CAN TAXES BE FAIR? SHOULD THEY BE?

William S. Peirce

We hear references to fairness and taxation all the time. The president calls on the rich to pay their fair share. Organizations actively promote the "fair tax." If you study public finance, you will hear much about specific versions of fairness in the form of horizontal equity (that equals should be treated equally) and vertical equity (that unequals should be treated in an appropriately unequal way). Although vertical equity has some echoes of Aristotle (*Ethics* 5.3), the juxtaposition of the concepts of fairness and taxation is a recent phenomenon, beginning in the late eighteenth century—the intellectual climate that gave us Adam Smith, the American Revolution, and the French Revolution. That climate was, of course, the culmination of centuries of development of parliamentary control of the sovereign, as well as the evolution of Judeo-Christian concepts of natural law and individual rights.

My topic is already impossibly large, but I want to sketch out an earlier view of taxation that explains why the pre-Enlightenment references to "fairness" are so scarce. Lacking the time and knowledge to review the facts of ancient history, and in the spirit of Adam Smith and the Scottish Enlightenment, I will engage in some "theoretical or conjectural history" inspired by Mancur Olson.[1]

Imagine yourself in a squalid village surrounded by wilderness a thousand or so years ago. You and your neighbors are engaged in the daily struggle to scrape together dinner. A cloud of dust appears on the horizon, followed by the thunder of galloping hooves. The villagers scramble to hide from the gang of roving bandits who kill or rape anyone they see, steal whatever they can carry, set fire to the rest, and gallop off. The surviving villagers crawl out of their hiding places and try to piece together their squalid life before winter sets in, knowing that the next gang of bandits may gallop in at any time.

Now put yourself in the position of the roving bandits. (History is written by the winners.) You ride for days through the wilderness, risk the perils of attacking and plundering, and have very little to show for the effort because squalid villages provide scant booty. Eventually, the more perceptive roving bandits realize that by settling in a

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village as stationary bandits and protecting the inhabitants from other marauders, they can induce the villagers to work harder, accumulate capital, produce more, and provide them with more loot than they could extract by plunder. The stationary bandits can evolve into government by providing internal order, judging disputes, defending property rights, converting indiscriminate looting into predictable taxes, and providing the public goods that increase production and, hence, tax revenues—roads, bridges, irrigation, training in useful skills, etc. Although the villagers became safer and more comfortable once the roving bandits evolved into stable government, there was no doubt that the government was an alien power, extracting surplus from the people. Taxes were not described as "fair" or "unfair" but rather as "tolerable" or "oppressive." A "good king" was someone who understood that arbitrary exactions and high tax rates did not yield him as much revenue as more moderate and predictable rates that allowed his subjects to prosper.

A perhaps more familiar story is found in 1 Samuel 8:5–18. Samuel judged Israel, but when he was old and his sons were corrupt, the people requested a king "like all the nations." Samuel explained what kings are like:

> He will take your sons, and appoint them for himself, for his chariots, and to be his horsemen; and some shall run before his chariots. And he will appoint him captains over thousands, and captains over fifties; and will set them to ear his ground, and to reap his harvest, and to make his instruments of war, and instruments of his chariots. And he will take your daughters to be confectionaries, and to be cooks, and to be bakers. And he will take your fields, and your vineyards, and your olive-yards, even the best of them, and give them to his servants. And he will take the tenth of your seed, and of your vineyards, and give to his officers, and to his servants. And he will take your menservants and your maidservants, and your goodliest young men, and your asses, and put them to his work. He will take the tenth of your sheep: and ye shall be his servants.

Again, the picture is that of an outsider who takes whatever he wants from his subjects. Fairness is not an issue.

The alien power did not always settle in the subject territory. The Roman Empire and many others extracted tribute from weaker nations. Often local agents (the hated "publicans" of the Bible) would be granted the tax franchise for a particular area. Each agent was responsible for paying the contractual amount to the government but could keep whatever he could squeeze out of the populace. This ancient device of "tax farming" persisted in some form for many centuries, which suggests the value of using someone with local and particular knowledge to estimate what the government could extract from taxpayers. The problems with authorizing an agent of government to squeeze an arbitrary amount from the taxpayer have led most commentators to condemn any practice that seems to put revenue agents on commission.

