

TAXATION AND REVENUE

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DR. KRESS: Admiral Hague, General Greeley, and gentlemen: This morning we discuss taxation--its principles and something of its practices.

Our speaker this morning is an exemplification of the old saying that if you want something done, ask a busy man to do it. When we wrote to him a few weeks ago, he was in a great press of work on his report of the Tax Study Committee for the Governor of Pennsylvania. He also had to postpone a lecture he was to give to a group for which he is tax consultant. A busy man finds it possible to do that sort of thing, in order to be here this morning.

In the Procurement Course, in a few months, we will give you his study on the spendings tax idea, as a possible substitute for rationing in wartime. One of our students last year took this study and expanded it. The student report is a contribution to knowledge, and we are in the process of having it reproduced. I have here another of our speaker's published papers, "Taxation and the Economy," that has been reprinted in three different books of readings.

But this morning he is not going to talk as an expert on taxation, but merely as a professor of public finance. From the outline of his lecture, copies of which you have, we are sure to find out all we need to know about taxation and revenue raising principles.

It is a pleasure to introduce to you Dr. Alfred G. Buehler, Professor of Public Finance, University of Pennsylvania.

DR. BUEHLER: Admiral Hague, General Greeley, and gentlemen: It is a very real pleasure for me to be with you today. This opens my college year very nicely. Our classes start soon, in a couple of weeks; and this gets me off on the right foot.

We have had a number of officers with us from year to year at the University of Pennsylvania. It is good for us; and we hope, of course, that it will be of some benefit to the officers.

Public Finance and Taxation

I like to think of public finance, when I meet with college groups such as this, as a subject which can be approached in an objective way. As you know public finance involves the study of economics, political science, and the other social sciences as well as finance. I like to

encourage our students at the university to exercise their minds and to arrive at such conclusions as they think are appropriate on the basis of the available data, conscientiously assembled to provide a factual background and honestly and intelligently interpreted.

The politics of public finance are suggested by the advice which one of our State senators gave to me when we started working on our Pennsylvania tax report a year ago last spring. The Governor had appointed a number of committees and one of them was this tax committee. I was appointed the chairman.

When our committee started to work, the senator said, "You might just as well not have any study. We are going to settle this problem on a political basis. You can save yourselves a lot of work if you don't have a study."

Now, the reason I mention that is this: Looking at public finance from the point of view of the politician, we can be pretty sure he is going to want to know how many votes he is going to get out of a tax or spending program. He is going to want to know how any tax proposal is going to affect his chances of staying in, if he is already in, or getting in, if his party is out. The politicians may not be greatly concerned over economic principals and their application in public finance. They may be guided only by expediency.

The economist in public finance is in a different position. He is likely to think of public finance as a science, a science which studies the relationships of A, B, C, and other variables out of which we may arrive at certain conclusions he calls principles. But, of course, you know from your own study of economics that pure economics studies "what is." When you get to the second stage, to what is socially desirable, there may be quite a few differences of opinion because then you are studying "what ought to be."

Economic phenomena may be very complex and difficult to explain. The statistics way suggests a variety of causal factors at work. When you study the so-called business cycle, you may find 140 or 150 different explanations. Public finance involves economics and is therefore as complicated as economics.

Public finance, which is the financing of government, the financing of our democracy, and the more perfect union of public education, highways, national defense, and other public services, is not only partly economics and partly political science; it is also partly ethics. I think many times that the problems we discuss come back to questions in ethics. The moment that an economist begins to apply economics and tells us what ought to be done, the chances are he is over in the field of ethics.

Table 1. Expenditures of Federal, State, and local governments a/
(Dollars)

Year	Total		Federal b/		State c/		Local d/	
	Amount (In Millions)	Per capita						
1940	17,531	133.95	9,062	69.24	3,565	27.38	4,904	37.47
1941	21,564	163.44	13,255	100.47	3,542	26.99	4,767	36.13
1942	42,231	317.39	34,042	255.84	3,631	27.45	4,558	34.26
1943	87,314	652.81	79,401	593.65	3,505	26.37	4,408	32.96
1944	103,192	770.26	95,041	709.41	3,561	26.76	4,590	34.26
1945	107,071	807.34	98,385	741.85	3,762	28.56	4,924	37.13
1946	70,414	532.89	60,402	457.12	4,415	33.63	5,597	42.36
1947	51,980	371.57	38,981	278.65	5,827	41.93	7,172	51.27
1948	48,946	341.38	33,023	230.33	7,723	54.21	8,200	57.19
1949	57,298	392.33	39,474	270.29	8,824	60.79	9,000	61.62
1950	59,117	397.94	39,568	266.35	9,849	66.67	9,700	65.29
1951	64,801	428.46	44,025	291.09	10,476	69.63	10,300	68.10
1952	87,275	569.02	65,375	426.24	11,100 e/	72.75	10,800	70.41

a/ Exclusive of debt retirement; grants-in-aid are counted as expenditures of the first disbursing unit.

