

## TAXATION AND REVENUE

7 September 1954

## CONTENTS

	<u>Page</u>
INTRODUCTION--Dr. A. J. Kress, Member of the Faculty, ICAF .....	1
SPEAKER--Dr. Alfred G. Buehler, Professor of Public Finance, University of Pennsylvania .....	1
GENERAL DISCUSSION .....	15

NOTICE: This is a copy of material presented to the resident students at the Industrial College of the Armed Forces. It is furnished for official use only in connection with studies now being performed by the user. It is not for general publication. It may not be released to other persons, quoted or extracted for publication or otherwise copied or distributed without specific permission from the author and the Commandant, ICAF, in each case.

Publication No. L55-15

INDUSTRIAL COLLEGE OF THE ARMED FORCES

Washington, D. C.

Dr. Alfred G. Buehler, Professor of Public Finance, University of Pennsylvania, was born in Swanton, Ohio, on 10 May 1900. He received the following degrees; B.A., Heidelberg College, Tiffin, Ohio, 1922; M.A., in economics, Yale University, 1923; and Ph.D., in economics, Yale University, 1930. His work in education includes: assistant professor of Business Administration, Lawrence College, Appleton, Wisconsin, 1924-25; assistant and associate professor of economics, University of Vermont, 1925-39; associate professor of public finance at University of Pennsylvania, 1939-42 and professor of public finance since 1942. He has worked as a tax consultant with Commonwealth of Pennsylvania, State of Vermont, McConnell Foundation, Smaller War Plants Corporation, and various other governmental and private agencies. His work on Pennsylvania taxation includes: chairman of Emergency Revenue Committee, 1951; chairman of Tax Study Committee appointed by the Governor, 1952-55; chairman of Pennsylvania Commission on Intergovernmental Relations appointed by the Governor, 1954-55; and member of Philadelphia Citizens' Budget Committee since 1951. Dr. Buehler was also vice president of Tax Institute, Inc., in 1948 and president in 1950; and vice president of National Tax Association in 1950-51 and president in 1951-52. He is now a member of the Executive Committee of the National Tax Association and of the Board of Directors of the Tax Institute, Inc. His publications are: "General Sales Taxation," 1932, "Undistributed Profits Tax," 1937, "Public Finance," a college text, 1948, of which he is a joint author. He has also contributed numerous articles to the "National Tax Journal," "American Economic Review," and various other publications.

## TAXATION AND REVENUE

7 September 1954

DR. KRESS: It seems as though there was a group some years ago at Yale University that had gotten a very famous speaker to come and talk to them. The introducer began by saying that this man was an alumnus of Yale, and, as you know, Y stood for youth, spending five minutes on that; A stood for alumnus, five minutes on that; L stood for loyalty, five minutes on that; E stood for eternal fealty, five minutes on that, spending five or six minutes on each one of those letters. Finally, the speaker was allowed to take the platform and he said, "I am glad I am not from the Massachusetts Institute of Technology."

Our speaker this morning was educated at Yale, but he has been away from there a long time. Dr. Buehler has had various assignments in science and public finance. He is the author of several publications. I went down to the library and hastily selected a few that we happened to have on hand. He is so busy with his two commissions and numerous associations of which he is a member that we had difficulty in finding a day to fit him in, both this year and last year. But it is like the old proverb, "If you want something done, get a busy person to do it."

Dr. Buehler, it is a pleasure to welcome you back to this platform this morning.

DR. BUEHLER: Admiral Hague, General Niblo, and gentlemen of the Industrial College: That Yale story made me think of a lecture that Charles Evans Hughes gave at Yale. I recall that he introduced his remarks by saying something like this: "Gentlemen of Yale and ladies and gentlemen."

The 100-Billion-Dollar Question

It is indeed a pleasure to be here again, and on a day as hot as this with the temperature soaring up toward 100 degrees, to be discussing with you a very heated question--that of financing the 100-billion-dollar expenditures of our governments.

The Federal fiscal year which just closed reported expenditures of 67.6 billion dollars; revenues of 64.6 billion dollars; and a deficit of 3 billion dollars. I am not going to give you many figures, but I thought

I should summarize briefly our fiscal situation. The State and local governments are apparently spending at an annual rate somewhat in excess of 30 billion dollars, so that we have a total government budget of approximately 100 billion dollars.

Now Federal expenditures are tending downward, as you gentlemen in defense know. In the 14 September 1954 budget statement, expenditures for 1955 are estimated at 64.0 billion dollars, about 3.6 billion less than this year, and revenues at 59.3 billion, creating a deficit of 4.7 billion.

