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Benefits Theories of Tax Fairness

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ABSTRACT

The benefits theory of tax fairness was the dominant approach to tax justice until the late nineteenth century. This paper examines the reasons for the rejection of the benefits principle in the nineteenth century and the evolution of benefits theory in the twentieth century in response to this criticism. It uses this historical inquiry as a launching point for re-evaluation of the prospects for benefits theory. Benefits taxation has a number of advantages. As an ethical claim, it appeals to intuitive principles of fair cooperation. As a rule of procedural justice, it tends to protect against oppressive tax schemes. Although benefits theory has the resources to respond to some of the most historically influential criticisms, it faces additional challenges. These include specifying the baseline against which benefits are to be measured and fair treatment of taxpayers who take a public-spirited view of government spending as opposed to those who are mainly concerned with their private advantages.

INTRODUCTION

Benefits theories of tax fairness evaluate tax burdens in light of the benefits received by the taxpayer from the state. The underlying idea is that of reciprocity: a fair taxation scheme is one in which taxes owed by a taxpayer bear the proper relationship to the benefits that the taxpayer receives from the state. This account of tax fairness was popular until at least the nineteenth century, but has fallen out of favour since John Stuart Mill's critique in *Principles of Political Economy*,[1] to the extent that it is barely mentioned

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[1] JS Mill, *Principles of Political Economy* (London, Longman, Green & Co, 1909, reprinted Fairfield, Augustus M Kelley, 1976) Book V, Ch II § 2, 804–05.

in treatments of tax policy by leading contemporary economists.[2] Its place in most discussions of taxation in contemporary legal theory is typically modest at best.[3]

This paper examines the history of this fall from favour and the response of benefits theorists. The benefits principle is amenable to two significantly different interpretations. One version of the benefits principle holds that taxpayers should pay taxes set in proportion to the benefits that they receive from the state. This classical version of the benefits principle was dominant until the nineteenth century. A second version of the benefits principle holds that each taxpayer should receive benefits that are sufficient to compensate them for the taxes that they pay. This modern approach to benefits taxation developed alongside modern economic analysis in the late nineteenth and early twentieth century and responded to some of the criticisms of the classical principle. This paper will reassess the prospects for benefits theories of tax fairness against the backdrop of this history. The verdict will be mixed. Benefits taxation has a number of advantages. As an ethical claim, it appeals to intuitive principles of fair cooperation. As a rule of procedural justice, it tends to protect against oppressive tax schemes as well as against more mundane wasteful spending. Moreover, the original reasons for its rejection in the late nineteenth century were not necessarily well justified. Nevertheless, benefits taxation faces difficult challenges in determining the baseline against which benefits are to be measured and in reconciling the perspectives of taxpayers who value public goods for different reasons.

This paper will first situate benefits theories of tax fairness within the range of possible approaches to tax fairness. It next explores the history of debates over the benefits principle and examines why the reputation of the benefits principle went into decline in the late nineteenth century. Third, it describes the emergence of a modern approach to benefits taxation based on advances in economic analysis. Fourth, it considers various arguments for each version of the benefits principle and how defenders of benefits taxation might respond to historically influential objections. Finally, it introduces two new problems for benefits taxation and examines some of the potential responses.

[2] Eg 'Taxation according to ability to pay for the last hundred years or more has been a universally accepted postulate, not only amongst political and economic writers, but amongst the public at large.' N Kaldor, *An Expenditure Tax*, 3rd edn (London, George Allen & Unwin, 1955) 26. See M Weinzierl, 'Revisiting the Classical View of Benefit-Based Taxation' (2018) 128, 612 *The Economic Journal* F37, F37–F40.

[3] Eg '[B]ut it also assumes that taxes are to be levied in accordance with benefits received from the government – a standard long since replaced by ability to that means accretion, consumption, wealth or whatever.' A Warren Jr, 'Fairness and a Consumption-Type or Cash Flow Personal Income Tax' (1975) 88 *Harvard Law Review* 931, 933–34; 'There is broad, if not universal, agreement that fair taxation should be in accordance with "ability to pay", or the capacity of the taxpayer to bear the tax burden.' S Utz, 'Ability to Pay' (2002) 23 *Whittier Law Review* 867, 867–68.

TAX FAIRNESS

There are three basic approaches that are commonly taken to tax fairness. One might order them in terms of the information required to evaluate tax fairness from least to most demanding. The simplest approach, and probably the most common in contemporary tax theory, analyses fairness in terms of relative ability to pay. Following John Stuart Mill, this is sometimes glossed as equality of sacrifice, which Mill argued meant that every taxpayer should feel 'no more and no less inconvenience from his payments than every other person experiences from his.'[4] Proponents of this approach usually favour taxation by reference to the taxpayer's income, wealth, or consumption, depending on which they believe to be the best proxy for ability to pay. Early proponents of the 'ability to pay' theory such as Mill tended to favour flat tax rates, but progressive taxation has become more popular in the past century.

The subject of this paper is a second approach to tax fairness, which compares tax burdens to the benefits received from government spending. This 'benefits' theory holds that taxes ought to be set in relation to the benefits that the taxpayer receives from the state. Assessing tax fairness in these terms requires knowledge not only of the economic position of the taxpayer but also of the impact of public spending on taxpayers. Evaluation of taxation in light of benefits to the taxpayer therefore requires more information than 'ability to pay' theories do. Like ability to pay theories, benefits theories of tax fairness are compatible with a range of policies. For example, proponents might favour taxation in proportion to income, wealth or consumption, according to whether income, property or consumption taxes is the best proxy for benefits received from the state. Alternatively, defenders of the benefits principle might favour policies that aim to match benefits from government with the burdens of taxation in a manner tailored to the circumstances of individual taxpayers.

A third approach to tax fairness is to analyse taxation in light of a broader theory of distributive justice. This approach is the most demanding in terms of the information required to evaluate tax fairness as it typically requires knowledge not only of taxpayers' economic standing and the effects of public spending but also of further facts relevant to whether the distribution of wealth is just. Such a theory might be an egalitarian theory of distributive justice, such as that advanced by John Rawls.[5] Or it might be a consequentialist theory such as utilitarianism.[6] Of course, there is heated debate within both the egalitarian and the utilitarian camps over the implications of these theories for tax policy.

[4] Mill, above n 1, 804.

[5] Rawls, in fact, endorses a scheme of proportionate taxation, but this is against the background of a distribution of property rights and government spending policies that allow for relatively egalitarian outcomes without strongly progressive taxation.

[6] One variant of applied utilitarianism is often discussed under the label of optimal tax theory. See JA Mirrlees, 'An Exploration in the Theory of Optimum Income Taxation' (1971) 38 *The Review of Economic Studies* 175.

What both types of theories have in common is that tax fairness cannot be analysed in isolation from the entire scheme of property rights and government benefits and must be derived in light of these facts from more abstract principles of distributive justice. For egalitarians and utilitarians, there is nothing normatively distinctive about taxation and tax fairness is simply a matter of applying generally applicable normative principles to questions of tax policy.[7]

This third approach is not necessarily mutually exclusive of the first two. One might endorse some comprehensive egalitarian or utilitarian theory of distributive justice as the ultimate justification of tax policy, while arguing that either the ability to pay principle or the benefits principle is the best way to implement this theory. For example, a utilitarian might argue that taxation in proportion to ability to pay is the best policy in light of uncertainty in interpersonal comparisons of utility. Similarly, a utilitarian could argue that aligning tax obligations with benefits derived from public spending is preferable, on the basis of greater efficiency. Egalitarians might likewise adopt a system of taxation based on ability to pay in light of their larger theoretical commitments. For example, John Rawls favoured a system of proportionate taxation on all income above a personal allowance.[8] But this policy would exist against a background of property entitlements and government spending policies that would allow for relatively egalitarian outcomes without progressive taxation.[9] The key difference between this approach and the first two is that proponents of comprehensive theories of distributive justice adopt rules of tax fairness as outputs of their larger theories of distributive justice and not as freestanding principles. In this paper, I will mainly consider freestanding arguments for benefits taxation, some of which might be integrated into a larger consequentialist framework.

CLASSICAL AND MODERN BENEFITS TAXATION

Following Richard Musgrave, I will distinguish between two strains of benefits theory.[10] The classical theory, which predominated until the nineteenth century, treated contribution in proportion to benefits received from the state as the basic norm of tax fairness. Modern benefits theory, which developed in the late nineteenth and early twentieth centuries, evaluated taxes in terms of the willingness to pay for public goods of each taxpayer, but does not necessarily require taxation in proportion to personal benefit.

