

A Benefits System of Taxation Designed for A Free Enterprise Economy

—From a Conference Address

by JOHN R. FERGUSON

THERE are two main approaches to taxation: "benefits," under which taxes are treated as a payment for goods and services provided by the government; and "ability-to-pay," under which they are apportioned according to the taxpayer's ability to pay.

The benefits approach is basic to the operation of a free enterprise economic system. It respects property rights and the rights of individuals and business enterprises to determine the allocation of wealth through the free workings of economic forces.

The ability-to-pay approach, which disregards property rights and the rights of individuals and business enterprises to determine the allocation of wealth, provides the government with the power to redistribute wealth as it may see fit. This is basic to the operation of a state-controlled economic system.

Henry George believed in the benefits approach and his advocacy of a land value tax was designed to ensure that those receiving benefits from government services should pay their fair share of the costs of such benefits. It might have been feasible in his day to finance the costs of all government operations through the taxation of land values. Most of the population lived in rural communities on or close to the land. Today the bulk of our population in North America lives in urban communities and it is essential to seek additional sources of tax revenues. If possible these taxes should conform to the logical principles underlying Henry George's land value taxation.

We have developed during this cen-

tury an exceedingly complex economy. Tax economists have found it easy to develop a tax structure based on the ability-to-pay approach for this fits neatly into the modern idea that the free enterprise system has failed to produce a just and equitable society and governments should therefore direct more of the economic activities. Little thought is given to the possibility that the tax system has hampered the free enterprise system.

Economists have also generally avoided the benefits approach because they cannot conceive how it might be applied. The Canadian Royal Commission on Taxation lightly dismissed this approach in its report in 1966 stating merely that it had serious practical and theoretical deficiencies.

This paper outlines a proposed system of taxation based on the benefits approach that could safeguard the property rights of individuals and business enterprises, through the operation of the market place, to play the most important role in the allocation of wealth. It would thus increase not only a high level of economic activity but an equitable distribution of the wealth produced.

The benefits system of taxation that I propose will include (1) municipal taxes based on land value taxation, (2) federal taxes which will include a relatively low but constant rate on personal incomes, and (3) a relatively low rate of taxes on business costs.

The first of these three taxes seems reasonable—it provides that the services of municipal governments be financed through the taxation of land values, for such values reflect the value of the services provided.

The second tax would be on personal incomes. The federal and provincial governments provide many goods and services that are essential to the well-being of individuals, and they should pay for them. Payment for such services could be provided by lower rates of taxation than are now employed but with a fixed rather than a progressive rate system. All individuals employed in economic activity might pay taxes on earned income (after allowing for reasonable exemptions) at, say, a 20 percent rate. Persons would thus pay income taxes in relation to the size of their incomes, and the rate would not increase but would remain constant. It is difficult to determine the extent to which each individual benefits from federal and provincial government services. A fairly reasonable assumption would be that generally speaking the level of a person's income will provide a rough measure of the benefits, including education, that he will have received from the availability of government services.

Finally business enterprises also benefit to a considerable extent from the operations of the federal and provincial governments and they should pay their fair share of the costs. Such taxes should be considered a business expense and should be added to all other business costs. It is unfair to tax profits, for this has the effect of penalizing the most efficient businesses and subsidizing the less efficient ones. A more equitable way to prorate the costs of government services to businesses is in relation to their costs of production rather than to their profits. However, in determining the amount of taxes payable, only those costs of production that are related to the value added by any business enterprise,

should be considered.

A business firm might be taxed on its total cost after deducting the costs of goods and services purchased from other businesses where a tax has already been paid. Thus it is proposed that business enterprises should pay a tax based on their cost of value added. It might be as low as 5 percent, and it would provide for all businesses to pay their fair share, but no more than their fair share, of the costs of government services. The role of profits not only as an incentive to produce but also as a measurement of business efficiency would be considerably enhanced.

Reorganization of the tax system to provide for the application of a benefits approach to include a land value tax for the raising of municipal government revenues, a low and constant rate of tax on personal incomes, and a tax on business costs as represented by those related to value added, would produce considerably more tax revenues than are being produced by the current tax system based primarily on the ability-to-pay approach. As government revenues would be readily predictable under a benefits system and easier to forecast, the budgetary problems would be simplified, for expenditure could be kept in line with anticipated revenues.

These tax proposals would have important implications for the financial markets, for combating inflationary pressures, and in the allocation of incomes and savings. Harnessing the initiatives and enterprising abilities of individuals would provide generally for the operation of a viable and efficient economy based on the free enterprise system and capable of producing far greater wealth at lower cost.

At the close of this talk, Mitchell S. Lurio, Boston director, led the audience in a thoughtful discussion during which Mr. Ferguson remarked that the ability-to-pay approach has general acceptance in Canada but has not worked well. He added that although the land value tax accords with benefits received (not ability to pay) he thought this value was too hard to determine.