With the series of Federal tax measures adopted within the last 12 months since I was here, one has the impression that our total taxes are coming down, and along with it, the cost of government. Local taxes are commonly going up all over the country, however, and in some instances state taxes are going up, too. So many taxpayers are actually not getting much of a break.

The debt of our governments is, in total, around 300 billion dollars. We closed the Federal fiscal year 30 June with a debt of 271 billion dollars plus the state and local indebtedness of about 30 billion.

About 80 to 82 percent of our total expenditures apparently--we do not have an accurate up-to-date figure, but using our latest census data--are being covered by taxes. That means that the remaining expenditures are being supported by so-called nontax receipts. Here I am not including the old-age insurance and the unemployment insurance payroll charges. Those are partly taxes and partly not, and for convenience of classification are excluded here. Perhaps around 9 billion dollars of these payroll charges are included in trust fund revenues. Then there are utility and liquor store revenues--Federal and State--of about 3.5 billion; miscellaneous revenues of about 10 billion; and an increase in the Federal debt this last year of 5.8 billion; an increase in state and local debts of about 3 billion; or a total of about 8.8 billion in increased public indebtedness.

We are taxed because our governments spend to provide us services. There can be no control of taxation unless there is control of our budgets. The cost of government has gone up and up over the years, as shown in table 1, following page. This is one of the amazing phenomena of modern times. Government expenditures have gone up because of the increasing population, higher prices, the increased demand for public services, and because of wars--past, present, and future.

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

Year	Total			Federal b/			State c/			Local d/		
	Amount (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.

Consider, for example, the Federal budget for 1955. These are the revised figures of September 1954. In the revised budget for 1955, there are total expenditures of 64.0 billion dollars. They include these expenditures: national security, 41.9 billion or 65.5 percent of the total interest on the debt, which is very largely war interest, 6.6 billion dollars or 10.3 percent; Federal aids of various sorts for veterans and their administration, 4.5 billion or 7.0 percent; and international affairs and finance, 1.5 billion or 2.3 percent. These war or war-related expenditures--and this is not a complete list; it is just a convenient, easy breakdown--amounted to 54.5 billion dollars or 85.1 percent of the budget.

If you and I as taxpayers are to have much more money to spend on the things we want, the major inroads must be made on war costs. If we cannot cut costs there, then we must anticipate high taxes indefinitely.

The purposes of government finance are the financing of our public needs, the promotion of the economy, the advancement of our military and governmental goals and the provision for social welfare. Looked at from the standpoint of the politician--and not using the word in any odious sense--the purpose may be to win friends and influence people by providing them beneficial services. From the standpoint of government employees, the purpose may be that of securing an income. From the standpoint of those who receive the benefits, the purpose of government is that of obtaining those benefits. The purposes of government, in economic terms, are the promotion of a growing national income, equitably distributed and flowing as steadily as possible to the population so that the economic welfare of all may be improved.

But economic goals are not the only goals. There are social goals--cultural, educational, recreational. There are military goals and political goals. And how is one to weigh these different objectives and reconcile them?

Public finance is the financing of governments. To control public finance so that we get the most for our money we must first reach agreement on what we are trying to do--the emphasis to be given to national security; the emphasis to be given to providing jobs, to educating the youth of America; the emphasis to be given to our other goals. As long as there is confusion and disagreement over our community objectives, there will be confusion in public finance, which is a means of advancing our national objectives.

Public finance, as a branch of economics, is the financing of the governmental activity directed toward satisfying our public wants for material things--that is, for goods and services. Political science is the science of government. Public finance is actually both economics and political science. As one writer, Gerhard Colm, formerly with the Federal Government in various positions and now with the National Planning Association here in Washington, has said in an article, "It is the nature of public finance that it is political economics."

### Public and Business Finance

I want to come back to public finance and economics, but let me go on first to comparing government finance with private business or corporation finance.

We are taught that the purpose of business is to make a profit--that puts it from the standpoint of the owner; that the purpose of government is to provide service--that puts it from the standpoint of the consumers.

But those who work for the Government regard it as a source of income. Those who get contracts from the Government secure certain gains or profits, and from that angle the purpose of government may seem to be that of obtaining an income.

If you look at business from the standpoint of the consumer, the purpose is not that of securing profits but of securing the things we want. I emphasize that because we have sometimes overdone the idea that business is conducted only for profit and that government is organized only for service. We have been unduly critical of our capitalistic system, as an illustration, because we have assumed it is nothing but a system in which people are out to make money, that the only people who make money are the people who may get the profits, and that government is something distinctly different, that its purpose is simply that of serving mankind. As I have said, the analogy may be pushed too far.