b/ For 1932 and subsequent years "Budget Expenditures" as currently conceived, less transfers to social security trust funds. Data for prior years are not strictly comparable in that they exclude a negligible amount of interest on refunds.

c/ "General Expenditure" less debt retirement, contributions to the unemployment compensation trust fund, and aid received from other governments. Prior to 1942, includes expenditures from all local shares of state-imposed taxes; 1942 and subsequent years, includes expenditures from only those local shares of state-imposed taxes which are not locally collected and retained.

d/ "General Expenditure" less debt retirement, contributions to the unemployment compensation trust fund (District of Columbia), and aid received from other governments. Prior to 1942, excludes expenditures from all local shares of state-imposed taxes; 1942 and subsequent years, excludes expenditures from only those local shares of state-imposed taxes which are not locally collected and retained. Data for years other than 1915, 1932, and 1942 are Tax Foundation estimates.

e/ Estimated by Tax Foundation.

Source: Department of Commerce, Treasury Department, and Tax Foundation.

In an article that comes to mind, Professor Elmer D. Fagan discusses the desirability and advisability of a scientific basis for progressive taxation. Fagan comes to the conclusion that the law of diminishing utility, which we used to talk about in economics, provides no satisfactory basis for progressive taxation. But he went on to say that one could find a basis for it in ethical judgments.

The moment one gets over into ethics and says, "This ought to be done," he is giving his opinion; and that which had been up to this point let us say, purely a question of fact, now becomes a matter of judgment.

The Growth of Public Expenditures

In studying the Government's budget processes as you have, one is inevitably impressed by the growth of public spending. Among the major contributing factors which account for the greater part of government spending are the increasing population, expanding public spending, wars, and national defense.

Many persons who complain about the New Deal, say it was the New Deal that brought us the large Federal budget. But the high Federal taxes and the big budget that we have are essentially related to the military situation. Whatever mistakes the New Dealers may have made--and they made quite a few--still, after all, they added directly only about 20 billion dollars to the Federal debt. The spending of the Roosevelt era of the 1930's was rather small in comparison with the spending occasioned by the Second World War.

This leads to the observation that if we are to find a way to control government spending, we must find a way to prevent wars and to control international tensions. That is an old observation, made by Adam Smith back in 1776, but it is a sound one.

Now, of course, we can attribute the growth of government spending partly to the rising population and the increasing prices. We also think of the so-called law, developed by Wagner, the German economist, that there is an inevitable tendency for government spending to increase, because governments continually provide more services and perform existing services more intensively and extensively. Wagner argued that the economy would inevitably be socialized. This result, however, need not follow the enlargement of government activity, although it is a risk which modern society encounters.

The pressure for increased government spending comes from a desire--sometimes praiseworthy, sometimes not--on the part of the individual and the group, to improve their levels of living. The farmers and public school teachers, veterans, and various other groups are ever trying to secure funds from the public purse to finance services of benefit to them.

But while the citizen may want beneficial public services, he may not want to pay for them. It is a typical American tendency for people to want something for nothing. We read about the French and Italian evasion of taxes but the exposures that are being brought out now in this country reveal that a great amount of tax evasion prevails here.

That gets us back to the basic question of taxpayer ethics. We Americans think there is no such thing as a good tax if we have to pay it. The only good tax is the one the other fellow pays. I am sure the sales tax is not good. I am sure the income tax is not good. I haven't found any good tax.

If the citizen can get something he wants and put the cost on other persons, he may be quite happy. Plainly, we need a higher citizen ethics in order to see the problem in the proper perspective, that is, that saving the world for democracy depends not only on saving the individual but on saving society itself.

We Americans made history by declaring the basic doctrine of popular government--"No taxation without representation." We have sometimes forgotten the corollary that there can be no representation, no government serving our needs, without taxation.

The power to tax is the primary power of government which supplies the funds needed to provide protection, educate the young, care for the dependent, and otherwise serve the citizens' public wants. Taxes are compulsory payments imposed for the financial support of governments or other public purposes.

If taxes are constitutionally voted by the representatives of the people, they should be fairly and efficiently enforced. It is the duty of the citizens to pay such taxes. It is indeed, more than a duty, it is an obligation.

I do not want to say that necessarily the group's welfare must take precedence over that of the individual. I do not want to be captured by the German philosophy and have the individual suppressed. Both the group and the individual are important.

