contribution of the poorer householders and thereby probably to make the distribution of fiscal burdens more equitable; possibly, to make the working classes more efficient. This desirable result is apt to be reduced by friction in the numerous cases<sup>2</sup> in which the rates are paid by the owners. *A fortiori* if, as testified by some,<sup>3</sup> the owners of small tenements act as monopolists. For in this case the relief of the occupiers will be, even theoretically, not indeed null, but probably less than in the case of perfect competition.<sup>4</sup> And practice may lag even further behind theory.

(b) An obvious tendency of rating property differently, according to its character and purpose, is to divert demand to the more favoured conditions. But in the more important existing cases of such difference, *e.g.*, between agricultural and urban rates, between rates on inhabited houses and those on trade premises, I do not suppose that this effect is considerable.

14 and 15. As to methods of raising revenue for local pur-

<sup>1</sup> Mr. Costelloe, among other witnesses before the Town Holdings Committee, insisted much on the impossibility of getting improvements adopted—the “dead-lock” of the present system. *Cp.* Final Report, 1892, p. xxi: “In our opinion the change would do much to remove the sense of injustice which, whether rightly or wrongly, is no doubt at present very widely entertained.”

<sup>2</sup> According to Mr. Sargent, three-fourths of all the cases.—*Town Holdings Committee*, Q. 4304.

<sup>3</sup> *Cp.* Mr. Costelloe's evidence before the *Town Holdings Committee*, 1890, Q. 4529.

<sup>4</sup> See Index, s.v. *Monopoly*

poses otherwise than by rates, I suggest that accurate information should be collected as to the expedients resorted to in foreign municipalities. At the same time, attention might be given to the teachings of experience abroad concerning the incidence of local taxation.

I express the opinion that, if such information is worth obtaining, it is worth printing legibly.