Then, of course, government in total--at least the Federal Government--is much larger than any business entity. This is very important because the impact of Federal financing on our society is far greater than the impact of any corporation. However, the influence of your spending and mine, of your savings and mine, and the influence of corporation finance is also felt in the economy. Such things as the

multiplier and accelerator principle apply to the funds which you and I spend and invest as well as to the funds which governments spend and invest. Our emphasis on fiscal policy has perhaps tended to neglect at times the influence which the activities of the individual and the corporation may have on the economy.

But governments do have at their command vast borrowing and taxing powers. The magnitude of government finance is very great; the control of the currency possessed by the National Government provides the opportunity for unified national action on the economic and financial front and has a greater impact and influence than that which can be exercised by any corporation, individual, or particular group.

### Economics and Public Finance

Without belaboring the point and carrying it further for the moment, let me return to the question, if I may, of the bearing of economics upon public finance. In a sense the big question in public finance is this: How can we get the most out of the dollars which we have available? Shall we spend these dollars, otherwise divert them to private use, or shall we turn them over to government use? The question may be put somewhat differently: What are the appropriate limits to government action? How far should governments go in providing for economic welfare, for social welfare, and other wants as well as national defense?

In a recent book by Professor Joe Due, of the University of Illinois, on public finance, an effort is made to apply welfare economics to public finance. The suggestion is laid down that governments should spend in such a way, tax in such a way, and borrow in such a way that the maximum economic welfare will be attained. That is reminiscent of the marginal analysis of the earlier economists, and it suggests comparisons that you and I have made and have had made for us in courses in economics. We are taught to compare the desirability of the money we have with the desirability of other things, and to compare the cost to us of obtaining the money we have with the benefits we receive from the things we buy.

Extend that analogy now to society, and the welfare economist would have the funds so used that the maximum social welfare would be attained. The difficulty with the concept is this: What is the maximum social welfare? It is controversial as to what our objectives should be. It is controversial as to what national welfare is. It is debatable how much each measure promotes the national welfare. Eventually this becomes a problem in judgment.

The judgment may be relatively simple when you and I, for example contemplate whether, if we have a choice, we shall come to a lecture this morning or devote our funds and energies to other purposes. If you have \$10 in your pocket, shall you spend the evening at the theater--so far as \$10 will go--or should you use the \$10 to buy yourself a hat for your fall wardrobe?

When we have the judgment of 160 million people involved, the decision as to how best to use our resources becomes extremely complicated. Who is to say what the social cost is and what the social gains are of a proposed public service? We arrive at a judgment, and that is all it is.

Through the processes of government, we elect people to go to Washington, to the State Capital, to the Town Council, to the Mayor's Office. Then we become parts of pressure groups. We go down there and watch them and try to make them do the things we think they ought to do which we are afraid they will not do, and there is this continual pressure back and forth. The man who wants political influence looks at appropriating public funds one way; a person who obtains the benefits looks at it another way; and the taxpayer who must pay the bill looks at public expenditures in still another way.

Let me give you a couple of illustrations. In the July bulletin of the First National Bank of Boston, there is an editorial which represents the conservative point of view on government spending and taxing. The writer declares, "The national habit of turning to the Government in time of trouble and for handouts of one kind or another continues." He says that pressure groups from all over the country are making shameful raids on the Treasury in the belief they are getting something for nothing. The principal budget item is national defense which calls for more than two-thirds of the total expenditure. He declares further, "While the American people insist that the Government should spend whatever is necessary as a safeguard against aggression, that there is much waste is obvious from casual inspection, as has been brought out by men in the military service." He states that nondefense expenditures are also wasteful because the Federal Government carries on activities that should be eliminated or which could be performed as well or better by State or local governments or private enterprise.

I attended a conference in Washington a few months ago on highway policy. One member of the group was a very conservative man who was very outspoken against waste in Government and high taxes. In discussing

highways, he expressed himself by saying that as far as highways were concerned this was a very important project, essential to national defense; the Government could not withdraw from this field and turn it over to the states; and that Federal highway spending should be maintained or even increased. I learned later--I did not know it at the moment--that this gentleman produces machinery which is used for road construction.

Another business friend of mine has been in Washington for the last several months a good deal of his time. He came down here with the notion that the Federal budget could be slashed waydown. There was a lot of waste here; across-the-board cuts were proper. That is what you do in corporations; you should do it in Government.