But if the individual places his welfare above that of the group, if he forgets about the group, then he is going to be getting all he can out of the public treasury and is not going to worry about the size of the budget, the burden of taxes, or the size of the debt.

If you ask me what the common good is, I will have to admit that it is a very difficult thing to define. You might enjoy reading, if you have time, a little book on public finance that was written by a British economist, Hugh Dalton. He was chancellor of the exchequer when the Labor Party was in power.

Dalton speaks about the principle of maximum social advantage, which means utilizing the public finances in such a way that we get the most out of each dollar we put in. He says we should keep on spending and taxing as long as there is a gain of income to society in comparison with the cost. It is the idea of marginal analysis that the economists made popular. This suggests that public finance should be consistent with our economic and social objectives.

Public Finance and the Economy

In the last 20 years there has been a greater emphasis on the problems of the economy. I suppose that never in our history has so much been written about depression, inflation, full employment, and various other economic problems. If wishing could accomplish the job, we would not have had a depression; but we had a depression and we did not get out of it until the Second World War lifted us out.

In an article in the Commercial and Financial Chronicle, Professor Paul Studenski states that we have done a pretty good job in public finance in recent years although we have had some inflation. The Federal budget is now approaching a balance. We met almost half of the Federal expenditures during the Second World War out of taxes. But we could have done better and we should have done better.

Inflation is not only a problem in economics, it is also a problem in politics and ethics. It is, moreover, a psychological problem. While we talk a lot about inflation, actually we like it. The inflation problem is somewhat like the problem of alcohol. We have a state liquor monopoly in Pennsylvania. We raise more money in Pennsylvania than any other state does from alcohol.

The basic trouble is the popular custom to tipple a bit and sometimes to consume too much alcohol. If a person could be temperate and control his appetite for alcohol, then alcohol would be no problem at all. Inflation in a sense is like that. There is always the danger that inflation cannot be controlled. But creeping inflation is pleasant and we hate to stop it.

We want to control inflation as long as it means controlling the prices that other people receive for their wages and for the things they sell. But we do not want to control inflation insofar as it affects us. We want the benefit of more government spending. That is a simple thing; but nevertheless, it is one of the things that is at the root of the Federal budget problem.

Let me take another illustration of the difficulties arising in the control of the Federal budget, which may be more direct. A certain community may have a veterans' hospital. It enjoys the increased trade and other benefits arising. At the same time the local citizens may complain

about the high taxes and say we must get the Federal budget down. Now, suppose that the Government announces that the hospital is going to be closed, because it is no longer needed. The citizens will soon complain to Washington and say, "You can't do that to us."

The budget cannot be controlled unless I am willing to give up some of the things that affect me. Taxes cannot be brought down unless I am willing to make some sacrifices. We can talk about achieving our goals, about having a growing and reasonably stable economy, with the national income fairly distributed; but unless we are willing, as a member of society to cooperate and bear such sacrifices as are necessary to make it possible, we shall fail to achieve our economic goals.

In the textbooks we have learned that governments seek to provide service and that business seeks to obtain profits. Well that is so. But there is another side to that--not always thought of--not only is government maintained for service, it also provides an income to employees and other beneficiaries. Certainly many of those who work for the Government are not working simply because they love their fellow man. That would be pure service. One may dedicate his life to the service of mankind, which is a wonderful thing. But it is essential that most of us have a job. I have learned in working for the Federal Government that most of the people who are working for the Government are about like people outside the Government. From the employee standpoint, the purpose of the Government is to obtain an income. Those who secure government aid or contracts also secure monetary benefits from the Government.

Public and Corporation Finance

In some respects public finance is similar to private finance; in other respects it is different. In gaining an understanding of the complexities of public finance, it will be helpful to note certain similarities and differences.

The profits of the corporation are made presumably by providing services which the people want. The purpose of business, as consumers see it, is to supply desirable goods and services. The people who work for corporations have about the same purpose, so far as I can judge, as those who work for the Government--the securing of an income. What I am trying to say is that business and the Government are more alike in some respects than I think many of us realize. They both provide services and they both provide incomes to certain persons.

I am not going to argue that the Government and business are just alike. It is sometimes said that the way the Government operates is to decide first how much money shall be spent, and then to decide what taxes have to be raised to support that spending. Whereas you and I and a corporation may work it the other way around. We may decide how much money we have. Then we spend within our income.