[7] Eg L Murphy and T Nagel, *The Myth of Ownership* (Oxford, Oxford University Press, 2002).
[8] J Rawls, *A Theory of Justice* (Cambridge MA, Harvard University Press, 1999), 246–47.
[9] ibid, 242–46.
[10] R Musgrave, *The Theory of Public Finance: A Study in Public Economy* (New York, McGraw-Hill, 1959) 66–69.

Classical Benefits Theory

The classical benefit principle was the leading approach to tax fairness from the early modern period into the nineteenth century. It was defended by Grotius, Pufendorf, Sir William Petty, Hobbes, Turgot, Mirabeau, Montesquieu, Senior and Thiers, among others.[11] American economist Henry Carter Adams described the benefits theory as '[t]he idea … that, insomuch as individuals receive benefits from the state, a payment should be made on account of and in proportion to these benefits.'[12] Proponents of benefits taxation such as Thiers sometimes compared taxes to insurance premiums levied in proportion to the wealth that the taxpayer has under the state's protection.[13] Early classical benefits theorists were mainly concerned with apportioning tax burdens to finance basic public goods such as the military and the legal system. Edwin Seligman, an opponent of the classical view, explained, 'Since protection was generally regarded as the chief function of the state, the conclusion was drawn that taxes must be adjusted to the protection afforded.'[14]

Although benefits theory is a rival of the 'ability to pay' theory, the two approaches might have similar implications if one makes plausible assumptions about the relationship between property ownership and benefits from the state. If the main function of the state is the protection of property, then it makes sense to allocate tax burdens in proportion to property holdings. Most theorists, therefore, favoured a form of proportionate taxation. For example, Adam Smith stated as his first maxim of taxation that 'The subjects of every state ought to contribute to 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.'[15] Smith drew an analogy between citizens of a nation and joint tenants in a common enterprise who contribute in proportion to their interests in the enterprise.[16] It is worth noting that in Smith's time, taxes roughly proportionate to income or wealth were the exception rather than the rule. Using them to replace the patchwork of tariffs, fees and duties would make public finance less arbitrary and quite possibly less regressive.[17] Both the benefits theory and the ability to pay theory

[11] E Seligman, 'Progressive Taxation in Theory and Practice' (1908) 9(1/2) *American Economic Association Quarterly*, 158–80.

[12] H Adams, *The Science of Finance* (New York, Henry Holt, 1899) 299.

[13] A Thiers, *The Rights of Property; A Refutation of Communism and Socialism* (London, R Groombridge, 1848) 229.

[14] Seligman, above n 11, 150.

[15] A Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, vol 2, E Cannan (ed) (London, Methuen, 1776, Reprint 1904) Book V Ch 2 Pt II, 310.

[16] ibid.

[17] The public finance of the pre-modern state in turn likely represented an improvement over the early middle ages when states mobilised resources by granting land to nobles, who extracted rents from the peasantry. See, eg T Seto, 'A Forced Labor Theory of Property and Taxation' in M Bhandari (ed), *Philosophical Foundations of Tax Law* (Oxford, Oxford University Press, 2017).

would therefore count as progressive when compared with the status quo and promise to produce a fairer distribution of burdens among taxpayers of similar economic station.

Since the benefits received by taxpayers are not directly measurable, one must use some proxy for benefits in order to determine tax obligations. Potential proxies include consumption, property holdings and income. Thomas Hobbes, for example, favoured a consumption tax on the grounds that subjects should contribute taxes in proportion to the benefits they receive from the state and that these benefits are roughly proportional to their expenses.[18] Persons who save rather than consume their income leave resources to be enjoyed by other citizens and thus should be taxed only on that increment of income which they consume. Thiers, by contrast, appealed to the benefits principle to argue that income from both labour and property should be taxed, since both property owners and workers benefited from the protection of the state.[19]

Late Nineteenth-Century Critiques of Benefits Theory

Classical benefits theory went into decline by the late nineteenth century. It was rejected by leading figures in Britain such as John Stuart Mill and in Germany such as Adolph Wagner.[20] Nineteenth-century critics identified three major challenges. First, the difficulty of measuring the benefits of public goods might undermine the benefits principle. Mill charged the benefits theory with 'setting definitive values on things essentially indefinite' by trying to attach precise figures to the benefits taxpayers receive from government.[21] Generally speaking, there are two ways in which one might try to estimate the value of public services for taxpayers. Henry Carter Adams helpfully labelled these the 'purchase theory' of taxation and the 'benefit theory'.[22] The chief difference, as Adams puts it, is that the first 'regards a tax from the point of view of cost to the state, the other from the point of view of advantage to the citizen'.[23] In other words, the purchase theory compares tax burdens to the cost of services a taxpayer receives from the state whereas the benefits theory compares tax burdens to the value that a taxpayer places on services received from the state. The former approach has the advantage of beginning with concrete data such as figures on public spending from the state budget. However, it is difficult to apportion tax obligations between citizens on this basis. The principle that each taxpayer should bear their share of the actual cost of providing services does not seem to determine whether

[18] T Hobbes, *Leviathan* (Cambridge, Hackett Publishing, 1994, Ch 30 [17] 227–28.

[19] Thiers, above n 13, 229–30.

[20] Mill, above n 1, 804–05; A Wagner, 'Three Extracts on Public Finance' in R Musgrave and A Peacock (eds), *Classics in the Theory of Public Finance* (London, Macmillan, 1958) 1–15, 14.

[21] Mill, above n 1, 805.

[22] Adams, above n 12, 298–99.

[23] ibid, 299.

the cost of services should be divided equally among taxpayers, in proportion to income, in proportion to property holdings, in proportion to consumption, or on the basis of some other metric. The basic problem is that most public goods are subject to diminishing marginal costs as one provides services to additional taxpayers.[24] Allocating tax burdens according to the marginal cost of each taxpayer will therefore not yield enough revenue to support the provision of these public goods. Once we set aside marginal cost, there does not seem to be any way to divide tax obligations between citizens in a way that is internal to the logic of the theory. One might try to allocate fixed costs in proportion to the marginal cost of providing services to each taxpayer. In most cases, the results will be that citizens will share in the costs in rough proportion to their economic standing. This version of the benefit principle therefore tends to collapse into a regressive version of 'ability to pay' theory.

In addition to the difficulties of using cost to the state to determine tax burdens, there is a principled reason for instead measuring benefits in terms of willingness to pay. Measurement in terms of cost to the state allows the possibility that some taxpayers' tax burdens will exceed their valuation of public services. This is especially plausible for taxpayers with little money and therefore a high marginal utility of income. For example, it may be perfectly rational to prefer having enough to eat and shelter for the night to paying one's share of the cost of police services. Benefits as measured by cost to the state could tend, therefore, toward a conflictual relationship between state and taxpayer. Measurement in terms of willingness to pay has the opposite effect. If a tax is set in proportion to willingness to pay for government services, any given taxpayer is very likely to benefit, net, from government, unless taxes are extremely high or public services are of very poor quality. Willingness to pay as a measurement of benefits, therefore, tends to consensual fiscal policy and a cooperative mode of politics in which taxpayers divide the surplus made possible by effective government.

Despite these advantages, in the heyday of the classical benefits principle, the willingness to pay approach was not very promising. There is no market for public goods such as national defence or the legal system and thus no market prices for them. Asking taxpayers how much they value services would be a futile exercise since, even if taxpayers could give accurate answers, there would be strong incentives to underestimate. Although one might assume for the purpose of simplification that all taxpayers of a particular class have similar tastes, and tax them accordingly, this assumption is unrealistic and, in any case, causes the benefits principle to collapse into an ability to pay theory.

[24] Marginal costs should decline until the state reaches the optimal size for the provision of public goods. The optimal size changes in response to changes in the costs of raising revenue and the cost structure of providing public goods. Historically, changes in military technology have had a great influence on state development because technological change alters the nature, extent and costs of the military force needed to maintain control over territory and compete effectively with other states. See R Bean, 'War and the Birth of the Nation State' (1973) 33 *Journal of Economic History* 212, 212–17.

