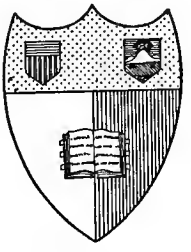
SELECTED READINGS IN PUBLIC FINANCE

BULLOCK



SELECTIONS AND DOCUME
IN ECONOMICS

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SELECTED READINGS IN PUBLIC FINANCE

BY

CHARLES J. BULLOCK

PROFESSOR OF ECONOMICS IN HARVARD UNIVERSITY

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PREFACE

THIS volume aims to bring together under one cover the collateral reading needed for a general course in public finance. It is intended to supplement the instruction usually given by lectures and text-books. The selections have been drawn from a considerable variety of sources, both new and old, and deal with most of the topics ordinarily included in such a course. Upon various controverted questions the arguments of the earlier disputants have been reproduced, and in other cases an effort has been made to draw upon the work of the older standard authors. In this way it is hoped that the book will serve a useful purpose in introducing the student to the literature of the science of finance.

It would be a pleasure to make express acknowledgment here of the many favors which have been granted in the preparation of the volume. But the footnotes to the various selections serve this general purpose; and the editor must be content simply to record his appreciation of the cordial coöperation of the authors who have given him permission to draw upon their works, and of the publishers who have consented to the reproduction of copyrighted material. Thanks are due also to the editor's wife, upon whom fell a large share of the harder work attending the preparation of the book.

CHARLES J. BULLOCK

PREFACE TO THE SECOND EDITION

THIS second edition retains the greater part of the original selections, but replaces a part with later material. It also draws upon recent scientific and official publications for a number of new selections.

CHARLES J. BULLOCK

CAMBRIDGE, MASSACHUSETTS

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SELECTED READINGS IN PUBLIC FINANCE

CHAPTER I

THE LITERATURE OF PUBLIC FINANCE[1]

1. Mediæval Finance. — Some of the subjects treated by public finance have never escaped entirely the attention of historians[2] and writers upon statecraft or political philosophy.[3] Until the close of the Middle Ages, however, the financial transactions of European states were not sufficiently important to invite anything approaching systematic study. Kings were supported chiefly by the revenues derived from their private domains or various fiscal prerogatives, while taxation was in theory — and generally in practice — an extraordinary resource, reserved, as Thomas Aquinas held it should be, for unusual emergencies.[4] The finances of a feudal state were hardly more than the finances of a royal household; and, in fact, savored rather of private than public housekeeping.[5] In the eleventh and twelfth centuries, with the revival of industry and commerce, numerous

[1] For an extended bibliography see Stammhammer, Bibliographie der Finanzwissenschaft (1903).

[2] A work entitled The Revenues of Athens, commonly attributed to Xenophon, discusses methods of improving the wealth and revenues of that city. Roman historians occasionally mentioned the subject of taxation; Tacitus and Suetonius are examples.

[3] In the thirteenth and fourteenth centuries some of the Schoolmen touched upon certain financial questions. Thomas Aquinas, for instance, considered the rights of the sovereign in respect to taxation. In ordinary times, he taught, the King should live upon the income from his domains; but in time of extraordinary emergencies, his subjects should submit to taxation, which, however, ought to be moderate and just. Similar maxims were expressed by Petrarch (De republica optime administranda), and by other Humanists.

[4] Aquinas wrote: "*Unde constituti sunt reditus terrarum Principibus, ut ex illis viventes a spoliatione subditorum abstineant.*"

[5] One of the laws of Charlemagne, the capitulary *de villis*, lays down the following rules for the management of the Emperor's estates: "We desire that each steward

towns began to grow rapidly in various parts of Europe and to gain a large measure of independence in internal affairs. With them, problems of finance soon engaged attention, and financial institutions early assumed something like a modern character. Poll and property taxes were introduced, duties laid upon articles of consumption, and municipal debts created. Yet, so far as we know, these interesting developments did not, outside of Italy, call forth any noteworthy discussion of financial problems.

2. The Formative Period. — In Italy, however, the quickening of intellectual life and the growing importance of commercial and financial transactions led to interesting developments in the fifteenth century. At Florence various financial problems came to the forefront, and the question of progressive taxation aroused the keenest interest.[1] In the Kingdom of Naples, moreover, Diomede Carafa, a soldier and statesman, produced a most interesting treatise upon statecraft (De regis et boni principis officio), in which financial questions received more serious treatment than ever before, perhaps, had been accorded to them. Carafa devoted one of the four parts of his work to the administration of the revenues of the prince. In general, he stood upon the ground of his predecessors, such as Aquinas and Petrarch, holding that income from domains should be the basis of state finance, and taxes a subordinate form of revenue. But he pro-

shall make an annual statement of all our income, giving an account of our lands cultivated by the oxen which our own plowmen drive and of our lands which the tenants of farms ought to plow; of the pigs, of the rents, of the obligations and fines; of the game taken in our forests without our permission; of the various compositions; of the mills, of the forest, of the fields, of the bridges and ships; of the free men and the districts under obligations to our treasury; of markets, vineyards, and those who owe wine to us; of the hay, firewood, torches, planks, and other kinds of lumber; of the waste lands; of the vegetables, millet, panic; of the wool, flax, and hemp; of the fruits of the trees; of the nut trees, larger and smaller; of the grafted trees of all kinds; of the gardens; of the turnips; of the fish ponds; of the hides, skins, and horns; of the honey and wax; of the fat, tallow, and soap; of the mulberry wine, cooked wine, mead, vinegar, beer, and wine, new and old; of the new grain and the old; of the hens and eggs; of the geese; of the number of fishermen, workers in metal, sword makers, and shoemakers; of the bins and boxes; of the turners and saddlers; of the forges and mines, — that is, of iron, lead, or other substances; of the colts and fillies."

[1] Palmieri (1405–1475) and Guicciardini (1483–1540) are the most important writers to be mentioned in this connection. For an account, in English, of progressive taxation in Florence, see Seligman, Progressive Taxation, 22–26, 70.

ceeded to divide public expenditures into three classes: (1) those for the defense of the state; (2) those for the support of the prince; and (3) those for contingencies. Expenses, he said, should be moderate, so that a balance may remain which will be available for emergencies; then, too, economy makes it possible to dispense with bad taxes and to use only the best. Taxes, he argued, should be stable, and should be certain, so that citizens may know precisely what they are expected to pay. All revenues, finally, should be strictly accounted for, and the accounts should be frequently examined by the proper officers. In all things the prince should remember that the wealth of his subjects is the real foundation of a prosperous condition of his finances.[1]

By the close of the sixteenth century the growth of vigorous monarchies upon the ruins of the feudal system had proceeded far enough to compel more serious consideration of politics and finance.[2] In 1576 Jean Bodin published a celebrated work upon political philosophy (Les six livres de la république), which for many years exercised a wide influence upon writers in all the countries of Europe. Bodin devoted the sixth book of his treatise to "several political questions," one of which was the proper management of the finances, "the nerves of the state." For such management, he said, three things are necessary: "The first is honest means of raising revenues; the second is to employ them for the profit and honor of the state; and the third, to save some portion of them for time of need." Concerning the first point, he argued that domains are "the most honest and assured" form of revenue; but he approved of customs duties "upon merchants who bring in or take out commodities, which are one of the oldest, most common, and most equitable" . . . of financial devices; and admitted the propriety of direct taxes[3]

[1] Carafa said: "*Subditorum quippe facultates potentiae regiae fundamentum existimari opporteret.*"

[2] Financial problems became important on account of the growth of public expenses, the increasing frequency and weight of taxes, and the many evil expedients, such as forced loans or debasements of the currency, employed in order to raise money.

[3] Bodin contended, however, that in Spain, England, Germany, and France it was established, by long custom, that "no prince has power to levy a tax upon his subjects, or to require this duty, without their consent."

upon the subjects of the prince when "all other means are insufficient and there is urgent necessity of providing for the state." Under the second topic, the employment of the revenues, Bodin mentions the various branches of outlay,[1] condemns extravagance, urges the need for economy, and advises that an annual account be prepared, showing the condition of the finances. And, finally, upon the third topic, Bodin urged that out of the revenues a reserve, or treasure, should be accumulated in order that the state "may not be obliged to begin a war by borrowing or levying a subsidy." Borrowing at interest he believed to be the ruin of princes and their finances.

During the seventeenth and eighteenth centuries public finance was increasingly studied in Germany, where not a few professors in the universities and officials in the service of various German states were occupied with the subject. Regarding finance as an important branch of public business, they generally approached it from the point of view of the prudent administrator, anxious to husband and develop the resources of his estate.[2] While, at the start, many of them were greatly influenced by Bodin, they investigated assiduously the conditions existing in the German states, and in time gave their studies an independent basis. In the writings of J. H. von Justi[3] German financial science of the eighteenth century reached its ripest development. Justi divided finance, as Bodin had done, into three parts: the study of revenues, of expenditures, and of methods of meeting extraordinary emergencies. Like other cameralists, he considered the income from domains the real foundation of public housekeeping, and taxes a subordinate

[1] He gives the following *résumé*: "With the King's household maintained, the troops and their officers paid, and just wages given to those who have earned them, it is right that the poor should be remembered. And if any funds remain, they should be employed in rebuilding towns, fortifying strongholds, building forts on the frontier, improving the roads, repairing bridges, equipping ships, constructing public edifices, and establishing colleges of honor, virtue, and learning."

[2] Finance became, in this way, a part of what was known as "cameral science," which included all branches of knowledge needed for the proper administration of the possessions of the prince. Sometimes "cameral science" was used in a narrower sense, as equivalent to financial science, and thus was contrasted with the cameralistic sciences in the broader sense.

[3] Staatswirthschaft, oder systematische Abhandlung aller oekonom. und Kameralwissenschaften (1755).

form of revenue. Yet this did not prevent him from studying the various kinds of taxes, in their economic and political bearings, more carefully than most other writers had done. Public expenditures he treats in some detail, assigning to military outlay at least one half of the total. In order to finance serious emergencies he favored, like nearly all his forbears, the accumulation of a state treasure; yet he considers also the other expedient, public debts.

Although Bodin's work was translated into English (1606), financial topics received less attention in England than in Germany during the greater part of the seventeenth century. Sir William Petty's Treatise of Taxes and Contributions (1662) was probably the first English work which professed to deal primarily [1] with public finance. In this, with numerous digressions, the author treats of public expenditures and revenues. The former he divides into: (1) outlay for "Defence by Land and Sea"; (2) outlay for the "Maintenance of the Governours, Chief and Subordinate"; (3) outlay for the support of religion; (4) outlay for education; (5) outlay for the relief of orphans, the impotent, and the destitute; and (6) outlay for various public works, such as highways and bridges. Petty then considers the various branches of revenue, holding that a tax upon the land of a kingdom is better than the reservation of "Crown Lands." He favored excise taxes, also, believing that they tended to distribute burdens in a fair manner, *viz.* in proportion to what every man "taketh to himself, and actually enjoyeth"; and discussed the advantages and disadvantages of other forms of taxation. After 1690 the growth of national expenditures and taxes, together with the rapid increase of the national debt, stimulated the discussion of such subjects as taxation and public debts; so that a large number of tracts and treatises, often of a fugitive character, made their appearance. Methods of dealing with the debt were warmly debated, and the best methods of raising the large revenues now required by the government formed another engrossing topic. Some writers advocated a general excise upon articles of consumption, and others

[1] Other works had dealt incidentally and briefly with financial topics. Thomas Mun's England's Treasure by Forraign Trade (written prior to 1641 and published 1664) devotes three short chapters to public revenues and treasures.

wished to confine such taxation to luxuries; some preferred a single tax upon land or a tax upon houses, while others argued for a general property tax or a combination of different kinds of taxes. Out of such discussions of particular topics a large body of financial literature had developed in England by the middle of the eighteenth century.[1] Yet little of the writing had been systematic, and nothing like a comprehensive treatise upon finance had come into existence.

In France, after the time of Bodin, comparatively little attention was given to the study of finance until disorders and abuses in the public housekeeping had become so grave as to call loudly for reform. Early in the eighteenth century Marshal Vauban, who in the course of his campaigns had observed the wretched condition of many parts of the country, proposed reforms in taxation, by which a tax upon all incomes, supplemented by various duties upon imports and articles of consumption, should replace existing taxes. In 1748 appeared Montesquieu's celebrated Ésprit des lois, which treats of both taxation and public debts, briefly, but in a manner which influenced not a little the subsequent course of thought. Montesquieu emphasized particularly the political relations of public finance, observing, for instance, that a free people will submit to heavier taxation than a despotic ruler can impose upon his subjects; and took a very unfavorable view of public debts. Ten years later Quesnay, the founder of the Physiocratic School, published his Tableau Œconomique, in which he developed the first consistent theory of the production and distribution of wealth, and correlated the theory of taxation with the fundamental doctrines of his new science. Holding that the net produce of the land is the only source from which the wealth of a society can be increased and the only fund from which taxes can be drawn, the Physiocrats argued that all other taxes should be abandoned and public revenue raised by a single tax upon the "*produit net*" of the soil.[2] Beyond urging that govern-

[1] Of this copious literature David Hume's essays on "Taxes" and "Public Credit" (1752) may be mentioned; also Sir James Steuart's Inquiry into the Principles of Political Economy (1767), which, besides considering the subject of public credit, devotes an entire book to taxes.