But the Government may find that in its spending it is limited by what the people will pay in taxes. There has been much discussion in the last few years, for example, of the proposition that if taxes exceed a certain amount, 25 percent of the national income--and in America taxes have in recent years--then the economy is going to be inflated and the private enterprise system is going to be weakened, because the people would prefer to accept deficit financing and currency depreciation to higher taxes. I mention that as one of the possible problems when taxes are thought to be too high to be increased further. Governments do have to consider the taxes which the population is willing to pay.

But if you ask how the taxpayers can control the budget and keep it within what they regard as rational limits, I will have to confess that it is a very difficult question. For example, I am in no position as an individual to say whether we are spending too much or too little for national defense. I know national defense is one of the historical reasons for the existence of the Government. Governments were created originally to protect the citizens and to dispense justice. All the historians tell us that. But I do not know how much money ought to be spent on national defense.

In Pennsylvania, to cite another illustration, our big tax battle this year was over the public schools. Today over half of the general fund goes into education. The question before the 1953 legislature was, Should a substantial new tax be imposed in order to raise more funds for the public schools? The legislators were really worried over that problem. The Democrats were thinking: "If we ask for a sales tax, won't that be bad for us?" The Republicans were thinking: "If we indorse the sales tax, will we be voted out?" But the real question was, Were we or were we not going to have adequate money for the public schools?

Now, of course, public schools are an essential function. You cannot argue that. I do not doubt that there is a waste in the Pennsylvania public school system. But how much more than anywhere else I do not know. That is a matter of judgment. The taxpayer should know the taxes he pays and how they are affecting him even if he does not know just how much money should be spent for national defense, education, social welfare, and other public services. Maybe the taxes have little or no effect on his economic incentives. Some of the tired businessmen that we read about work just as hard after the income tax is raised as before. Maybe they even work harder in order to make more dollars and maintain the income left after the payment of taxes.

But there is a place there where, as the tax rate goes up, the business executive will lessen his efforts and say, "What is the use?" For example, if the tax rate on incomes above 10,000 dollars were 100 percent, so far as the economic motivation is concerned, a person would quit working and risking his capital after he got up to that amount.

The taxpayer can also see that if he did not have to pay 500 or 1,000 dollars of income tax, he might buy a new car, a new refrigerator, or other things that his family wants.

While the taxpayer is therefore in no position to know how much ought to be spent for national defense and other governmental functions, he is in a position to know how the taxes he openly and directly pays affect him. That is the lever he can use in working on the budget of the Federal Government. He can use his influence to prevent higher taxes or join with his neighbors in demands for tax reductions. If the resistance to new or existing taxes is effective, the budget is likely to be lower than it would otherwise be.

Government financing is conducted on a much larger scale. Governments, in comparison with corporation finance, or at least the Federal Government, have some control over the currency system. Governments can utilize what we call fiscal policy. By fiscal policy is meant that utilization of government spending, taxation, and the public debt to promote such economic objectives as a more stable economy and a higher national income. Within limits what you and I do also affects the economy. Personal and business spending, for example, increases the total spending and under conditions of high employment would have an inflationary effect; therefore it is very important to coordinate the public and private sectors of the economy in promoting our economic objectives.

The magnitude of government financing, including the total Federal, State, and local budgets of approximately 100 billion dollars, is very great, exceeding that of any corporation. The total spending of business and individuals, however, is even greater. But the Federal Government can conduct its financing in a unified manner on a national basis and thus substantially affect economic conditions.

The Principles of Taxation

Now what principles should be followed in taxation to raise the large sums of money that we need to meet the costs of modern government? The cost of government can hardly be divided equally on a per capita basis. The poor people have a lot of votes and will not tolerate equal taxation. The aged, the infirm, and children could hardly be expected to contribute to the cost of government on an equal basis with the more fortunate. Many people have no children to send to the public school; the unemployed may also be unable to pay taxes. We accept the principle, that it is our privilege and duty, if we are able, to maintain our educational projects--those things that are advantageous for the group, which the individual himself may not be able to provide. We also accept the necessity of providing military, police, and fire protection, public health service and other public service to those unable to pay for them.

Some people that are able refuse to provide for their needs. That can be carried too far. That gets us again into the problem of ethics that I mentioned. This discussion may suggest another theory of taxation, the ability to pay. Many persons say, "The citizen should pay taxes according to his ability to pay them." We have a question of ethics here as well as economics. There are actually theories of ability to pay. For instance, one person says the sales tax is a tax levied according to the ability to pay. Another person denies it. That is a matter of judgment, of defining what we mean by ability to pay. In the popular sense "ability to pay" has come to mean taxation in relation to net income--a higher rate for the higher brackets. That is about as far as one can get with it. Just how high the taxes ought to be is a matter of judgment. On this question there are many differences of opinion.

