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CHAPTER 9

Indirect Taxes

THE PRECEDING chapter sets forth some possible uses of corporation taxes in a war finance program. Such taxes reduce the purchasing power in the possession of the corporations themselves, by absorbing corporate net income which, so far as not distributed as dividends, could be invested by the corporations, perhaps largely in the purchase of civilian goods. They tend also to reduce the flow of dividends, and accordingly the flow of purchasing power into the hands of those individual consumers who are stockholders. They may reduce also in some degree, through their indirect bearing upon corporate bargaining with labor, certain other corporate disbursements to consumers, in the form of wages and salaries. But the only large effect of corporation taxes on disbursements to individuals is in cutting dividends and, as dividends go predominantly to individuals in the high and higher middle income brackets, this curtailment of individual purchasing power only partly meets the needs enumerated in earlier chapters.

Therefore, whatever policy is adopted in the matter of corporation taxes, an enlarged flow of incomes to individuals, particularly in the low and lower middle income brackets, will continue. Means besides corporation taxes are needed to destroy the inflationary effects of this excess of spending power; and such means must reach individual incomes from all sources, not merely those from dividends, and should be designed especially to reach incomes in the low and lower middle brackets. This chapter discusses a group of taxes—

excises, sales taxes, and customs—that do reach consumer incomes in general, when such incomes are spent on particular consumer commodities and services.

Taxes of this sort, usually called indirect, do not *prevent* price increases in consumer goods; indeed they appear to the consumer, so far as he recognizes them at all, to *cause* an increase in prices. Whether they actually do cannot be answered categorically, because the answer varies from case to case and is in some instances obscure and uncertain. The range of possibilities may be indicated by considering two extreme cases. (1) Conditions controlling the market price of a commodity may be such that a tax on it will raise the price paid by the consumer by the full amount of the tax, so that he in reality pays the tax and therefore suffers a loss of spending power through an indirect payment of tax to the government.[1] (2) Market conditions may be such that the price (total price paid by the consumer) will not advance after the imposition of the tax, although it may already have advanced for other reasons; in that case the tax is paid by the seller, out of his receipts from the sale (or other resources), unless he is able to pass it back—to force its payment by those who work for him or supply his materials.

In neither case does the tax prevent a price advance: in the first case, it actually causes the advance; and in the second, any advance due to market and other conditions will occur whether the tax is imposed or not. In both cases the tax transfers civilian spending power to the government: in the first, it takes from the consumer the additional money he spends in purchasing the commodity because of the tax; in the second, it takes funds from the seller, or from those to whom he 'passes back' the tax.

In the first case, the tax absorbs consumer spending power; and this absorption assists in meeting the needs outlined in Chapter 3. So far as consumption of the commodities taxed is especially common among consumers in the income brackets there shown as likely to have the chief excess of spending power, the bracket above $10,000, and especially that from $1,750 to $10,000, this absorption is the more effective in meeting these needs. Note should be taken, however, of the probability amounting almost to a certainty that total consumption of the taxed commodity will shrink; in other words, since consumers will not buy as many units of the commodity as before, they will not in the aggregate spend on that commodity after the tax is imposed the same amount as before *plus* the total tax collected.[2] Accordingly, the net reduction in consumer spending power for buying other commodities achieved by the tax would be less, and might be very much less, than the total tax.[3]

In the second case, unless the seller succeeds in passing the tax back to his workmen or suppliers, the tax absorbs funds from business enterprise (the seller), not consumer incomes. Even if the seller passes the tax back, it may still be borne by business enterprise, his suppliers of materials or services, although it may be borne by his or their workmen through lower wages, and thus reduce consumer incomes. When, under this second case, the tax is borne by the enterprise, it has certain effects similar to those of direct taxes on corporations, although it reaches unincorporated as well as incorporated enterprises. It reduces the income which the enterprises can distribute as dividends or otherwise to their owners, or can as enterprises spend on civilian goods. In fact, indirect taxes expected to be borne by enterprises are sometimes urged as a means of absorbing profits made by sellers through advancing prices.

Between the two cases just discussed, a range of possibilities exists. For a specific commodity the elasticities of demand and of supply may be such that the tax will be shared: part will fall upon the consumer and part on the seller. The relative shares may vary greatly from commodity to commodity. In wartime various factors may limit the possibilities. Governmental intervention through direct controls, or enemy action, may restrict the supply of many commodities and render it inelastic or nearly so. Moreover, if the supply is cut drastically, the elasticity of demand may be greatly altered: the demand for refrigerators, for example, might be highly elastic if 1,000,000 units were sold annually, but might become relatively inelastic at 100,000 units, because the smaller number would be sought by consumers whose incomes were large enough for them to purchase even at substantially higher prices. Again, the wartime general increase in consumer incomes might render the demand less elastic for a given total of sales.[4]

We consider briefly another type of case which may be regarded as falling between the two extremes. If the supply of a commodity is substantially restricted by enemy action or by governmental direct controls, the price will tend to rise. The government may then intervene by imposing a price ceiling. Sellers will presumably undertake to comply. But compliance means that sellers will pick and choose their customers and regulate the amounts they sell to each; that is, rationing will be by the sellers, under conditions that can easily lead to misunderstanding and protests. Suppose the government then applies an excise to the commodity, and permits the sellers to add it to the price charged; and suppose the excise is just large enough to make demand at the new price equal to supply. This case has certain characteristics of both extremes discussed above. The distinguishing feature here is that 'market conditions' are not the sole factors determining who will bear the tax: the situation, both before and after the application of the tax, is in large degree governed by the direct controls imposed by the government. As direct controls have a large and expanding place in a wartime economy, the number of commodities for which the situation may be as outlined here is important.