[2] Quesnay, in the Tableau Œconomique, showed that it followed from his theory of

ments should confine their activity to the narrowest possible limits, and, therefore, exercise economy in their expenditures, the Physiocrats contributed nothing further to the history of public finance.

A new era opened with the publication of Adam Smith's Wealth of Nations (1776). Drawing upon the work of his predecessors and the results of his own observations and ripe reflection, Smith skillfully developed a body of doctrine which in finance, as in other departments of economic study, served as the foundation of most subsequent inquiry. Believing that one of the two objects of political economy is "to supply the state or commonwealth with a revenue sufficient for the public services," he devoted the fifth book of the Wealth of Nations to the "Revenue of the Sovereign or Commonwealth," and treated, in order, public expenditures, public revenues, and public debts.[1] Translated into one language after another, the Wealth of Nations exercised a profound influence upon economic thought in the leading countries of Europe; while it came, before long, to dominate the thought of Great Britain, and was extensively read in the United States. With many topics treated in the following chapters it will be necessary for us to begin by considering the doctrines of Adam Smith.

3. The Nineteenth Century. — In Great Britain after the time of Smith the systematic study of public finance seemed to languish. Writers of economic treatises continued to discuss taxation and public debts; but showed a tendency to confine themselves to questions of more or less abstract theory, and often relegated the subjects to a decidedly subordinate position.[2]

the "produit net" that taxation "should be placed immediately upon the revenue of the landed proprietor, and not upon commodities where it would multiply the cost of collection and injure commerce."

[1] The three chapters, or main divisions, of the fifth book recall clearly the three divisions of Bodin's chapter, *viz.* "honest means of raising revenues," methods of employing them, and reserving treasure for times of need. Smith placed expenditure first, as Petty had done, instead of second, as Bodin had preferred to do.

[2] James Mill (1821) treated of taxation while considering the consumption of wealth. John Stuart Mill (1848) discussed somewhat briefly taxation and national debts. Ricardo, on the other hand, entitled his most important work, Principles of Political Economy and Taxation (1817), and made important contributions to the theory of shifting and incidence.

Yet not a few important pamphlets or treatises were written upon special topics of immediate practical interest;[1] and, in 1845, McCulloch published his Treatise on Taxation and the Funding System, which, as the title indicates, deals systematically with two out of the three divisions of public finance recognized in the Wealth of Nations. Not until 1892 did the first real treatise upon finance appear in Great Britain; and this work still holds exclusive possession of the field,[2] although there has been an increased output of literature dealing with special parts of the science, particularly with taxation.[3]

In France during the nineteenth century financial studies followed practically the same course as in Great Britain. General treatises upon economics relegated financial topics to a subordinate position,[4] while there was a considerable output of meritorious works upon financial history and administration or other special subjects.[5] In 1862 Joseph Garnier brought out an unsatisfactory treatise upon public finance,[6] and somewhat later Paul Leroy-Beaulieu produced a decidedly superior manual which still ranks with the leading works upon our science.[7] France, too, has given us a very useful Dictionnaire des finances, edited by Léon Say, who, as student, administrator, and publicist, was one of the prominent figures in French finance during the last quarter of the nineteenth century.

In Germany the study of finance had developed so far during the eighteenth century that the production of systematic treatises proceeded apace during the nineteenth. The first important development was the modification of many of the received cam-

[1] One of the most noteworthy was Robert Hamilton's Inquiry concerning the Management of the National Debt (1813).

[2] C. F. Bastable, Public Finance (third edition, 1903). R. H. Patterson's Science of Finance (1868) is not a treatise upon public finance.

[3] It should be observed that the fifth book of Professor Nicholson's extensive treatise, Principles of Political Economy (1893–1901), devotes not less than fourteen out of its twenty chapters to public expenditures, taxation, and public debts.

[4] J. B. Say (1803), for instance, treated expenditures, revenues, and public debts under the head of the consumption of wealth.

[5] Especially worthy of mention is René Stourm's Le budget (fourth edition, 1900).

[6] Traité des finances (fourth edition, 1883).

[7] Traité de la science des finances (eighth edition, 1912). Mention should be made, also, of the useful work by Jèze and Boucard, Éléments de la science des finances et de la législation financière française (second edition, 1901).

eralistic doctrines under the influence of the teachings of Adam Smith. This work was practically accomplished by 1832 when K. H. Rau published the first part of his Grundsätze der Finanzwissenschaft,[1] which for several decades remained the leading manual for university students and aspirants for administrative posts. After the middle of the century the influence of Smith began to decline, but not until his doctrines had left a permanent impress upon German financial science. Of the modern treatises the chief is Adolph Wagner's Finanzwissenschaft (1877–), which is still uncompleted, although four portly volumes have appeared. Of the shorter works, those by Roscher (fourth edition, 1894), Cohn (1889), Eheberg (seventh edition, 1903), and von Heckel (1907, 1911) should be mentioned;[2] while we should not overlook the third volume of Schönberg's Handbuch der politischen Oekonomie (fourth edition, 1896–98), which contains a valuable collection of monographs upon the various parts of public finance. Most of the German writers have studied with care existing financial institutions and their history, and public finance has received a noteworthy impetus from their labors.

While financial problems have demanded and received no little attention in the United States ever since the establishment of our national government, systematic study of public finance has been a comparatively recent development. In state papers or the writings of public men who have had to deal with questions of finance, a considerable body of literature has always existed,[3] but in wholly unsystematic form. Our earliest textbooks on economics accorded financial topics the same cursory treatment which they received at the hands of contemporary English or French writers. During the last forty years federal or state commissions appointed to consider urgent problems have published more or less elaborate reports upon taxation

[1] This, according to what has become the traditional German method, formed the third volume of Rau's Lehrbuch der politischen Oekonomie.

[2] The volumes by Roscher and Cohn are parts of larger treatises upon economics. Cohn's Finanzwissenschaft has been translated (Chicago, 1895). Eheberg's work is perhaps the most convenient for the student.

[3] Hamilton's Report on Public Credit (1790); Walcott's Report on Direct Taxes (1796); Gallatin's Sketch of the Finances of the United States (1796). For a much later period, may be mentioned John Sherman's Speeches and Reports on Finance and Taxation (1879).

and some other subjects, of which a few have been of high merit.[1] More recently there has been a gratifying increase of interest in finance,[2] as in other departments of economic investigation, which has given us a considerable number of special studies upon taxation,[3] public debts,[4] the financial history of our own country,[5] and various other subjects,[6] as well as three general treatises upon public finance.[7] Finally, the formation of the National Tax Association has given us a national organization which is actively interested in all branches of public finance and publishes annually a volume of Proceedings.[8]

[1] The New York Commission of 1871 and 1872, the Maryland Commission of 1886, and the Massachusetts Commission of 1897 are examples of the reports dealing with taxation. The federal revenue system was searchingly investigated after the Civil War by Mr. David A. Wells, who, as commissioner of revenue, issued several reports.

[2] Of this perhaps the first signs were the numerous articles upon financial topics in Lalor's Cyclopædia of Political Science (1883–84) and the translation of Cossa's Scienza delle finanze, under the misleading title, however, of Taxation, its Principles and Methods (1888).

[3] Ely, Taxation in American States and Cities (1888); Seligman, Essays in Taxation (eighth edition, 1910), The Shifting and Incidence of Taxation (third edition, 1909), Progressive Taxation (second edition, 1909); Howe, Taxation in the United States under the Internal Revenue System (1896); Wells, Theory and Practice of Taxation (1900).

[4] Adams, Public Debts (1887); Ross, Sinking Funds (1892); Scott, the Repudiation of State Debts (1893).

[5] Works upon special parts of the field are too numerous to mention here. Of general works there are two: Bolles, Financial History of the United States (1879–1886); and Dewey, Financial History of the United States (1902).

[6] Urdahl, The Fee System in the United States (1898); Kinley, The Independent Treasury of the United States (1893); Clow, Administration of City Finances in the United States (1901).

[7] Adams, The Science of Finance (1898); Daniels, Elements of Public Finance (1899); Plehn, Introduction to Public Finance (third edition, 1909).

[8] Proceedings of the National Tax Association (1908–), A. E. Holcomb, Secretary, 195 Broadway, New York.

CHAPTER II

GENERAL CONSIDERATIONS CONCERNING PUBLIC EXPENDITURES

4. The Views of Smith and Mill concerning the Functions of Government.—Adam Smith formulated his views in the following passage:[1]

According to the system of natural liberty, the sovereign has only three duties to attend to; three duties of great importance, indeed, but plain and intelligible to common understandings: I. the duty of protecting the society from the violence and invasion of other independent societies; II. the duty of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice; and III. the duty of erecting and maintaining certain public works and certain public institutions, which it can never be for the interest of any individual, or small number of individuals, to erect and maintain, because the profit could never repay the expense to any individual or small number of individuals, though it may frequently do much more than repay it to a great society.

The doctrine that, beyond providing for external defense, affording legal protection, and undertaking a few indispensable public works, the government should not interfere with the affairs of its citizens has often been called the doctrine of *laissez-faire*. In the middle of the nineteenth century, when its influence was perhaps greatest, the theory was formulated in moderate and effective form by John Stuart Mill. At the outset Mr. Mill remarks[2] that "there must be a specification of the functions which are either inseparable from the idea of a govern-

[1] Wealth of Nations, Bk. IV, ch. 9.

[2] Principles of Political Economy, Bk. V, ch. 1.

ment, or are exercised habitually and without objection by all governments; as distinguished from those respecting which it has been considered questionable whether governments should exercise them or not. The former may be termed the *necessary*, the latter the *optional*, functions of government.

The *necessary* functions of government recognized by Mill are substantially the same as those recognized by Adam Smith, although the later writer does not draw the line of demarcation quite so sharply as the earlier. In fact, Mill says:

In attempting to enumerate the necessary functions of government, we find them to be considerably more multifarious than most people are at first aware of, and not capable of being circumscribed by those very definite lines of demarcation, which, in the inconsiderateness of popular discussion, it is often attempted to draw round them. We sometimes, for example, hear it said that governments ought to confine themselves to affording protection against force and fraud; that, these two things apart, people should be free agents, able to take care of themselves; and that so long as a person practices no violence or deception, to the injury of others in person or property, legislatures and governments are in no way called on to concern themselves about him. But why should people be protected by their government, that is, by their own collective strength, against violence and fraud, and not against other evils, except that the expediency is more obvious?

* * * * * * *

There is a multitude of cases in which governments, with general approbation, assume powers and execute functions for which no reason can be assigned except the simple one, that they conduce to general convenience. We may take as an example the function (which is a monopoly too) of coining money. This is assumed for no more recondite purpose than that of saving to individuals the trouble, delay, and expense of weighing and assaying. No one, however, even of those most jealous of state interference, has objected to this as an improper exercise of the powers of government.

* * * * * * *

But enough has been said to show that the admitted functions of government embrace a much wider field than can easily be included within the ring-fence of any restrictive definition, and that it is hardly possible to find any ground of justification common to them all except the comprehensive one of general expediency, nor to limit the interference of government by any universal rule save the simple and vague one that it should never be admitted but when the case of expediency is strong.

In a subsequent chapter[1] Mill considers the optional functions of government, and presents his reasons for believing that in the civilized countries of modern times the scope of governmental activity should be limited as narrowly as possible. In the first place, he says, governmental interference with economic affairs generally involves compulsion, which is unpleasant in itself, and, by preventing men from acting according to their own judgment, tends "to starve the development of some portion of the bodily or mental faculties." Then, too, governmental action usually involves expense, which must be defrayed out of compulsory contributions levied upon the persons or property of citizens. Mill then continues:

A second general objection to government agency is that every increase of the functions devolving on the government is an increase of its power, both in the form of authority and, still more, in the indirect form of influence. The importance of this consideration, in respect to political freedom, has in general been quite sufficiently recognized, at least in England; but many, in latter times, have been prone to think that limitation of the powers of the government is only essential when the government itself is badly constituted; when it does not represent the people, but is the organ of a class, or coalition of classes; and that a government of sufficiently popular constitution might be trusted with any amount of power over the nation, since its power would be only that of the nation over itself. This might be true, if the nation, in such cases, did not practically mean a mere majority of the nation, and if minorities were only capable of oppressing, but not of being oppressed.

[1] Principles of Political Economy, Bk. V, ch. 11.

Experience, however, proves that the depositaries of power who are mere delegates of the people, that is, of a majority, are quite as ready (when they think they can count on popular support) as any organs of oligarchy to assume arbitrary power and encroach unduly on the liberty of private life. The public collectively is abundantly ready to impose not only its generally narrow views of its interests but its abstract opinions, and even its tastes, as laws binding upon individuals.