A second difficulty is that the classical benefits principle might be thought to have undesirable distributive consequences. To the extent that the state protects persons as well as property, this might suggest that taxes should combine a per capita charge with a tax proportionate to property holdings, which would yield a quite regressive overall rate structure.[25] Mill argued that, when taken to its logical conclusion, the benefits principle suggests regressive taxation because those who, without the protection of the state, would be oppressed by the wealthy and powerful would seem to enjoy disproportionate benefits.[26] In practice, proponents of the classical benefits principle are more likely to favour proportionate taxation than regressive taxation. Either interpretation of the benefits principle was unpalatable for most progressives. Late nineteenth-century advocates of progressive taxation in the United States such as Edwin Seligman, Richard Ely and Henry Carter Adams attacked the benefits principle as obsolete and inadequate to the needs of the modern fiscal state.[27] In part, their criticism was motivated by the perceived incompatibility of the benefits principle with progressive taxation. They urged acceptance of ability to pay theories of tax fairness as being more adequate to the circumstances of the modern progressive state. This tendency grew even stronger as income taxation became the primary mode of public finance in most developed countries and public spending became focused to a much greater extent on the social welfare state.

A third criticism of the benefits principle was that it rested on too limited a conception of the nature of government. John Stuart Mill argued, 'Government must be regarded as so pre-eminently a concern of all, that to determine who are most interested in it is of no real importance.'[28] The range of projects undertaken by modern states makes the classical model seem inadequate. As Mill observed, 'it is not admissible that the protection of persons and that of property are the sole purposes of government. The ends of government are as comprehensive as those of the social union.'[29] One cannot, therefore assume that taxpayers benefit from the state in proportion to the protection afforded to their persons and property. Some defenders of progressive taxation took a more extreme position. For example, Seligman argued that 'we pay taxes not because the state protects us, or because we get any benefits from the state, but simply because the state is a part of us. The duty of supporting and protecting it is born with us. In a civilised society, it is as necessary to the individual as the air he breathes.'[30]

[25] Mill, above n 1, 804.
[26] ibid, 805.
[27] AJ Mehrotra, *Making the Modern American Fiscal State: Law, Politics, and the Rise of Progressive Taxation, 1877–1929* (New York, Cambridge University Press, 2013) 112–16.
[28] Mill, above n 1, 805.
[29] ibid, 805.
[30] E Seligman, *Essays in Taxation* (New York, Macmillan, 1895) 72.

This third line of criticism is difficult to assess. The observation that the activities of the state extend beyond personal protection does not entail that personal benefit is inapt as a criterion for apportioning tax obligations. Instead, one might look at the full range of advantages that a citizen obtains from the state. Mill's larger point, that government is a public rather than a private concern, is weightier. One might think that citizens should relate to their collective obligations as citizens in a way that differs fundamentally from their role as private consumers. Although fair terms of exchange might be a central value in the second sort of relation, this may not be the right way to think about the first sort of relation. Seligman's comments, on the other hand, seem to press the point too far. From the other side of the unhappy history of twentieth-century totalitarianism, his argument seems muddled at best.

Modern Benefits Theory

Ironically, just as the benefits principle was being eclipsed in the mainstream of tax theory, innovations in economic analysis provided a new approach to benefits taxation that addressed some of the traditional objections. The modern benefits principle holds that a tax is fair if benefits received from the state adequately compensate the taxpayer for the burdens of taxation. This new approach to benefits taxation is grounded in economic analysis and models public finance as an exchange between the state and taxpayers. Modern benefits theory can be traced to the work of Knut Wicksell and was further developed by Erik Lindahl.[31] Wicksell's basic insight was that requiring unanimous consent rule for each spending project and the taxes needed to fund it could both solve the problem of measuring private valuations of public goods and guarantee that each taxpayer receives public services that she values at least as much as the taxes that she pays. The unanimous consent rule allows each taxpayer to veto projects that do not provide adequate compensation. Conversely, taxpayers who value a particular public good highly should be willing to pay higher taxes to support it, even if some of their fellow citizens decline to support it financially. Negotiation in the shadow of a unanimous consent rule thus creates something like a market for public goods. Of course, securing unanimous agreement outside of very small collectives is virtually impossible in practice. Some people are irrational. Others might hold out for strategic reasons, making negotiations unduly cumbersome. For this reason, the unanimous consent rule would need to be relaxed to some degree in practice. I will not explore the practicalities of implementing Wicksell taxation in any detail, but instead evaluate Wicksell taxation as a normative standard for tax fairness.

[31] K Wicksell, 'A New Principle of Just Taxation' in Musgrave and Peacock, above n 20, 72–118; E Lindahl, 'Just Taxation – A Positive Solution' in Musgrave and Peacock, above n 20.

The modern approach to benefits taxation differs significantly from the classical approach. The classical benefits principle states that tax obligations should be assigned in proportion to the benefits the taxpayer receives from government. The classical principle thus looks to the total benefit received by a taxpayer and compares this to the total benefit received by another taxpayer. The modern benefits principle requires that every taxpayer should receive benefits from the state that they value more than the income that they sacrifice in tax. Modern benefits taxation accomplishes this by looking to the marginal value of taxes paid by each taxpayer since, if every taxpayer finds each increment of taxation worthwhile in terms of the services that they receive, every taxpayer will be made better off, net, by the fiscal system. In short, the classical principle looks to total benefit, while the modern principle looks to marginal benefit. Whereas the classical principle requires a particular relation between the taxes paid by each taxpayer, the modern principle is consistent with taxpayers who receive similar benefits owing substantially different amounts of tax so long as each taxpayer is adequately compensated by a package of public services that she values more than the foregone revenue. The classical principle, on the other hand, gives no assurance that a given taxpayer will prefer the combined package of government services and taxes offered by the state. At high enough levels of taxation, some taxpayers may be made worse off by government. The modern principle, by contrast, ensures that fiscal exchange represents a net gain for every taxpayer.

Wicksell taxation represents an ingenious scheme for achieving efficiencies in the provision of public goods. For goods with increasing marginal costs and decreasing marginal benefits, an efficient level of production is reached where marginal cost equals marginal benefit. At this point, the next unit produced will cost more than it is worth, while the previous unit is worth more than it costs to produce. It is thus not rational to either increase or to decrease production. A competitive market in the production and sale of private goods will reach this equilibrium. Standard microeconomic theory suggests that this analysis does not apply to public goods because public goods are non-excludable and non-rival. In other words, one cannot sell individual citizens national defence, because it is not possible to defend a nation's territory without thereby protecting those who live in it. And unlike private goods, one citizen's enjoyment of military protection does not diminish that of any other citizen. An omniscient policymaker could simply set public goods provision and taxes to support them at an efficient level, but actual policymakers have no way to do so without a market in public goods. Wicksell's scheme uses the unanimous consent rule as a way to reveal information about taxpayers' valuations of public goods and exclude policies that make some taxpayers worse off. Wicksell taxation produces an efficient outcome in the provision of public goods by allowing any party or group of parties that values the public good at above marginal cost to assume the cost of producing it by offering to pay the additional taxes necessary to produce the good. Other taxpayers should not object even if they do not care at all about the public good, so long as they are not asked to make any additional contributions. Wicksell taxation thus allows taxpayers to reach an efficient equilibrium in which all taxpayers fund exactly as much public good production as they find cost-justified.

The classical benefits principle can claim no such advantage. Requiring taxpayers pay taxes in proportion to the benefits that they receive in return does not entail that these benefits exceed the net value of taxes paid to support them. Conversely, the classical principle permits but does not require schemes in which taxpayers who prefer additional supply of a particular public good pay additional taxes to support it. Although the classical principle does not require economically efficient taxation, supporters of the classical principle might argue that aligning tax obligations with benefits received reduces the likelihood that one faction will fund public goods that it prefers, while shifting the tax burden onto others. If those who benefit the most from a service bear the greatest burden, it is more likely that taxpayers will set the provision of public services at roughly the efficient level. And unlike the modern benefits principle, the classical principle is consistent with a range of decision procedures and so allows for more flexibility in institutional design.

In addition to Wicksell taxation, two other strategies for aligning tax burdens with benefits from public spending are worth noting. One alternative to Wicksell's unanimity rule is jurisdictional competition. The American economist Charles Tiebout argued that efficient provision of local public goods can be achieved by delegating tax policy and public goods provision to local governments, thus allowing taxpayers to choose jurisdictions on the basis of which package of taxes and services they prefer.[32] Funding local public goods such as police, parks and libraries out of local property taxes links the benefits and burdens of taxation, since the value of high-quality public services tends to be capitalised into real estate prices. Citizens who prefer low taxes and sparse services can select a low-tax jurisdiction, while citizens who prefer high taxes and lavish public services can select a high-tax jurisdiction. Jurisdictional competition goes part-way to achieving the results of Wicksell taxation without the need for negotiation between citizens. In addition, one might think that local residents are best positioned to monitor the quality of local public goods and adjust their support for taxation in light of the quality of local public administration. Of course, Tieboutian competition works only in certain institutional settings and only for certain public goods. Significant power over taxing and spending decisions must be delegated to political entities that cover sufficiently small territories that a given worker might reasonably choose between living in a number of different jurisdictions. Such schemes are most practicable in nations such as the United States and Switzerland with a strong tradition of local government and a large number of well-paid workers. Where these conditions are not met,

[32] C Tiebout, 'A Pure Theory of Local Expenditures' (1956) 64 *Journal of Political Economy* 416, 416–24.

jurisdictional competition may allow mobile taxpayers to displace tax burdens on those who cannot move between jurisdictions.

