PROGRESSIVE TAXATION
IN MODERN WORLD

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Fiscal policy has undergone substantial changes during the course of its evolution. The objectives and the tools of fiscal policy have changed in their character and their effectiveness in modem times. In the highnoon of *laissez faire* the State was expected to perform a very limited range of duties — maintenance of defence, internal order and justice, and certain public services: at least these were the duties which Adam Smith, the father of Political Economy, assigned to the State. Beyond that all social controls were to be exercised by competition in free markets, and the equilibrium thus achieved was regarded as the optimum one. Naturally, the Government did not need large revenues to finance these limited activities. It tapped haphazardly different sources of income as they came in its way without paying much heed to niceties of equity or economy. This fact explains the *raison d'etre* of otherwise ludicrous Physiocratic proposal of '*impot unique*' — the single tax on land.

However, ultimately the tide turned against the *laissez faire* doctrine. The faith in the efficiency of price system, and the harmonious working of perfect competition, especially in its distribution aspect, declined. And then the popular opinion swung steadily and at accelerated pace from its earlier individualistic attitude towards 'expansion and intensification of Government activities'. Not only more and more revenue the Government desired to finance its expanded activities for which the masses were clamouring, but also it began to exploit the potentialities of its fiscal policy for ulterior ends. The foremost among them in historical precedence and in importance was more equalitarian distribution, of income. Under *laissez faire* the control of productive resources simultaneously determined the pattern of income distribution. But the legitimacy of not tempering with resource ownership and resulting income distribution was itself questionable. It were the guarantees and securities provided by the society and the State that had made the existing resource ownership and their effective exploitation possible. Therefore, the society had every right to re-allocate resources or the income derived from them in order to maximize social benefit through its legal functionary — the Government. Thus, the fiscal policy came to be used for ironing out the inequalities in income distribution.

Having once put aside the restrictive curbs which *laissez faire* policy put on it, fiscal policy had other sumptuary ends to serve. A vast array of possibilities for its effective utilization lay still unexplored. Starting from the very platitudinous purpose of discouraging the production and consumption of obnoxious commodities, the fiscal policy was potent enough to lift the economy to full employment and maintain it there. It meant that the fiscal policy could avoid the vast wastage of economic welfare and demoralization of labour which was attendant upon mass unemployment. Again, fiscal policy had got special attraction for countries which had embarked upon all-out programmes for economic development. In fact, the fiscal policy came to assume an importance in the modern world which can't be exaggerated.

Now obviously the effectiveness of fiscal policy depends upon the effectiveness of the tools it employs. Traditionally, the tax system of a country vitally affects its economy. But the potency of the tax system itself varies substantially according to its internal composition; and, moreover, one tax system may be more or less capable of achieving various ends than some other. Accordingly, we have to examine whether or not a progressive tax system is more suitable to conditions of modern world.

Equity in taxation is considered to be the cardinal principle. Equity in taxation, which Smith defined as taxation on the basis of ability to pay, has been interpreted variously according to whims of the interpreter. Mill took it to mean equality of sacrifice: 'apportioning the contribution of each person towards the expenses of Government, so that he shall feel neither more nor less inconvenience from his share of the payment than any other person experiences from his'. The premise of equality of sacrifice can lead us to the principle of progressive taxation according as we assume fairly rapid diminishing marginal utility of income or not.

Here, we must pause! It has been objected by Sir Sidney Chapman, and more recently by De Viti and Robbing, that comparisons of sensibility, whether of pain or pleasure, sacrifice or enjoyment, are not susceptible to measurement as between individuals. 'The law of diminishing marginal utility only shows that a scale can be drawn up showing the order in which an individual will prefer a series of alternatives; and that the successive alternatives have decreasing significance for action.' Such a scale can always be drawn up by introspection on the part of an economic subject, or by observing his behaviour when exposed to external economic stimuli. But such scales, depicting the decreasing satisfactions of different individuals, cannot themselves be compared in their magnitudes. Introspection on one's part can reveal only one's own state of mind; it cannot make it possible to traverse in other minds.