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A third general objection to government agency rests on the principle of the division of labor. Every additional function undertaken by the government is a fresh occupation imposed upon a body already overcharged with duties. A natural consequence is that most things are ill done ; much not done at all, because the government is not able to do it without delays which are fatal to its purpose ; that the more troublesome, and less showy, of the functions undertaken are postponed or neglected, and an excuse is always ready for the neglect ; while the heads of the administration have their minds so fully taken up with official details, in however perfunctory a manner superintended, that they have no time or thought to spare for the great interests of the state, and the preparation of enlarged measures of social improvement.

But these inconveniences, though real and serious, result much more from the bad organization of governments than from the extent and variety of the duties undertaken by them. Government is not a name for some one functionary, or definite number of functionaries : there may be almost any amount of division of labor within the administrative body itself. The evil in question is felt in great magnitude under some of the governments of the Continent, where six or eight men, living at the capital and known by the name of ministers, demand that the whole public business of the country shall pass, or be supposed to pass, under their individual eye. But the inconvenience would be reduced to a very manageable compass in a country in which there was a proper distribution of functions between the central and local officers of government, and in which the central body was divided into a sufficient number of departments.

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But though a better organization of governments would greatly diminish the force of the objection to the mere multiplication of their duties, it would still remain true that in all the more advanced communities the great majority of things are worse done by the intervention of government than the individuals most interested in the matter would do them, or cause them to be done, if left to themselves. The grounds of this truth are expressed with tolerable exactness in the popular dictum, that people understand their own business and their own interests better, and care for them more, than the government does, or can be expected to do. This maxim holds true throughout the greatest part of the business of life, and wherever it is true we ought to condemn every kind of government intervention that conflicts with it. The inferiority of government agency, for example, in any of the common operations of industry or commerce is proved by the fact, that it is hardly ever able to maintain itself in equal competition with individual agency, where the individuals possess the requisite degree of industrial enterprise and can command the necessary assemblage of means. All the facilities which a government enjoys of access to information; all the means which it possesses of remunerating, and therefore of commanding, the best available talent in the market—are not an equivalent for the one great disadvantage of an inferior interest in the result.

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I have reserved for the last place one of the strongest of the reasons against the extension of government agency. Even if the government could comprehend within itself, in each department, all the most eminent intellectual capacity and active talent of the nation, it would not be the less desirable that the conduct of a large portion of the affairs of society should be left in the hands of the persons immediately interested in them. The business of life is an essential part of the practical education of a people; without which, book and school instruction, though most necessary and salutary, does not suffice to qualify them for conduct, and for the adaptation of means to ends. Instruction is only one of the desiderata of mental improvement; another, almost as indispensable, is a vigorous exercise of the active energies: labor, contrivance, judgment, self-control; and the natural stimulus to these is the difficulties of life. This

doctrine is not to be confounded with the complacent optimism, which represents the evils of life as desirable things, because they call forth qualities adapted to combat with evils. It is only because the difficulties exist, that the qualities which combat with them are of any value. As practical beings it is our business to free human life from as many as possible of its difficulties, and not to keep up a stock of them as hunters preserve game for the exercise of pursuing it. But since the need of active talent and practical judgment in the affairs of life can only be diminished, and not, even on the most favorable supposition, done away with, it is important that those endowments should be cultivated not merely in a select few, but in all, and that the cultivation should be more varied and complete than most persons are able to find in the narrow sphere of their merely individual interests. A people among whom there is no habit of spontaneous action for a collective interest—who look habitually to their government to command or prompt them in all matters of joint concern—who expect to have everything done for them, except what can be made an affair of mere habit and routine—have their faculties only half developed; their education is defective in one of its most important branches.

Not only is the cultivation of the active faculties by exercise diffused through the whole community, in itself one of the most valuable of national possessions: it is rendered, not less, but more, necessary, when a high degree of that indispensable culture is systematically kept up in the chiefs and functionaries of the state. There cannot be a combination of circumstances more dangerous to human welfare than that in which intelligence and talent are maintained at a high standard within a governing corporation, but starved and discouraged outside the pale. Such a system, more completely than any other, embodies the idea of despotism, by arming with intellectual superiority as an additional weapon those who have already the legal power. It approaches as nearly as the organic difference between human beings and other animals admits to the government of sheep by their shepherd, without anything like so strong an interest as the shepherd has in the thriving condition of the flock. The only security against political slavery is the check maintained over governors by the diffusion of intelligence, activity, and public spirit among the governed. Experience proves the ex-

treme difficulty of permanently keeping up a sufficiently high standard of those qualities : a difficulty which increases, as the advance of civilization and security removes one after another of the hardships, embarrassments, and dangers against which individuals had formerly no resource but in their own strength, skill, and courage. It is therefore of supreme importance that all classes of the community, down to the lowest, should have much to do for themselves ; that as great a demand should be made upon their intelligence and virtue as it is in any respect equal to ; that the government should not only leave as far as possible to their own faculties the conduct of whatever concerns themselves alone, but should suffer them, or rather encourage them, to manage as many as possible of their joint concerns by voluntary coöperation : since this discussion and management of collective interests is the great school of that public spirit, and the great source of that intelligence of public affairs, which are always regarded as the distinctive character of the public of free countries.

Mill conceded, however, that, while the presumption should always be in favor of liberty, there were numerous cases in which governmental interference could be justified. These, briefly, are cases in which the persons concerned do not understand their own interest, as education ; or are exercising power over other persons, such as infants, or idiots, who "are everywhere regarded as proper objects of the care of the state" ; or can manage their affairs only through agents, as the shareholders of a joint-stock company, which needs proper regulation ; or cannot give practical effect to their desires unless a common rule is imposed upon all concerned, as laborers who wish to shorten their hours of toil ; or who are aided by the government in the general interest of society, as paupers ; or are conducting literary or scientific undertakings which do not appeal to the interest of enough private individuals to secure the needful support. Mill then concludes :

The preceding heads comprise, to the best of my judgment, the whole of the exceptions to the practical maxim, that the

business of society can be best performed by private and voluntary agency. It is, however, necessary to add, that the intervention of government cannot always practically stop short at the limit which defines the cases intrinsically suitable for it. In the particular circumstances of a given age or nation there is scarcely anything, really important to the general interest, which it may not be desirable, or even necessary, that the government should take upon itself, not because private individuals cannot effectually perform it, but because they will not. At some times and places there will be no roads, docks, harbors, canals, works of irrigation, hospitals, schools, colleges, printing presses, unless the government establishes them ; the public being either too poor to command the necessary resources, or too little advanced in intelligence to appreciate the ends, or not sufficiently practiced in joint action to be capable of the means. This is true, more or less, of all countries inured to despotism, and particularly of those in which there is a very wide distance in civilization between the people and the government : as in those which have been conquered and are retained in subjection by a more energetic and more cultivated people. In many parts of the world the people can do nothing for themselves which requires large means and combined action ; all such things are left undone unless done by the state. In these cases the mode in which the government can most surely demonstrate the sincerity with which it intends the greatest good of its subjects is by doing the things which are made incumbent on it by the helplessness of the public, in such a manner as shall tend not to increase and perpetuate but to correct that helplessness. A good government will give all its aid in such a shape as to encourage and nurture any rudiments it may find of a spirit of individual exertion.

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I have not thought it necessary here to insist on that part of the functions of government which all admit to be indispensable, the function of prohibiting and punishing such conduct on the part of individuals in the exercise of their freedom as is clearly injurious to other persons, whether the case be one of force, fraud, or negligence. Even in the best state which society has yet reached, it is lamentable to think how great a proportion of all the efforts and talents in the world are employed in

merely neutralizing one another. It is the proper end of government to reduce this wretched waste to the smallest possible amount, by taking such measures as shall cause the energies now spent by mankind in injuring one another, or in protecting themselves against injury, to be turned to the legitimate employment of the human faculties, that of compelling the powers of nature to be more and more subservient to physical and moral good.

5. Public and Private Business Compared.—The financial activity of a government, like that of an individual, is concerned with the expenditure of money. In other respects, however, such as the ends pursued and the means employed, public and private business offer many points of contrast which are well presented by Eheberg :[1]

1. The ends sought by the state reach far beyond the sphere of individual activity. The economic activity of an individual is limited to the effort to procure, by means of mental or physical labor, the material goods which are needed to support life and satisfy his higher wants. The purpose of the state, however, is, first and foremost, to provide immaterial goods which defy measurement in money and yet are the basis of all spiritual or material progress, such as legal security, the maintenance of peace and national independence, and the development of the economic life of the people.

2. In private business the ruling principle is special service and special payment: every service rendered receives its appropriate payment which is determined by mutual agreement between buyer and seller. But the services rendered by the state, in so far as they are of a general and immaterial kind, cannot be individualized and separately valued ; so that special payment for special service is impossible. The payments which citizens make for services received from the state are not determined by contract, but by the authority of the state and according to norms which it establishes. Except in so far as it draws revenue from productive property which it owns, the state

[1] Finanzwissenschaft, Einleitung, § 3.

secures its income by compulsion; it possesses, that is, the right to demand the services of its citizens without payment, and to levy taxes upon the incomes or property of its subjects or other persons who happen to be within its jurisdiction.[1] . . .

3. The facts, that many of the services of the state are of an immaterial character and minister to intellectual or moral needs, and that many of them cannot be valued in terms of money, make it difficult or wholly impossible to compare the cost of production with the value of the product, as must be done in every well-ordered private business. While the payments which the citizens make in the form of taxes or duties can be readily calculated, the services rendered by the state cannot be reduced to figures. In this latter case an estimate can be formed only by a careful comparison of outlay with the results of expenditure. Often, too, it is necessary to observe the results achieved over a long period of time, since only then can it be determined whether the domestic or foreign policies to which the state devoted its revenues justified the sacrifices and met the expectations of the people — whether, that is, they contributed to spiritual and material progress. Such a comparison of the burden and the profit can best be made by an intelligent and unbiased representative assembly. . . .

4. A further peculiarity of public business is the unlimited duration of the elements with which it deals. Many expenditures for public purposes are made for the future as much as for the present.[2] For this reason it is just that future generations should bear part of the burden of important public works or the defense of the state against great dangers — a thing which is accomplished through the agency of public debts.

5. Finally, public business differs from private in that it is limited in respect to its outlay and its income. The outlay of

[1] Eheberg here alludes again to the fact that the state may have landed domains or public industries from which some revenue is raised. But he says that history shows that taxation has steadily increased in importance, at the expense of these revenues from domains and industries. — ED.

[2] For this reason, as Wagner observes, "the state can undertake enterprises which no private business could attempt on account of the limited duration of its life." Finanzwissenschaft, I, 14–15. Even more important is the consideration that in private business a quick return from the investment is generally desired, whereas the state can afford frequently to sacrifice present to future returns. — ED.

the state is limited by the range of the duties which are assigned it at any time; and the amount of its income depends upon the nature and extent of its outlay. While in private business the acquisition of wealth is not limited in this manner, the income of the state finds its measure in its financial needs. And while in private business expenses must be regulated by the income, the income of the state is determined, rather, by the amount of expenditures which are requisite. It is true that, in determining upon public expenditures, the possible revenue available should not be left out of consideration;[1] but within these limits the state regulates its income according to its expense.

6. The Economic Effects of Public Expenditure: Early Opinions. — The economic effects of public expenditure are far reaching. If the outlay is wisely directed, the economic life of the people may be greatly benefited,[2] while unwise expenditure tends to impoverish a country. But, besides these obvious direct effects, public expenditure produces certain important indirect results. No inconsiderable part of the income of society is taken by governments in the form of taxes,[3] and the expenditure of such enormous sums affects profoundly the direction which industry takes, and, sometimes, the rate of wages which must be paid in private occupations.[4]

[1] This qualification is strongly emphasized by Roscher, who quotes Frederick the Great as saying that a state will bankrupt itself if it adopts the policy of saying, "I need so much; raise the money," rather than, "I have so much money, and can therefore spend so much." Finanzwissenschaft, § 109. — Ed.

[2] This benefit, of course, is the justification of the expenditure. The first constitution of Pennsylvania (1776) declared that "the purpose for which any tax is to be raised ought to appear clearly to the legislature to be of more service to the community than the money would be, if not collected." This, perhaps, was suggested by the remark of Sir James Stewart: "If the money raised be more beneficially employed by the state, than it would have been by those who contributed it, then I say the public has gained. . . ." Inquiry into Political Economy (1767), Bk. V, ch. 7.

[3] Leroy-Beaulieu estimated some years ago that the taxes levied in various countries of Europe represented from 6 to 15 per cent of the income of the people. Traité, I, 133.