A third means of aligning benefits and burdens is funding programmes out of dedicated taxes that fall mainly on those who benefit from the programme. This might be done by restricting public services to those who have paid the relevant tax, or by funding a service out of a tax that is targeted at those likely to make use of the service. Contributory social insurance schemes that condition benefits on prior tax payments are examples of the first strategy. Taxation of vehicles and petrol to support road maintenance is an example of the second. The first approach is preferable from the perspective of linking burdens and benefits, but is only effective for excludable goods. The second requires that the tax imposed is a good proxy for use of the service. This is somewhat rare for public goods.

Response to the Nineteenth-Century Critique

The traditional argument against the benefits principle, that benefits to the taxpayer are impossible to measure, is a serious problem for the classical benefits principle. It is less threatening to the modern approach to benefits taxation, which identifies a number of ways to analyse willingness to pay. The technical challenges for proponents of the modern benefits taxation, although considerable, are less than those faced by utilitarian analysis, which has had renewed popularity in the twentieth century. For cases in which these technical difficulties prevent a more fine-grained approach to taxation, it is always open to the benefits theorist to use consumption, income or wealth as a proxy for the benefits received from public spending. This might yield policies that are similar to some versions of taxation based on ability to pay, but would rest on a very different normative foundation.

The modern benefits principle does not provide an explicit response to objections to the distributive consequences of benefits taxation. Proponents of the benefits principle have at least two plausible responses to the claim that benefits taxation leads to regressive policies. First, if one calculates benefits in terms of willingness to pay, the wealthy will tend to pay higher taxes for the same services. As a person gains more resources, she is willing to bid more for a given good or service because she has more resources left over to pursue other projects, and thus compares the good or service to relatively fewer valuable projects.[33] Whereas a poor person might need to decide between larger public parks and a second bedroom, a rich person who owns a five bedroom house might be deciding between larger public parks and a sixth bedroom. If the two taxpayers have similar needs for living space, the wealthier person should be willing to sacrifice more to receive the same service than a poor person. Benefits taxation therefore

[33] A de Viti de Marco, *First Principles of Public Finance*, E Pavlo Marget (trans) (New York, Harcourt, Brace & Co, 1936) 172–73.

implies that the wealthy should pay more in taxes even when both rich and poor receive roughly the same services. When, as is often the case, local public goods increase the value of property holdings, this provides further reason to tax those with more property more than those with less. Because rich and poor are likely to value public goods in different ways, there is a danger that the wealthy and influential will succeed in enacting public spending on goods that they value and shifting part of the resulting tax burden onto the poor and powerless who would, on balance, prefer greater private consumption. Knut Wicksell was, in fact, concerned to prevent such outcomes.[34] When Wicksell was writing, in the last years of the nineteenth century, Sweden derived four-fifths of its tax revenue from indirect taxes.[35] As Wicksell pointed out, the 'whole legislative and tax approval machinery' rested 'exclusively in the hands of the propertied classes.'[36] The unanimous consent rule prevents the wealthy from imposing their preferences for lavish public spending on the poor, and encourages wealthier taxpayers to offer tax concessions or transfer payments to poorer citizens in order to buy their consent for spending projects that the wealthy prefer. Conservative Wicksellians, such as James Buchanan, concede that this is a foreseeable consequence of Wicksell taxation.[37]

Second, and perhaps more importantly, Wicksell taxation is conceived as a means to finance public goods and does not foreclose taxes that are levied for purely distributive reasons. This means that the benefits principle might be used to evaluate public finance and public spending *after* one has instituted any policies calculated to achieve a fair distribution of initial resources. Adopting the benefits principle as the primary guide to fairness in taxation is consistent with a two-tier tax system in which one set of taxes is imposed to regulate wealth inequality, and a second layer of taxation, based on the benefits principle, is used to finance public goods.[38] John Rawls, in fact, endorses Wicksell taxation for the provision of public goods once other tax and transfer policies have ensured a fair distribution of resources between citizens.[39] In this way, purely distributive questions might be distinguished from questions about financing public goods. Different taxes in the same fiscal system might serve different ends. Inheritance taxes and a progressive income tax might be largely designed to achieve distributive aims, while any additional tax revenue needed for public goods and

[34] C Blankart and E Fasten, 'Knut Wicksell's Principle of Just Taxation Revisited' in V Caspari (ed), *The Evolution of Economic Theory: Essays in Honour of Bertram Schefold* (London, Routledge, 2011) 134.

[35] Wicksell, above n 31, 72–118, 84.

[36] Wicksell, above n 31, 72–118, 86.

[37] JM Buchanan, *The Limits of Liberty* (Chicago IL, The University of Chicago Press, 1975) 72–95.

[38] The distinction between these two sorts of taxes is parallel to Richard Musgrave's distinction between the allocation branch and the distribution branch of government. Musgrave, above n 10, 5–6.

[39] Rawls, above n 8, 249–51.

social insurance might be derived from taxes that follow the logic of the benefits principle.

Supporters of the modern benefits principle might disagree about what sort of initial distribution is appropriate. Libertarians might argue that no such distribution is justified, whereas Rawlsians and market socialists might argue that a highly redistributive tax and transfer scheme is required. This might involve taxing the wealthy to fund wage subsidies and welfare payments that provide poorer citizens with more ability to 'purchase' public goods through the political process if they so choose.[40] On a theoretical level, this seems a perfectly adequate reply to the claim that benefits taxation is regressive. As a matter of practice, one might worry that it is not possible to maintain political support for redistributive measures without disguising them behind the veil of public goods provision. It is difficult to assess the significance of this concern in the abstract, since its practical significance depends on the features of particular political cultures.

Along with an over-emphasis on the regressive nature of benefits taxation, the redistributive character of ability-to-pay theories is sometimes oversold. Progressive taxation in proportion to income or wealth may mitigate inequity relative to proportionate taxation, but unless taxation reaches levels that amount to functional expropriation, there are considerable limits on the extent to which taxation alone can redress inequality of wealth. In order to do so, progressive taxation must be used to finance transfer payments. But in this case, public spending is doing much of the redistributive work. It is misleading, therefore, to identify ability to pay theories with egalitarianism when considering taxation to fund public goods as opposed to transfer payments. Modern benefits taxation requires linking taxation and public spending in a way that prevents sleight of hand in which taxes are justified as support for collective projects and used for transfer payments. Clarity is, however, a theoretical virtue. Redistributive social programmes should be justified directly as requirements of justice or of political prudence, and not concealed by severing the link between taxation and public spending on the one hand and effacing the distinction between public goods and transfer payments on the other.

In response to the point that benefits taxation misunderstands the proper relationship between state and citizen, proponents may argue that their theory promotes relations of freedom and equality. Wicksell suggested that, 'Each member of society would be happy in the knowledge that the goods which taxation withdraws from his private use are destined solely for purposes which he recognizes to be useful and in which he has a genuine interest, be it for purely selfish or for altruistic motives. Surely this would do more than anything else to

[40] Although this might be quite expensive for wealthier taxpayers, it would create a context for purchasing public goods that is more favourable for the wealthy, in that poorer citizens would have greater means to support public goods and no incentive to support higher spending on public goods on the grounds that others will pay for it.

awaken and maintain the spirit of good citizenship.'[41] More generally, Wicksell's scheme aims to secure the freedom of each citizen to choose which public projects to support. Citizens must work together to find policies that command general assent and attend to the interests of all. In this way, the proposal seems especially democratic in spirit.