Logically, this objection is perhaps unimpeachable. But its acceptance implies that a devastating blow has been struck at welfare economics and modern Public Finance. Even if this objection is submissively accepted we can at least say with Irving Fisher, 'Philosophic doubt is right and proper, but the problems of life can't and don't wait.' Therefore, it is wise practical politics to act on the dictates of popular opinion. Moreover, it can be pointed out against Robbins, who is so anxious to preserve the sanctity of economics as a science, that he himself states that economic generalizations are deductions from a series of postulates which are based upon facts of universal experience; and then it is quite unwarranted for him to object when public finance utilizes facts of common experience for formulating its generalizations. After all, does not the everyday experience of life prove that a rupee taken from a larger income entails less sacrifice than the same amount taken from a smaller income?

A. C. Pigou has effectively replied to this objection that inter-personal comparisons of satisfactions are impossible. He says that to speak of differences in individual satisfactions by some assignable amount may not be possible, but at least the two scales can be compared in the relation of greater or less or same. 'Quantities not susceptible of numerical measurement can always be arranged in a scale or greater or smaller, and this is the only strictly quantitative achievement of even numerical measurement.' Moreover, economics is concerned with groups of people, not with single persons. If we take substantial groups of the same race and of the same country we can unhesitatingly say that they are on the average pretty much alike, and their reactions to external stimuli can be compared with a degree of accuracy. Therefore, on the basis analogy, observation and intercourse, inter-personal comparisons can properly be made.'

Thus it is obvious that the principle of diminishing marginal utility of income is not an intruder, illegitimately coming in the field of Public Finance. It is a real and vital concept for the superstructure built up in modern times, and yields significant conclusions if properly inter-related. If we accept the law of diminishing marginal utility along with 'equality of sacrifice' principle, we are led to progressive taxation as the most equitable one.

However, all along income, on which the tax is to be levied, has been regarded as a given quantity and not a quantity that is produced or acquired otherwise. De

Viti says that ‘if we also take account of the fact that income is produced by the owner, then naturally every increment of income would involve an increment of cost — comparatively smaller sacrifice and effort it required for the production of initial units of income than for subsequent ones. Each new unit of labour for getting additional income represents for the producer an increasing subjective sacrifice, since labour effort is subject to the law of progressive exhaustion. And this is vindicated by the fact that more and more attractive bait in the form of material and immaterial reward is required to elicit out additional effort. Hence even if it is granted that the law of diminishing marginal utility is applicable to each successive increment of income, the progressive taxation is not justified on grounds of equity. We must juxtapose against the principle of decreasing satisfactions for successive increments in income, the principle of increasing marginal sacrifice for producing additional income. De Viti deduces from this relationship the ideals of proportional taxation, and not of progressive taxation, as more justifiable one from the standpoint of equity.

At the outset it may be pointed out that De Viti’s criticism relates to taxation of income which is ‘produced’ by labour effort — manual or intellectual — in the form of physical exertion or of risk, or of time, or of responsibility, etc. It is not relevant to the income which is inherited. Inherited wealth entails no sacrifice on the part of the inheritor and therefore the law of decreasing marginal utility of wealth is applicable here without being offset by increasing successive increment of cost for acquisition of extra income. De Viti himself says, ‘Jurists presume that the heir carries on the responsibility of the deceased, but this presumption is not valid with respect to relationship between the heir and the deceased in the matter of satisfaction and sacrifices, since, at the death of the testator, these cease to be a physical continuity between them.’ Obviously then, progressive taxation is justified without reserve on inherited wealth.

But what about the produced income? Is the principle of increasing marginal sacrifice sound enough to necessitate only proportional taxation? So far as unearned incomes from capital and property are concerned, this principle does not come up to the mark at all. A major part of the property ownership in land and other natural resources is the result of some historical accident or expropriation of the weak by the strong. And any income accruing to the owner has no relation to the sacrifice involved in its production, Even in case of other property, they are largely the consequence of inheritance, which means that producers of income are at the very outset not given an equal start — inequality of opportunity will Necessarily mean that certain people will be able to appropriate income out of all proportion to their labour cost. It means that the scale of increasing marginal sacrifice for labour will be at a lower level for ‘individual’ enjoying a better start, *i.e.,* owning considerable income-yielding property, Lastly, there is the case of income earned through actual labour, physical and mental. Perhaps only in this case increasing marginal sacrifice is involved for each successive units of income. Even then, the principle of proportional taxation is not automatically deducible. We had started from the premise that taxation should promote equity or equality of sacrifice. Now, in this case we have to see which tax system equalizes the net sacrifice when we set the scale of decreasing marginal valuation against increasing marginal cost of labour. It is just possible that the net sacrifice is equalized only when the multiplier increases with the multiplicand of income, that is, by progressive taxation, and not by proportional taxation when the multiplier remains constant at every multiplicand.