The details of the taxes and forms of government varied from place to place and time to time, but from the viewpoint of the mass of mankind, the differences were not great. The masses could expect that nearly all the surplus above subsistence would be extracted from them either as taxes or as rents to a landlord. When taxes became intolerable, the masses were squeezed to the point where population would actually be decreasing

from malnutrition or because people fled from the high-tax civilization to refuge with the barbarians.

Even before the great invasions of Rome in the fifth century, central control of the empire had weakened. As taxes on farmland were raised to the point where small farmers abandoned their plots, the large landowners absorbed the smaller plots and became the feudal lords who contended with each other and with kings for power and taxes throughout the Middle Ages. Much of the political history focuses on barons, dukes, princes, and kings, but the maneuverings of these folks for land and revenue made little difference to the mass of mankind. Nevertheless, the concept of justice in taxation was developing, and property rights and contracts retained their force. The teachings of the Church became increasingly important: "God will certainly punish anyone who reinstitutes an old tax."[2] New taxes also were forbidden by the Edict of Paris in 614, and it was expected that an *exactio inaudita* (unheard-of tax) would provoke divine retribution.

Kings would often have to ask the barons for special assistance to fund wars. This was generally granted for defensive wars, but not for offensive expeditions, which were expected to be self-financing through plunder and tribute. Montesquieu (*The Spirit of the Laws*, book 30) cites a number of contracts between kings and cities or particular populations setting, among other matters, the taxes that could be levied on the city or group. These examples are from the seventh to the twelfth centuries in Western Europe when the king, however limited the geographic extent of his kingdom, was the highest earthly power until his throne was usurped or his kingdom was conquered. Yet kings did feel bound by their contracts. Whether this was evidence of a fear of eternal retribution, some innate ethical feeling, or a pragmatic calculation of the value of being known to keep one's word, or some combination of these, the result was to strengthen an ideal of justice in taxation that involved stability, predictability, and appropriateness.

Today *just* is often used as a synonym for *fair*, but the medieval concept is more closely related to the idea of being fitting, proper, and lawful. Plato's potter (*Republic* 421c–427c) should not be paid either too much or too little because only the optimum pay would result in the maximum production of high-quality pots. This is purely an efficiency rule. It has nothing to do with fairness. Aristotle (*Ethics* 4.2) described the contributions that a man should make to his community. They should reflect his wealth and station in life, being neither too cheap and tawdry nor too extravagant. For example, a very rich man might present a well-equipped naval vessel to his city. Someone with less wealth could offer a good banquet to the poor of the city. By the time St. Thomas Aquinas brought the later works of Aristotle into the mainstream of Western scholarship, that version of justice in taxation was firmly established. That is, the individual's contribution to the community should be somehow proportionate to the wealth and standing of the individual, but there was no thought of using taxes to change the wealth of one person relative to another.

King Louis XIV is reputed to have responded to reports that the people were complaining about high taxes by stating, "It is all mine anyway, I can take whatever I want." That claim is a throwback to the view that taxing power is just the continuation of the plunder by the roving bandits that is justified by the power of the government. In stark contrast, the roughly contemporaneous words of John Locke (1690) define the new

intellectual atmosphere: "Every man has a property in his own person; this nobody has any right to but himself. The labor of his body and the work of his hands, we may say, are properly his" (*The Second Treatise of Government*, section 27). That leaves no room for slavery or feudalism and room only for those taxes to which he has consented. At this stage, reached in different countries at different times, it becomes possible and seemingly useful to speak of "fairness" in taxation. The concept presupposes the existence of a surplus above subsistence for the masses—a surplus that is not considered to be rightfully the property of landowners or governments, but rather belongs to the individuals who create it by their labor.

This rough and impressionistic notion of a real divide in the way intellectuals perceived the world is borne out by a careful study by Alfani and Frigeni.[3] They analyze manuscripts and printed documents from about 1100 to 1830 centering on Italy. They find that people were aware of the vast disparity in wealth throughout that period, but in the earlier years considered it acceptable and a part of a natural or God-given order. This is consistent with Aristotle, Augustine, and Aquinas. Beginning in the sixteenth century, however, they find signs of a shift in the intellectual framework toward free and equal individuals living in a state of nature. This is consistent with Grotius, Hobbes, and Locke.