I talked with him a few weeks ago, and he is a changed man. Now he says that Government and business are not the same. Furthermore, this is an election year. He used to be a democrat; now he is a republican. The republicans cannot win the seats they want in the House and Senate, he says, unless they spend some money and reduce taxes.

### The Principles of Taxation

I am talking a great deal about the budget here because essentially the tax problem is a budget problem. Taxes cannot be controlled unless the budget can somehow be controlled.

There are two basic revenue principles of taxation. One is that the tax must produce the revenue; the other is that the tax should produce that revenue justly. Governments, as you and I know, never let justice stand in their way when they really need revenue. They have commonly placed the productivity of a tax ahead of justice. The professors, who may be idealists, like to talk about justice. We spend a lot of time talking about ability to pay.

We explain to students that ability to pay is objective in the sense that it relates justice in taxation to our economic status as measured by net income, property and consumer expenditures; it is subjective in the sense that it involves a comparison of the pain, sacrifice, or disutility of the taxes we pay.

There has been some argument about the applicability of the law of diminishing returns in investment. It is generally true that the more you invest, the easier it is to make another dollar, that the

percentage of return on your investment increases as your investment increases? If so, ability to pay, as measured by rates of return on investment, increases progressively and calls for progressive taxation. It seems to be a general tendency, however, for rates of return to decline at some point, depending upon the variable circumstances involved. Progressive taxation must therefore be justified on grounds.

Those are some of the questions related to ability to pay. It is a concept largely accepted but difficult to measure in any precise manner. There are many variations in the interpretation of it, but it has come to mean taxation according to net income at some scale of progression. Unfortunately the proper schedule of tax rates remains a matter of dispute and may be settled by fiscal and political expediency.

In contrast there is the benefit principle which would have us pay for governmental services according to the benefits we receive. Would you gentlemen in national defense not like to have the responsibility of allocating to every individual in the country his share of the cost of defense according to the way he benefits from defense?

That shows the absurdity of the benefit principle. However, it has certain applications, such as in highway finance, where we can relate the gasoline tax to the service from the highway, and in the Social Security field, where we have the payroll taxes or charges which are related to the benefits we receive.

Taxation for the regulation of economic activity, or of fiscal or social policy, purposes is directed toward changing our society. Taxation for revenue is sometimes said to be directed toward preserving our society and doing as little damage to it as possible. There is an underlying basis for revenue and regulation, however, which brings consistency into the formulation and application of these principles that is this: Both taxation for revenue and regulation should be, so far as possible, consistent with our economic and social objectives.

Now, while taxation cannot, when used for revenue purposes, entirely consistent with those objectives, at least in an immediate sense, perhaps in the long-run sense it can be substantially consistent with them. Taxation for revenue should injure the economy little as possible and should involve the minimum of injustice, a minimum of disturbance to our society and its institutions which accept.

Table 2. Federal, State, and local tax revenues, by sources, fiscal year 1953 a/

Tax	Amount (millions of dollars)			Distribut-
	All gov- ernments	Federal	State Local	
Net income				
Individual	30,838			
Corporate	22,057			
Inheritance, estate, and gift		29,784		
Tobacco			21	
Alcoholic bever-				
Gasoline				

i/  
Trea  
Sourc  
refund  
on cust  
State: A  
ernments

There has been, as we know, in the last two decades much emphasis on economics and fiscal policy and the use of Government finance to promote economic objectives. As an economist that. I realize however that public finance is more important. We are not simply economic men and women buying and selling services in the market place.

It would be desirable, if taxes allocated among the States know what our responsibilities could be a just

Federal Commission on Intergovernmental Relations was organized and it has been working on the problem of Federal aid primarily and, secondarily, on the question of the distribution of tax sources. Many believe that we should eliminate, so far as possible, confusion and needless duplications in the functions and financing of our governments. The thought has been expressed that, where possible, government should be brought back home to the people at the State Capitol and in the town halls.

The job involved in the coordination of the Federal-State relations is really a superhuman task--herculean labor. It involves deciding what the functions of our governments ought to be and what responsibilities for each function as to service and financing, each level of government should have.

The question at bottom is essentially this: Suppose we today were called here to rewrite the National Constitution. What responsibilities would we give to the Federal Government? What taxes would be assigned to the Federal Government and to the States and the local governments? Do we think that the centralization of authority has gone too far in Washington or that it would be desirable to centralize still further? Those are just a few of the questions that a constitutional convention would have to consider.