Not only may the indirect taxes absorb civilian money incomes, but they may also, or as an alternative, contribute to certain other wartime economic objectives; this possibility appears for certain less extreme cases as well as for such taxes as come under the first case above. As noted already, consumers may, when faced with the necessity of paying a price which includes the amount of the tax, scrimp on the commodity: the total expenditure after the imposition of the tax may be less than the former expenditure plus the tax. Because of this possibility, the tax becomes a powerful weapon for restricting the purchase of certain commodities. It thereby tends to reduce consumption of such commodities, releasing to the war effort resources which would otherwise be used in producing those commodities in their former or enlarged volume.[5] Of course the more a tax curtails the purchase of a particular consumer good, the more dubious its efficiency in absorbing consumer money incomes; a tax high enough to prevent entirely consumption of a particular commodity would absorb no income.

Indirect taxes of the excise type are sometimes suggested as meeting a wartime objective—the 'rationing' of a commodity that is in short supply. What can be achieved in this direction is narrowly limited, as the more detailed discussion in Section 1 brings out. Such taxes are suggested also as a means of capturing the windfall profits which arise when the price system is permitted to effect rationing, by limiting demand through an advance in price, and this view also is discussed below. The more important purposes excises can serve in wartime, apart from providing revenue for the government, are to absorb civilian money incomes and curtail consumption of specific commodities. We now examine in more detail the main categories of indirect taxes.

1 SELECTIVE EXCISES

The federal tax system already includes a great variety of excises upon commodities and services, although those imposed upon liquors and tobacco are and have long been the main sources of excise revenue. In the fiscal year 1941, of $2,399 million collected in excises, $820 million came from liquor and $698 million from tobacco. At the other end of the list were such purely regulatory excises as those on marihuana and colored oleomargarine, which yielded and were meant to yield an insignificant revenue. No simple description of the wide-ranging objectives—fiscal, sumptuary, moralistic, and regulatory—which underlie the system of excises would be adequate. A summary even of the objectives underlying the use of the excises on liquor and tobacco must omit important details, since revenue is not the sole aim. In broad terms, however, these standard and familiar excises have been designed to produce revenue by tapping individual incomes when these are spent for specified commodities. Income is transferred by these excises from individuals to the Treasury in a manner that, in most cases, is administratively easy. By tapping portions of individual incomes spent in particular directions, revenue is obtained, at least indirectly, from all consumers who purchase the taxed commodities, including people who would not be reached by an income tax which necessarily exempts a vast number of small incomes.

If a fresh start could be made in framing a program of excises appropriate to present needs, some of the existing federal levies might be reduced or even eliminated. But, as a practical matter, this prospect is not open. Taxpayers have in most cases adjusted themselves to existing excises; they do not expect reductions in the near future; and reductions would probably be repugnant to public opinion when heavier taxation in many directions is both inevitable and desirable. In what follows, therefore, the possible advantages of reductions in the excise system as it stood after the passage of the 1941 Revenue Act are not considered; and possibilities of extending the system are discussed.

Excise Taxes as a Means of Curtailing Civilian Consumption

As noted above, the two major wartime economic purposes to be served by indirect taxes, of which excises constitute a principal category, are to absorb civilian money incomes and curtail consumption of civilian goods competitive with defense. At an earlier stage of our defense effort, strong arguments could be advanced that excises were a less satisfactory means of accomplishing the first purpose than certain other taxes—personal income taxes for absorbing consumer spending power, and excess profits and other corporation taxes for absorbing funds from enterprises—and that the second was accordingly the primary purpose of an excise system, and should largely determine its design. With our active participation in the war, and the greatly increased magnitude and urgency of our wartime economic effort, these arguments have lost some of their force; for excises, as well as other types of levy, are needed as adding to the total revenue of the government. Although curtailment of consumption of specific goods may no longer be regarded as emphatically the chief objective of the excise system, it remains worthy of considerable attention.

Carefully devised, an excise program may aid in releasing resources in spheres competitive with defense and, conversely, allow expansion in areas that are non-competitive and where resources are idle which cannot be diverted to defense. It can be used by government to help rearrange resources and to obtain more speedily what is required for defense. What can excises on consumer goods and services accomplish to this end? This is a pertinent question, because the assumption is made here that, in a war tax program, excises will be imposed mainly at or near the consumer level. Excises upon raw or semi-finished articles seem defective in that they provide a crude and ineffective method of allocation as compared with direct controls (discussed in Ch. 5). Even at an early stage of the war program, direct controls seem to have been accepted as the better alternative for controlling commodities of this sort.

The present excise system includes a considerable range of levies on consumer goods into whose production labor and materials useful for the war program go. To extend these and to add new excises would be a means of further diverting these resources from civilian to military uses. Cannot this diversion be effected more efficiently by direct controls? If war needs indicate that all or some portion of the resources used in the manufacture of a consumer good should be shifted from civilian purposes, why rely on an excise? What rate of excise will effect this diversion? Unless the tenacity with which consumers will hold to the article is known and unless the changes in income which will affect demand can be estimated fairly closely, the excise may be set too high or too low. Why not intervene directly and restrict the production of the good by *fiat?*

Direct restriction will often constitute the chief means, especially since an outstanding characteristic of current war finance, in contrast to all previous experience, has been the extent of resort to direct controls. Government has not attempted merely to bid or tax away from private industry those types of labor and capital it required; instead it has, in one way or another, superseded market forces in fulfilling many of its military requirements. New production of certain consumer goods competitive with the war program has already been restricted to quantities specified by the WPB; and it has been restricted, in other instances, at the level *below* the consumer by priorities on the use of many materials, such as aluminum, zinc, and steel, which make it impossible for manufacturers of many consumer goods, especially durable, to maintain their production. In these cases excises have apparently been regarded as an inferior instrument with which to effect diversion of resources, and the generalization may be ventured that whenever civilian consumption of a product is to be cut sharply and whenever the firms in an industry are few, diversion will be effected more easily and speedily by direct controls. Only when the cut in civilian consumption is modest and the firms in an industry are so numerous that extensive policing is required to enforce a governmental decision would excises seem to have advantages. A safe conclusion, therefore, is that in the present emergency diversion of resources will be a minor rather than a major function of excises.