[4] Capital will flow naturally into those industries the products of which are in

But there is an old and very common fallacy, that governmental outlay is, in itself, a good thing, since it "puts money into circulation" and increases the demand for labor. Jean Bodin, for instance, in 1576, enlarged upon the advantages which come from the expenditure of the royal revenues upon public works: "For beyond the fact that such works are necessary, there result besides great benefits to the commonwealth; inasmuch as by this means the arts and artificers are supported, the poor are relieved, and dislike of taxes and duties is removed, when the prince restores to the public at large and to individual subjects the money he takes from them."

Not infrequently this fallacy is found in company with the mercantilist notion that no sort of expense is seriously detrimental provided the money be spent for goods of domestic production, and not for imported commodities.[1] Thus Sir William Petty argued that expenditures for public works should be increased because, among other things, indigent people can be employed thereon; and said: "Now as to the work of these supernumeraries, let it be without expence of Foreign Commodities, and then 'tis no matter if it be employed to build a useless Pyramid upon Salisbury Plain, bring the stones at Stonehenge to Tower-Hill, or the like. . . ." At the present day such errors recur persistently in popular discussions, usually in some such form as the following paragraph which appeared in a well-known newspaper in 1902: "What does the heedless throng know about the Philippine question, anyway; and what does it care? To be sure the army is costing the people millions

great demand for public purposes. So, too, if governments offer more than the market rate of wages for labor, the wages in private employments may be affected.

[1] Sir Thomas Mun, for instance, wrote concerning luxurious expenditure as follows: "Again the pomp of Buildings, Apparel, and the like, in the Nobility, Gentry, and other able persons, cannot impoverish the Kingdom; if it be done with curious and costly works upon our materials, and by our own people, it will maintain the poor with the purse of the rich. . . ."

annually, but it is furnishing employment for thousands of men who might otherwise be idle, and the army supplies are purchased in this country, while the money for munitions and ordnance is disbursed in America to Americans. The war gives employment to idle men and distributes money to the contractors who are manufacturers."

7. The Views of Smith and Say. — Although at least one of Petty's contemporaries perceived that such an idea was absurd,[1] it remained for Adam Smith to destroy the foundation of this as of other mercantilist theories. Smith showed[2] that all non-productive expenditure diminishes, so far forth, "the funds destined for the employment of productive labor," even though "the expence of the prodigal should be altogether in home-made, and no part of it in foreign commodities," the exportation or non-exportation of gold and silver making no material difference in the situation. Accordingly, while he considered it unnecessary to repeat the general principle, he argued that particular forms of public expenditure in no way increased the industry of the country or the employment given to labor. He says:[3] "By the reduction of the army and navy at the end of the late war, more than a hundred thousand soldiers and seamen, a number equal to what is employed in the greatest manufactures, were all at once thrown out of their ordinary employment; but, though they no doubt suffered some inconveniency, they were not thereby deprived of all employment and subsistence. The greater part of the seamen, it is probable, gradually betook themselves to the merchant-service as they could find occasion, and in the meantime both they and the soldiers were absorbed in the great mass of the people, and employed in a great variety

[1] In 1699, Charles Davenant remarked: "Some persons have a strange notion, that large payments to the state are not hurtful to the public; that taxes make money circulate; that it imports not what A pays when B is to receive it."

[2] Wealth of Nations, Bk. II, ch. 3; Cannan's edition, II, 320–322.

[3] Bk. IV, ch. 2; Cannan's edition, I. 434.

of occupations."[1] And similarly he contended[2] that the payment of interest upon the public debt was a burden upon industry even though the securities were all owned at home and no money left the country as a result of the operation.

A generation later Jean Baptiste Say, a disciple of Smith, developed the argument in greater detail:[3]

If I have made myself understood in the commencement of this third book, my readers will have no difficulty in comprehending, that public consumption or that which takes place for the general utility of the whole community, is precisely analogous to that consumption, which goes to satisfy the wants of individuals or families. In either case, there is a destruction of values, and a loss of wealth; although, perhaps, not a shilling of specie goes out of the country.

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The government exacts from a taxpayer the payment of a given tax in the shape of money. To meet this demand, the taxpayer exchanges part of the products at his disposal for coin, which he pays to the taxgatherer: a second set of government agents is busied in buying with that coin cloth and other necessaries for the soldiery. Up to this point, there is no value lost or consumed; there has only been a gratuitous transfer of value, and a subsequent act of barter; but the value contributed by the subject still exists in the shape of stores and supplies in the military depot. In the end, however, this value is consumed; and then the portion of wealth which passes from the hands of the taxpayer into those of the taxgatherer, is destroyed and annihilated.

Yet it is not the sum of money that is destroyed: that has

[1] With England's experience after the Seven Years' War it is interesting to compare that of the United States after the Civil War. Mr. J. F. Rhodes says: "It is well worth repeating that in the six months from May to November, 1865, 800,000 men had changed from soldiers to citizens; and this change in condition was made as if it were the most natural transformation in the world. These soldiers were merged into the peaceful life of their communities without interruption to industry, without disturbance of social and moral order." History of the United States, V, 185–186.

[2] Bk. V, ch. 3; Cannan's edition, II, 412.

[3] Traité d'économie politique, Bk. III, ch. 6.

only passed from one hand to another, either without any return, as when it passed from the taxpayer to the taxgatherer; or in exchange for an equivalent, as when it passed from the government agent to the contractor for clothing and supplies. The value of the money survives the whole operation, and goes through three, four, or a dozen hands, without any sensible alteration; it is the value of the clothing and necessaries that disappears, with precisely the same effect as if the taxpayer had, with the same money, purchased clothing and necessaries for his own private consumption. The sole difference is, that the individual in the one case, and the state in the other, enjoys the satisfaction resulting from that consumption.

The same reasoning may be easily applied to all other kinds of public consumption. When the money of a taxpayer goes to pay the salary of a public officer, that officer sells his time, his talents, and his exertions, to the public, all of which are consumed for public purposes. On the other hand, that officer consumes, instead of the taxpayer, the value he receives in lieu of his services; in the same manner as any clerk or person in the private employ of the taxpayer would do.

There has been long a prevalent notion that the values, paid by the community for the public service, return to it again in some shape or other; in the vulgar phrase, that what government and its agents receive is refunded again by their expenditure. This is a gross fallacy; but one that has been productive of infinite mischief, inasmuch as it has been the pretext for a great deal of shameless waste and dilapidation. The value paid to government by the taxpayer is given without equivalent or return: it is expended by the. government in the purchase of personal service, of objects of consumption; in one word, of products of equivalent value, which are actually transferred. Purchase or exchange is a very different thing from restitution.

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If, then, public and private expenditure affect social wealth in the same manner, the principles of economy, by which they should be regulated, must be the same in both cases. There are not two kinds of economy, any more than two kinds of honesty or morality. If a government consume in such a way as to

give birth to a product larger than that consumed, a successful effort of productive industry will be made. If no product result from the act of consumption, there is a loss of value, whether to the state or to the individual; yet, probably, that loss of value may have been productive of all the good anticipated. Military stores and supplies, and the time and labor of civil and military functionaries engaged in the effectual defense of the state, are well bestowed, though consumed and annihilated; it is the same with them as with the commodities and personal service that have been consumed in a private establishment. The sole benefit resulting in the latter case is the satisfaction of a want; if the want had no existence, the expense or consumption is a positive mischief, incurred without an object. So likewise with the public consumption; consumption for the mere purpose of consumption, systematic profusion, the creation of an office for the sole purpose of giving a salary, the destruction of an article for the mere pleasure of paying for it, are acts of extravagance either in a government or an individual, in a small state or a large one, a republic or a monarchy. Nay, there is more criminality in public than in private extravagance and profusion; inasmuch as the individual squanders only what belongs to him; but the government has nothing of its own to squander, being, in fact, a mere trustee of the public treasure.

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Madame de Maintenon mentions, in a letter to the Cardinal de Noailles, that, when she one day urged Louis XIV to be more liberal in charitable donations, he replied, that royalty dispenses charity by its profuse expenditure; a truly alarming dogma, and one that shows the ruin of France to have been reduced to principle. False principles are more fatal than even intentional misconduct, because they are followed up with erroneous notions of self-interest, and are long persevered in without remorse or reserve. If Louis XIV had believed his extravagant ostentation to have been a mere gratification of his personal vanity, and his conquests the satisfaction of personal ambition alone, his good sense and proper feeling would probably, in a short time, have made it a matter of conscience to desist, or at any rate, he would have stopped short for his own sake; but he was firmly persuaded that his prodigality was for the public

good as well as his own; so that nothing could stop him but misfortune and humiliation.[1]

So little were the true principles of political economy understood, even by men of the greatest science, so late as the eighteenth century, that Frederick II of Prussia, with all his anxiety in search of truth, his sagacity, and his merit, writes thus to D'Alembert, in justification of his wars: "My numerous armies promote the circulation of money, and disburse impartially among the provinces the taxes paid by the people to the state." Again I repeat, this is not the fact; the taxes paid to the government by the subject are not refunded by its expenditure. Whether paid in money or in kind, they are converted into provisions and supplies, and in that shape consumed and destroyed by persons that can never replace the value, because they produce no value whatever. It was well for Prussia that Frederick II did not square his conduct to his principles. The good he did to his people, by the economy of his internal administration, more than compensated the mischief of his wars.

8. Dietzel's Theory of Public Expenditures. — In 1855 Karl Dietzel published a book in which he sought to controvert the views of Smith and Say concerning the effect of public expendi-

[1] "When Voltaire tells us, speaking of the superb edifices of Louis XIV., that they were by no means burdensome to the nation, but served to circulate money in the community, he gives a decisive proof of the utter ignorance of the most celebrated French writers of his day upon these matters. He looked no further than the money employed on the occasion; and, when the view is limited to that alone, the extreme of prodigality exhibits no appearance of loss; for money is, in fact, an item, neither of revenue, nor of annual consumption. But a little closer attention will convince us of the fallacy of this position, which would lead us to the absurd inference, that no consumption whatever has occurred within the year, whenever the amount of specie at the end of it is found to be nowise diminished. The vigilance of the historian should have traced the 900 millions of francs expended on the chateau of Versailles alone, from the original production by the laborious efforts of the productive classes of the nation, to the first exchange into money, wherewith to pay the taxes, through the second exchange into building materials, painting, gilding, &c. to the ultimate consumption in that shape, for the personal gratification of the vanity of the monarch. The money acted as a mere means of facilitating the transfers of value in the course of the transaction; and the winding up of the account will show a destruction of value to the amount of 900 millions of francs, balanced by the production of a palace, in need of constant repair, and of the splendid promenade of the gardens."

tures. His theories have exercised no small influence upon later German writers. Dietzel said, in part:[1]

Even if we should confine our attention to the production and consumption of material goods, as well as personal services, and were willing to exclude altogether immaterial goods, it would still be easy to show that the consumption of goods by a government is a thoroughly productive form of consumption. Besides other favorable conditions, productive industry needs, for its undisturbed and successful prosecution, protection against external forces which would otherwise disturb, delay, deteriorate, or annihilate the process of production. These disturbing factors may be either natural or human forces. The protection of industry against such disturbances is, therefore, a necessary condition of production; and the expenditures made for such a purpose must be considered productive.

With institutions designed to protect industry against natural forces this is beyond question, and is denied by no one. Factories, shops, and storehouses are, therefore, generally considered productive investments; for the product could not be obtained or its value would be reduced if industry were not protected against the possible destructive effects of rain, wind, or sun.

But it has not generally been perceived that the same is true of institutions designed to afford protection against human agencies. Human force, to be sure, is usually directed toward seizing upon the products of industry; but it often has the result of merely decreasing the value of the products, and decreases the labor force through drawing away the workmen to protect the land against attack. It often has the more lasting result of reducing labor power on account of injuries received in service, or of destroying it altogether.

Everything which is threatened with destruction, but finally saved, is virtually newly produced; in such a case we possess a thing which, without the protective institutions, we should not possess. These protective institutions, therefore, and the expenditure by which they are maintained, must be considered productive. This is true of protection of the products of labor and of the laborers themselves. Every expenditure by which a productive laborer is maintained is productive.

[1] Das System der Staatsanleihen, 11–15.

In small affairs we recognize this productivity of protective institutions without trouble, since we assign a shepherd to every herd and do not consider such expenditure unproductive. In large affairs, however, we do not recognize this, but deny to expenditures for public order and national defense the acknowledgment of their productivity.

The principal institution for the protection of society against the evil effects of violence by human agencies is the state. It protects the peaceful labor of citizens, and the products of such labor, against disturbance or destruction by domestic or foreign enemies. As little as the herd can dispense with the shepherd can society exist without government and its protective action.

Expenditure to procure domestic tranquillity and to defend persons and property against attack is, to be sure, less harshly judged than military outlay; its usefulness and the necessity of such public action is generally recognized. But should policemen be considered economically productive and the army unproductive? . . .