To reorganize the American Government and modernize it and to decide rationally on the functions to be performed and their financing would involve the rethinking of the philosophy of our constitution and the overhauling of our governmental structure.

The Federal Commission on Intergovernmental Relations is studying the problem. It will present an analysis of our complicated intergovernmental relations and presumably recommend some needed reforms.

There is much resistance to turning government over to the States. Some close observers predict that Federal aid may continue at about 3 billion dollars a year and may even increase. The formulas for distributing Federal aid may be revised however and Federal restrictions may be relaxed somewhat to allow the States more freedom in using Federal money. The Federal needs are so great that the Government will have to continue, some believe, to tax incomes, personal and corporate, and commodities and estates. According to this viewpoint, no very substantial separation of revenue sources is feasible.

Out of the study of intergovernmental relations should come some sound conclusions concerning the responsibilities for national defense, for highways, for education, and other functions; also, the responsibilities for financing those functions.

### The Public Debt

We have accumulated a Federal debt of some 271 billion dollars and a state and local indebtedness of approximately 30 billion dollars. The Federal debt is essentially a war debt. The sum of about 20 billion of it is an economic recovery debt of the New Deal period. The state and local borrowing is essentially public works indebtedness.

Are wars productive or are they wasteful? Perhaps defense is productive in the sense that it helps preserve our institutions and our society. It may be productive in the sense that it stimulates the economy, increases output, and gives some encouragement to the development of new products.

I heard a businessman a few years ago make a very eloquent speech in which he said, "Private business is productive. Government is unproductive. It produces nothing; it lives like a leech on the taxpayers."

But in your course of economics, I think you probably still learn as I did that production is the rendering of services, and if governments provide services, they are productive in that sense. The real question then is, Are governments more or less productive than private enterprise, than you and I as individuals? If governments are more productive, then the public use of our money is justified.

The Federal debt problem reminds one of the old saying that we have a bear by the tail. Nobody likes a big debt. It should be reduced. Since 1931 there have been only a few years in which the budget has been balanced, and the debt keeps going up.

Fortunately, our production has been increasing; our income has been increasing; and we can carry a larger debt, but the debt may have substantial effects on the economy. Debt expansion may have an inflationary effect; debt retirement may have the opposite effect.

Budget policy with respect to the debt may be at odds with economic policy. From the budget angle, it is desirable to keep the interest rate and debt charges down. However, a low rate of interest pegged and

frozen by the Government may have adverse effects on the economy. It may stimulate economic activity when stimulation is undesirable as when inflation is rampant.

The problem of the public debt is the problem of managing the debt with a minimum of ill effects upon the economy and the maximum of good effects; it is also the problem of managing the debt in a manner consistent with budget policies so that the debt costs do not become excessive. And looking at the long-range problem, the need would seem to be to reduce the debt gradually in periods of prosperity so that the debt will become more manageable and we shall have a bigger margin to rely upon in periods of crisis when the international situation becomes more threatening or when we suffer a depression.

### The Conflict of Interests

There runs all through public finance the pressures and conflicting attitudes of different groups. We are now in the period of uncertainty, as we know. We are told by the economists in the Government that we have touched bottom and that the signs point to a gradual economic recovery from a mild recession--if we may call it that.

We dislike recessions and depressions. We seem to like mild and continuing inflation. In other words we like deficits and we like a large Federal debt. Now that may conflict with the objectives of economic stability and the desire to keep the debt charges down so that the taxpayers will suffer the minimum burden.

Another illustration of a conflict of interests is a controversy over the tax legislation in the last year. Should taxes be reduced in such a way that the reductions would go to the low income groups entirely or very largely? Should taxes be reduced in such a way that the stimulus would be given directly and primarily to consumption? Should taxes be reformed and reduced in such a way that the stimulus would be given primarily or exclusively to investment?

Unfortunately, when taxes become heavy, we are likely to burden both consumption and investment, and when we have a tax reduction, it therefore becomes desirable to take taxes off both consumption and investment. When taxes go up, we put them up on all classes and they have economic effects upon all classes. When taxes come down, it would seem desirable to reduce them upon all classes to maintain a distribution of the tax load which would be consistent with our economic

and social objectives. The tax doctors, the economists, and the statisticians do not know so much about the effects of taxes as they would like to know. Admiral Hague and I were chatting as we came in about the discoveries and advances in the natural sciences and medicine. Unfortunately, in Federal taxation, as in economics and political science, there is still much to be known. "Fiscal science" is still a long way from being an "exact science." It is still very largely an art.