Proponents of benefits taxation might in turn suggest that 'ability to pay' theories encourage a myopic focus on tax policy in isolation from the larger fiscal system, and that optimal tax theory glosses over the effects on individuals by aggregating effects across taxpayers. The benefits theory of taxation, by contrast, is individualist in its approach to taxpayers, but synthetic in its treatment of the fiscal system. It is individualist in that it is focused on the treatment of individual taxpayers, as opposed to metrics such as social utility that aggregate across individuals.[42] This might be especially attractive to those looking for alternatives to utilitarian analysis, although it may also be acceptable to rule consequentialists such as Buchanan. Although attentive to the interests of individual taxpayers, benefits taxation facilitates evaluation of the fiscal system as a whole by linking taxation and public services. This may provide grounds to justify or to criticise a tax as it focuses attention on both the benefits and the costs of particular policies.[43] Integration of tax burdens and public spending into a common analytical framework is a significant advantage for the benefits theory in relation to 'ability to pay' theories.

ADVANTAGES OF BENEFITS TAXATION

The benefits principle might be defended as a requirement of fair terms of cooperation between citizens or as a means of ensuring fair relations between the state and its citizens. The classical benefits principle is most obviously aimed at the first notion of fairness, and the modern benefits principle at the second. However, both principles may be defended in either way. I will first consider the benefits principle as a norm of fair distribution of tax burdens and then consider how the principle might be defended in terms of broader considerations of political economy.

Tax Fairness as Proportionality

The classical benefits principle is founded on an intuitive notion of fairness in exchange that is aimed at balancing the benefits and burdens of cooperation.

[41] Wicksell, above n 31, 97.

[42] JM Buchanan, 'The Pure Theory of Government Finance: A Suggested Approach' (1949) 57 *Journal of Political Economy* 496, 497–99.

[43] Although generally sympathetic to the progressive movement, legal historian Ajay Mehrotra argues that the attack on benefits taxation by American proponents of progressive taxation caused progressives to ignore the power of public spending to achieve distributive aims: 'By privileging

Contributions to the state reflect the benefits that one receives in return. From those to whom much is given, much is expected, and those who receive little might be expected to contribute little in return. Fiscal exchange under the classical principle is not based on market pricing, but instead requires that tax obligations reflect a taxpayer's ordinal position in terms of benefits from the state, so that those who receive greater benefits bear greater burdens. According to this line of thought, the mark of an unfair tax system is one in which tax burdens are shifted onto those who benefit less from the state.

As an archetype of unfair exchange, one might think of oppressed peasants who are forced to pay taxes to support a state that protects the rights and interests of landlords.[44] From the point of view of the peasants, it might be a matter of near indifference whether their present landlords are replaced by new landlords. That the peasants pay less in tax than their landlords would be little consolation, since the peasants receive almost nothing in return for their tax payments. By contrast, in a city in which citizens share broadly in the city's prosperity, citizens might willingly pay for protection and infrastructure. A fair tax system would be one in which the wealthier citizens paid more in tax since they benefit more from the success of the city. But less affluent citizens might also be expected to contribute something to common projects that produce common benefits. The citizens might face substantially higher taxes than the peasants, but because these taxes bring tangible benefits to each citizen and tax obligations are roughly calibrated to these benefits, the city's tax system is seen as fair and legitimate.

In modern democratic societies, it may be more apt to think of the benefits principle in terms of reciprocity between taxpayers (or at least prospective taxpayers) than in terms of exchange between taxpayers and the state. Taxpayers in a democratic society cooperate by contributing to the support of a government that provides public goods. They share in the benefits of public services and must decide how to apportion the burden of supporting these services. The benefits principle requires that fiscal exchange between taxpayers observes a norm of proportionality. Apportioning the burdens of cooperation in accordance with the benefits ensures that no one gains a disproportionate benefit from the collective endeavour by gaining a large share of the benefits while bearing little of the burden. And it prevents the burdens from being borne disproportionately by those who do not benefit. If the endeavour is successful (ie the government

the ability-to-pay principle over the benefits rational, these thinkers were severing the link between government spending and revenue collection … Although these intellectuals could not have foreseen how they were creating this blind spot in progressive thinking, the early stages of American fiscal myopia were becoming manifest.' Mehrotra, above n 27, 117.

[44] Even opponents of the benefit principle such as Seligman concede that it may have had progressive implications in pre-modern conditions: 'A century ago, when the absolute rulers of central Europe loaded down their subjects with grievous burdens and devoted the profit to their own petty pleasures … it was natural that a school should arise to protest and to proclaim the principle of benefit. Their argument was that as the state protects everybody, everybody is under a duty to pay taxes; in other words, their plea was for universality of taxation.' Seligman, above n 30, 71.

produces net benefits for taxpayers), this success is broadly shared with benefits spread across the population. And if the endeavour is less successful (ie the government costs more than the benefits it provides), these losses are also spread across the population. The provision of public goods under the classical benefits principle is thus aimed at providing proportionate advantages for all taxpayers, rather than at redistribution of advantages between taxpayers.[45]

Under the classical benefits principle, cooperation in the creation of public goods is subject to similar norms of those which typically govern private partnerships. All partners have a right to a share in the benefits of the relationship, but the right to profits is proportional to contributions to the partnership. This rule has at least two main appeals. First, it appeals to the participants' sense of fairness.[46] Second, it gives each partner an incentive to continue the relationship, rather than leaving for other ventures. In a world in which people can choose their partners in cooperative ventures, cooperative arrangements that do not allocate benefits in proportion to contributions will tend to see poorly compensated partners leave to join ventures in which all are treated equally (i.e. in proportion to their contributions). For this reason, voluntary cooperative endeavours will tend to adopt rules that spread benefits so as to give cooperators incentive to continue the relationship. The state is obviously not a voluntary cooperative endeavour. However, modern tax systems rely on a fair degree of compliance by the population. And democratic government functions better when there are common understandings about fairness in taxation. For these reasons, it is not desirable for tax rules to diverge too much from citizens' sense of fair terms of cooperation between strangers.

An implication of this model of tax fairness is that non-tax contributions to common projects, such as military service, may substitute for tax obligations in the accounting of a citizen's benefits and burdens. There is historical evidence that people sometimes do reason in this way. Political scientists Kenneth Scheve and David Stasavage have recently argued that high tax rates for the wealthy in the mid-twentieth century were in large part a response to mass conscription during the First and Second World Wars.[47] Voters saw high taxes on the

[45] Although this strategy for the provision of public goods is in that sense anti-redistributive, it is consistent with the existence of an entirely separate tax and transfer scheme aimed at purely distributive ends.

[46] In terms of the distinction introduced by political philosopher Brian Barry, the classical benefits principle is a form of justice as mutual advantage rather than justice as impartiality. See B Barry, *A Treatise on Social Justice,* Vol I: Theories of Justice (Berkeley CA, University of California Press, 1989) 7–8. Justice as impartiality is concerned with rules of cooperation that treat all parties as equals and do not unfairly advantage any party. Justice as mutual advantage is concerned with rules of cooperation that benefit all cooperators and divide the benefits of cooperation in a way that encourages all cooperators to continue the relationship. When the initial bargaining position is one of relative equality, the two approaches lead to similar results. However, when there are initial inequalities, rules that are aimed at mutual advantage will tend to preserve these inequalities since both the more advantaged and the less advantaged will benefit from cooperation.

[47] K Scheve and D Stasavage, *Taxing the Rich: A History of Fiscal Fairness in the United States and Europe*, (Princeton NJ, Princeton University Press, 2016) 135–69.

wealthy as justified in light of the sacrifices made by common people during the wars. Those who became wealthy while others gave their lives to protect the nation gained a special obligation to make substantial sacrifices for the public benefit in order to offset the contributions made by ordinary citizens subject to mass conscription.[48] As memory of mass conscription faded, popular demand for high tax rates for the wealthy declined and the highest marginal rates drifted downward.[49] The logic of the classic benefits principle makes sense of this historical pattern in a way that ability to pay theories and egalitarian theories do not. Mass conscription during wartime disrupts the balance between benefits and burdens that were obtained during peacetime. This balance can only be restored by increasing progressive taxes on the wealthy to account for the increased contributions of other members of the public. If Scheve and Stasavage's historical claims are correct, this is reason to think that the logic of the classic principle is deeply ingrained in popular sentiment.