The unproductivity of expenditures for war is used as the chief argument against public borrowing because up to this time loans have been utilized for the most part to meet the great expenses of war. This view rests upon the assumption that the wars could have been avoided, which is a delusion. From the economic standpoint war, like any destructive outbreak of natural forces, seems to be the result of circumstances and forces which are actually operating in society and must be accepted as a given fact. For our economic life, therefore, the only possible course is to seek to make this power, like the forces of nature, useful or harmless, as the case may permit. When undertaken for the purpose of defense, war makes property secure and insures the orderly ongoing of productive undertakings; and all the wealth which, without its intervention, would have been destroyed or not produced, must be considered as produced with the coöperation of war. When it is a war of offense, it serves to obtain advantageous conditions for economic development or it averts future injuries to it. In both cases its purpose is to maintain or advance the national wealth. In the first case it secures valuable territory or favorably situated localities, or, as a commercial war, opens up avenues of

trade in regions previously closed. In the second it undertakes to maintain the balance of power, and to prevent the growth of other states which might later prove dangerous to the economic development of one's own land.

War is, therefore, under existing conditions, an event that inevitably occurs from time to time, and we should not consider it an extraordinary occurrence that wrongfully burdens industry and destroys its products. The outlay for war is one of the general costs of producing society. To diminish these costs and to provide for meeting such outlay with the least possible disadvantage to society, must be the leading economic principle in respect to war. It is realized by means of public loans.

If the state by means of borrowed capital undertakes great outlays for other purposes which immediately subserve the production of material wealth, this form of public consumption cannot be considered unproductive. This is true when it uses the money for constructing means of communication, roads, canals, railroads, and the like; and here the loans are not condemned on the ground that they encourage unproductive consumption. But could not the loans have been avoided, even in this case, if the state had limited or foregone other expenditures which are considered unproductive, as, for instance, outlay for public education and worship? These expenditures, however, are productive even so far as the production of material wealth is concerned. . . . Education improves the power of the workman to labor, and religion tends to uplift the people morally, thereby contributing to the safety of productive industry.

Elsewhere Dietzel says [1] that the state is a part of the "immaterial" capital [2] of society, and the most important of all the forms of immaterial capital. The state, he says, is "a relation which the whole body of the people has created by the expenditure of economic goods or labor, in order to contribute to the production of other goods," these being the "higher

[1] System der Staatsanleihen, 71, 99.

[2] "Immaterial" capital he defines as "all those relations and circumstances which exert a favorable influence upon economic society and increase its productivity, and which are created by the expenditure of economic goods."

development of society," and, in general, "the higher forms of goods." Dietzel then proceeds to argue:

This immaterial capital (the state) needs to be maintained intact, just like any other capital; and, as society progresses, must be continually increased if the equilibrium between the different parts of the whole capital of society is to be undisturbed. Every economic period must, therefore, make some expenditure for this purpose; expenditure which, according to the varying conditions of the different periods, may be of various amounts. While, then, we enjoy without expense so much of the life of the state as is an inheritance from the past, the outlay which our own generation makes for this purpose must be viewed as an investment of disposable private wealth in fixed capital which belongs to the whole community.

CHAPTER III

THE INCREASE OF PUBLIC EXPENDITURES IN MODERN TIMES

9. The Growth of Expenditures: Wagner's so-called Law. — That there has been a marked increase of public expenditures in modern times is an undoubted fact, but interpretations of this phenomenon differ widely. Professor Adolph Wagner, after examining the available data, laid down the following "law of the increase of state activities": [1]

Comprehensive comparisons of different countries and different times show that, among progressive peoples, with which alone we are concerned, an increase regularly takes place in the activity of both the central and the local governments. This increase is both extensive and intensive: the central and local governments constantly undertake new functions, while they perform both old and new functions more efficiently and completely. In this way the economic needs of the people, to an increasing extent and in a more satisfactory fashion, are satisfied by the central and local governments. The clear proof of this is found in the statistics which show the increased needs of central governments and local political units.

10. A General Survey and Interpretation of the Facts: by Professor F. S. Nitti. — The increase of public expenditures has been so striking as to attract the attention of many writers,[2]

[1] Grundlegung der politischen Oekonomie, Bk. VI, ch. 3 (third edition, 1893).

[2] Besides Wagner and Nitti, the subject has been treated by Leroy-Beaulieu, Traité, Part II, Bk. I, ch. 6; Bastable, Public Finance, Bk. I, ch. 8; Adams, Science of Finance, Bk. I, ch. 4; Eheberg, Finanzwissenschaft, § 23; Ely, Evolution of Industrial Society, 315–330.

but no one has discussed it more instructively than Professor Nitti,[1] of the University of Naples:

As a matter of historical fact it cannot be disputed that the budgets of all countries show a continuous increase. France has been longer under a unified government than other European countries, and it is easier to follow changes in the French budget than in those of other nations. Now the French budget has steadily grown; the ordinary public revenue, stated in millions of francs, has been as follows:

Year	Revenue	Year	Revenue
1243	3.7	1607	90.8
1300	5.5	1648	184.0
1364	8.1	1683	226.0
1422	13.6	1715	266.0
1491	44.8	1756	253.0
1515	72.8	1789	475.0
1560	84.0		

We shall learn later on how far this increase is real, and how far it is merely nominal; for the present we are concerned with the fact that the figures show a noteworthy increase which becomes still more serious after 1789. If we continue our computation based upon the official documents, we shall perceive that the most extraordinary increase occurred in the nineteenth century:

(In millions of francs)

Year	Expenditure	Year	Expenditure
1798	750	1875	2,209
1810	1,007	1880	2,760
1830	1,095	1892	3,343
1850	1,473	1896	3,400
1860	2,084	1901[2]	3,554

* * * * * * *

England, by its geographical position, historical conditions, and the character of its inhabitants, has had forms of government very different from those found in France, together with a greater degree of local self-government. But in Great Britain the increase of both central and local expenditures has been as

[1] F. S. Nitti, Principi di scienza delle finanze, 64–100 (1903). Translated with permission of the author.

[2] Without Algerian expenses.

rapid as in France. A statement of the expense of the national government[1] will reveal clearly this increase:

(In millions of pounds)

Year	Amount	Year	Amount
1691	3	1875	74
1747	11	1882	85
1797	58	1892	89
1809	78	1898	102
1814 (war)	112	1900	118
1866	65	1902	142

The years following 1898 are years of war and not a fair basis for comparison; but the budget estimates for 1903 are eloquent, for although they show a great decrease of war expenses, they reveal a striking increase of expenditures that will prove permanent.

* * * * * * *

And in England this tendency is not confined to the national government. The expenses of the local governments have grown no less rapidly, indicating vigorous local activity. From 1868 to 1898 the local expenses increased even more rapidly than those of the national government:

(In millions of pounds)

Year	Amount	Year	Amount
1868	36.5	1890	69.3
1874	45.5	1896	91.6
1880	62.9	1899	111.7

Thus that country of all Europe which shows the greatest development of local government, England, and that one which shows the greatest centralization of power, France, do not differ materially in respect of the extraordinary increase of public expenditures. And similar results appear in other countries with various political or economic conditions.

But England, it may be said, has for more than a century waged wars in all parts of the world — has fought Napoleon, and contended for colonial empire in America, Asia, and Africa. France, too, has had great victories and great dis-

[1] These figures are not wholly comparable. The expenses of Ireland are sometimes excluded, and sometimes included.

asters, and has waged constant warfare. Perhaps, then, the situation is different with the countries that have followed a more peaceful policy — those which, on account of their small size or geographical situation, have less anxiety for their defense and less inclination for offensive war. Belgium, Switzerland, and Sweden, small in population, but centers of culture and civilization, and long exempt from war, may perhaps show conditions that differ from those in England and France.

In this view of the case, Belgium ought to be a happy exception; but her expenses have increased, none the less, even faster than those of France and England:[1]

(In millions of francs)

Year	Amount	Year	Amount
1835	87.1	1881	402.3
1841	114.9	1891	402.1
1851	118.6	1895	410.3
1861	163.4	1899	570.4
1871	222.5		

Switzerland, which has had no wars, which by reason of its small size can be a neutral state, but which is a remarkable center of activity and trade and a country with a democratic government, displays the same phenomenon of increasing public expenditures. From 1850 to 1896 the outlay of the Swiss Confederation increased as follows:

(In millions of francs)

Year	Amount	Year	Amount
1850	6.7	1880	41.0
1860	21.9	1890	66.6
1870	30.9	1896	79.5
1873	23.6	1899	98.0
1876	43.4	1900	102.7

And the expenses of the Swiss cantons have increased even more than those of the Confederation. From 1886 to 1896,

[1] It is necessary to remember, however, that in Belgium the railroads are operated by the state. Thus the department of public works in 1835 spent 4,200,000 francs. In 1899 the department of railroads, post, and telegraph (its new name dating to 1884) spent 147,800,000 francs. Nevertheless, even with the railroad expenses deducted, the growth of the Belgian budget has been enormous.

according to official documents, the expenses of the canton of Vaud have increased 33 per cent; those of Geneva, by 40 per cent; those of Basel, by 57 per cent; and those of Zurich, by 91 per cent. (Professor Nitti then presents figures for Holland and Sweden, both of them peaceful states, disclosing a marked increase of expenditures during the last fifty or sixty years.)

We can demonstrate, therefore, that the extraordinary growth of public outlay is not characteristic of the great states alone. It appears, indeed, to have no connection with the various political causes to which it has been attributed up to the present moment.

In greater or less degree the same increase has occurred in all the countries of Europe and America. This is a general phenomenon, especially since the beginning of the nineteenth century.

Germany, constituted an empire only in 1871, took over into the imperial budget only the expenditures for foreign affairs, posts and telegraphs, and the administration of the army and navy. Other branches of expenditure were left to the several states. Nevertheless the budget of the Empire has witnessed the following increase of its expense account:[1]

(In millions of marks)

Year	Amount	Year	Amount
1874	672.8	1894	1,269.0
1881	550.0	1897	1,255.0
1886	637.6	1900	1,960.5
1889	1,020.0	1901	2,197.3

The increase is enough to make one dizzy, the more so when we think of the enormous increase of the budgets of Prussia, Bavaria, Saxony, and all the other states that compose the Empire.

It has been said that democracy has been the principal cause of the costliness of government; but it appears that this statement lacks universal validity. Despotic or oligarchical governments do not appear to be less inclined to spend money, under

[1] A part of this increase, perhaps some 500,000,000 marks, is merely nominal, and is due to the growth of what may be termed bookkeeping transactions between the imperial government and the various German states. — Ed.

modern conditions, than democratic governments. According to official data, the ordinary expenditures of Russia have increased as follows :

(In millions of roubles)

Year	Amount	Year	Amount
1803	109.0	1860	438.0
1840	187.0	1880	793.0

But since 1880, according to official figures, the increase of ordinary outlay has been still more rapid and bewildering:

(In millions of roubles)

Year	Amount	Year	Amount
1881	840.2	1895	1,520.8
1890	1,056.5	1900	1,889.2

The increase of expenditures has been extraordinary, therefore, in Russia; they have increased, at least in appearance, to nineteen times the figures for 1803. Consequently we cannot say that under absolute government there is a tendency to check or to decrease expenditures, as has often been remarked; but it must be admitted that precisely the opposite is true. (Nitti then gives statistics for the United States, concerning which some data will be presented later, and for Japan.)

And we cannot say that this tendency is confined to national governments: local governing bodies of all classes have witnessed an increase of their expenditures as rapid as that of the national expenditures.

In Belgium provincial expenses rose from 5,773,680 francs in 1840 to 16,593,000 in 1899. Those of the Belgian communes advanced from 90,000,000 in 1865 to 179,000,000 in 1892.

We have already seen that in England local expenses increased from £26,000,000 in 1868 to £91,000,000 in 1896. If we take the budget of any large city, we shall discover the same fact. The City of Paris, which is like a small state, since it has more inhabitants than Denmark, Greece, or Norway, spends more than Portugal and Greece combined. Since 1813 its expenses have risen as follows:

(In millions of francs)

Year	Amount	Year	Amount
1813	23	1887	257
1869	168	1896	397

But Paris is the capital of the richest state of continental Europe. . . . Yet cities far inferior to it, far more modest centers of population, cities which have lost their former importance as capitals, show the same tendency. We possess an accurate history of the finances of Turin, published in 1901 by authority of the city government. This shows that expenses increased from 1797 to 1900 in the following manner:

Year	Expenses (in *lire*)	Per Capita Expenses
1797	547,300	5.88
1825	1,204,800	11.21
1855	5,266,400	31.36
1875	10,696,900	49.11
1900	15,912,800	48.40

Thus *per capita* local expenses have increased eightfold, while it is beyond question that the wealth of the people has not increased in the same proportion.

It is interesting to note that, between 1797 and 1900, the *per capita* expenditure for police and public health rose from 1.1 to 6.44 *lire;* those for public safety and justices, from 0.12 to 6.44 *lire;* those for public works, from 0.07 to 3.08 *lire;* those for public instruction, from 0.07 to 7.74 *lire.* Outlay for charity increased slightly, from 0.84 to 1.23 *lire;* while that for public worship declined from 0.16 to 0.05 *lira.* These figures indicate better than anything else could the causes which have determined their course.