QUESTION: Would you care to discuss the desirability or undesirability of the national sales tax as a means of raising revenue?

DR. BUEHLER: Yes, I should be very glad to discuss it. I shall try to be objective. Like every other tax proposal, this is controversial. Our Federal Government has been using about every available source of revenue. We have the personal income tax, which is a very high tax in comparison with the income taxes in other countries; we have a very heavy corporate tax structure; we have rather high estate and gift taxes; and we have been raising about 10 billion dollars annually in excise taxes. We have reduced excises and personal income taxes in 1954, however, and have also given up the excess-profits tax. In the 1954 revenue act on the other hand, there is a provision which accelerates corporate income tax payments gradually over a five-year period so that at the end of the period, corporations will be paying half of the taxes on the current year in the last six months of the year. That has the effect in that period of stepping up tax liabilities and in one sense is a tax increase.

To return to the sales tax question, in the event of another war or similar emergency, the only major source of revenue which we have not already used, aside from a tax on net worth or some kind of capital levy, would be a general consumption tax. It could be a tax on consumer spending--I think you have had readings on that, assembled by Dr. Kress--which would go to the individual and be a tax on him as an individual. Or it could be a general sales tax at the retail level or a tax at the manufacturing level, just to mention two of the more likely possibilities.

The arguments advanced for the sales tax in peacetime are: (1) It would permit eventually, if not immediately, the reduction of taxes on incomes, especially for the middle and upper brackets, and perhaps corporation taxes, and maybe estate and gift taxes and (2) the sales tax would tax all goods and services uniformly and we would get rid of the patchwork excise system of different excise tax rates on different commodities.

The first point raises the question as to who should pay the taxes, and I shall not go into that problem. It is an issue over which there is continuing controversy.

The second point is a quite interesting one. It has been assumed by advocates of the sales tax that if we had a sales tax at the manufacturing level, we would get rid of all excise except those on alcohol, tobacco, and gasoline. I think I can be objective here and say that the argument seems quite Utopian and unrealistic. There is no nation in the world, so far as I know, which has adopted the sales tax--and many nations have--and which has gotten rid of the excise taxes.

We might, it is true, dispense with other excises and get along with the sales tax, but in a period of war I would expect specific excise taxes to come back. We can point to Canada and Britain as an illustration of that.

The advocates of the sales tax emphasize that we are taxing many commodities; that we have different rates; and that some articles are not taxed at all. It is said that we have singled out some things for taxation with the erroneous notion that they were luxuries. The taxed industries say that their products are necessities, not luxuries. The system is undoubtedly discriminatory, however one may feel about it.

If we are going to tax a great number of commodities and services the time will be reached when it will be sensible to have a uniform tax on those commodities and services, with special taxes on alcohol, and tobacco that have been found necessary in every country; and if the Federal Government keeps on spending on highways, I would assume we would need a gasoline tax. Then we would presumably need and impose some additional selected excises in time of war, or other great revenue emergency.

I would think that at the present time, when the emphasis is on keeping budgets down, it would be desirable that we should live on existing sources of revenue. I know that affects defense, and I am not suggesting here that defense expenditures should be cut. As the economy advances our income increases, and we obtain increased revenues automatically from existing sources.

Then, too, we have about 34 states imposing general sales taxes. Some are at a very low rate, as in Delaware and Virginia, where they are hardly even known. Others are higher, such as the 3 percent tax

in California, Michigan, and so on. If the Federal Government could keep out of the general sales tax field, it would leave an important source of revenue to the States.

If we should adopt a Federal sales tax it would be preferable to have a retail sales tax and not a manufacturing tax, if we want to control Federal expenditures. The retail tax would be out in the open and the people could judge whether they were paying too much for Federal services.

If we think the budget ought to go up and, say, to illustrate, we think more defense money is essential and there is too much resistance to the retail sales tax, we could, from that angle, defend a manufacturing tax in preference to a retail sales tax. I don't think personally it would be justified.

From the standpoint of the business groups which are crying for budget and tax reductions it would seem inconsistent to advocate a hidden manufacturer's sales tax. They ought to get together with themselves and decide whether they want more taxes or less taxes; if less taxes, they should oppose any new taxes.

Another consideration is very important. A retail tax does not have the pyramiding effects that the manufacturing tax does and should cause less disturbance to prices. All things considered, the retail sales tax is, I think, economically superior to a tax on manufacturing.

