

# Ricardo, smith and petty on taxation research papers examples

[Technology](#), [Development](#)



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## **Abstract**

The paper focuses on the development of taxation based on contributions of Ricardo, Smith and Petty. They both developed the taxation idea from Locke's theory of a single tax on rent. Their major contribution was on the incident tax, which demonstrates value system, power relations and group interests on taxation. Finally, the paper analyzes how taxation influences economic decision in the 21st century.

## **Introduction**

The development of political economy in the 17th century was characterized by an effort to flee from Locke's theorem that all taxes would eventually fall on the rent of land as well as his proposal of a single tax on rent. Smith produced a system where his argument on tax incidence was not different

from Locke's theorem. Ricardo established political economic system which generated a consistent theory of tax incidence which was not covered by Locke's theorem. Thus, Ricardian political economy prepared a path back to Locke's proposal, which is a single tax on rent. Ricardo managed in showing that most taxes would eventually fall on profits but not rent. Petty also advocated for the taxation policy that would promote economic growth. These scholars contributed greatly on the impact of taxation on consumption and the economy at large. The paper focuses on the impact of the taxation on the individual and the economy based on the views of these economic scholars.

## **Adam Smith on Taxation**

Adam Smith made a great contribution on taxation. He thought that taxation was one of the causes that the progress of opulence has been so slow. He investigated which taxes might cause the least loss or obstruction to the industry of the people where he argued that the revenue that is raised insensibly from people ought to be preferred. He compared taxes on property and taxes on consumption where he stated that taxes upon possessions are naturally equal, but those on consumptions are naturally unequal because they are paid by the merchant, consumer and importer. According to Smith taxes on the property were equal because they would be proportional to the taxpayer's ability to pay. This is so because taxes on the property would not be transferred to other people. Despite his acknowledgment that taxation on land was unjust, Smith ascertained a breath of liberty to inspect individual's stock and money for the purpose of

taxation. On the consumption taxation, which would be shifted on to the price, Smith argued that it was uneven because it was proportional to individual's liberality, but not their ability to pay. However, taxes on consumption was seldom felt by individuals who paid them. According to Smith it was a benefit because it constituted the least infringement on liberty. Therefore, taxes on consumptions were better off compared to those on property because they have less tendency to destroy the situation of individuals.

Besides his contribution to property and consumption taxation, Smith formulated a complete theory of tax incidence that was consistent with his political economy. He examined a variety of taxes based on the natural-price system in order to assess the Locke's theorem that all taxes would fall on rent. The natural-price system was based on three types of commodities such as necessities, luxuries and raw produce. He used landlords, capitalists and wage-laborers who earned rent, profits and wages respectively to evaluate the issue of taxes on these actors. He argued that taxes levied on raw produce influenced the rent and may be initially developed by the farmer and eventually paid by the landlord. His natural-price system signified that a tax on raw produce would reduce the rent while maintaining the prices of luxuries and necessities unchanged.

Smith argued that taxes imposed on the consumption of necessities would increase the wages of labor and eventually increase the price of all manufactures and reduce rent. The landlord was expected to bear the burden of the tax in the form of a reduction of nominal rent and a decrease in the real purchasing power of rent. Likewise, capitalists would have to bear

the burden of the tax, although the rate of profit would not change, they would be capable of purchasing fewer luxuries due to an increase in the price. Although laborers were not affected by taxes on necessities, their wages would be increased in proportion to any increase in the price of necessities. Therefore, Smith argued that the superior people who understood their own interest mainly opposed all taxes on the necessities of life as well as all direct taxes on the wages of labor. Similarly, taxes on luxuries has no tendency to increase the price of any other commodities besides that of the commodities taxed.

Therefore, smith demonstrated that some taxes on property and income as well as consumption would be shifted on to the price. According to Smith, a tax imposed directed on wages was expected to have the same effect as a tax on necessities. Thus, the burden of tax on wages would be felt by consumers and landlord. Meanwhile, Smith argued that profits were based on the interest of the owners of capital and compensation on the of capital to risk. The users of capital were expected not to shift a tax imposed on profits to the interest. This is so because the owners of capital would export their capital to the foreign market. Hence, the users of capital would transfer the tax to the price of manufacturers and rent. The tax on profits had an equal effect as taxes on wages and on necessities where rent would decrease while the price of necessities and luxuries would increase. Given rent was the residual of the price of raw produce, the tax would decrease the rent, but would not alter the price of necessities and luxuries.

## David Ricardo on Taxation

Ricardo made great contributions on the subject of taxation. Following Smith, Ricardo examined the incidence of taxes based on the natural-price system with respect to raw produce, necessities and luxuries. Nevertheless, he thought that smith's theory of tax incidence was undermined by a deceptive theory of rent. On taxation. He was subject to the Malthusian principle of population, which assumed the wage basket was fixed at the subsistence level. In the case of either the price of raw produce, necessities or luxuries were selected as the numeraire, the system would establish the rate of profit based on the numeraire. This system generated Ricard's major conclusions regarding the incidence of different taxes.

Ricardo argued that a tax on raw produce as well as a tax on necessities would increase the price of the commodity taxed by the amount of tax. This type of tax would also raise money wages and eventually decrease the rate of profit in all industries. This was so because raw produce and necessities were consumed by the laborers and used for production since the wage basket was fixed. For his theory to be correct, he assumed that the ratio of the input of the commodity taxed to the total production cost was equal between all sectors. In this case the price of luxuries would not be influenced by a tax on raw produce or necessities. Likewise, a tax on luxuries would not decrease the profit rate, but would raise the price of the commodity taxed by the amount of the tax. This result was based on the assumptions that luxuries were not consumed by laborers and were not employed in the production of any commodity.