Italy, in its turn, could not escape the general tendency. On the contrary it can be said that she has increased her expenditures excessively, reaching at times the extreme limits of pressure upon taxpayers.

We cannot carry our researches back of the year 1860. There were then as many budgets as states; and since states frequently changed not only their rulers but also their territories, and since all central authority was lacking, investigation is useless. . . . Limiting our inquiry, therefore, to the period following 1860, we find that even in Italy the increase of public expenditures — central as well as local — has continued:

PUBLIC EXPENDITURES IN ITALY[1]

(In millions of *lire*)

Year	National Government	Provinces	Communes
1863	930.4	25.7	223.9
1874	1,141.4	78.0	368.4
1885	1,481.4	98.7	451.6
1896	1,731.5	140.7	505.8
1898	1,640.8	117.1	554.0
1900	1,654.2	—	642.0

In Italy, then, the increase of outlays has been continuous; or, rather, we should say that there was no check to the increase for almost thirty years. Only after the expenses had grown to the extreme limit was there a sudden reaction, and then a slight reduction. But more recently expenditures have been on the increase.

Without doubt the increase of public expenditures is general; but it is necessary to inquire how far it is real, to inquire whether our figures are absolutely valid, and, if not, to ascertain what other elements need to be taken into account in order to present the facts in their true light.

Professor Nitti then proceeds to consider whether this apparent increase of public expenditures is real. He says:

Léon Say, in a little work which made considerable stir in 1886,[2] devoted several interesting pages to demonstrating that the growth of expenditures is a universal evil. Certainly no small alarm was aroused by the increase which occurred during the period when Say wrote. The expenses of all the countries of Europe, which amounted to 9,900,000,000 francs in 1865, had by 1879 exceeded 14,641,000,000. Two thirds of this increase was absorbed by the growth of military outlays, and one third by the development of public works and public education. The malady seemed to Say to be universal, and he fully believed that it was a real malady and one that was most dangerous in democratic countries. If comparisons extending over a few years

[1] Professor Nitti explains that the figures are not in all respects satisfactory, but that they are drawn from the best available sources. — Ed.

[2] This may be found in Vol. III. of Say's Finances de la France sous le 3me. République (Paris, 1900).

were startling, our surprise should be still greater when we compare the expenditures of former centuries with those of our own time. Some authors, and especially the German theorists, who attribute an ethical quality to state action, have believed that from the increase of public expenditures we can draw the conclusion that the sphere of state action constantly increases. And this increase of state functions, manifested by the increase of expenditures, has even made Bluntschli and some others affirm that there exists an historical tendency toward progressive state socialism. Nothing could be less true. The increase of public expenditures is more apparent than real so far as the more remote past is concerned; and it is only during the nineteenth century that a true increase occurred, but an increase less marked than is supposed.

The statistics can easily deceive us, for in economic affairs, as Bastiat has remarked, there is not only the "seen," but also the "unseen." And in dealing with budgets showing public expenditures it is necessary never to stop with the "seen."

To determine whether the sphere of state action is greater now than in the past, and whether the satisfaction of collective wants claims an increased proportion of our wealth, our calculation must be made in such a way as to avoid the errors into which people so often fall. In comparisons of past budgets it is necessary, in fact, to take account of the following factors: (1) the amount of the dues formerly paid in services or in kind; (2) the extent of the country's territory at the different times under consideration; (3) the population; (4) the amount of wealth belonging to private individuals; (5) variations in the value of money. It is only in this way that comparison can be made; otherwise our labors would be barren and without result.

We cannot, for example, compare the finances of feudal governments with those of modern. The former were based upon contributions in nature or in services, and upon income from domains; the latter are based upon public revenues from charges and taxes, especially the latter. Revenue from personal services is to-day unimportant; in the past it was the principal resource, in peace or in war, and public enterprises could not have been carried on without it. In feudal times, when war broke out,

every vassal sent to his suzerain a certain number of armed men. Forms of service varied very greatly, but they were numerous everywhere. To-day there is almost no sort of personal service except jury duty and military service, which is for a short period and undergoes constant reduction.

In the next place, we usually speak of Germany, England, and France as if they had always represented the same territorial units; whereas the formation of great states is a comparatively recent event which coincided with great geographical discoveries and the rise of new forms of international commerce. It was a slow process of unification which brought about the formation of the great states of to-day. The France of Henry IV was not the France of to-day; and still less was that of Philip the Fair. And Great Britain is not what she was in the time of Cromwell. . . .

And above all, the number of the population is the factor which has changed. The nineteenth century represents a period of increase such as has never, perhaps, had a parallel in the history of the world. The actual population is much greater than that of former times; never, perhaps, has the earth supported one half of the immense population which now crowds its surface. Europe had at the opening of the nineteenth century but one half of the inhabitants she had at the end of it; and all the countries of Europe have, to a greater or less extent, witnessed a considerable increase in the number of their inhabitants.

England, for example, is not only immensely richer than in former times, but is also far more populous. At about the year 1000 A.D. the British Isles did not have, in all probability, 3,500,000 inhabitants. England and Wales had only 5,500,000 in 1688; 6,000,000 in 1740; and less than 9,000,000 in 1801. Now, according to the census of 1901, the population of Great Britain is 41,600,000, while that of England and Wales is 32,500,000.

Sweden has witnessed an undoubted increase of public expenditures, but her population has advanced rapidly also. She had hardly 900,000 inhabitants in 1570; but in 1700 she had 1,500,000; in 1815, 2,500,000; and in 1900, 5,150,000. The population of Norway rose from 883,000 in 1800 to

2,122,400 in 1898. That of Prussia advanced from 13,707,000 inhabitants in 1800 to 31,855,000 in 1895. That of Italy grew from 17,000,000 in 1800 to 33,000,000 in 1900, and France, which according to the census of 1896 had 38,500,000 inhabitants, had but 20,000,000 at the beginning of the eighteenth century and less than 25,000,000 at the time of the Revolution. Some European countries to-day have a larger population than all Europe possessed in the time of Charlemagne.

But if population has advanced, wealth has increased still more. In Europe the annual revenue of every nation increased extraordinarily, to a degree almost incredible, during the nineteenth century; and the same is true of the United States of America. . . . The improvements in the technique of industry have been so great that the prevailing low prices of commodities could coincide with higher wages for labor. Certain countries in which the increase of wealth has been greatest, as Sweden, offer us the possibility of witnessing the wealth of each inhabitant grow more rapidly than his contributions to the support of the central and local governments.

The revenue of the French people has advanced remarkably. According to the investigations of the officials administering the direct taxes, the revenue drawn from the land advanced from 1,440,000,000 francs in 1791 to 4,671,000,000 francs in 1879. Revenues from personal property, which Délai d'Agier estimated at 1,050,000,000 francs in 1791, were, according to Wolowski, about 6,000,000,000 francs in 1881. Later calculations have shown a very rapid increase. . . .

Thus the increase of wealth in the most progressive countries has been such that the growth of public expenditures, startling as it is, does not greatly exceed it. Doubtless what we have said of Sweden, and what we could say of Great Britain, the United States, Germany, Switzerland, Belgium, and other rich countries, cannot be said of some countries in which it has actually happened that public expenditures have grown faster than the wealth of the inhabitants.

Let us continue, then, to study the growth of expenditures not only in its external features but in its economic reality. In proportion to their wealth, do the citizens contribute more to the support of government to-day, or did they contribute more in

former times? That is the question which we are considering; for it is of little consequence, in fact, to know if the mere quantity of money which the citizens contribute is greater or less than formerly.

Now all calculations agree in showing that money has lost no small part of its purchasing power. Money is worth less than formerly because with the same quantity of it one cannot purchase as much as in former times. . . .

During many centuries kings and their governments made continual alterations in their coinages, reducing the amount of metal which the coins contained while pretending to keep them intact. The *livre* of Charlemagne's time was actually a pound of silver, and it was only by successive debasements that it was reduced to the French *livre* and Italian *lira* of five grams. . . .

But we can study these changes and calculate them without difficulty. A more troublesome problem arises from the fact that not only have coins retaining the same names contained a smaller quantity of metal, but that also the purchasing power of the metal has fallen. In the time of Charlemagne, a given quantity of metal was worth nine times as much as it is to-day, that is, it would exchange for nine times as many commodities as at present. In the time of Charles VIII it was six times as valuable as at present; and in the middle of the eighteenth century three times as valuable. Thus a Frenchman who, in the time of Charles VIII, owed one franc in the money of the time, owed in reality six francs of our money.

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If, then, we take all these elements into account, — if we recall the existence of various revenues from domains, take account of personal services, observe the changes in the territories controlled by the states, and allow for changes in wealth, population, and the purchasing power of money, when we compare present budgets with past, — we shall see that we are now contributing to the support of government, not much more than in the past, as has been claimed, but sometimes even less.

There does not exist, then, and no one has proved that there exists, a progressive tendency toward state socialism, as some have maintained. Perhaps there are some countries in which, after taking into account all the elements above mentioned, the

citizens are paying to the state proportionally less than in the past, although they are paying more money than formerly. In any case, if it is very difficult to draw comparisons with the remote past, we can make comparisons with times less remote. And it is necessary then to recognize that for a century public expenses, national and local, have increased much more than in former centuries, on account of the increased solidarity brought about by various causes. The increased expenditures of the nineteenth century are real increases; and in some way, despite the extraordinary increase of wealth, the citizens bear burdens which continually grow heavier.

Neither changes in the value of money nor changes in the income of the people explain fully the increases which appeared during the last half of the nineteenth century. The budgets of France, England, and Russia grew larger and larger, from year to year, by tens of millions, sometimes by hundreds. Now these increases are real, for in regard to them none of the qualifying factors above described has more than a temporary influence. What causes, then, produce these increases, which occasion such deep anxiety, and often disturb the equilibrium of the best balanced budgets? The increased expenditure of the nineteenth century, and especially of the last half of it, is real and is due chiefly to:

(a) *The continued growth of military expenditures.* — The statistics collected and published with so much care by Bloch in the famous book which led the Czar to call the conference at The Hague are certainly worthy of attention. For fifty years military expenditures have risen everywhere with a rapidity almost fantastic; and the increase has been as great in democratic as in monarchical countries. Under the most liberal governments, in England, Switzerland, and Sweden, the outlay has taken the same forms as in countries ruled by absolute monarchs. In earlier times there were many more wars, but they cost much less, from such items as the purchase of arms up to the equipment of soldiers. An iron head at the end of a long stick constituted a lance; and the arms and machines of war were generally simple. Modern arms are almost always expensive; a great steel cannon often costs more than the equipments for a whole battalion of soldiers in former times. The largest fleet

possessed by Athens cost less, perhaps, than a single modern warship. And then up to the Napoleonic wars there did not exist such vast permanent armies as we have to-day. War was the profession of a small number, and military apprenticeship was consequently a simpler matter. Expenses for war were small then, although frequent; there was more fighting, but the outlay was less. In our day peace itself costs the great powers more than the greatest war of antiquity ever cost. A modern war costs five or six billions, often more; and if wars do not often occur in Europe, it is because we now stop to think of the immense loss of men and treasure that would be occasioned thereby.

(b) *Great public works.* — It is only from about the middle of the nineteenth century that the use of steam and electricity as motor forces and the introduction of the electric telegraph upon a large scale occasioned a large increase of public expenditure. The world has never seen another transformation which could compare even remotely with that produced by steam and electricity. In this way, despite the enormous development of wealth in certain countries, the rate of interest has been kept up to a high point by reason of the demand for capital in the construction of public works, in addition to the demand in private industry which has continually assumed new and varied forms. In many countries the governments have constructed, upon their own account, in addition to public highways, which were rare almost everywhere at the beginning of the nineteenth century, tens of thousands of kilometers of railways and hundreds of thousands of kilometers of telegraph.

(c) *The growth of public debts.* — It is true that countries contract debts because they have expenses which they wish to make; but it is equally true that they could not make many expenditures if they could not borrow. And how the debts of the various countries have grown! In 1800 the nominal capital of the French debt was 713,000,000 *francs;* in 1891 it was 30,170,000,000, and in 1897 it was 31,093,000,000. In Italy the interest on the recorded debt at the time the kingdom was unified was 111,000,000 *lire;* the interest paid in the fiscal year 1897 was 556,000,000 *lire.* There is no country which does not resort largely, and even excessively, to borrowing. It would seem that, among the great states of Europe, England alone offers a

fortunate exception. She enjoys extraordinarily favorable natural conditions, and could, without difficulty, devote a part of her revenues to extinguishing old debts, rather than contract new ones. But even she, on account of her new policy, is resorting in large measure to loans.