If this analysis is correct, the classical benefits theory reflects a notion of fairness in exchange that is continuous with pre-modern political organisation. It is probably not an accident that the classical benefits principle was the leading theory in the early modern era when the modern state was in an early phase of its development. In a world with little conception of a distinctive public sector, it is natural to apply rules about fair terms of cooperation between private individuals to relations between the state and the taxpayer. It is hardly surprising, then, that accounts of tax fairness in the early modern era tended to preserve some of the normative character of pre-modern social relations. Two contradictory lessons might be drawn from this observation about the relationship of the classical benefits principle to non-state forms of exchange. On the one hand, one might conclude that the logic of the classical benefits principle preserves the normative character of private social relations, and is therefore inappropriate in the context of a modern state with a large professional administrative staff and an impersonal, law-governed relationship between state and citizen. As was discussed previously, this was an undercurrent of some of the criticisms of the classical principle in the nineteenth century. On the other hand, one might take the character of public finance in pre-modern states as having implications for the norms of human cooperation generally, and reason that cooperative endeavours that conform to these norms are more likely to be successful.[50] The extent to which underlying norms of social cooperation differ across time and place is

[48] ibid, 157–59, 166–68.

[49] ibid, 185–205.

[50] There is a tendency to discuss popular sentiments when doing hard-headed tax theory. No doubt, people hold all sorts of absurd views about taxation. And even setting aside idiosyncratic positions, there is a strong tendency for the median voter to favour new spending while opposing new taxes. But policy that aligns with common intuitions about tax fairness is important for several reasons. First, there is likely a significant relationship between tax morale – the disposition to comply with tax law – and perceptions of fairness. Second, in democratic states, tax policies that are widely viewed as unfair are likely to be politically unstable.

a highly complex question. The extent to which people model tax fairness on broader cooperative norms is also uncertain.[51] A high level of certainty about either response is probably not warranted.

The case for the modern benefits principle in terms of fairness between taxpayers is somewhat weaker. This is because the unanimity rule grossly underdetermines the distribution of tax burdens for public goods that all agree should be funded. For example, all property owners are presumably willing to pay a significant share of their income in order to support the minimum military and police services necessary to protect their property. These could be funded by a poll tax so that each taxpayer (except, perhaps, for the most destitute) pays the same sum. Or they might be funded exclusively from taxes on the wealthy. Neither arrangement would seem to violate the modern principle, since all citizens would rank both arrangements as superior to a world without police or military. It is consistent, therefore, with Wicksellian principles to require a relatively small number of taxpayers to pay for such services. The unanimity rule therefore does little to distinguish between very different distributions of tax burdens to support public goods that all would agree to support – the inframarginal public goods. Of course, it is unlikely that negotiations in the shadow of the unanimity rule would result in such extreme outcomes. But more plausible outcomes might differ greatly from one another along these lines. For this reason, it might be preferable to combine Wicksell taxation with rules that allocate taxes to support goods that everyone agrees upon – the inframarginal taxes – in ways similar to the classical benefits principle. This approach would ensure that the costs of essential services are not lumped onto any one subset of taxpayers.

Constraining the State

Although the classical principle might be better suited to provide an account of fair cooperation between citizens, the modern benefits principle appears more promising in giving an account of fair relations between citizens and the state. The modern benefits principle requires that each taxpayer receive benefits from the state that are at least as valuable as the taxes that they pay. This ensures that the state has a no worse than neutral net economic impact on every taxpayer. The modern benefits principle, therefore, might be seen as requiring that the exchange of taxes for public services be justifiable to each citizen.

[51] Matthew Weinzierl has found that American survey respondents across all demographic categories found arguments for progressive tax based on the classical benefits principle more appealing than arguments based on diminishing marginal utility. M Weinzierl, 'Popular acceptance of inequality due to innate brute luck and support for classical benefit-based taxation' (2017) 155 *Journal of Public Economics* 54, 54–63.

The modern benefits principle provides a plausible answer to the difficult problem of how to reconcile citizens' full-blooded entitlements to property and income with the state's full-blooded authority to levy taxes. The difficulty is in avoiding one of two extremes in formulating a principle of tax fairness. At one extreme is the rejection of any limits on taxes enacted through legitimate legal procedures. The problem with this view is that if there are no constraints on how tax obligations may be arranged, it seems that property entitlements and entitlements to earn income from labour have little normative substance since the state has the power to effectively expropriate property holders through the tax system. All workers and all property owners earn at the sufferance of the state. Some may not find this result particularly objectionable.[52] If the post-tax distribution of property rights is fair to each citizen, then perhaps it does not much matter how this result was achieved. As a matter of abstract moral principle, there is something to be said for this view. As a matter of what one might call political morality – the background norms that structure political life in a polity – it is less attractive. The other extreme is the position that all taxation is a prima facie violation of property rights because it expropriates part of the value of a property from the rightful owner. This would provide a limiting principle for taxation, but one that casts doubt on the legitimacy of all taxation, even taxes that fairly directly serve the interests of property owners. What is needed is some principle that allows a significant range of tax policies but does not permit any tax whatsoever.

One possible role for the benefits principles is to provide such a happy medium. The classical principle and the modern principle do this in slightly different ways. The modern principle constrains the state by requiring that fiscal exchange be at worst neutral for every taxpayer. In effect this means that when the state taxes property owners, it provides them with services that compensate each property owner enough to offset the losses from taxation. For example, a 5 per cent tax on the value of all land in a jurisdiction would reduce the financial value of landholding. But if the tax revenue is used to protect the property rights of landowners, it is likely that the net effect of the tax will be to increase the value of the landowners' property rights. The same logic applies to local public goods such as roads, fire departments, libraries, schools, and museums. Public goods that make an area more attractive to live in will tend to raise property values and so may compensate the property owner for tax payments. Thus, even a taxpayer who does not personally value the public good in question may benefit, since public goods that appeal to a sufficient number of prospective buyers will increase the market price of the taxpayer's property. The modern benefits principle thus restricts fiscal outcomes to those that are broadly win-win, and thereby ensures that the state, on net, enhances the entitlements of taxpayers.[53] In such a system, taxation is fully consistent with robust property rights.

[52] Murphy and Nagel, above n 7.

[53] Because the unanimity criterion must be relaxed in practice, it is likely the case that taxpayers who have extremely idiosyncratic tastes will sometimes be subject to negative sum taxation.

The classical benefits principle negotiates the boundaries of legitimate taxation somewhat differently than the modern benefits principle does. In some ways it is more permissive, and in some ways more constraining. Whereas the modern benefits principle restricts fiscal policy to outcomes that are beneficial for all taxpayers, the classical principle requires that the gains from cooperation through the state be divided fairly between taxpayers. In other work, I have defended horizontal equity as a norm that prevents negative sum conflicts over distributive policy between similarly situated taxpayers.[54] The crux of the idea is that a horizontally equitable tax code is preferable to a patchwork of wasteful credits and deductions designed to benefit some taxpayers at the expense of others. Horizontal equity thus constrains distributive conflicts between similarly situated taxpayers while remaining neutral on the question of how much to spend on public goods and the question of whether to redistribute from rich to poor (or, less happily, from poor to rich). Horizontal equity, however, does nothing to constrain the level of taxation or prevent one economic class from expropriating or oppressing another. The benefits principle might be thought both to constrain differences in the treatment of similarly situated taxpayers and to require fair treatment of taxpayers who are differently situated. Observing rough proportionality in the distribution of benefits and burdens prevents the state from collecting taxes primarily from one group of taxpayers and using them to support public goods favoured by another group of taxpayers. In this respect, the classical benefits principle has an advantage over horizontal equity, at least when considering taxation to support public goods as opposed to transfer payments. This observation also provides reason to prefer the classical principle to the modern principle. Although the modern principle prevents the state from imposing policies that are negative sum for any taxpayer, it is consistent with policies that concentrate the benefits of public goods disproportionately among only a few taxpayers. The classical principle, by contrast, is concerned with apportioning gains from cooperation fairly, so that those who receive similar benefits pay similar tax.

The Jurisdictional Role of the Benefits Principle

A final role played by the benefits principle is jurisdictional. Rather than using the benefits principle to determine tax obligations, one might appeal to the

For example, someone who derives unusually great enjoyment from defending their own property might prefer to underfund police services because they prefer arming themselves and patrolling their property to hiring police. Such a taxpayer might genuinely prefer not to pay taxes to support the police department. But because this is such an odd preference, it is difficult to allow it to determine tax policy even for solitary taxpayers. In certain polities, geographical sorting might partially accommodate such preferences: citizens who prefer self-help to police services can move to the frontier.