Although each capitalist would try to shift the burden of tax by increasing the

price of a commodity, a tax imposed on profits in all industries would not change the price of commodities. The eventual incidence of such a tax would be imposed by all capitalists in the economy. A tax imposed on profits in a particular sector would have the same effect as a tax on the commodity generated by that sector.

Since Ricardo supported the Malthusian principle of population, he did not think that a tax on wages would be paid by laborers. He argued that in case a tax was levied on wages, the laboring population would reduce and the price of labor would increase. A raise in money wages would result in a reduction of the rate of profit via the trade-off between wages and profits. Hence, capitalists would pay the tax on wages and not laborers. He concluded that a tax on wages would have the same impact as a tax on the profits of all sectors, therefore the capital-labor ratio was expected to be equal between industries.

A tax imposed on the rent of land would burden the landlords. Ricardo derived this argument from his theory of differential rent. Here, the landlords would not transfer the tax to capitalists by increasing their rent because capitalists could be charged only the difference in productivity between their lands and the marginal land where no rent was paid. Nevertheless, if a land tax was fixed per acre, it would be in reality a tax levied on profits in the sector of raw produce. Likewise, it would produce the same effect as a tax on raw produce and the price of raw produce would become relatively high, but the rate of profit in all industries would decrease.

Similarly, Ricardo discussed various taxes based on the principles of price-neutrality, minimization and distribution-neutrality. Taxes on raw produce,

necessities and luxuries did not comply with the principle of price-neutrality because they would increase the price of the commodity taxed. On the other hand, the direct taxes would not violate this principle because there was no tax on rent or profits. Based on the minimization principle, taxes on raw produce, necessities, wages and profits as well as a fixed land tax were undesirable because they would fall on profits, checking capital accumulation.

On the other hand, tax on luxuries would not check capital accumulation because it would be paid for unproductive consumption. Therefore, the tax imposed in proportion to the rent of land would damage capital accumulation less than other direct taxes because it would fall on rent and not profits. However, Ricardo powerfully opposed a special tax on rent since it violated the security of property which he gave the first priority. He argued it would be extremely unjust to tax exclusively the revenue of any certain class of the community because the burdens of the state should be shared by all citizens.

## **William Petty Contribution On Taxation**

Petty is believed to be one of the predominant innovators in the history of economic thought. He made a great contribution on taxation where he examined the contemporary tax system. He argued that there must be some method of valuation other than money, which can fluctuate based on the relative abundance and scarcity. He considered the best tax policies that would promote economic growth. He proposed the use of the tax and spend method by focusing on consumption taxation and imports rather than



income. He argued that the tax policy would be employed to finance public spending by the state while balancing the accounts.

Petty argued that there was no way of distributing the burden of taxation in proportion to the citizens' expenditures save by taxing those expenditures themselves. He demanded a natural justice a heavy if not an exclusive taxation. This was so because he believed the income of individuals was less than their expenditures by the amount of their saving.

He also focused on taxes by treating rent as the mysterious nature where he thought it was well to explain it before talking too much about its taxation.

Here, Petty gives an example on rents with the revenues expected on naval trades. Following Smith, he argued that landlords are more likely to engage in luxury consumption because tax imposed on luxuries would reduce prices.

## **Analysis**

The taxation had great influence during the 17th century and still influences the economy in the 21st century. For instance, the doctrine of tax incidences shows that the development of British political economy wanted to escape from ineffective tax policies such as Locke's. The taxation influenced the decision making of the 17th century because it had a great impact on the economy. Scholars such as Ricardo thought taxation had a negative impact on the individual and the economy at large. For instance, his fundamental position was that no tax could be recommended as a permanent basis for a system of revenue. He also advocated for a reduction in the existing tax because they overburdened citizens.

In the 21st century, taxation has great influence on a value system, power

relations and group interest because it has an effect on both production and consumption. Taxation has a direct impact on the level of effective demand and employment. They affect work incentives, the amount of saving and the level and pattern of investment. On the other hand, some taxes distort the allocation of resources and lead to inefficiencies that affect decision making. The level and structure of taxes determine the level of disposable income, and the distribution of after-tax income among different individuals.

It is clear that the current condition of the economy and its structural features influences the ability to tax and the type of taxes that can be levied.

The economic approach to taxation and development evaluate how economic changes, influences the evolution of the tax system. Therefore, changes to the tax system reflect the structural change of the economy.

Well-designed tax systems can reduce the efficiency losses imposed by taxes and increase the growth rate. Revenue realized from taxation can be spent on public goods and investments that promote the economy.

The analysis of the tax incidence indicates the distributive effects of taxes.

Here the focus is on how various tax regimes affect factor returns and commodity prices. The distributional impacts of some taxes are fairly straightforward, while the effect on others is quite complex. For instance, the burden of a proportional income tax that is imposed on all income is proportional to a household share in national income. In contrast, taxes that do not apply to all types, of all commodities change relative commodity prices, influence factor use in certain industries and change the production structure of the economy.

## Conclusion

I have learned that taxation has a great impact on the individual income as well as the economy at large. Therefore, the tax system used should improve economic efficiency and increase tax compliance. I have also learnt that tax should not burden certain group, but should honor society's norms of fairness and equity. Likewise, government should collect the taxes due easily and economically, at the small cost of tax compliance. Therefore, taxpayers should have the capability of understanding the tax code and pay the taxes based on minimal attempt. I have also learnt the dynamic efficiency problem of taxation is that it reduces incentives to save and invest. This is so because the goal of taxation is to maintain incentives for saving and investment in the economy. Since the taxation is meant to enhance the revenue, various taxes imposed on commodities must be consistent with society's norms. Just like Smith, Ricardo and Petty taxes used should not be unjust to the citizens.

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