(d) *The development of all forms of social prevention.* — These have increased the economic activity of the state. Formerly the state directed its action to repressing rather than preventing the most serious social ills that afflict society. To-day not only the social conditions have changed, but also the development of science leads us to adopt a different course. When activity was confined to healing or diminishing the evil, it was possible to rely upon individual effort; hospitals, charitable institutions, and asylums, created to cure or lessen the suffering which attracted attention and enlisted sympathy, could be created by individual initiative. But we do not ordinarily resort to individual effort when we adopt preventive methods. Thus hygienic or sanitary regulations, designed to prevent the evils, can only be undertaken by governments, central or local. General voluntary preventive action requires too great an educational and moral development ever to be wholly effectual.

(e) *The increasing participation of all the people in public affairs.* — Thanks to this, both national and local authorities have had to assume the burden of undertakings which formerly were not considered of general utility, or, at any rate, were neglected. It is true that the increase of public expenses has sometimes been more apparent in countries with absolute governments than among those with liberal institutions; but it cannot be denied that the latter have often led the way. Government of the nation by the nation, as de Rémusat remarked in 1832 in the French chamber of deputies, is not often economical government. An absolute government has frequently cost the people less, and, in order to maintain itself, has been known to reduce taxes even to the neglect of the public service. To-day, when the control of the government rests with the people and the expenses of sovereigns are separated from the public expenditures and form a separate item in the budget, people do not look upon taxation as a loss; in greatest part expenditures are truly *public* expenditures, since they are made

in the public interest. Under the constitutional governments which have succeeded the older absolute forms, it is not possible to consider the administration as an enemy, taxation as a scourge, and money paid to the state as money lost. . . . From any point of view it cannot be denied that, by having a share in public affairs, the masses of the people create expenses which formerly did not exist or existed on a very limited scale, such as expenses for compulsory public education, for the public health and social prevention, compulsory insurance, and the like, which did not previously exist. . . .

These then are the causes, the new conditions, which have brought about for a century a real increase of public expenditures.

11. The Growth of Federal Expenditures in the United States. — The facts concerning national expenditures in this country have been ascertained to be as follows:[1]

For the purposes of this article it will be desirable to exclude all the disbursements of the Post Office Department except the deficits paid out of the federal treasury, since the expenses defrayed from the ordinary postal revenues constitute no burden upon the taxpayers.[2] Then, for different reasons, we shall exclude all payments upon the principal of the public debt. These, of course, are a burden upon the taxpayers, but they show great variation from year to year according to the condition of the federal finances; and would have the effect, if they were included, of vitiating the comparisons that we shall attempt to make of the costs of running the federal government at various dates. By excluding this item the statistics for different years will be made strictly comparable, and this advantage is so great as to justify the omission, important as it is.

It is important first of all to secure a general view of the growth of expenditures since the formation of the national government. The following table begins with the year 1792

[1] The Growth of Federal Expenditures, by C. J. Bullock. Reprinted from the *Political Science Quarterly*, XVIII, 97–111.

[2] Thus for the fiscal year 1900 we shall state the expenditures at $487,713,000, which includes the postal deficit. If the expenses defrayed out of departmental revenue were included, the total would reach $590,068,000.

because the official reports do not present separately the figures for 1789, 1790, and 1791:

EXPENDITURES OF THE UNITED STATES[1]

Year	Ordinary	Interest	Total	Per Capita
1792	$5,896,000	$2,373,000	$8,269,000	
1800	7,411,000	3,402,000	10,813,000	$2.04
1810	5,311,000	3,163,000	8,474,000	1.17
1820	13,134,000	5,151,000	18,285,000	1.90
1830	13,229,000	1,912,000	15,141,000	1.18
1840	24,139,000	174,000	24,313,000	1.42
1850	37,165,000	3,782,000	40,947,000	1.76
1860	60,056,000	3,144,000	63,200,000	2.01
1870	164,421,000	129,235,000	293,656,000	7.61 (6.80)[2]
1880	169,090,000	95,757,000	264,847,000	5.28
1886	191,903,000	50,580,000	242,483,000	4.22
1890	261,637,000	36,099,000	297,736,000	4.75
1900	447,553,000	40,160,000	487,713,000	6.39
1902	442,082,000	29,108,000	471,190,000	5.96

Even a cursory examination of these figures shows that the history of federal expenditures may be divided into five periods. The first of these extended from 1789 to 1811, and reflects the conditions that existed during the formative period of national finance. The ordinary expenditures steadily increased during the twelve years of Federalist rule, and culminated in 1800; after which the economies inaugurated under the Democratic régime resulted in a somewhat smaller outlay.[3] In a similar

[1] These figures are taken from the Report of the Secretary of the Treasury for the year 1901, pp. 131 and 133. They include the expenditures stated in the first and third columns of each page. They will be found to differ slightly from the statistics given on p. 113 of the same Report. For 1870, 1880, and 1890 the differences are due to the fact that our table excludes the item of "premiums" on debt. For 1840 and 1860 the differences are so slight as to be immaterial. For 1850 there is a difference of $1,404,000 which is not readily explained.

[2] The figures in the parenthesis show the per capita expenditures in specie. Interest payments were always made in gold, but the ordinary expenses are stated in currency values. Accordingly, I have reduced the latter to terms of gold before calculating the per capita outlay. For the fiscal year 1870 the greenbacks were worth 81 per cent of their face value.

[3] Yet in 1809 the ordinary expenditures rose to $7,414,000 on account of unusual outlays upon the army and navy.

manner the annual interest charge constantly rose until the year 1801, and then slowly declined as Gallatin was able to effect some reduction of the principal of the public debt. Between 1800 and 1810 there was a marked decline in the per capita cost of running the government, although, if our table included the sums applied in reducing the debt, the total burden borne by the people would not show so great a decrease.

Our second period extended from 1812 to 1860. Passing over the unusual conditions that prevailed during the early years of this epoch, we find that in 1820 both the ordinary expenditures and the interest charge had more than doubled,[1] while the per capita outlay had risen almost to the level reached in 1800. During the next fifteen years interest payments rapidly decreased, since the government accomplished the unprecedented feat of extinguishing the whole of the debt. But the ordinary expenditures never returned to their former proportions, and were permanently increased as a consequence of the War of 1812. In every instance in our history the prosecution of a war has entailed a similar result. The total expenditures of the government steadily decreased from 1820 to 1830 on account of reduced interest charges, and the per capita outlay of the latter year fell to the remarkably low level of 1810. After 1830 the ordinary expenses steadily increased, and the per capita cost of government gradually rose, especially after the Mexican War. By 1860 the federal expenditures had risen to $2.01 per capita, or practically the figures for the year 1800. Yet the increase of wealth had been such as to make the relative burdens of the taxpayers decidedly less than they were at the opening of the century. Upon the whole, during the first seventy years of our national existence, the federal government had been administered with remarkable economy, and at an expense that generally was considerably less than two dollars per capita.

The third period includes the decade 1861 to 1870. During the continuance of military operations the outlay of the government reached colossal proportions, but by 1870 conditions had become fairly normal so that one can form some estimate of

[1] Our table shows that interest payments rose only from $3,163,000 in 1810 to $5,151,000 in 1820. But the interest charge for 1812 was $2,451,000, so that the statement in the text represents correctly the results of the War of 1812.

the results of the war. Our table shows that interest charges had increased by $126,000,000; ordinary expenditures, by $104,000,000; and the per capita outlay, by $4.79, when the figures for 1870 are reduced to a gold basis. In other words, the Civil War had increased by over two hundred per cent the per capita cost of running the federal government, even when, as in our tables, the payment of the principal of the debt is left out of account.[1] And again, as in the case of the two earlier wars, the expenditure never afterwards fell to its former level.

Our fourth period embraces the sixteen years that terminated June 30, 1886. It witnessed the rapid reduction of our debt and a corresponding decline in the annual interest charge. Ordinary expenditures increased but slightly up to 1880, for the growth of pensions was offset by reduced outlays upon the army and navy. As a result there was a decrease in both the total and the per capita cost of government. After 1880 the growth of a large surplus revenue led to an increase of the ordinary expenditures, but this tendency was for some years more than counterbalanced by a reduction of the interest charge; so that in 1886 the total outlay had fallen to $242,483,000, which represented a per capita burden of $4.22. This was the lowest point ever reached by the federal expenditures after the Civil War.[2]

During our fifth period, which extends from 1887 down to the present time, the reduction of interest charges has been too slight

[1] The facts are sufficiently striking to warrant detailed analysis in the following table:

Expenditures	1860	1870
Civil and Miscellaneous	$27,977,000	$53,237,000
War	16,472,000	57,656,000
Navy	11,515,000	21,780,000
Indian	2,991,000	3,408,000
Pensions	1,101,000	28,340,000
Interest	3,144,000	129,235,000
Total	$63,200,000	$293,656,000

[2] In 1877 and 1878 the total expenditures were slightly less than they were in 1886, but the per capita outlay was greater.

to offset the marked growth of expenditures in other directions; so that there has been a decided increase in the cost of maintaining the federal government. Between 1886 and 1893 the aggregate expenses rose from $242,483,000 to $383,477,000, while the per capita outlay advanced from $4.22 to $5.78. This was due chiefly to congressional extravagance fostered by a large surplus revenue. Then came four years of industrial depression, which produced a succession of deficits and enforced some degree of economy. The total expenditures were reduced from $383,477,000 in 1893 to $365,774,000 in 1897, in which year the per capita outlay stood at $5.11. But then ensued the Spanish War, which has exerted a profound influence upon our finances, as upon other departments of our national life. In 1902 the total expenditures stood at $471,190,000, which represented a per capita burden of $5.96; while the estimates of the Secretary of the Treasury predict an increase of some forty or fifty millions for the fiscal year 1903. Once more we have an impressive demonstration that a war is practically certain to leave behind the legacy of larger expenditures, and that, too, even when it has not entailed a material increase of the public debt or a considerable addition to our pension rolls.

12. Our Increasing Public Expenditures: by T. E. Lyons[1]—Mr. E. T. Lyons, of the Wisconsin State Tax Commission, has published the following careful study of the causes that have increased state and local expenditures in the United States:

One of the most significant features of civil government in recent years has been the rapid increase in public expenditures. As these expenditures are primarily met by taxation, the movement has manifested itself in a widespread complaint against high taxes. As citizens of Wisconsin and officers in the tax department, we cannot be oblivious to these complaints; indeed, we are often made the target of the criticism. From the violence and persistence of this agitation in public and private speech and in our local press, it might naturally be inferred that the condition was confined to Wisconsin, but such is far from the case. Like protest has been heard in nearly every part of the country and particularly in the states north of Mason and Dixon's Line.

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[1] An address delivered at Madison, Wis., Feb. 10, 1916.

With these preliminary remarks, let us inquire :

1. Whether public expenditures have in fact increased in recent years, and, if so, to what extent.

2. Whether such increase is greater and the tax burden heavier in Wisconsin than in other states.

3. What sources or agencies have caused this increase ; and

4. Whether there is any remedy for the condition.

On the first question there need be no cavil or dispute. Public expenditures have increased in recent years and increased rapidly, if not alarmingly ; not only in this state, but in the several states and in the federal government as well ; not for one year, but for many years,—indeed for a whole generation. This basic fact is attested by our own experience as administrators and taxpayers, and is confirmed by repeated investigations made by other states and the national government. In a paper read at the meeting of the National Tax Association in San Francisco last August, the chief statistician of the Federal Census Bureau showed that according to statistics collected by that department the expenditures of the federal government had increased 54½ per cent from 1903 to 1913, and that during the same period the average increase in the expenditures for the several states and their political subdivisions was 105.9 per cent for the states, 95.2 per cent for the counties, 103.2 per cent for cities of more than 8000 population, and 100 per cent for all other political subdivisions. Excluding the federal government the figures show an average increase of 101½ per cent in the cost of government for all the states, counties, and municipalities in the country.

Exactly parallel figures are not available for the state of Wisconsin, but as practically all revenue required for the support of government in this state is raised by taxation, a comparison of the total amount of taxes levied for the state and all its political subdivisions for the years 1903 and 1913 furnishes reasonably comparable data. The total amount of taxes levied on the general property of the state for 1903 was $20,776,180 as against $41,755,035 in 1913, showing an increase of approximately 100 per cent. These figures, however, do not include corporation and inheritance taxes paid directly into the state treasury, and if these be added the increase is 114 per cent. The 1913 tax levy being abnormally high, as hereinafter explained, it is believed that the years 1905 and 1915 furnish a more representative com-

TOTAL GOVERNMENTAL COST PAYMENTS, WITH PER CENT OF INCREASE, 1913 AND 1903 [1]

Division of Government	Total Governmental Cost Payments		
	1913	1903	Per cent of Increase
Total	$3,284,343,266	$1,773,186,446	85.2
Federal	952,600,857	616,739,361	54.5
States	382,551,199	185,764,202	105.9
Counties	385,181,760	197,365,827	95.2
Incorporated places of 8000 and over	1,119,843,682	551,234,172	103.2
All other civil divisions (estimated)	444,165,768[2]	222,082,884	100.0

parison. The total amount of taxes collected from all sources in 1905 was $25,590,903 as against $52,574,515 for 1915, showing an increase of 105½ per cent, or 4 per cent above the average rate of increase for the entire country.