Taxes and the Economy

Another tax theory may be mentioned. It is the idea that taxes ought to be appraised in terms of their economic and social effects. When Adam Smith in his "Wealth of Nations" said that taxes should be imposed according to ability to pay, he was considering primarily justice to the taxpayer. He was, however, in his fourth maxim considering the welfare of the whole economy when he said that the taxes should be selected which would least injure the economy.

I think that the writers and the students have always given some thought to the problems of the economy. Justice in taxation is more than justice to the people who pay the taxes. It also involves justice to others who feel their effects. It might be, for example, that to increase the taxes on, let us say, the lower and middle incomes would be deflationary. But which is the greater evil--to tax the lower incomes or not to tax them and thereby increase the inflationary pressure of consumer spending? At the other end of the income scale it may not be worth while to vote to push taxes to the point where they weaken the incentives of the physician, the lawyer, the business executives, and the other people who are getting the higher incomes to exercise their talents in supplying useful services. In recent thinking the tendency has been to consider the whole society and to appraise, so far as one can, the effects of taxation on the national income, the stability of flow, and the distribution of that income among the population.

There is another basic idea here, that is, taxation ought to be as direct and personal as possible. Ideally we might say that every taxpayer should be charged every month his share of the cost of the Government. But the taxpayers do not want to pay their taxes that way. A lot of smaller taxes, many of them hidden, appear to be more acceptable to the citizens than one large tax. From the Government's side, it is easier to raise large sums of money from diversified sources than it is from one big income tax. That has been known for centuries.

Table 2. Federal, State and local tax revenues, fiscal year 1952

(Excluding social security taxes) a/

Tax	Amount (Millions of dollars)			Percent of total		
	Federal <u>b/</u>	48	All	Federal	48	All
		States	local <u>c/</u>		States	local
Personal Income	30,949	905	68	49.6	9.2	.8
Corporation income	21,163	830	7	33.9	8.4	.1
Death and gift	815	211	3	1.3	2.1	.1
Alcohol <u>e/</u>	2,513	519	- <u>d/</u>	4.0	5.2	- <u>d/</u>
Tobacco	1,563	449	- <u>d/</u>	2.5	4.6	- <u>d/</u>
Gasoline	713	1,871	- <u>d/</u>	1.2	19.0	- <u>d/</u>
Amusements	376	14	- <u>d/</u>	.6	.1	- <u>d/</u>
General sales <u>f/</u>	-	2,229	551	-	22.7	6.4
Property	-	370	7,580	-	3.8	87.9
Other	4,297	2,440	412	6.9	24.9	4.7
Total	62,389	9,838	8,621	100.0	100.0	100.0

a/ Federal social security tax collections were 4,573 million dollars.

State social security tax collections were 1,423 million dollars.

b/ Tax refunds excluded.c/ For fiscal year 1951.d/ Included in general sales tax collections.e/ Includes license taxes.f/ Includes both general and specific sales taxes.

Source: U. S. Commerce, Labor, and Treasury Departments.

Table 3. American public debt, end of fiscal year 1952

(Millions of dollars)

Total	Federal	State	Local
290.5	259.1	8.9	22.5 (estimated)

Source: U. S. Bureau of the Budget and U. S. Department of Commerce

While all taxes cannot be levied directly upon the individual in relation to his income, wealth, and expenditures, some of them can be. The total tax load should be distributed so far as possible, so that each individual will be taxed in the manner we would rationally follow if we could impose his total tax bill directly upon him according to the pattern we consider most logical.

That would be related to the type of society we want. Adam Smith wanted a laissez faire--a competitive economy. We may want a different type of economy, a different type of society. We have to decide what our economic and social objectives are if our taxes are to be consistent with our goals. And, of course, much of the difficulty with public finance is that we do not know what we want to accomplish as a nation.

Running all through taxation, in practice, is a political thread. Many times the decision is made on political grounds and not on the basis of a consideration of the effects on the whole economy.

Of course, the problem is complicated, because so many factors are involved. Noneconomic objectives may conflict with the economic. To illustrate, we know that in fighting a war of any magnitude we are going to suffer, considering human weaknesses, from the inroads of inflation. Ideally wars ought to be financed in such a way that we would have no inflation during the war and no inflation after the war. But we have the psychological problem--that, even though the cost of a war is going to be borne currently by the population, whether we finance the war with inflation or without it, and the people have to sacrifice anyway, still the people may prefer what looks to them like putting the burden on the future or at least placing more of the burden on other persons. Then it is a choice between defending ourselves with inflation, let us say, or not defending ourselves at all.