The concept of the state of nature reflects an abandonment of the medieval (and earlier) concept of a natural hierarchical order. A count of key words confirms the shift: *aequalitas* occurs seventeen times from 1700 to 1785, and 334 times from 1789 to 1830; whereas *aequitas*, which was common prior to the French Revolution, declined afterward. To put it bluntly, the atmosphere shifted from the regal "Why do they complain about taxes, it is all mine?" to the individualistic "What right do those bandits have to plunder any of my hard-earned wealth?"

Regardless of shifts in intellectual climate, the practical administrators needed to raise tax revenue, especially in times of war and with the increasing cost of a professional military establishment. The traditional land taxes, tariffs, tolls, and excises had been stretched to the point where everyone recognized their weaknesses. By the beginning of the nineteenth century, many practical tax specialists thought that "capacity" or "faculty" to earn income was the appropriate tax base. It was commonly held that property was a good measure of faculty in a primitive economy but that it had become progressively less comprehensive, as an increasing proportion of income seemed to be generated without involving much visible property.

When the British prime minister William Pitt was scrambling for revenue to fight the war against Napoleon, he proposed a "property tax" that was, in fact, an income tax. It was adopted in 1806. It relied heavily on "stoppage" (withholding at the source), but there were many difficulties in compliance in that era, when the few written records were considered strictly confidential. One device was to establish committees of men in the same occupation and city who were charged with estimating the income for each of their competitors. The British tax was so thoroughly reviled, especially for its highly intrusive implementation, that when the wars ended and the budget stabilized in 1816, the tax was abolished and Parliament voted to destroy all the records, as had been done with the income tax of 1404. Despite the public bonfire of destruction, the income tax administrator secretly retained a duplicate set (Adams, 347).

In 1842 Prime Minister Robert Peel persuaded Parliament to reinstate the income tax temporarily until the budget was in balance. It never was repealed, nor was the initial 3 percent flat rate maintained. The top rate on earned income peaked at 83 percent before 1979, with a surcharge of 15 percent on investment income above 7,100 pounds. The U.S. had a top rate in excess of 90 percent in the 1950s. So much for the assertions of Seligman, the great champion of the income tax for the U.S., that "the moderate rate [less than or equal to 6 percent] has been an important factor in the success of the income tax [in Great Britain]," and, with respect to Italy, "Obviously an income tax running up to twenty per cent, to which all manner of other kinds of local taxes are to be added, would indeed be unendurable if enforced to the hilt."[4]

The U.S. adopted an income tax to finance the Civil War in 1863. The rate was 3 percent on income exceeding $600, with a 5 percent rate above $10,000. Soon, the 5 percent rate was raised to 10 percent. The tax expired in 1872, when the revenue was no longer needed (Seligman, 437). Still, pressure was building for a permanent income tax. Enormous accumulations of wealth during the rapid growth of the post–Civil War boom stirred the ire of reformers. Moreover, the growth of the free-trade movement created a problem. If the tariffs that had traditionally supported the government, and aided northern manufacturers, were to be reduced, some substitute tax would be necessary.[5] Not least, the Progressive movement, with its enthusiasm for direct government action and control of individual behavior, contributed to the pressure.

An income tax was passed in 1894 but declared unconstitutional. When the Sixteenth Amendment was ratified in 1913, that obstacle was removed and the income tax soon followed, because "wealth is escaping its due share of taxation" (Seligman, 675). The rates were graduated, with a tax of 1 percent of the first taxable $20,000 and then increasing by 1 percent steps, to 7 percent over $500,000 (equivalent to $11.7 million today). When Justice Oliver Wendell Holmes Jr. opined in 1904 (275 U.S. 87, 100) that "taxes are what we pay for a civilized society," he was living in a world of 1 percent tax rates. Is a 40 percent rate forty times as civilized?

The progressive rates of the new law were immediately challenged in court as a denial of "equality," but the Supreme Court allowed the law to stand. This was a significant change, because legal theory and popular opinion had long supported the idea that taxing everyone an equal proportion of income (the biblical "tithe" or 10 percent) was the just way to share the cost of government. To understand the sudden prominence of progressive taxation, it is necessary to look at what the economic theorists had been writing.

Adam Smith's *Wealth of Nations* provides a compendium of the best economic thinking circa 1776. His four Maxims of Taxation (5.2.2) are frequently cited and still cogent, and it is maxim 1 that is especially pertinent here:

> 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.