Another proposition which makes De Viti sceptical about the legalilarianism of progressive taxation is the relationship between the decreasing marginal valuation of income and the diminishing marginal valuation of public services. He maintains ‘that the individual sets a decreasing importance to each successive increments of public services, which are instrumental in the production and enjoyment of private income.’ Therefore, although his successive satisfactions from income decline he should not be called upon to pay a progressive taxation because he also gets declining satisfaction from additional public services which increased revenue will finance. This argument is basically inaccurate in so far as it assumes a direct *quid pro quo* between the tax one pays and the benefits one enjoys. By very definition a tax is immune from any such correlation. Moreover, the State is not simply an institution operating on ‘cost-and-service’ basis; it is a social union formed on family principle in which some pay for the others. Therefore, it is quite possible that an individual’s valuations of successive extension of public services decline fairly rapidly; but he may be levied progressive taxation if the society as a whole has a less rapidly declining scale of marginal valuation for public services.

To sum up, we started from the basic premise of equity .in the allocation of the burden of taxation which in terms of subjective value meant equality of sacrifice. The objection, that sacrifice is a subjective term and can not be measured objectively, and that inter-personal comparisons of sacrifice, which this ‘equality of sacrifice’ concept implied, are not possible, was argued to be not feasible. It was pointed out that the principle of diminishing marginal utility of income, which is implied in equality of sacrifice, is a real concept and that comparisons of satisfactions if not between individuals at least between groups of individuals are possible. Moreover, we concluded that increasing marginal sacrifice for additional income did not materially vitiate the principle of progressive taxation. Similarly, the successive decline in satisfaction from public services for a particular individual is irrelevant to the proportion of his income he pays for broader social ends. Hence we can say that on financial criterion progressive taxation appeals to be the proper levy.

But fiscal policy may not and has not stopped at equitable allocation of the burden of taxation. It may have some other sumptuary ends to fulfil. One such prominent end in historical evolution has been more equalitarian distribution of wealth and income. Adolph Wagner, a German economist, presented his socio-political theory of taxation which struck a new note in the prevalent tone of fiscal policy. He proceeded on the view that the belief in the efficiency of the working of self-interest and of free competition has been undermined. The private organization of productive process and the existing institution of property — especially in land and capital — and the distribution of wealth which takes place on this basis have always profound social repercussions. One who considers, like the Physiocrates and Adam Smith, the existing economic order as the only justifiable one must consider the resulting income distribution as the only righteous and just distribution. Therefore, it is but natural that he will favour the type of taxation which does not alter the existing income, distribution — proportional taxation. But the question is 'Does the equilibrium, achieved under perfect competition, represent the optimum point of efficiency and welfare?' The pattern of income distribution in conditions of free competition can only be justified if we assume that the people have started with equality of opportunity and that any inequality in income earned is solely due to difference in innate natural abilities. However, this is not the case in modern times. Economic advance offers opportunity to men of ability, and inheritance perpetuates the resulting inequalities with cumulative effect. Therefore, it is compatible with maxims of justice that competitors should have 'fair' start, which in objective terms means equality of opportunity or promoting more equal distribution of wealth. The readiest tool for affecting this purpose is progressive taxation. This is what is meant by socio-political theory of taxation — taxation is regarded to iron out the inequalities in income distribution which result from free competition. Even Mill thought that 'the idea of distributive justice consists not in imitating but in redressing the wrongs of nature.'

