

ECONOMIC BRIEF NO. 3

Deciding Which Tax Is the Best Tax

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No one likes taxes, but they are a necessary evil in any civilized society. Whether you believe in big government or small, governments must have some resources in order to perform their essential services. So how does one go about evaluating a particular tax?

No one has yet come up with a better set of criteria for judging a tax than the Canons of Taxation first proposed by Adam Smith more than two hundred years ago. According to Smith, a good tax should meet four standards: standards of equality, convenience, certainty, and efficiency.

Other students of taxation at other times have added to Smith's criteria. Some have noted that a tax should be adequate, meaning it should

produce sufficient revenue to support whatever it is that citizens want their government to do. Some have argued for a Benefit Principle whereby the amount of tax each is called upon to pay bears some relationship to the benefits each taxpayer receives from government. Others have argued that a tax should be neutral in its effect on the way markets work. But Smith's Canons are the starting point for any serious evaluation of a tax.

Applying Smith's Canons to any particular tax is largely a subjective undertaking. Yet, if one attempts to evaluate the principal taxes — that is, property tax, income tax, and sales tax — against Smith's Canons, one will quickly find that there is no

such thing as a perfect tax. The property tax, for instance, scores fairly low on convenience and efficiency, but fairly high on certainty. The income tax scores fairly high on equality, but is costly to administer and (in the U.S.) is so complicated that it leaves much to be desired on certainty. A sales tax scores high on convenience, certainty, and efficiency, but poorly on equality.

Because there is no perfect tax, an argument can be made that the best tax system is one that uses all three major types of taxes in small doses. By combining all three major types, it is possible to offset the weaknesses of each with the strengths of the others.

In the final analysis, however, the standard for judging a tax is often political.

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ADAM SMITH'S CRITERIA FOR EVALUATING A TAX

Equality: *When ability to pay is taken into consideration, a good tax should distribute the burden of supporting government more or less equally among all those who benefit from government.*

Convenience: *The time and manner of payment of a tax should be as convenient as possible for the taxpayer.*

Certainty: *The amount of tax that is due, the method of payment, and the deadline for payment should be clear so that each taxpayer can be certain about his or her obligations.*

Efficiency: *The cost of administering the tax should be as low as possible so that a large fraction of what is taken from the taxpayer's pocket is not used up in collecting the tax.*