Smith's advice and discussion have held up remarkably well for more than two centuries, but note that in this maxim, he slurred over the distinction between taxes as a price for the benefits received from government by

the taxpayer (the benefit principle) and taxes as a measure of the ability of the individual to pay or the sacrifice that is inflicted on the taxpayer (ability-to-pay principle). He papers over the distinction by assuming that both approaches point to taxes proportional to income, although in other passages Smith suggests that additional taxes on luxury goods are acceptable because they fall only on the rich for goods they need only to display their status. A great deal of public-finance literature since Wicksell has dealt with the benefit principle.[6]

Presumably, it is fair, and certainly efficient, to charge for services that can be directly or indirectly priced; for example, charge tolls on limited-access highways and finance construction of roads with a gasoline tax. After exhausting the cases where fees for service are technically feasible and politically acceptable, however, governments usually have a lot of bills to pay (for example, the military budget and other aspects of foreign affairs, interest on the debt). This is where "ability to pay" usually becomes the standard.

Instead of making the tax strictly proportional to income, the amount of income necessary for subsistence could be exempted, with a flat rate above that. This is sometimes called a digressive tax. For example, you pay 0 percent on the first $20,000 and 25 percent on everything above that. The marginal rate is 25 percent for everyone above the exemption level, but the average rate never quite gets to 25 percent, although it approaches it for the very rich.[7] Even this modest departure from strict proportionality raised warnings from those who forecast class warfare over the amount to be exempted.

The strong support for progressive taxes in the economic mainstream originated in two separate, but highly interrelated, developments in economic theory during the century following the publication of the *Wealth of Nations.* The first of these is utilitarianism and the second is the dominance of marginal analysis. Jeremy Bentham coined the term *utilitarian* and adopted the slogan "the greatest happiness of the greatest number." Bentham was a lawyer but wrote voluminously in many fields, including the design of legislation. His work influenced economics directly through his writings and indirectly through his sometime coauthor, economist James Mill, and participation in the education of John Stuart Mill, son of James. While the slogan suggests a mathematically impossible double maximization, it does convey the sentiment that has motivated much of the subsequent analysis of taxation and public expenditures, including modern cost-benefit analysis.

Although he did not use the modern words, Bentham wrote his utilitarian analyses under the assumption that the marginal utility of income is declining.[8] This view starts with the plausible proposition that a dollar more or less makes a lot less difference to the rich person than does a dollar more or less to the person who has very few dollars. The extra dollar that allows the beggar to buy a crust of bread increases his welfare (or happiness or utility) more than a decrease of a dollar would decrease the utility of Warren Buffet. Decreasing marginal utility is usually assumed in economics for most ordinary goods and services. You may value one bag of carrots or professional tooth cleaning, but the second one that month is worth less to you and the third even less than that. But is that true for income in general?

Most economists ceased to ask that question after the "Marginal Revolution" of 1870. At about the same moment, William Stanley Jevons (1835–1882), writing in English, Leon Walras (1834–1910), writing in French, and Carl Menger (1840–1921), writ-

ing in German, adopted a form of analysis that a cynic described as "the reinvention of a crude form of differential calculus a couple of centuries after Newton and Leibniz." Nevertheless, this "marginal analysis" soon came to dominate economics and made the concept of decreasing marginal utility of income almost automatic for economists. If we assume that successive units of income have less value, and we assume that everyone is equal with respect to capacity to enjoy income, then the tax implications can be quite dramatic.

If the objective is to collect the required tax revenue while imposing the minimum total sacrifice on society, the appropriate tax is zero up to a certain point and then 100 percent after that. That is, depending on the revenue requirements, the government would set one annual income, for example, $100,000. If you have less than that, you pay no tax. Anything you earn above that is sent directly to the Treasury. Of course, most people realized that this was not going to work well—at least not for long. A few extreme socialists and utopians wanted to believe in it, and even an economic theorist as profound as Francis Ysidro Edgeworth had difficulty in abandoning the spirit of it. Indeed, if one accepts the goal not just of minimizing the sacrifice of taxation, but of maximizing the utility of society, why would you not advocate continuing the leveling by transferring money from rich to poor until everyone had the same income?