However, it may be pointed out that inequality of wealth is a result, not a cause, of progress; and therefore it is wrong to think that more equal wealth distribution will have adverse effects on productive activity. The cause of economic progress is greater efficiency of cooperative effort and of specialization and invention. It is quite justifiable for the society to demand more equitable wealth distribution. The division of wealth is not between individuals as such but between each individual vis-à-vis society. In the words of Hobhouse, 'What can justly be said is not that A of his own efforts creates so much wealth, and B so much, but that operating on and with the existing social system (with its skilled workers, machinery, a market, peace and order) the increment of wealth due to A is so much and due to B so much …… Thus society steps in as a sharer in the fruit of their productive effort.' However, social reforms, which Wagner's theory tries to achieve, must be sharply distinguished from complete socialism. All that progressive taxation aims at is to mitigate the gross inequalities of wealth which may occasionally disturb the political equilibrium.

The gradual but inevitable drift towards progressive tax system has been also necessitated by mass awakening. So long as the dominant class was the propertied class with large incomes, the tax system was either inversely proportional to wealth, as was the case in France before the French Revolution, so that the secular and ecclesiastical nobility enjoyed the privileges of exemption, or at the most proportional to wealth. But with the growing influence of the irises, the tax system turned mote progressive, so that their needs and aspirations were more adequately fulfilled without their bearing a heavier burden in financial terms. This is what should be the outcome of class struggle. When the political control was in the hands of the rich few, they made the proletariate pay for the needs of the State although they were the class to benefit most from the State's activities. But when the control has passed into the hands of formerly exploited class, the same attitude is to be expected. The persons with large incomes will be made to finance activities which primarily benefit the masses; indeed such exactions may be transformed into weapons in a remorseless struggle against the propertied classes.

Besides reducing inequalities in the income distribution, progressive tax system has to achieve another important and of fiscal policy in modern times, that is, first attaining and then maintaining full employment. After Keynesian Revolution in economic thought, the classical assumption of full employment as the norm is no longer admitted. The mature industrialized economies suffer rather from a secular tendency to stagnate. Keynes explains this by pointing out that private, investment, unaided by Government effort, is unable to fill the gap between consumption and full employment income level. That is, at full employment saving overshoots investment due to low average propensity to consume. In these circumstances, the full employment can be achieved only by filling the gap between saving and investment at that level, and this can be done either by raising the consumption function or by stimulating private investment or investment on

Government account. Now, if the diminishing marginal propensity to consume — which meant that with every increase in income the consumption increases by less than proportionate or the proportion of savings to each additional increment in income increases—is assumed, as Keynes does, a shift in income from the rich to the poor will increase total consumption. This phenomenon occurs because as the income of the rich will decline they will be obliged to reduce their savings more than they reduce consumption; and, on the other hand, the increase in the income of the poor will result in almost equal increase in their consumption. This overall upward shift in consumption function can substantially help to achieve full employment with autonomous private ‘investment only. Here we find a great potency in progressive taxation. It is an engine for transfer of income from the rich sections of the community to the poor, and it is precisely this fact that helps to avoid mass unemployment and the vast economic wastage it entails.

If the advanced economies are faced with the danger of secular stagnation due to over-saving relative to investment opportunities, the under-developed countries are faced with the problem of rapid economic development due to lack of adequate savings. The question is ‘what type of fiscal policy is more suitable to these countries?’ Of course, the one which promotes domestic savings as well as puts more funds at the disposal of the Government in order it can provide basic facilities and leadership in industrial undertakings. Progressive taxation serves for the latter objective, hut it also discourages accumulation of large incomes which provide, the bulk of savings. It also deters entrepreneurs from engaging in venturesome out remunerative enterprises because most of the income will be lopped off without sharing the risk of loss. On the other hand, the shift of income in favour of poorer sections of the community will be dissipated on immediate consumption and will not be employed for capital construction. Thus, so far as the economic development objective is concerned, progressive taxation may not be a very helpful instrument. Its discriminatory use in favour of some activities and against others is a strong point of recommendation. Moreover, progressive taxation need not always be steeply progressive; if it is only mildly progressive, it will not go against the interests of economic development.

Thus, we find that the progressive tax system promises vast possibilities in the modem world. In its financial aspect of collective revenue, progressive taxation alone is characterized by equity and justice. And most of the sumptuary ends are more adequately, fulfilled by this mode of taxation than any other. Its discrete use can be a helping band for broader objectives of full employment and economic development. In the context of modern, world, progressive taxation appears, therefore, to be the only suitable mode of taxation.

READINGS

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