I have said there is an analogy to private financing. Let me illustrate: When our children are growing up, they may have some musical interests and want a piano. The family may decide that the children must have a piano even if spending is inflationary because their musical education cannot wisely be postponed.

In Philadelphia we wanted to improve and extend the subway system after the war. It did not seem to matter whether the city spending was inflationary or not. Perhaps, however, some spending can be postponed. In other words we may have a choice. When we have a war on, we know we must spend on it. But the war ought to be financed with a minimum of inflation. We should rationally chose among our objectives and hold to our course.

Some borrowing is inflationary and some taxes are not. We have a chain reaction of effects and countereffects; let us try to reduce it

to simple terms. The question would seem to be, Does the taxing and spending process increase the funds in circulation in relation to the supply of goods and services? We may increase the money in the markets but have the goods and services in constant supply; or the taxes may be so deadening that the supply is reduced. The quantity of money in circulation may be the same, but in relation to the supply it may be increased.

When the Government spends for new production facilities in a period of inflation, that is inflationary. No question about that, because it is bidding up the demand for goods and services. But when the plants come into production, the output is increased and supply expands. That works in the opposite direction. So we have to take this secondary effect into consideration too.

The Public Debt

I have been trying to emphasize some things here that experience shows require emphasis. Some of them are simple things but they are basic.

Coming now to the present Federal predicament--and it is indeed a predicament--the tremendous Federal budget and our great debt present perplexing problems. What can be done about it? The State and local governments have another 30 billion dollars of debt. Is the debt to become a perpetual and perhaps increasing obligation about which we can do nothing except eventually to liquidate it through inflation or in some other manner?

Our ideas about the public debt have changed. I remember during the war meeting here in Washington a banker; he was a conservative Midwestern banker. We were talking about the debt and he said the debt was not so bad. We had gone through the so-called New Deal period and much of the war period; and he declared that the economy could have carried a much larger debt. That was a businessman's attitude toward the debt at the time. Back in the 1930's many persons thought a debt of 50 billion dollars would ruin the country.

The burden of the public debt is not determined simply by its size. The debt problem must be related to the size and growth of the national income, the amount of debt-charges in relation to the total Federal budget, the effects of the debt on the economy, and other variable factors. I do think that our load is not more than we can bear. But there are dangers in deficit financing. There are dangers in a growing debt. There are dangers in a growing budget. As the budget, the debt, and taxation grow, the problems of each grow.

I would like to leave this thought with you. In government spending, in taxation, in our financial administration, in the management of

the debt, we should, so far as is humanly possible, relate our program to the problems of our society and to the problems of our economy. We should keep in mind the kind of society we want--economic and social objectives, our desire for a growing and more prosperous economy, for the better way of life which we all want. Then we should direct public finance toward attaining those objectives.

QUESTION: What is the position of the municipalities in the present tax situation? They seem to have a more or less inelastic source of taxable income. In the face of a rising budget and inflation, aren't they in a rather precarious position, at least some of them, today, through no fault of their own?

DR. BUEHLER: Undoubtedly the cities of the country are in a tight spot. They have the old property tax to fall back on, and some minor revenue from the parking meters and that sort of thing. Some cities impose a sales tax and various other so-called business taxes. They may levy an income tax. They may collect both an income tax and a sales tax.

In Philadelphia we have a mercantile license tax, so-called, imposed by the school districts; and a gross receipts tax imposed by the city government. While the rates are low, actually they are sales taxes in effect. Even if the city does its best, it does have some very difficult financial problems.

No doubt there is the difficulty of working out appropriate relations between the State and local governments. I think in most of the States the legislatures are still pretty much dominated by the rural representatives, and they are sometimes not too much concerned about the welfare of the cities. Then there may be political problems, as we have in Philadelphia, which has a Democratic administration, while the State has a Republican administration.

Looking at this as a revenue problem from the broad, overall standpoint, and leaving out expediency in politics, it would be preferable to have sales and income taxes levied exclusively at the state level.

We have in Pennsylvania a rash of local income taxes, almost 300 of them. I had a letter from California just a few days ago about the great number of city sales taxes--there are approximately 150 of them.

I think it would be much better for Pennsylvania if we would deny to all local governments, except a few of the larger cities, the power to impose an income or sales tax. We now have a uniform sales tax throughout the State and in time may have a uniform income tax which could be employed to raise money for the benefit of the local, as well as the State, governments. As the question perhaps implies, it may happen that too many responsibilities requiring spending may be placed upon or be assumed by cities.

QUESTION: Would you discuss what might have been the effect on our economy if we had had a pay-as-you-go policy during the war period?