Excises have, however, other functions, some of which are closely connected with the program of direct controls for the very important reason that, because of direct controls, certain consumer goods, especially durable (and certain imported goods), will be in short supply. Whenever the government restricts the amount of an article which is to be produced, whether by specifying total production or by limiting the quantity of raw materials to be used in manufacturing the article, problems are raised concerning the allocation of the limited supply among consumers. A simplified illustration will serve to pose the issues. Suppose that only half as many bicycles are manufactured in 1942 as in 1941 and that the unit cost of production is the same.[6] At existing prices, more customers will be in the market than can be satisfied. As a first possibility sellers might allow prices to rise to the level that will call forth just enough buying to take the short supply. In this case the market itself automatically provides a method of allocation, but against this advantage must be set two serious disadvantages. The sellers would get large windfall profits, and the mere willingness of specific buyers to pay the higher price may not be the most desirable basis for allotting the short supply among consumers. A second possibility is that the sellers might keep their prices unchanged and resort to informal rationing on whatever basis they pleased. This would eliminate their windfall profits, but it is certain to be unsatisfactory and perhaps intolerable to the public, since the sellers might choose to sell or might be suspected by the public of selling to 'good' customers, relatives, political friends, etc. A third possibility is that the government itself should take further steps in intervention by fixing prices and by establishing rationing on some basis that takes account of the urgency and social significance of certain individuals' demands. Such a step, although desirable in cases of goods in widespread and nearly necessitous demand, is bound to be administratively difficult.

A fourth line of action which may often be more desirable than any of the foregoing is that the government should impose an excise sufficient to cover the spread between the market price after curtailment of output, or after enlargement of demand in the face of unchanged output, or both, and the former price. In this case the government might capture the windfall profits which would otherwise accrue to sellers as a result of short supplies and higher prices. In avoiding the administrative problems of a genuine rationing scheme, it would allow the 'rationing' to be done by prices as under the first possibility above. The windfall profits are likely to be appreciable in view of higher prices because, while supply is being restricted by direct controls or other limiting factors present in wartime, demand is increasing because of a rise in money incomes.[7]

As for the function of allocating goods in short supply among consumers, an excise provides only what may be called 'price rationing', the 'automatic' rationing achieved by excluding purchasers unable or unwilling to pay higher prices, or, if the price system is left free to do the rationing, the excise is merely a rough means of capturing the windfall profits. 'Price rationing' is seriously defective when the cut in civilian consumption of an article has to be sharp, and, if the article is a necessity, even when it is not sharp. No one would suggest that the small supply of automobile tires and tubes could be distributed satisfactorily to civilians by selling to those willing and able to pay the price (including any applicable excise). The short supply must be put into the hands of persons to whom it is indispensable from the viewpoint of the nation in an emergency. And if a necessity, such as milk, were in short supply, social as well as economic considerations would indicate that command over money alone should not determine allocation to individuals. A satisfactory allocation device is not to be found, therefore, in the application of excises to necessities, however small or large the cut in their supply, or even to certain luxuries and semi-luxuries when the cut is drastic. In these cases a full-fledged scheme of rationing, not the 'automatic' rationing achieved by price advances, is appropriate. Partial intervention by setting a price ceiling puts upon dealers the task of choosing what consumers shall have the privilege of spending their money for the article, since demand can no longer make itself precisely felt in money terms. Partial intervention by limiting the total production of a good has related difficulties, already noted. In short, satisfactory allocation of such goods among consumers can be realized only if direct controls include true consumer rationing, and inadequacy of direct controls cannot be overcome by excises. We must regard rationing at the consumer level as not among the primary functions of excises. However, at a lower level, excises do have a role: by restricting the use of certain consumer goods, excises reduce the demand for the various materials and services entering into the taxed articles, and thereby aid in allocating resources.

Excise Taxes as a Means of Diverting Resources

As the foregoing discussion indicates, the primary purpose which can feasibly be served by excises is to absorb civilian spending power, the secondary purpose is to divert resources from the production of certain civilian goods to the war effort, and the other suggested purposes are somewhat less significant. In examining the existing excises and possible changes in them, we give attention first to the secondary purpose, diversion of resources; because the later analysis in terms of the first purpose, absorption of income, will prepare the way for the examination of sales taxes which follows this section.