[54] I Lindsay, 'Tax Fairness by Convention: A Defense of Horizontal Equity' (2016) 19 *Florida Tax Review* 79, 79–119.

benefits principle to determine who should be liable for taxation in a given jurisdiction. This idea is embedded in the modern system of international taxation, but pre-dates it. For example, the nineteenth-century American lawyer Thomas Cooley argued that 'The protection of the government being the consideration for which taxes are demanded, all parties who receive or are entitled to that protection may be called upon to render the equivalent. The protection may be either to the rights of persons or to rights in property and taxes may consequently be imposed when either person or property is within the jurisdiction.'[55] Delineating the right to tax is difficult when economic activity crosses jurisdictional boundaries. One also might use benefits logic to determine how to allocate the right to tax the corporate profits of a multinational that operates across international boundaries.[56] It is fair that foreign investors who benefit from the public goods provided by states in which they invest pay to support the provision of these goods. One problem with international tax competition is that it threatens to deprive capital importing nations of tax revenue, since states with little bargaining power may be compelled to offer tax concessions if they wish to attract capital in an environment in which competitors offer tax incentives for foreign investors.[57] Similarly, one might justify taxation of foreign nationals on the basis of residence by reference to their enjoyment of public goods provided by the host state.[58] Whether to tax a nation's citizens who live abroad depends in part on judgments about the extent to which expatriates benefit from public goods provided by the state, including the goods that will be enjoyed by an expatriate who returns home. Although 'benefits theory' logic is perhaps least controversial in the area of international taxation, tracing out its implications for international tax policy is immensely complicated, and cannot be accomplished within the scope of this paper.

DIFFICULTIES WITH THE BENEFITS PRINCIPLE

The Baseline Problem

As was argued above, proponents of benefits taxation have plausible responses to the claim that benefits taxation has objectionable distributive implications. However, the problem of redistribution points to a deeper concern with the benefits principle. This I will call the baseline problem. The baseline problem is

[55] TM Cooley, *A Treatise on the Law of Taxation: Including the Law of Local Assessments* (Chicago IL, Callaghan and Co, 1881) 14.

[56] Eg, R Avi-Yonah, 'International Taxation of Electronic Commerce' (1997) 52 *Tax Law Review* 507, 520–23.

[57] P Dietsch, *Catching Capital: The Ethics of Tax Competition* (Oxford, Oxford University Press, 2015) 54–62.

[58] Eg, 'Residence taxation as such only seems to be a legitimate fiscal tool on the basis of the benefit principle': W Schön, 'Taxation and Democracy' [Forthcoming 2019] 72 *Tax Law Review* 40.

that benefits of a particular public good must be measured against the state of affairs in which the good is not provided. This creates both normative and positive challenges. In some cases, the appropriate baseline is relatively clear. The value of a public park to a taxpayer is the difference between how the taxpayer values a neighbourhood with the park and the same neighbourhood without the park. Although it may not be possible to measure private valuations of the park directly because it is uneconomical to charge admission and because some benefits may accrue to those who do not enter the park, it is possible to determine implicit valuations by looking at the market for property located near the park. Goods that have a more pervasive effect on the taxpayer's quality of life can be more difficult to value. What, for example, is the value of the legal system to a taxpayer? One could imagine a simple agricultural economy in which disputes are resolved by a combination of self-help, informal mediation, and community discussion. But it is difficult to imagine a complex economy that functions well without a specialised dispute resolution system backed by specialised enforcers. Lack of a formal legal system would both sharply diminish the economic value of property rights and significantly compromise personal security.

If one adopts the theory that benefit is to be measured in terms of willingness to pay, then one must consider the alternative to lack of protection from the state and how much the taxpayer would be willing to pay to avoid this state of affairs. But this seems to depend on what the taxpayer's situation would be outside of the state. Would the taxpayer own the same property? Or would there be a free-for-all such that the taxpayer could expect to end up with much less property. For taxpayers having valuable skills, one might consider the market for their labour abroad when considering their willingness-to-pay for protection by the state. But for other assets, one might wonder whether one is to suppose that patterns of ownership are to remain the same outside the protection of the state. If so, this seems a rather artificial assumption that will undervalue public spending given that the purported benefit of taxes is the protection of property. But if not, it seems quite plausible that a taxpayer would be willing to pay a very large proportion of income in order to protect her property. The modern benefits principle would therefore place only very mild constraints on the taxation of wealthy taxpayers (the poor being much quicker to conclude that taxes are not worthwhile since they are closer to their expected outcome in the state of nature).

With respect to protection of persons, the problem is even worse. Taxpayers would presumably be willing to pay a very large sum for protection of their persons. But in this case, willingness to pay will give little guidance on how to allocate tax burdens. Benefits theorists have two options at this point. One is to rely on the classical benefits principle, which might suggest that if taxpayers benefit equally from protection to their persons, they should share the costs of providing this protection equally. This response is plausible, but might raise objections on distributive grounds. A second, perhaps more promising, approach is that taken by James Buchanan. This is to separate constitutional negotiations, which fix the political order, property entitlements and the legal system (the 'protective state'), from the provision of other public goods (the 'productive state').[59] The constitutional contract thus fixes the baseline against which negotiation over ordinary taxing and spending decisions take place. This has the advantage of determining a background against which fiscal policy can be evaluated. But it may incorporate a bias toward non-redistributive policies since separating the protective state from the productive state as Buchanan does, limits the extent to which the benefits that the wealthy receive from the protective state can be used to justify greater contributions to the public goods produced by the productive state. On the other hand, the justification of the protective state might require significant transfers from rich to poor, since transfer payments might be the price of political consent.[60]

The baseline problem is especially challenging for public goods such as national defence, police protection and the legal system that are fundamental to political order. For these goods, the modern benefits principle puts few constraints on tax policy, and the classical benefits principle is difficult to interpret. Here, the modern principle gives some reason to prefer progressive taxation, while the classical principle is more consistent with proportionate taxation. If one accepts the classical principle, taxes to support these public goods should probably be apportioned on the basis of the taxpayer's economic standing through some mixture of income, consumption and property taxes. If one accepts the modern benefits principle, it seems plausible to support such goods on the basis of sharply progressive taxation. Aside from egalitarian distributional preferences, there is a plausible argument that the unanimity rule will tend in a progressive direction since poor taxpayers have less to lose from the breakdown of political order and may more plausibly threaten to veto such spending projects than wealthy taxpayers. The implications of benefits taxation to support goods that are not essential to the political system are slightly more straightforward and here Wicksellian taxation would have more predictable results.

A second baseline problem concerns the point in time at which costs and benefits are to be measured. This is a particular problem for social insurance programmes that redistribute costs and benefits over a taxpayer's life and provide insurance against poor outcomes or, in the case of state pensions, good outcomes. The difficulty is that the point of these programmes is in part to mitigate risks by redistributing ex post.[61] Social insurance programmes work by pooling risks, by transferring resources from the lucky (the employed, the healthy, the able-bodied, etc) to the unlucky (the unemployed, the unhealthy, the disabled, etc). Part of the value of the social welfare state is that it provides benefits in the case of misfortune that most taxpayers will not need to use.

[59] Buchanan, above n 37, 88–90.
[60] ibid, 92.
[61] J Heath, 'The Benefits of Cooperation' (2006) 34 *Philosophy & Public Affairs* 313, 346–47.

Another function of the social welfare state is to help manage mismatches in income and needs over a person's life. Programmes such as state-funded education, childcare subsidies and old age pensions respond to the problem of variable income over one's life-cycle and uncertainty about future costs during low-income periods by allowing citizens to pay into programmes when they have sufficient income, and to collect benefits when they have particular needs.

The dilemma faced by proponents of the benefits principle is that the more they appeal to the benefits received by an actual taxpayer, the less scope there is for social insurance, while the more they appeal to benefits received by hypothetical taxpayers, the less the theory speaks to the benefits received by actual taxpayers. For programmes that mitigate risk over the life cycle, it is probably best to assess matters from the perspective of a young adult. This reflects exposure to various risks that a person faces over the course of their life but does not abstract away from many of the personal characteristics that determine their particular preferences. The insurance element of social programmes is more difficult to analyse. The value of insurance, especially for events that are difficult to insure on the private market, is considerable. This suggests that a taxpayer who pays slightly more in taxes than she expects to receive in social insurance benefits may still be advantaged by the social welfare state. It is difficult, however, to decide how to value the risks mitigated by social insurance. Some taxpayers are at greater risk of unemployment than others. Some taxpayers are more likely to be sick; others are more likely to outlive the numbers on actuarial tables. These risks are partially, but not entirely, understood ex ante. Children have actuarially different prospects from birth if we are told the identity of their parents. By the time that they are adults, even more information about their life prospects is available. In some cases – national health insurance that covers medical costs for those in poor health, and old age pensions that disproportionately benefit the healthy and long-lived – benefits from social programmes may be offsetting since the chronically ill are less likely to collect pensions. But in other cases, the same relatively small number of people tend to draw benefits from multiple programmes. To the extent that these benefit recipients are identifiable ex ante, this tends to undermine the insurance value of social welfare programmes for other taxpayers.