A clever socialist, George Bernard Shaw, put it this way: "Socialism means equality of income or nothing, and that under Socialism you would not be allowed to be poor. You would be forcibly fed, clothed, lodged, taught, and employed whether you liked it or not. If it were discovered that you had not character and industry enough to be worth all this trouble, you might possibly be executed in a kindly manner; but whilst you were permitted to live you would have to live well."[9]

Faced with this logic, most economists retreated slightly to the goal, not of maximum utility or minimum sacrifice, but rather to the notion that everyone should endure the same proportional sacrifice of income. Opposition to progressivity was the common position even among the liberal utilitarians of the nineteenth century.[10] The opposition was based in part on the fear that progressivity would diminish incentives to work and invest and hence hobble the engine of economic growth that was essential for raising the laboring poor to a more comfortable level.

Another factor was the fear that breaking the rule of proportionality would lead to continuing efforts to shift all tax burdens to the small minority of the very rich (Adams, chapter 31). It is interesting that the economists, in general, were more caught up in the utilitarian notion that the happiness of society would be enhanced by reducing the burdens on the poor, while the lawyers retained the tradition from history and political philosophy that, in the absence of firm rules (such as proportional taxation), the problems of "faction" as discussed by Madison in *Federalist* No. 10 would tear the republic apart or turn it into a tyranny.

But John Stuart Mill, who had grown up with utilitarianism, added this caution: "For what reason ought equality to be the rule in matters of taxation? For the reason that it ought to be so in all affairs of government. A government ought to make no distinction of persons or classes in the strength of their claims on it. If any one bears less than his fair share of the burden, some other person must suffer more than his share. Equality of taxation, therefore, as a maxim of politics, means equality of sacrifice." Despite the emphasis

on sacrifice, "To tax the larger incomes at a higher percentage than the smaller is to lay a tax on industry and economy; to impose a penalty on people for having worked harder and saved more than their neighbors. It is not the fortunes which are earned, but those which are unearned, that it is for the public good to place under limitation." Moreover, the income tax relies on self-reporting of income and thus "is, in practice, unequal in one of the worst ways, falling heaviest on the most conscientious." Mill's comments provide a hint of the way out of the morass, but before we follow that trail, let us dig ourselves in deeper.[11]

If one accepts the view that the marginal utility of income is diminishing, and one accepts the goal that everyone should sacrifice an equal proportion of his total utility to pay for government, then it is easy to see that rich people should pay more dollars in taxes than should poor people. Does that require a progressive tax on income? It is easy to lapse into that conclusion, but it is incorrect. Briefly, if the loss of a dollar is as painful to a rich man as to a poor, then equal sacrifice would call for equal dollar taxation. That is, a lump sum tax or a head tax—each person must pay a tax of, for example, $1,000/year.[12] That is the extreme of regressivity, unless one considers extremely decadent societies such as the strange world of prerevolutionary France, where, according to Pierre-Samuel Du Pont de Nemours, "One will hardly believe that in order to become noble it is sufficient to become rich; and to cease to pay taxes it is sufficient to become a noble. So there is only one way of escaping taxation and that is to make a fortune" (Adams, 218).

How quickly would the marginal utility of income have to decrease before equal sacrifice resulted in proportional taxation? The answer seems to be that proportional taxation is appropriate if and only if the marginal utility of income curve is a rectangular hyperbola. That is a wonderfully precise answer. Unfortunately, it requires assumptions about conditions that can never be observed. We have no way to observe utility, let alone the shape of the marginal utility curve. Moreover, does anyone believe that the relationship between income and happiness is the same for everyone, or even for any one person throughout a lifetime? And we have not even inquired about the relationship between the happiness of one person and what he observes of his neighbors. In particular, if Mr. Smith is altruistic, deriving pleasure from observing that Mr. Knight is wealthy, and Mr. Knight is envious, deriving pleasure from the poverty of his neighbors, the way to improve the total happiness of society is to tax the altruist Smith and give the money to the mean-spirited Knight. Most of us would probably not vote for such a tax, even if it could be designed and administered.

Yet, the prevailing economic definition of fairness leans on such weak reeds. In the modern public-finance literature, fairness (and, perhaps, efficiency) depends on both horizontal and vertical equity. Vertical equity depends on the degree of progressivity, as discussed above. Horizontal equity requires that "equals be treated equally," but equals in respect to what? Academic tax specialists and reformers in the U.S. have usually begun with a bias toward a comprehensive definition of income.[13] This amounts to adding whatever the person consumed during the year to his increase in net wealth. Thus, it is the power to consume without decreasing wealth.