We begin with the articles and services already subject to tax, especially those which seem most directly competitive with the war program (Table 18). The predominant articles, except gasoline, are consumer durable. Recent events have upset the basis upon which most of the estimates of revenue were made; and, looking to the immediate future, little revenue can be expected, because of drastic cuts in or complete suspension of output, from manufacturers' excises on such

TABLE 18

Excises under the 1941 Act on Consumer Goods and Services Competitive with the War Program

CATEGORY [a]	RATE [b]	ESTIMATED REVENUE [c] (millions of $) FISCAL YEAR 1942	1943
Automobiles & motorcycles	7	85.8	7.9
Trucks	5	16.6	14.6
Tires & tubes	5 & 9 cts. per lb.	40.7	20.4
Automobile parts & accessories	7	26.5	30.8
Gasoline	1½ cts. per gal.	372.5	358.4
Electrical energy, domestic & commercial consumption	3 1/3	50.6	51.7
Lubricating oils	4½ cts. per gal.	44.0	45.0
Mechanical refrigerators	10	14.0	5.7
Telegraph, telephone, cable messages	10	44.4	52.8
Telephone bill	6	36.2	56.6
Washing machines	10	.2	.2
Rubber articles	10	8.1	5.9
Electric light bulbs	5	2.4	4.0
Firearms, etc.	10	4.3	4.3
Radios & accessories Phonographs & records Musical instruments	10	13.2	12.1
Sporting goods	10	5.8	11.8
Luggage	10	2.8	4.5
Electrical appliances	10	6.5	6.7
Photographic apparatus	10	6.1	11.2
Electric signs	10	1.5	1.6
Electric, gas & oil appliances	10	6.5	6.7
Business & store machines	10	5.3	4.6
Optical equipment	10	.3	.4
Matches	2 cts. per 1,000	5.1	8.2
Jewelry	10	34.9	61.7
Transportation of persons	5	20.8	38.0
Total		855.1	825.8

[a] Some of these categories are less inclusive than their titles seem to imply; e.g., 'rubber articles' exclude footwear.

[b] Per cent, except as indicated.

[c] Secretary of Treasury, *Annual Report, 1941,* pp. 667-8.

goods as automobiles, motorcycles, tires and tubes, and rubber articles. The production of some other goods in the list is also being considerably curtailed by direct controls. Yet continuation of the production and sale of some of these goods and services is to be presumed, and therefore a more severe scale of excises will help to divert resources from producing those goods to the war effort.

What are the appropriate rates of excises? What rate would cause, for example, a cut of one-fifth in the consumption of a given commodity? In the initial selection of new rates, persons with special knowledge of the markets for the excisable commodities and who are also informed concerning the presumptive war requirements could make intelligent guesses.[8] The uncertainties imply risks of error in setting rates, and rates that at any time prove inappropriate would need to be corrected without great delay. This could be managed if Congress would consent to give the executive authorities some freedom, within limits set by legislation, with respect to variation in rates. Flexible adjustments to a changing situation and prompt timing of excises would facilitate bringing demand by civilian consumption upon certain resources into line with the war program with a minimum of lag and lead. Certainly, the present rates can be regarded as high only in comparison with our own tax history; in comparison with current needs and with the levies in other belligerent countries, they are modest.

What revenue can advances in rates yield, or what amount of civilian income can they absorb? Even if the taxes are imposed in order to restrict purchases for civilian consumption, such purchases as do take place will be accompanied by the payment of taxes and hence by diversion of civilian spending power to the government. But an advance in the rate of a particular excise, levied for the purpose of curtailing purchases, will not usually bring a proportionate increment in the total excise revenue from the commodity, and may not bring any. For example, doubling the rate per physical unit might in some cases reduce purchases one-fifth, and the total excise revenue would then be increased three-fifths. Similarly, if a doubled rate reduced purchases 30 per cent, the revenue increase would be two-fifths. The rate might conceivably be raised so high that the accompanying reduction in purchases would cause an actual decrease in the excise revenue; and a still higher rate might in rare cases eliminate purchases, and thus reduce the excise revenue from that commodity to zero.[9] Rates high enough to produce such outcomes are extremely improbable. The general rule is instead that an advance in rate will be accompanied by a less than proportionate increase in revenue (other things, including total consumer incomes, being assumed equal).

Limitations of the increase, or actual reductions, in excise revenue from higher rates become much more probable and important if consumption is curtailed also by a powerful system of direct controls, such as now operates for numerous commodities subject to excises. For example, direct controls on the production and sale of private passenger automobiles and of tires and tubes are already so drastic that excise revenue from them, at any conceivable rates, will run far below recent levels. For numerous other commodities the effects of direct controls in restricting purchases and thereby reducing excise revenue are not now and may not soon be as drastic; and, for at least some of these commodities, substantial advances in existing excise rates might offset the contraction in purchases, maintaining or even increasing the excise revenue moderately. Such advances in rates might, of course, cause a still further contraction in purchases beyond that achieved by direct controls; but for some commodities subject to drastic direct controls the demand may be so acute after the limitation of supply that increasing the price by the amount of the added excise would not significantly reduce actual purchases. So far as the latter conclusion is valid, curtailment of consumption (and diversion of resources) could not be advanced as the object of higher rates, though windfall profits would still be captured.

Could the revenue from the portion of the excise system that relates to such commodities as are listed in Table 18 be increased by any feasible rate advances? The answer rests largely on highly uncertain predictions as to the probable shortages in and direct controls imposed upon a long list of commodities. One can say with virtual certainty that, unless rates are advanced, the actual revenue will run below the figure given, because consumption will be reduced by shortages and direct controls.[10] In view of the cuts in consumption, whether brought about by the excises themselves, direct controls, or other causes, only severe advances in rates could increase or even realize the total revenue as estimated in Table 18. In order to secure an increase as large as $400 million in the total revenue from excises on the goods listed, very drastic increases in rates would be necessary.

Although we have been speaking of excises on commodities such as those of Table 18 in terms of the limitation of civilian consumption and diversion of resources to war use, such excises do absorb civilian incomes. They transfer from civilian possession to government, with negligible reservations, funds in the full amount of the revenue collected; and civilian spending power is absorbed in the same amount.