DR. BUEHLER: I said in my earlier informal discussion that we would have to pay the cost of a war whether we did it by taxation or by deficit financing. I am assuming that we finance the war internally-- if we should assume that we could obtain a contribution from the Dominion of Canada or another foreign government to the 10 billion dollars per year, that would change the problem. But, assuming that the costs all have to be financed internally, then we have got to pay for the war right away so far as our resources are concerned. Or, to put it another way, we cannot fight in Korea or Indo-China or any place else with weapons that we are going to make tomorrow. We have to fight with the men and materials that we have now.

So looking at it objectively, we, as a nation have to make sacrifices anyway; and, the more we pay through taxation rather than by deficit financing, the less inflation we should have. We have to consider the effects of taxes on the people and their willingness to produce for the war program while restricting their consumption on nonessentials. Some individuals may profit from inflation, but most of us are bound to be hurt by it. While tax sacrifices are painful, the inroads of inflation are even more costly.

Consider, for example, an analogy between a sales tax of some kind and inflation. The sales tax was resisted during the war because some people felt it was inflationary. Others just did not like it and they opposed it as an unjust impost.

But a sales tax would probably exempt food. This would take out a big part of the family budget. Of course, the rental of living quarters would not be taxed. If by putting on a sales tax we could raise, say, 10 billion dollars a year in taxes, instead of borrowing 10 billion dollars through the banks, the economic effects would be somewhat different.

But during the Second World War we borrowed from the banks and we had some inflation. The effect of the inflation was to raise the price of everything. In effect everyone was indirectly taxed. Inflation is a sort of tax, a cruel tax which burdens the poor as well as the rich.

Why then, do we not avoid inflation through heavier taxation? There is always the hope that if tax increases are postponed, we shall as individuals come out more favorably than if the taxes were put on right away. For example, if instead of proposing a sales tax, we should consider adopting a net worth tax, or what used to be called a capital levy, the richer classes would probably figure that the tax on wealth would be pretty tough; and that perhaps inflation would be easier on them than a heavy tax on their savings. Others may feel, even though

they are wrong, that a sales tax or higher income taxes would burden them more than inflation. This is a problem the Nation needs to think through and master.

QUESTION: Doctor, I would like to ask a question in the field of the economics of taxation, with particular reference to the excess-profits tax. We have all seen little articles in various periodicals about taxing beyond the point of reduced returns. Financial experts, at least a certain element among them, say there are certain products that have been taxed too heavily, so that the total revenue that is produced is less than it was previously at a lower rate of taxation. I would like to know to what extent that actually does exist; and if it does, why?

DR. BUEHLER: The classic example of the revenue effects of high taxes is that of the tax on liquor, which is pretty high. The Federal tax is \$10.50 a gallon. Then some states have a monopoly on packaged liquor. In addition to the store profits, some like the State of Pennsylvania, put a tax on it too. It may be that, depending on the nature of the demand, more revenue can be raised with lower rates than higher rates.

There is an analogy there between the problems of monopolies and prices in the economy. The question for a monopoly to decide is whether it will get more profit with a high price, a moderate price, or a lower price. Theoretically we can find, I suppose, by experimentation the point at which the largest quantity will be sold and whether more profit will be made at a moderate price than at a high price.

Of course, part of your problem is the problem of substitutes. You have the substitution of bootleg liquor for the taxed liquor. I suppose that the incentives for tax evasion would increase as the tax rate goes up. It would be a very interesting study to try to determine whether people are more dishonest when the taxes go up or dishonest anyway.

If you go through the hearings on the excises, you will find that in the case of about every industry they presented the same argument-- that more revenue would be raised if the rates could be lowered. I suppose you could reduce that to absurdity and say that you would get still more revenue if you had no tax at all. So there is a point, no doubt, where the most revenue would be raised.

One meets that same logic in the discussion of the various Federal taxes. It is commonly argued that there would be an increase in investment and economic activity if corporate and personal income taxes were reduced. But if you look at the statistics, you realize that there would have to be a very substantial increase in the base of the

tax to make up for the loss of revenue if the Government reduced the rate, for instance, from 30 to 10 percent.

The chief arguments against the so-called excess profits are (1) that it is impracticable to define excess profits, (2) that the tax, in practice, is exceedingly complicated, (3) that it falls very unequally upon the various industries and particular concerns, (4) that it frequently penalizes growing concerns by punishing them when they finally "strike it rich," and (5) that its high rate is an invitation to corporate extravagance in the outlays for advertising and other expenses. While the excess-profits tax may raise considerable revenue, equivalent revenue could more readily be obtained by increasing the corporate income tax rates, if that sum must be raised from corporations. The primary argument for the so-called excess-profits tax is political. In a time of emergency when wages, rents, and prices are subject to controls, it has been deemed necessary to strike at war gains and profiteering, although the weapon employed is a very imperfect one.