The classical benefits principle might finesse this issue by making benefits proportional to contributions but compressing the payments schedule so that high contributors are somewhat underpaid relative to the value of their contributions, and low contributors are somewhat overpaid. This would preserve the proportionality that the principle requires, while allowing for some degree of redistribution to be built into the social insurance scheme. This strategy is less compatible with the modern principle. At any but a low level of redistribution, the most advantaged citizens will make contributions that are greater than their expected benefits. The very wealthy can self-insure against bad outcomes. When social insurance contributions become high enough, insurance on private markets becomes competitive with government benefits for high earners, even when taking into account market failures in private insurance.

The baseline problem is not necessarily fatal to benefits taxation. But it does undermine one of its purported advantages. Although benefits taxation requires a thicker informational base than ability to pay taxation, it does not appear to require analysts to look beyond taxation and public spending to evaluate tax fairness. However, the baseline problem suggests that evaluation of the benefits of the minimal state is bound up in thorny questions about the correct way to model a taxpayer's willingness to pay for essential services. The value of social insurance programmes to taxpayers crucially depends on how we model the risks that they mitigate. Both of these inquiries implicate deep questions about distributive justice. This is not necessarily a disadvantage for benefits taxation, as being embedded in a larger theory of distributive justice might make the approach to tax fairness more rather than less plausible. But it does mean that benefits taxation may have less appeal as a freestanding theory of tax fairness and must be considered as one part of a larger theory of fair terms of political cooperation.

The Public-Spirited Citizen Problem

A second problem with benefits taxation is that it may be unfair to public-spirited citizens. To simplify matters, suppose that there are two types of taxpayers: public-spirited taxpayers, and taxpayers who are not public-spirited.[62] Public-spirited taxpayers care both about their private projects and about collective projects that do not directly influence their own well-being. This might be because they are nationalists who intrinsically care about the status of their nation, or because they are altruists who care about the welfare of their fellow citizens. Non-public-spirited taxpayers are concerned only with their private projects and care about the nation only insofar as its condition affects these private projects. Both types of taxpayers are willing to contribute to public goods. But their preferences for public goods and their willingness to pay for them will differ significantly. Public-spirited and non-public-spirited taxpayers are each willing to pay to support public goods that support their private projects. But public-spirited taxpayers are additionally willing to pay taxes beyond those necessary for their private projects in order to support projects that benefit the nation as a whole or benefit their fellow-citizens as individuals. Because of their greater willingness to pay for public goods, public-spirited taxpayers are likely to assume a somewhat greater proportion of the tax burden in a Wicksellian tax system. Under a Wicksell tax system, the public-spirited essentially purchase greater provision of public goods through their own taxes

[62] Actual taxpayers fall on a continuum between entirely public spirited and entirely non-public spirited. It is easier to use ideal types for purposes of exposition. The basic problem will arise insofar as taxpayers differ from one another in their degree of public-spiritedness, even if few fall at either extreme.

that benefit public-spirited and non-public-spirited alike. Public-spirited citizens might object that this is unfair. They are no more benefited in their private projects than non-public-spirited citizens are. But because non-public-spirited do not intrinsically care about anything outside of their private projects, they bear a smaller share of the tax burden. Public-spirited citizens might also object that they are being disadvantaged precisely because of their good moral character. This may sometimes be so. It is important to keep in mind, however, that taxpayers could be public-spirited for a variety of reasons, some of which may be rather unsavoury. Zealous militarists who favour higher taxes to support foreign wars for the greater glory of the nation are no less public-spirited in the sense intended here than wealthy taxpayers who favour higher taxes to feed the poor.

One response to this problem for Wicksellians is to dig in and insist that there is nothing improper with taxing citizens according to their marginal benefit. As already noted, this is the approach favoured by Wicksell himself.[63] They might suggest that a compromise between the preferences of public-spirited and non-public-spirited taxpayers is a sign of a fair procedure. This, however, is not really responsive to the public-spirited taxpayer's complaint. The objection here is that the compromise is not fair because the preferences of public-spirited and non-public-spirited taxpayers are different in kind, such that aggregating across them benefits the selfish.

An alternative response is to differentiate between self-interested and other regarding preferences for the purposes of calculating willingness to pay for public goods. Taxes could then be apportioned using self-interested preferences. This response, however, tends to exacerbate the difficulties in measuring benefits as even procedures that identify willingness to pay will not be enough to distinguish between self-regarding and other regarding preferences. A third approach would be to fix the supply of public goods independently of tax obligations so that this compromise between taxpayers would not be infected by the differences in public-spiritedness among taxpayers. Taxes could then be apportioned on the basis of private valuations of these public goods, rather than all-things-considered willingness to pay. This response is similar to that favoured by proponents of the classical benefits principle. But it would sacrifice many of the efficiency gains of the unanimity rule because the supply of public goods would no longer be determined by the willingness to pay of individual taxpayers.

The public-spirited citizen problem is, in a sense, a reworking of the venerable criticism that benefits taxation misunderstands the difference between public and private consumption and is therefore inappropriate for analysis of the public sector. The critique is subtler than the nineteenth-century version. The point here is not that demand for public goods cannot be modelled by analogy to private consumption, but that treating altruistic and self-directed preferences as

[63] Wicksell, above n 31, 97.

equivalent is unfair to those who are altruistic or collectivist. Ironically, it is the classical version of the benefits principle, which looks to private benefit, rather than the modern principle, which looks to willingness to pay, that is better able to respond to this criticism.

CONCLUSION

After nearly a century of being confined to the margins of tax theory, benefits taxation is almost certainly underrated today. Its advantages are several. First, the benefits principle provides a way to analyse the relationship between property rights and tax burdens that avoids the Scylla of concluding that all taxes are a prima facie violation of property rights, and the Charybdis of conceding that commitment to private ownership of resources puts no constraints on tax policy. Benefits taxation places limits on the tax burdens that may be imposed on a taxpayer and the permissible scope of redistribution across taxpayers while leaving open a range of policies that provide sufficient benefits to each taxpayer. Second, the benefits theory situates tax fairness in the context of deeper norms of reciprocity. This has the theoretical advantage of providing a normative foundation for norms of tax fairness and the practical advantage of identifying policies more likely to elicit voluntary compliance from taxpayers and political support from voters. Third, the modern approach to benefits taxation promises to realise efficiencies in the provision of public goods that were previously thought possible only in private markets.

The traditional objections to benefits taxation, that it involves appeal to unmeasurable quantities and that it is regressive, have some weight but are not dispositive. As a normative standard, willingness to pay is conceptually clear and may be estimated at least approximately using a variety of techniques. Even when benefits are difficult to measure, the benefits principle may suggest an alternative justification for taxes on income, consumption, or wealth. A second objection – that the benefits principle is regressive – is only effective against certain interpretations of the benefits principle. Both of these objections, however, are connected to a deeper problem, which is that the baseline against which willingness to pay is to be measured cannot be made precise without making a host of controversial normative judgments. A third objection, that the benefits principle is inconsistent with the proper relationship between citizen and government runs the risk of treating citizens as serving the state, rather than the state as serving citizens. But a related critique has more force. Modern benefits theory may tend to treat altruistic taxpayers unfairly and advantage those who care largely about their private projects.

The classic benefits principle and the modern principle have different strengths and weaknesses. Both principles help to mediate the conflict between property rights and taxation authority, but do so in slightly different ways. The modern principle promises greater efficiency and an elegant solution to the measurement problem, but is difficult to implement in practice. The classical principle better tracks plausible norms of fair cooperation but is more vulnerable to the measurement objection and less well calibrated to produce efficient provision of public goods. The classical benefits principle is better suited to evaluate taxes in support of public goods that are likely to be supported for altruistic reasons. Wicksell taxation, by contrast, is better suited to evaluate taxes to support public goods that are similar in character to private consumption goods.

The case for the benefits principle is not straightforward. But neither is the case for any of its competitors. At the very least, benefits taxation is a plausible rival to 'ability to pay' theories. In light of the difficulties with each version of benefits taxation, it is probably not desirable to adopt a single principle to justify the fiscal system as a whole. What may be more promising instead is a modular approach in which different types of taxes are levied to support different sorts of spending programmes. Each part of such a fiscal system might be justified by the classical benefits principle or by the modern benefits principle or by purely distributive aims, but no single principle of tax fairness would explain the system as a whole.