Most of the commodities in Table 18 are consumer durable goods, already subject to excise under the 1941 Act. Certain other commodities which may be considered eligible are listed in Table 19, together with the value of their production in 1939. Both the inclusions and omissions may arouse dissent. As we are thinking mainly of excises at the consumer level, the list is intended to exclude producer goods; but the line between them and consumer goods is sometimes shadowy. Electric lamps, for example, are used for business purposes as well as in residences.

If excises are applied to such additional durable commodities as appear in Table 19 at rates which on the average run somewhat above 20 per cent, perhaps $200 million a year might be absorbed from civilian incomes and added to federal revenues. Even though taxed at such rates, the articles would still be cheaper than in any other major industrial country in the world. Rates of 20 per cent or more might bring substantial curtailment in consumption of these goods, diverting resources to the war. The arguments outlined above, concerning the revenue yield, its relation to direct controls, the uncertainty of its estimate, and the incidental effects of the excise in releasing as well as absorbing purchasing power, apply to these cases. The effect of direct controls is clearly apparent in this list, for production of certain of the items is already stopped or severely restricted. In these circumstances, the average rate upon the remaining items would have to be much more severe in order to yield a revenue approaching $400 million.

The list in Table 19 includes, in addition to consumer durable goods, a few that fall in the category of semidurables.[11] Application of the logic outlined would bring within the orbit of excises a considerable number of semidurable goods (and perhaps even a few perishables): woolen and worsted manufactures, carpets and rugs, etc. Civilian consumption of articles of this sort has to be curtailed, and excises are one means to this end. Perhaps the revenue from semidurables would run, with moderately severe rates, to about half that realized from the durable goods of the type listed in Table 19, $200 million.

Excises as a Means of Absorbing Civilian Money Incomes

So far we have been discussing selective excises on commodities which, in greater or less degree, compete with the war program and for which the argument can be advanced that an excise will divert consumption. As noted earlier, this purpose of an excise is secondary to that of absorbing civilian

TABLE 19

Additional Items, Chiefly Consumer Durable and Semidurable Goods, to which Excises might be Applied

	VALUE OF PRODUCT, 1939 (millions of $)
Cutlery (excl. silver & plated cutlery) & edge tools	62 *
Heating & cooking apparatus, except electric	439 *
Household furniture	649
Clocks & watches	81
Watch cases	9
Batteries, domestic	45
Domestic laundry equipment	66
Sewing machines, domestic	13
Silverware	60
Electric lamps	79
Beauty shop & barber shop equipment	11
Soda fountains	14
Linoleum & other hard floor covering	67
Portable lamps (lighting equipment)	26
Motor boats	4
Bicycles	23
Plumbers' supplies	144
Paints, varnishes & lacquers	416
Oil burners	21
Domestic stokers	10
Woolen & worsted manufactures	736
Footwear	735
Fabricated textile products other than wearing apparel	317
Carpets & rugs	176 *
Clay products, incl. pottery & porcelain ware	258 *
Sale of gas, domestic (1940–41)	278

* In 1937.

spending power, especially as the system of direct controls is being rapidly extended to accomplish the first purpose. We therefore now consider excises in terms of their major function, the absorption of civilian money incomes. An excise system established for this purpose might still be selective, but need not be as selective as one designed to divert resources to war production: it might and probably would include excises on many commodities and services noncompetitive with defense. The present excise system contains numerous levies on such commodities (Table 20).

To increase rates of the existing excises on noncompetitive goods or to extend the list would not serve on a large scale to direct specific resources toward the requirements of the

TABLE 20

Excises under the 1941 Act on Consumer Goods and Services Non-Competitive with the War Program *

	RATE	ESTIMATED REVENUE [b] (millions of $) FISCAL YEAR 1942	1943
Liquor, total		1,095.0	1,195.8
Distilled spirits	$4.00 per proof gal.[a]	640.0	746.4
Fermented malt liquors	$6.00 per bbl.	353.1	367.8
Other		81.6	101.9
Tobacco, total		772.1	841.4
Cigarettes (small)	$3.25 per M.	693.9	763.4
Tobacco	18 cts. per lb.	55.0	53.9
Cigars (large)	$2.00-13.50 per M.	14.1	14.7
Other		9.1	9.4
Stamp		42.9	45.0
Toilet preparations	10%	11.0	20.4
Furs	10%	27.2	53.0
Transportation of oil by pipeline	4½%	13.9	14.2
Safe deposit boxes	20%	3.7	4.4
Admissions to theatres, etc.	Approx. 10-11%	122.6	159.6
Club dues & initiation fees	11%	9.9	9.9
Sugar		72.2	66.2
Bituminous coal	1 ct. per ton	4.9	5.3
Use of motor vehicles & boats	$5-200 per year	70.3	161.8
Bowling alleys, billiard & pool tables	$15 per year	1.1	1.5
Coin operated amusement & gaming devices	$10-50 per year	4.2	5.7
Other		12.7	5.9
Total, excl. tobacco & liquor		396.6	552.9
Total		2,263.7	2,590.1

* Even some of these commodities may now be regarded as competitive with the war program. For example, distilled spirits because alcohol is used for explosives and may be used for rubber, and bituminous coal because of the shortage of railroad facilities.

[a] Brandy $3.75 per proof gal.