Just one thing more on this subject: All forms of a national general sales tax have thus far been political dynamite. They would fall upon great numbers of people and have been warmly opposed by organized labor and other groups. In a grave war emergency, however, the people may be willing to accept a general sales tax.

QUESTION: Doctor, I cannot comprehend the rationale of the excise tax. I know that it is levied in theory upon the producer and yet that a tax placed on a manufactured item is on the same item that the consumer buys in the retail store. Sometimes you will see the price card on a product marked to include a 15 or 20 percent excise tax. How can they prove the statement that the tax is not passed on to the consumer?

DR. BUEHLER: I think it is intended and widely accepted that excises at the manufacturing, wholesaling and retailing are generally

passed on to consumers. One advantage of the retail tax is that you can specify what the tax on the consumer is. If it is a tax at the manufacturing level of, say, 10 percent, there will be very few manufacturers who will want the consumer to know just what the tax was on the manufacturer's price. Of course the manufacturing tax is probably administratively easier to handle than the retail tax.

Actually, we got into excises because they were a means of raising large revenues. We have had them for centuries. People get used to them and do not complain too much.

Now that is partly an answer to the question. You may have had some other points in mind.

QUESTION: Only one thing: An excise on manufacturing is not deductible on your individual income tax because the revenue department says it is a tax on the producer and not on you.

DR. BUEHLER: That could be a matter of the law. You know the practice is that state excises are deductible by consumers for Federal income tax purposes if it is provided that they are to be passed on to the consumer. Federal excises, under present laws, are not, however, deductible by consumers for income tax purposes.

QUESTION: It has been suggested from time to time that the corporation income tax be abandoned. Is that a sensible suggestion and one that could be adopted along with increases in the personal income tax structure?

DR. BUEHLER: Well, I shall be blunt. No it is not a sensible suggestion. It overlooks the fact that it is very easy to raise 20 billion dollars currently from corporations. The incidence of the corporation income tax is virtually unknown; therefore, nobody knows just who pays it. That is politically important. I think it is unrealistic to expect our governments to dispose of the corporation tax.

Furthermore, many persons feel that corporations are quite profitable, that some of them are monopolistic, and that business abuses warrant corporate taxes as regulatory measures. It is relatively easy, moreover, to raise large revenues from the corporate income tax. Rationally one might argue in a different direction, that when we are taxing corporations, we are taxing individuals, and it would be most logical and equitable to tax those individuals directly. The 52 percent

corporate tax has to be borne by investors, consumers, employees, or someone else; therefore, it would be desirable to tax those individuals as individuals if we could. This is a sensible point of view, but it is not likely to be adopted.

A very important practical question is this: If we give up the corporate tax, how would we raise the 20 billion dollars it now yields? If we are going to raise it from the personal income tax, how would we allocate the tremendous burden? How should we integrate the corporate and personal income taxes? These problems involve all of the questions and complications of the comparative treatment of corporate and noncorporate enterprise, the taxation of distributed profits which go out in dividends and the undistributed profits which go back into the business, and of large and small concerns.

One suggestion is that we tax corporations in the same manner as partnerships, meaning that every individual stockholder would be taxed not only on the dividends he receives but also on the undistributed part of the profits. The taxation of undistributed profits presents some troublesome problems. Stock may be bought and sold day by day or frequently during the year. Who is to say who is the owner for tax purposes? Furthermore, the individual can argue that he receives no income from undistributed profits and should pay no tax.

The Supreme Court has held that income must be received or realized to be taxed, and there is constitutional doubt that the retained profits which are beyond the grasp of the corporate stockholder could be taxed as individual income.

Then, there is the question of incidence. It is quite commonly assumed now that some part of the corporate income tax, perhaps much, is shifted. It is uncertain how much of the tax is shifted and on whom the tax finally falls. The politician may reason that it is a good tax because its burdens are substantially concealed.

There is a theoretical possibility here that would permit getting rid of the corporate tax--I do not think it would appeal to you gentlemen in defense--that is, slash the Federal budget so low that we can give up the corporate tax or reduce its rate to 10 percent or even 1 percent, the rate we had in 1909. Then we would not have to worry about the impact of the light corporate tax structure.

To sum it up, while there is much to be said against corporate taxation and in theory we might prefer a more rational type of direct, personal taxation, in practice there is no immediate likelihood that corporate taxation will be abandoned.

COLONEL BARTLETT: I wonder if you would tackle the subject of evasion. Is the evasion of taxes at Federal, State and municipal levels on the increase by taking advantage of legal loopholes?