That includes, for example, wages, interest, dividends, capital gains, rents (including the rent that an owner occupier could have received from his own house), gifts (of cash,

securities, goods, and services). It would not matter where the power to consume came from or how it was used. The British debate, however, often favored the notion that wage and salary income should be discounted 25 percent relative to investment income because wages and salaries end when the recipient dies or loses his job. It is interesting that the U.S. personal income tax provides favorable treatment to income from land and capital, whereas Andrew Mellon, wealthy investor, Treasury secretary for Harding, Coolidge, and Hoover, and considered an archconservative, stated, "The fairness of taxing more lightly incomes from wages, salaries, and professional services than the income from business or from investments is beyond question."[14]

The actual tax law, of course, is a jumble of special treatment for particular sources and uses of income. Ownership of real estate is heavily favored, as is any investment that generates capital gains. Similarly, on the use side, medical expenses, gifts to charities, child-care expenses, historic preservation, energy conservation, electric cars, and saving for education and retirement are among the favored expenditures. Which is fairer, the comprehensive definition or the tax law definition? Each exception to the comprehensive base for particular sources or uses of income is defended in the name of "fairness" by its beneficiaries. It matters because it is (roughly) taxable income, rather than comprehensive income, that determines who is treated as an equal of whom.

In recent years an effort has emerged to consider consumption, rather than income, as the tax base and, thus, the fair basis for defining equality. The classical reasoning for this is that consumption measures what a person uses up from the product of the economy, whereas income should be a better measure of what he produces. John Stuart Mill arrived at consumption as the preferred tax base by an alternate route. In his view, the lower tax on earned income would allow the wage earner to accumulate savings for the years when his earning capacity had diminished. The modern pressure for consumption taxation is driven in part by belief that saving and investment should be encouraged. Some versions of consumption taxation also promise less intrusive administration.[15]

Some of these problems seemed remote prior to 1930, when the federal government took less than 5 percent of GDP. But with total government spending now exceeding one-third of GDP, including massive redistribution, the warnings about control of a dominant faction to prevent exploitation of the rest of society become more pertinent. In the modern era, economists have continued to analyze the effects of taxation on incentives to earn income and to balance these against changes in social utility, defined in some unmeasurable way. The philosopher John Rawls added the twist of assuming that only the income of the person at the lowest level needed to be a concern of public policy. But economists and philosophers of the Rawlsian type do not stop to consider the Madisonian question of what will happen to a tax bill of the most sophisticated design when it is submitted to Congress. Nor do they consider the possibility that the sovereign is a revenue-maximizing entity at war with his subjects; that is, a stationary bandit.

Because of the impossibility of defining a "fair" tax, it is worthwhile searching for a different approach. The comment by Mill, "It is not the fortunes that are earned, but the fortunes that are unearned," provides the starting point. Of course, an income tax becomes totally arbitrary and capricious if the IRS agent has to review your return to judge each receipt for its "worthy

earnedness." Spare us that intrusion! In fact, it is possible to make a distinction between earned and unearned if we are willing to give up the idea of taxing the individual on his income and turn, instead, to a tax levied on the source of the unearned income. This does require giving up progressivity as it is usually defined because that concept applies only to people.

The specific alternative to consider is the land value tax (LVT) as developed with great vigor and insight by Henry George in his bestselling book, *Progress and Poverty* (1879). Others, including the Physiocrats, Smith, Ricardo, and Mill, had discussed the LVT, but George and those inspired by George have worked out the details most fully. To put the matter in its simplest form, the LVT would replace other taxes with a single levy on the market value of the land that each person claims title to. Thus, the mechanics are similar to the existing real estate tax used by most local governments and school districts in the U.S. The difference is that the tax would apply only to the value of the land. All buildings and other improvements would be exempt.

The market value of land reflects the income you could receive just from holding title to the land. Thus, if you happened to inherit a block of vacant land in the middle of Manhattan, or any other thriving city, you could easily lease it to a developer who would do the work of arranging for a building to be built and rented out and managed. The developer would be compensated for his work, but you could just sit back and enjoy the lease payments. Those payments would be described by an economist as "economic rent." The proposed LVT would be designed to take a substantial portion (for example, 90 percent) of the economic rent, but it would be levied as a percentage of the market price of the land, so that you could not avoid it by leaving the land idle. You would have a strong incentive to put the land to work at the optimum moment.