[b] Secretary of Treasury, *Annual Report, 1941*, pp. 667-8.

emergency; but it would absorb excess money income and transfer it to the Treasury. This was less desirable in the earlier stages of the war effort, because of widespread slack in our economic system and because the resources required for producing these commodities were of little or no significance for the military program, and an increase in production could in many of these cases be achieved with little or no additional labor and other resources. If resources already utilized in their production had been freed by heavier excises, they would not have been taken up by the government demand and the result would have been, at least temporarily, unemployment and a check upon the expansion of the national product. In the present stage of the war effort, however, the greatly enlarged pressure for diversion of resources makes this consideration less forceful. Moreover, production and consumption of many noncompetitive luxuries and semi-luxuries as such must be sharply restricted, and part of the restriction can be achieved by excises. Using much labor and resources in such trades simply cannot be afforded; transfer to more essential trades (which may already have released resources to war production) must be brought about, even if direct utilization in war industries is impossible. Workers unsuitable for the war program may be substituted in essential civilian industries for those who can be transferred to war activities. When the war crisis reaches a point where such transfers of resources become necessary, commodities which were formerly regarded as noncompetitive become in fact competitive with the military program.

A further consideration favoring extension of these excises on noncompetitive goods is that the necessity of absorbing civilian spending power, to prevent inflation, is so great that other tax devices and voluntary and forced loans to the government will not fully meet it; and excises may contribute. The individual income tax has distinct advantages as a device for reducing consumer income (see Ch. 10-12). But if, for political or economic reasons, the feasible income tax program is inadequate, excises on consumer goods could be urged as an inferior alternative, yet an alternative emphatically superior to inflation. Even though excises are generally recognized as lacking some advantages an income tax has as a means of absorbing consumer incomes, public policy may be shaped by the purely practical consideration that a combination of the two devices might be more acceptable to the people than a very severe application of the one device which is admittedly preferable. Public opinion, which is never exactly known and is in any case a rough composite of many divergent viewpoints, may hold or be supposed by political leadership to hold that less discomfort and hardship would follow if the total consumer income to be taxed away were taken, not through a single tax however efficient, but through a variety of taxes all of which did not hit the taxpayer at the same time and in the same way. Such an attitude, however lacking in logic, may be a powerful factor in guiding tax policy.

How much additional revenue can be gained from increases in existing excises and addition of new excises on noncompetitive goods? Present excises on such goods are estimated to yield, for the fiscal year 1943, $2.6 billion. We have not examined carefully a list of specific commodities on which present rates could be advanced, or to which new excises could be applied, but believe that moderately severe advances might raise about $500 million additional. If severer rates were applied, especially on such widely used commodities as beverages and tobacco, the increase might reach a much higher figure, perhaps nearly $1 billion, roughly the amount estimated in the Treasury program for this type of tax.

The immediately foregoing discussion, concerning the grounds upon which noncompetitive commodities may advisedly be subjected to excises, applies also to commodities which are competitive with defense. For them also, an excise absorbs private spending power; and the further fact that excises on them may aid the war effort by reducing their consumption is merely another strong reason for taxing them. But even if this reason did not exist; if, for example, their consumption were curtailed by direct controls alone, the necessity of absorbing consumer spending power would be a factor favoring excises on them, to the same extent as it favors excises on noncompetitive goods.

On the basis of our very rough estimates the yield of such higher rates and new excises as have been discussed above would amount to about $5 billion (Table 21). With negligible reservations, this entire sum, or such other sum as the excise system actually adopted may yield, would be a draft on civilian incomes; and a very large part of it would be a draft on the spending power of consumers. As the official estimates for existing excises and our estimates for new excises have already been brought seriously in question by direct limitations on output of certain commodities, and as further developments in this direction are in prospect, the $5 billion figure is an outside limit for revenue under the rates herein discussed.

2 SALES TAX OR GENERAL EXCISE

A general sales tax as a means of approaching the chief objectives set for a war finance program is frequently suggested

TABLE 21

Estimated Excise Revenue Possibilities, Fiscal Year 1943

	MILLIONS OF DOLLARS
According to official estimates, from present excises on	
Competitive goods	852.8
Noncompetitive goods	2,590.1
Total	3,442.9
According to our very rough estimates, from additional and new excises	
Additional on competitive goods	400.0
New on competitive durable goods	400.0
New on competitive semidurable goods	200.0
Additional on noncompetitive goods	500.0
Total additional	1,500.0
Total (in round figures)	5,000.0

and merits attention here. It not only is a direct means of absorbing consumer spending power; but it appears as a tax on spending rather than on saving, although its final effect may in many cases be to reduce saving. Application of a federal sales tax at the retail distribution, or even the wholesale, stage would encounter certain obstacles in administration. This might suggest that a federal sales tax would take the form of a general excise, applied at the level of sales by manufacturers or other producers. Although a federal sales tax applied at the level of manufacturers or other producers is without doubt more feasible administratively than one applied at the distribution level, experience with federal sales taxes on certain commodities at the retail distribution level indicates that the administrative obstacles are not decisive. Especially when various other elements of the tax structure must be elaborated to a degree and in a manner greatly increasing the administrative task, the argument that a retail sales tax cannot easily be administered loses much of its force. A positive argument in favor of applying a federal sales tax at the retail level may be advanced with particular force when one of the main objectives of tax policy is to absorb civilian income. A sales tax at the retail level falls upon the commodity after various additional costs, such as for transportation, storage, and distribution, not included at the level of the manufacturer or other producer, have entered into its price. The retail sales tax is accordingly a much more comprehensive levy upon the total value of consumer goods than is a general manufacturers' excise. The same rate will yield much more revenue if applied at the retail level than at the manufacturers'.