DR. BUEHLER: I wish we knew whether it is on the increase, Colonel Bartlett. We do not have statistics to show whether there is relatively more evasion now than there was in earlier years. We do know that there has been for centuries quite a bit of evasion of property taxes.

The property tax that we should emphasize is a valuation tax. That is, we have to assess property in order to tax it. The income tax is also a valuation tax. These taxes, where we have to determine the value of something--property, income, excess profits--are complicated taxes which provide many possibilities for evasion. There is a very substantial amount of illegal evasion, of that we can be sure.

I have hoped for many years that we could have studies which would shed light on the question of whether evasion is increasing or decreasing. We really do not know. But we do know that there is altogether too much of it.

Whether the ethics of taxation are different from the ethics one has in his home, in church, in school, in business, or in government is a very interesting question. Does tax evasion indicate a low state of morals generally? Or do those who evade their legal tax obligations pay their private debts and display a higher ethics in their other social relations? We can reason that as taxes increase the incentives to evade are stronger. But taxes are also evaded when the tax rates are low. An illustration of that is the Philadelphia income tax. The rate is now 1.25 percent. Studies there have shown a great amount of evasion, and they verify the conclusion that local governments can resort to an income tax for substantial revenue only if the tax is withheld from wages and salaries. If the tax is not withheld, enforcement of the tax is apparently hopeless.

QUESTION: What seems to be the trend in the use of personal income taxes for local revenues, for municipal purposes?

DR. BUEHLER: There is not very much of a definite trend except in my state of Pennsylvania, where we have about 350 local income taxes.

A law enacted in 1947 permits Pennsylvania local governments to tax anything which is available to the state constitutionally but which the State does not tax. It has been called the "tax anything" law. The result has been that we have had an outcropping of these local taxes.

Not many months ago the city of Pittsburgh adopted an income tax, and then the local governments around Pittsburgh adopted an income tax. If they did not get the tax revenue, the city of Pittsburgh would take it. Their residents are allowed a credit against the Pittsburgh tax if their home communities levy a similar tax.

While there are some local income taxes in a few other states, the number has not greatly increased. But there is great interest in the income tax as a possible city revenue.

I had just this last week a letter from a study group in the city of London which was going into the question. New York City has considered the income tax as a source of new revenue. Large cities can obtain substantial revenues from the tax if they withhold it at source of payment of wages and salaries.

QUESTION: Dr. Buehler, we have gotten around to ethics, would you care to discuss a national lottery?

DR. BUEHLER: The lottery is an old form of raising revenue. So far as I know, the lotteries have not been substitutes for a sales tax or an income tax. We are inclined to think that we could raise vast revenues from lotteries, but I believe the experience of the governments with lotteries has been that they are available for only minor revenues.

The ethical question, is also raised in taxing horse and dog racing. Quite a few states now obtain revenue from race tracks.

There is also an economic question. We have learned in talking about this in Pennsylvania, where we have no state pari-mutual racing system, that the merchants and the business people are concerned about the money spent at the race tracks. They reason that this money

is taken out of the coffers of the merchants. There is some truth in that. If you spend money on a lottery, you can't spend it somewhere else.

I doubt very much that defense could rely on the revenues from a national lottery. They would be only "a drop in the bucket."

QUESTION: Dr. Buehler, what would you say about the justification of the very large depletion allowances which are enabling certain individuals to build up rather large fortunes which are almost unobtainable by people in other types of business? I am talking about those who have oil wells with 27.5 percent allowances on petroleum incomes.

DR. BUEHLER: The depletion allowances do seem to be quite generous. I noticed in a recent speech about deductions by Secretary Humphrey of the Treasury that he referred to depletion allowances as a subject which needed study and on which action might be taken. I think it certainly is a subject that needs investigation.

The previous administration had proposed to raise about 400 million dollars a year, as I remember, from cutting down on depletion allowances. The so-called loopholes in the income tax do reduce the revenue. We have to keep in mind that the tax system is one which is subject to pressures from the different groups of taxpayers, and everyone feels that he should have special treatment. Once we set up depletion allowances for one industry, every other industry wants them.

I was down here in Washington some months ago and heard some of the discussions on depletion. I was amazed to see the various industries coming in, and each industry said it was essential to national defense. That is always an appealing argument and it is frequently abused.

Mr. NIKLASON: Dr. Buehler, you were assigned a very difficult subject. I am sure everyone here will agree that you handled it exceedingly well, both the lecture and the answer period. Thank you very much.

(9 Nov 1954--250)S/gw