To impose an LVT today while dropping all other taxes may seem unfair to those who have just invested their hard-earned savings in a piece of land. That is the transition problem that arises with any change in the tax law—there are winners and losers, and sometimes special transition rules can be adopted to ease the pain. Most parcels of land in the city already have buildings on them, so the taxpayer would save by eliminating the building tax while paying more for the land. The most important point is that the LVT would, over time, make the whole economy, especially the cities, function more efficiently.

The LVT is easier to justify if we think of starting with a blank slate, before anyone has laid claim to land. John Locke uses man's ownership of his own labor to justify his appropriation of the land he will use from the God-given commons. However, Locke adds the essential proviso that an individual has the right to exclude others from what had been common property "*where there is enough and as good left in common for others*" (*The Second Treatise of Government*, section 27, italics mine). In most places today, raw land is no longer a free good, so how can the latecomers enjoy the same opportunities as those whose forebears arrived in time to claim the land?

When land of a particular quality is no longer a free good, unregulated markets will readily generate annual rental rates for particular parcels, and those annual rents can readily be capitalized into sales prices for parcels that change hands and appraised values for parcels that do not. Land rents, like other prices, can serve to allocate inputs to their most productive uses. The rents are an opportunity cost that must be paid by the

user of the land if the economy is to operate efficiently. But who should receive that rent? Henry George argued that the rent should belong to society because it measures either the natural advantage of a parcel (for example, superior fertility of soil or location on a natural trade route) or the efforts of other people (for example, highways, ports, and other public infrastructure, the activities of neighbors that attract business to your block, and the growth of population in the vicinity).

Could the LVT generate enough revenue to replace the other taxes on which governments now rely? That can be answered in three ways: ethical, theoretical, and empirical. The ethical argument is that the state may be entitled to the product that results from the activity of the community, but that it has no right to what individuals have produced with their own labor and capital. The state should balance its budget by cutting expenditure, just as the individuals do. The theoretical argument is that "All Taxes Come Out of Rent" (ATCOR). This controversial idea is that taxes must be paid from only the surplus, which is rent. Hence it is more efficient to tax rent directly, rather than taxing labor or capital or transactions and relying on the inefficient shifting of the tax burden. The empirical approach is to attempt to calculate the taxable value of land and, from that, estimate the tax revenue that could be collected.

The standard data sources are heavily biased downward, as spelled out by Mason Gaffney.[16] It is easy to see, however, that land rents could make a substantial contribution toward current government spending of $6 trillion. The median household resides in a house worth about three times household income. The land under the residence is about 40 percent of that value. Average land values relative to income are higher than medians (land is a luxury of the rich), so it is likely that the total value of residential land exceeds total personal income and even gross domestic product (GDP). This suggests that it would be possible to tax away more than $1 trillion of land rents from residential property alone. Add to that rents from commercial, industrial, public utility, mineral, and agricultural land. Gaffney extends the rent concept beyond land to include other socially created values, such as the frequency spectrum, aircraft landing fees, and pollution charges, and finds "enough and to spare."

The opposition to LVT often cites the unfairness of taking nearly all the rent and, hence, nearly all the value of property in land. Most holders of land today have acquired it in legally and morally defensible ways. That is correct and a serious concern, but there are two sets of counterarguments. Georgists often claim that even a fully legal land title still leaves the buyer of land as the holder of stolen property. After all, British titles date to a roving bandit, "a French bastard landing with an armed banditti," as Thomas Paine so gently expressed it.[17] U.S. titles generally date to a grant by a European monarch of land that belonged to someone else. Even in the rare case when a title does not originate in "force or fraud"—even if it originates in Locke's enclosure from the state of nature—why should that historical accident contribute to the inequality of fortunes today?

The set of arguments that I find more convincing, however, relate to the comparison of the LVT with nearly all other feasible taxes. If the LVT is theft, it is a one-time problem. The income tax robs people every year of the fruit of their labors. When this moral case is combined with the efficiency and privacy advantages of the LVT, the case seems overwhelming. So, rather than arguing about

fairness or justice in taxation, let's shift the focus toward the one tax base that has a well-defined market value based on opportunity cost; that is, what the market determines to be the rent of the land. The focus can then shift away from the utilitarian pseudoscience of minimizing unobservable "sacrifices" and maximizing unseen "utilities" or pretending that we can say anything about the "fairness" of taking from one person to give to another.