A 'general' excise, as distinct from the selective excises examined in the preceding section, on manufacturers and other producers, or a retail sales tax, would presumably not cover all goods. Furthermore, it would presumably be at a flat rate for all commodities taxed, although no insuperable obstacles appear to the application of somewhat different rates to different commodities; but if different rates were applied, the excise would lose an essential element of its 'generality' and become in truth a combination of several selective excises. Moreover, in addition to a general excise at a moderate flat rate, selective excises at rates varying from commodity to commodity might be applied to specific commodities. In any case, a general excise would cover numerous commodities, including many not directly competitive with defense through the use of materials and equipment and labor needed for defense. So far as the general excise fell upon these noncompetitive commodities, it would, like the selective excises on similar commodities discussed at the end of the preceding section, afford merely a means of absorbing consumer incomes by raising prices above the level they would otherwise reach.

Chapter 10 indicates that such a use of excises, to absorb consumer spending power, is on certain grounds less satisfactory than an income tax to tap that power directly. The income tax absorbs some of the total spending power as such and leaves the consumer free to dispose of the remainder as he chooses in the light of supplies and prices. It can be designed to protect from tax levy some minimum amount of income regarded as basically necessary for individual consumption. The general excise or sales tax, as ordinarily applied, lacks these advantages. So far as a *completely* general excise at uniform rates cannot be realized—and various political and practical considerations indicate strongly that any feasible excise will fall far short of generality—the absorption of money spending power is somewhat haphazard. Some consumers will use more of their means on taxed commodities and less on untaxed than others. And each consumer, while free to dispose of his purchasing power, will be influenced in his choices by the differential effects of the tax upon prices of various commodities. Finally, and this is one of the most forceful objections, the excise tax falls upon purchases from the bare minimum of purchasing power as well as other purchases. Persons whose incomes do not exceed the cost of the recognized minimum needs for subsistence and such comforts as are regarded essential for public health and morale must pay the excise. Even if the rate is only moderately heavy, they may have to forego consumption recognized as essential from a national point of view. This objection is, however, not insuperable. Some device might be worked out by which consumers would be given certificates enabling them to purchase, free from the general excise, amounts up to the recognized minimum of essential consumption; or provision might be made for free distribution to all of tax-paid stamps covering an amount of consumption intended to be exempt. Whether the administrative difficulties in operating such a device are decisive cannot be foreseen with certainty, but recent experience with rationing leads us to believe that they are not bound to be decisive.

Even though the income tax is recognized as having certain advantages over the sales tax as a device for absorbing consumer spending power, a practical warrant for applying the sales tax in addition to a less drastic income tax may be found along lines noted in the closing argument of the preceding section. As a practical political matter, the possibly greater acceptability to the public of a combination of the two taxes than of a more severe application of the income tax alone may be adequate reason for the adoption of a general sales tax.

Advocates of the sales tax also urge that it has certain advantages over the income tax as a means of absorbing purchasing power. Like all excises, it is collected promptly and therefore promptly absorbs spending power; whereas the income tax, as now constituted, taps purchasing power only after it has been in the hands of taxpayers many months following the receipt of income. This disadvantage of the income tax might be largely removed if an effective stoppage-at-the-source device were provided (see Ch. 11). Even then, as certain kinds of income, particularly from unincorporated businesses, including farms, and from rented real estate, cannot effectively be stopped at the source, the sales tax would offer a means of prompt rather than delayed collection. Moreover, regardless of what is done about stoppage-at-the-source, the income tax fails to reach adequately all consumer incomes which can contribute to excess demand for the supply of consumer goods. Among the categories missed, in whole or in part, are income from tax-exempt securities, chiefly of states and local governments; from unincorporated businesses, especially farms; and of low bracket individuals who have enjoyed a large increase of income from the war effort and are likely to spend rather than save most of it, and whose income, even if it is above the minimum exempt from income tax, may not be taxed because of the great difficulty of enforcing the law. Income from these sources might escape the income tax but could not escape the sales tax, so far as that income was used to purchase commodities subject to a sales tax.

The advocates contend also that, if a sales tax is not imposed, enough civilian spending power can be absorbed by the income tax only if such high rates, even on the lowest brackets, are set that many taxpayers would suffer severe hardship (see Ch. 10), especially those with relatively fixed incomes, who constitute a very substantial fraction of all present income taxpayers. For many such persons, the lower income tax which would be feasible if a sales tax were adopted would leave a larger share of their incomes free from taxes and other fixed charges for meeting the higher cost of living. In disposing of this free part of their incomes they could not of course avoid the sales tax on commodities subject to it, but they might find it possible and even necessary to choose their purchases with a view to minimizing payments of the tax.

Considerations of the foregoing type strengthen the practical political consideration mentioned above as possibly justifying a combination of sales tax, despite its regressivity, with a moderately severe income tax, instead of using a very severe income tax alone. If the major defect of the sales tax, its impact upon the minimum of income essential to sustain life, health, and morale, can be overcome by some workable device such as tax-paid stamps, the case for its inclusion in a war finance program might well prove decisive.

The revenue possibilities of a sales tax or general excise cover a wide range, depending mainly upon the flat tax rate applied but also upon the generality with which the tax covers commodities and services. A very general tax at a moderate rate (not far from 5 per cent), after allowance for excluding the minimum consumption needs from tax, might yield from $1.5 to $2 billion, and more severe but perhaps feasible rates might raise the amount to from $3 to $5 billion. A drastic rate, while adding to the revenue from the general excise, might mean some reductions in revenue derivable from the selective excises.