QUESTION: Doctor, you mentioned that there is some tax waste in the State of Pennsylvania. From Philadelphia you can look across the river and find the State of New Jersey with no personal income tax, no sales tax, a low gasoline tax, and excellent roads. I don't know what their financial situation is. Now, why is the difference so marked from one state to another in their financing?

DR. BUEHLER: The answer to your question is that the low taxes of New Jersey are largely a myth. They are low at the state level, for the reasons you have mentioned. But the local property taxes are high, as disclosed in the report of the New Jersey Tax Committee that came out just a few months ago.

If you take the total of the state and local taxes in New Jersey and compare them with the figures for Pennsylvania, you will find out an interesting thing. We had a group of studies made and we found out, surprisingly enough, that New Jersey actually is a state with fairly high taxes when you include the local taxes. The combined state and local taxes in New Jersey in 1951, for example, were substantially higher in relation to population and income than the total taxes in Pennsylvania and were also considerably above the national average. From the standpoint of industry, because corporation people sometimes move into low-tax states, it would be very important to find out what the property tax is over there; and also from the standpoint of the home owner. The property tax is particularly heavy on home owners in New Jersey. The taxes on business property may, however, be quite favorable.

I don't want to imply that New Jersey is not a desirable state in which to live. The question is, What do you get for your tax money? Are the governmental services obtained worth what they cost?

QUESTION: Coming back to this question of tax evasion which is basically an ethical problem, you implied that your studies show a fairly high rate of evasion here in this country. Do you know what percentage is involved there?

DR. BUEHLER: The percentage of Federal tax evasion has not yet been published but the results of a survey in the Boston area should soon be available. Every study we have had in Philadelphia showed that the city income tax suffers a substantial amount of evasion. It means that the people whose taxes are withheld are paying the bulk of the city income tax. Many people whose tax is not withheld just do not pay, including some government employees.

QUESTION: What can be done about this tax evasion problem?

DR. BUEHLER: Well, I made a speech a year ago and I worked hard on it. It was the presidential address at the National Tax Association. My subject was "Ethics and Taxes." I laid before the National Tax Association the idea that the ethics of the taxpayer and the tax official ought to be improved, and that this great association should do something about it. The association was so disturbed about the complexities of the problem that so far it has not done anything about it. We talked about the problem and decided that something ought to be done about it. I suggested that we get down to business and draw up a code of ethics, try to get the taxpayers and the tax practitioners to agree on the things that come within the code.

Are ethics in taxes at a higher or lower level than ethics in other human relations? The income tax is still to a considerable extent a tax which depends on the taxpayer's honesty, judgment, and his cooperation. So is the property tax.

Now, it is proposed that the Government should compute our income taxes. This would be an interesting experiment. It would lessen the work of the taxpayers. But suppose the Government is computing your income tax and sends the taxpayer a bill. He may look over the bill and say, "Gee that's swell. They did not know about the other income that I had." Would the average taxpayer be more or less inclined to report outside income?

It is a question, too, of having ample personnel as to quality and quantity for tax enforcement. It is often said in Washington that if the Bureau of Internal Revenue had more employees, someone would have more time to put pressure on the taxpayers and there would be more revenue. This may very well be true. A tax is a compulsory payment, and as such it requires enforcement.

I know that many people do not like the withholding of income taxes. Some employers do not like it. But I think if one is honest about it,

he will have to admit that the Government gets considerable revenue, perhaps 5 billion dollars a year from withholding, that it would not otherwise get. Maybe in 10 years we will have withholding for the self-employed as well as the other people.

By better enforcement and with taxpayer cooperation, we should be able to reduce greatly the amount of tax evasion. Lord Stamp in his book on taxation said that it was rather traditional for Americans to evade taxes. He said tax evasion becomes communal evasion; it becomes a community habit. The evasion habit grew out of the property tax and the weaknesses there. Property tax evasion has long been prevalent. Now we are learning that income tax evasion is also a popular pastime. This is a serious problem which we must struggle to overcome. But tax enforcement should not depend solely upon the ethics of the taxpayers.

COLONEL BARTLETT: Doctor, I recall that your lecture started out by introducing the subject of ethics. Now in the discussion we have come full turn back to it. This is perhaps an appropriate point to end the questioning.

We particularly enjoyed and valued your remarks on the ethics of taxation, as the practical end of the economic refresher course. On behalf of the Commandant and the student body, I thank you very much for your lecture.

(18 Nov 1953--250)S/ibc