To quote Frank Chodorov, "Taxation is highwaymanry made respectable by custom, thievery made moral by law," while the LVT just allows the community to reclaim the value it has produced.[18] ☨

1 Mancur Olson, *Power and Prosperity: Outgrowing Communist and Capitalist Dictatorships* (New York: Basic Books, 2000), 3–12.

2 Pope Gregory (*circa* 600) as quoted by Charles Adams, *For Good and Evil: The Impact of Taxes on the Course of Civilization* (Lanham, MD: Madison Books, 1993), 137. Hereafter, citations to Adams's rich collection will be parenthetical within the text.

3 Guido Alfani and Roberta Frigeni, "Inequality (Un)perceived: The Emergence of a Discourse on Economic Inequality from the Middle Ages to the Age of Revolutions," *Dondena Working Papers* (Milan: Carlo F. Dondena Centre for Research on Social Dynamics, Univ. Bocconi), no. 58, July 2013.

4 The most famous historian of, and advocate for, the income tax was E. R. A. Seligman, *The Income Tax: A Study of the History, Theory, and Practice of Income Taxation at Home and Abroad*, 2nd ed. (New York: Macmillan, 1914), 132, 216, 353. Adams, *For Good and Evil,* 347, adds detail. Joseph A. Pechman, *Comparative Tax Systems: Europe, Canada, and Japan* (Arlington, VA: Tax Analysts, 1987), 298, provides international comparisons.

5 Alexandra Wagner Lough, "The Federal Income Tax and the Georgist Movement," lecture presented to the meeting of the Council of Georgist Organizations, Pittsburgh, PA, August 8, 2013.

6 Knut Wicksell, "A New Principle of Just Taxation" (1896). Reprinted along with some of the succeeding discussion in Richard A. Musgrave and Alan T. Peacock, *Classics in the Theory of Public Finance* (New York: St. Martin's Press, 1967).

7 This is the concept underlying the "flat tax" advocated by Robert E. Hall and Alvin Rabushka in *Low Tax, Simple Tax, Flat Tax* (New York: McGraw-Hill, 1983).

8 Lionel Robbins, *The Theory of Economic Policy in English Classical Political Economy* (London: Macmillan, 1965), supplies the evidence for this assertion.

9 George Bernard Shaw, *The Intelligent Woman's Guide to Socialism and Capitalism* (New York: Brentano's Publishers, 1928), 470.

10 T. W. Hutchison, *A Review of Economic Doctrines, 1870–1929* (New York: Oxford University Press, 1962), 52.

11 John Stuart Mill, *Principles of Political Economy* (1848), 5.1.2.

12 The analysis was worked out by Jacob Arnold Cohen-Stuart, "On Progressive Taxation" (1889), reprinted in Musgrave and Peacock. A gentle introduction to the whole body of literature is Walter J. Blum and Harry Kalven Jr., *The Uneasy Case for Progressive Taxation* (Chicago: University of Chicago Press, 1953). Richard A. Musgrave, *The Theory of Public Finance* (New York: McGraw-Hill, 1959), 98–102, clarifies the essential points.

13 Seligman examined various definitions of income. The most engaging treatment is by Henry C. Simons, *Federal Tax Reform* (Chicago: University of Chicago Press, 1950).

14 Andrew W. Mellon, *Taxation: The People's Business* (New York: Macmillan, 1934), 56–57.

15 George R. Zodrow and Peter Mieszkowski, *United States Tax Reform in the 21st Century* (New York: Cambridge University Press, 2002).

16 Mason Gaffney, "The Hidden Taxable Capacity of Land: Enough and to Spare," *International Journal of Social Economics* 36, no. 4 (2009): 328–411.

17 Thomas Paine, "Of Monarchy and Hereditary Succession," *Common Sense (*1776).

18 Frank Chodorov, "Socialism via Taxation" (1946), in *Fugitive Essays: Selected Writings of Frank Chodorov,* compiled, edited, and with an introduction by Charles H. Hamilton (Indianapolis: Liberty Fund, 1980).