3 CUSTOMS

For one category in the system of indirect taxes, customs duties, the analysis in the two preceding sections does not apply, or applies imperfectly or even in reverse. Customs duties, though before the adoption of the Income Tax Amendment in 1913 a major source of federal revenue, are no longer relied upon heavily for revenue. They are in fact designed primarily to implement the international trade policy of the government, a policy which, in greater or less degree, aims at restricting imports of goods competitive with domestic products. Because of recent restrictions upon our international commerce occasioned by shipping shortages and other causes incident to the war, revenue from customs has been declining even from the moderate levels of the 'thirties.

Recognizing the long-run trade policy of the government, one might infer that no possibility exists of enlarging substantially the revenue from customs, and absorbing civilian spending power by this means. *Advances* in rates of duty on commodities competitive with domestic products, already largely or entirely excluded from import by existing duties, would not increase revenue; and substantial advances in the rates on certain other competitive commodites might reduce or eliminate their import and hence reduce rather than increase revenue.[12] Advances in the rates on commodities not produced domestically, provided the demand for the commodities is sufficiently inelastic, and imposition of duties on additional commodities in this category, would indeed increase revenue, provided other causes did not reduce imports. For such commodities, a duty is closely similar to an excise on a domestically produced commodity; and the arguments of the preceding sections, concerning absorption of purchasing power and other economic effects, apply without significant qualification.

But the especially important possibility for securing an increase in the revenue from customs lies in *reductions* rather than advances in rates. The commodities involved are, of course, in the first category mentioned, those competitive with domestic products. Reduction in the duty on any such commodity now excluded by a high duty might lead to a resumption of imports, and thereby enlarge total customs revenue. Reduction in the duty on any such commodity, present importation of which is somewhat restricted by the existing duty, might lead to an increase in importation; and if the increase were somewhat greater proportionately than the decrease in the rate of duty, the revenue would rise. For both these cases, however, shortage of shipping or other causes might prevent additional importation, or even reduce the former volume, and the rate of customs duty would lose its significance.

Under the existing law, some such reduction in rate (up to 50 per cent) can be accomplished by executive discretion and does not need legislative action, although various other obstacles to prompt action might appear. With our present economic situation marked by acute shortages in many lines, the argument for protecting domestic producers from foreign competition by very high duties may temporarily at least have lost some of its force, particularly with reference to certain commodities on the protected list. On such commodities in which domestic shortages are especially acute, reduction of duties may prove a substantial aid in importing goods from abroad to make up the shortages; and this argument would hold even if no additional revenue were yielded. On these grounds, the executive branch of the government may wish to consider carefully reductions in rate, within the 50 per cent rule, on certain commodities. If such action is taken, the total customs revenue might be augmented substantially.

Reductions in rates exceeding 50 per cent would require legislative action; and the great complexity of the tariff structure and the prolonged Congressional study involved in any legislative change therein render of doubtful wisdom any consideration in wartime of such drastic reductions. The same statements apply with respect to advances in rates or the imposition of new duties on commodities not produced domestically; although the close similarity of this case to excises might lead to more prompt and easy legislative action than if the question were that of reducing rates on competitive goods.

NOTES

[1] Whether a tax will fall under this first case is not determined by the form of the statute imposing the tax. Thus a statute directing that the seller shall collect 'from the purchaser' 10 per cent of the selling price, as a tax, does not necessarily mean that the consumer will pay 10 per cent more than formerly. Unless market conditions are such as to bring the commodity under case (1), the seller might reduce his 'selling price' so that the total paid by the purchaser, including the tax, would be the same as before the tax was imposed; and the tax on this commodity would then fall under case (2), despite any intent written into the law. Here, as in other cases, economic forces, not legal measures, determine *who* will bear a tax.

[2] If consumer incomes are rising, the actual expenditure after tax is imposed may in fact exceed the previous expenditure (at the lower level of income) plus the tax.

[3] This point is treated more fully in Sec. 1 in the detailed comment on selective excises, and bears upon the somewhat different function of excises in curtailing consumption which is discussed immediately below.

[4] In this and the foregoing paragraphs the reasoning runs in terms of a consumer good. With some adaptations, similar reasoning applies to a producer good, such as motor trucks, or gasoline for business use, or an industrial raw material, to which an excise might be applied.

[5] The argument takes a somewhat different form for one category of indirect taxes, customs duties, discussed in Sec. 3.

[6] This assumption is most convenient for purposes of exposition. It can be replaced by different assumptions without damaging the main thread of the argument.

[7] Circumstances can, however, easily be conceived in which the windfall profit would *not* be large: for example, if a diminished supply of the civilian good was produced at a sharply higher unit cost, or if the capital employed by the firm to make the civilian good could not be shifted to war uses. Even if costs per unit did not change, the total profit, on the smaller volume at a higher price, might not be greater.

[8] As a general rule, demand for most durable goods is presumed to be elastic (the volume demanded declines more than proportionately as the price rises), but in a period of rapidly growing general demand this rule is of little use. Moreover, when supplies are small, demand may become more and more inelastic, in which case very heavy excises would be required to be effective for purposes of diversion.

[9] The argument, substantially along reverse lines, in connection with possible increases in revenue from reductions in the rates of customs duties, is introduced in Sec. 3.

[10] Some expected cuts in consumption were taken into account when the estimates reported in the table were made, as evidenced by the declines from 1942 to 1943 in the revenue from automobiles and tires and tubes and gasoline, but further cuts have occurred since.

[11] Sale of gas for domestic consumption is also included here. An excise on it would seem to be parallel to the existing levy upon the sale of electrical energy for domestic consumption, although this industry has not been expanding as rapidly as the electrical energy industry.

[12] Actually some increase in the rates on certain of these commodities might lead to a somewhat less than proportionate decrease in the amount imported, and thus enlarge somewhat the total revenue.