If further evidence of our increasing public expenditures be required, it may be found in the successive levies of taxes for all purposes in the several towns, cities, and villages of the state. Without exception these levies have steadily and almost uniformly increased. The greatest variation was in the year 1913, when the increase was unusually great. But notwithstanding the outcry against high taxes that year and a reduction of $2,500,000 in the next state levy, the total amount of taxes levied for all purposes for 1914 exceeded those of the preceding year by nearly $500,000. Again, despite the vigorous campaign against high taxes in the fall of 1914 and the earnest efforts of the state administration to hold them in check, the total tax levy on the general property of the state for 1915 exceeds that of any preceding year by $1,057,000. The obvious explanation is that the reduction in the state levies of 1914 and 1915 was more than offset by increase in the local levies. These figures effectually refute the charge that increased expenses are always caused by the state government, and suggest the inquiry whether the acme

[1] From address of Chief Statistician of Census Bureau delivered before the National Tax Association at San Francisco, Aug. 12, 1915.

[2] Includes $126,792,995 actual governmental cost payments of incorporated places of 2500 to 8000 population.

of high taxes has yet been reached. They also furnish the answer to the first question considered and conclusively show that public expenditures have practically doubled in this state and throughout the United States during the last decade.

Has Such Increase been Greater and is the Tax Burden Heavier in Wisconsin than in Other States?

In the discussion of this question much misunderstanding has arisen from confusing appropriations, levies, and expenditures and by limiting the inquiry to a single unit of government, such as the state. A moment's reflection will show that neither expenditures nor taxes can be accurately measured by appropriations or levies of a state, county, or any other single unit of government. The defect in appropriations is that they include agency and trust transactions between the state and its minor political subdivisions and cover substantial amounts representing mere book transfers which are neither levied, collected, nor expended for state purposes. To illustrate: when a new university or normal-school building is required, the legislature makes an appropriation for the purpose and the money when collected is credited to the general fund, but when required for actual use is transferred to the university or normal-school fund as the case may be, thus appearing as a receipt and disbursement of both funds. Obviously the receipt occurs when the money is collected by taxation or otherwise and disbursement when the money is paid out for actual construction. According to a report of state finances issued by the board of public affairs on the first of January last, the amount of these transfers appearing on the state books alone for 1913 was over $3,000,000 and the transfers between the state, the counties, and their municipal subdivisions, including school districts, exceeded $30,000,000. These transfers from one fund to another do not represent either taxes or expenditures in the proper sense.

Similarly the amount of the levy in any given year is affected by the cash balance on hand at the end of the preceding fiscal year and the amount of aid extended to local districts. This is well illustrated in the case of the state by the levy of $2,566,711 for 1912 as against $7,655,318 for 1913. There was a large balance in the treasury on the first of July, 1912, which made

the low levy for that year possible, while the empty condition of the treasury on the first of July and the call of new legislation for state aid to highways required a high levy for 1913. An average of the levies for both years does not materially differ from the levies of the preceding and following years.

Comparisons of levies for state purposes in different states are equally misleading, because of the difference in the distribution of revenues derived from other sources, and in the functions performed by different state governments. For example, there is paid into the state treasury of the state of New York annually over $9,000,000 from liquor licenses and over $2,500,000 in Ohio, whereas Wisconsin derives no revenue at all from these sources. On the other hand, the state absorbs nearly all corporation taxes in Wisconsin, while they are distributed to the counties and local districts in many other states. Of course the levy on the general property of the state is reduced in proportion to the amount derived from other sources, and when this latter item varies the comparison fails. Again, Wisconsin assumes functions and renders services as a state which are performed by the counties and local subdivisions in many other states. This point is well illustrated by a comparison with Iowa, where the total tax burden is approximately the same as in Wisconsin.

In 1913 the expenditure for state purposes in Iowa was only about one half as much as in Wisconsin; but expenditure for county purposes in Iowa was double that of Wisconsin, and the per capita expenditure for local government was also greater. Obviously comparison of state or county expenditures alone would not show the true relation.

This diversity in the distribution of revenue derived and functions performed by single governmental units makes all comparisons based upon either their levies or expenditures misleading. In every state the entire cost of government—state, county, and municipal—ultimately falls upon the taxpayers, and they are concerned with the amount of the total burden, not in how it is distributed. If all political units, from the highest to the lowest, be taken into account and the transfers and duplications eliminated, either appropriations or levies may well be compared, but not otherwise. The actual expenditure, however, is the final test, and this should include all the political subdivisions in order to form a just basis of comparison.

Fortunately the last federal census furnishes information of this character for all the states and their political subdivisions containing 2500 inhabitants and upwards, together with a reasonably reliable estimate for the municipal districts having a smaller population. These statistics were compiled by an impartial body on the same basis of accounting and classification and, therefore, afford the best available basis for comparison. Separate bulletins containing the results of these investigations have been made by states, counties, and all municipal districts containing more than 2500 population, with an abstract combining the results of the three. They contain a comparison of the expenditures for 1903 and 1913, showing the total and per capita expenditures for state, county, and municipal purposes and the aggregate of all three, together with a percentage of increase in the case of states. The expenditures are further classified according to the main functions of government, showing the amount spent for each purpose. Most of the figures hereinbefore given and all that follow are taken from these sources.

PER CAPITA COST OF GOVERNMENT FOR STATES, COUNTIES, AND CITIES OF 2500 POPULATION AND OVER, FOR 1913

	States	Counties	Cities	Per Capita in Cities	Per Capita by Whole Population
Average for all states	$3.95	$4.49	$27.29	$35.73	$20.73
Alabama	2.77	2.33	14.15	19.25	7.69
North Carolina	1.46	2.99	18.02	22.47	7.11
Tennessee	1.84	4.44	21.53	27.81	10.78
Indiana	2.92	4.17	18.66	25.75	15.30
Illinois	2.21	2.57	23.54	28.32	19.57
Iowa	2.69	7.25	20.22	30.16	16.41
Michigan	4.30	3.05	24.18	31.53	19.13
Minnesota	6.66	4.07	26.82	37.55	21.98
Wisconsin	5.27	3.37	19.47	28.11	17.21
Ohio	2.63	5.03	24.05	31.71	21.54
Missouri	2.27	4.10	27.46	33.83	17.47
New Jersey	4.88	5.10	24.53	34.51	28.33
Colorado	2.46	9.19	30.94	42.59	25.68
New York	6.93	4.09	39.49	50.51	40.36
Nebraska	2.90	5.32	47.25	55.47	20.55
California	7.98	20.67	49.74	78.39	56.73

It is impractical to give either the total expenditure or per capita cost of government for all the states within the limits of this paper. The comparison is, therefore, confined to the average for all the states and for two Southern states, one Eastern, and one Western state, and the five North-central states, including Wisconsin. The states compared are Alabama, North Carolina, Iowa, Wisconsin, Illinois, Michigan, Minnesota, New York, and California. Tables are appended showing the per capita cost of government by states, counties, and municipalities of 2500 population and upward, and the total per capita cost for all these purposes for the average of all the states and for each of the states named separately ; also the per capita cost for the five principal governmental functions of general administration ; protection of person and property, construction of highways, charitable and penal institutions, and education.

State Expenditures

Taking up the increase in expenditures for state purposes first, the census bulletin referred to shows an average increase of 105.9 per cent in the cost of state government for all the states from 1903 to 1913. Expenditures for state purposes in Wisconsin increased from $5,306,543 to $12,741,646, or 140 per cent, in the same period. The bulletin issued by the state board of public affairs shows this increase to be 150 per cent. In either case it will be observed that the cost of state government alone increased more rapidly in Wisconsin than the average for all the states. There is a great diversity between different states in different sections of the country in this respect. In the less progressive states of the South the increase is very slight compared with the richer and more prosperous states of the North. The increase in the rapidly growing states of the Rocky Mountain and Pacific Slope region is naturally very great, but neither of these sections can fairly be compared with Wisconsin. In many of the Northern states the increase was more rapid than in Wisconsin. For instance, from 1903 to 1913 state expenses in Maine increased 166 per cent ; in Vermont, 138 per cent ; in Connecticut, 147 per cent ; in New Jersey, 149 per cent ; in New York, 200 per cent ; and in North Dakota, 233 per cent.

Comparing Wisconsin with the surrounding states it appears

that the increase in the cost of state government was much more rapid than in Iowa and Illinois and about midway between the increase in Michigan and Minnesota. During the decade in question state expenses increased 91 per cent in Iowa, 95 per cent in Illinois, 144 in Michigan, 140 in Wisconsin, and 155 in Minnesota.

The census figures further classify expenses for state purposes according to population, showing the average per capita cost to be $3.95 for all the states of the Union. On the same basis the per capita cost of state government in Michigan is $4.30; in Wisconsin, $5.27; and in Minnesota, $6.66. Generally speaking, the per capita cost is higher in the Northern than in the Southern states and highest of all in the sparsely settled states of the Rocky Mountains and Pacific Slope. The range is from $1.47 in South Carolina to $10.46 in Nevada, with a per capita cost of $6.93 in New York, notwithstanding its limited area and enormous population of nearly ten millions.

Subventions and Grants

The figures used in arriving at the above per capita cost of state government include in each case grants to local subdivisions for the support of schools, construction of highways, and other forms of local aid. The census figures show the total and per capita expenditure for each of these purposes, and the noteworthy feature of this classification is the exceptionally large expenditure of Wisconsin for state aid to education. Of the forty-eight states of the Union, Wisconsin ranks second, or next to New York, in the total amount expended for educational purposes, our expenditure being $4,047,059 in 1913 as compared with New York's maximum of $5,491,170. The average per capita expenditure for education for all the state governments is 57 cents as against a per capita expenditure of 50 cents in Illinois, 72 in Iowa, 73 in Michigan, $1.15 in Minnesota, and $1.67 in Wisconsin. This far exceeds the per capita contribution of New York for educational purposes and is only equaled by Utah and Nevada. Of course the high per capita expenditure of these two Western states is due to their great area and small population. This liberal aid to education given by Wisconsin and the construction of a new capitol building go far to

explain our high per capita cost of state government. The amount expended for all other purposes compares favorably with the average of other states. It would seem, therefore, that our one extravagance, if any, is education.

The figures last quoted represent state expenditures only and do not cover expenditures for other political subdivisions, such as counties, towns, cities, and villages. Comparisons on this basis are, therefore, less trustworthy than where all public expenditures are included for reasons given above. The varying amount of aid given by the states to local districts in the form of subventions and grants further impairs the value of the comparison of state expenditure alone, as these items do not fairly represent the cost of state government. To illustrate: in the comparison above given, based upon the census returns, the expenditures of Wisconsin for state purposes for the year 1913 were given at $12,741,646, but $3,415,809 of this amount was returned to the local districts for the support of schools, construction of highways, and other local aid, leaving only $9,325,837 as the expenditure for state government proper. The bulletin issued by the board of public affairs makes this item half a million less. In 1914, out of a total state expenditure of $13,964,-163, the state returned $4,190,226, or 30 per cent, to the localities. The aggregate amount of these subventions and grants returned to the local districts from 1902 to 1912, inclusive, exceeded the total amount of taxes levied for state purposes during that period. In other words, taking this period as a whole, the state returned to the localities more money than it received from them in taxation. This means that all state expenses were met by the corporation and inheritance taxes and department earnings.

Expenditures for All Governmental Units

As already shown, the per capita cost of state government in Wisconsin is $5.27 as against an average of $3.95 throughout the United States, but the per capita cost of county government is $3.37 in Wisconsin as against an average of $4.49 for the United States, and the per capita cost of municipal government is only $19.47 in Wisconsin as against an average of $27.29 for all the states. Combining the three items representing cost of government in these separate units gives a total of $28.11 as the per

capita cost of government for Wisconsin as against an average of $35.73 for the entire United States. On this basis the total per capita cost of government for Illinois is $28.32; for Iowa, $30.16; for Michigan, $31.53; and for Minnesota, $37.55. It appears, therefore, that the total cost of government to an urban resident of Wisconsin is $7.62 less than for the average citizen of the United States; 21 cents less than for a citizen of Illinois; $2.05 less than for a citizen of Iowa; $3.42 less than for a citizen of Michigan; and $9.44 less than for a citizen of Minnesota. The cost of government to a resident of Wisconsin is $20 less than to a resident of New York and only two fifths of what it costs a resident of California.

These results are arrived at by adding together the total cost of government for states, counties, and cities containing more than 2500 population, and dividing this sum by the population of the districts involved for the reason that the residents of these cities must bear all three burdens. The census bureau, however, arrives at the total per capita cost by dividing the sum of the expenditures of states, counties, and cities containing more than 2500 population by the total population of the country. Obviously by including the population of districts having less than 2500 inhabitants in the divisor and excluding the expenditures of these districts from the dividend, a lower per capita cost is produced. The relative position of Wisconsin, however, remains practically the same, and on this basis the per capita cost of all government in Wisconsin is $17.21 as against an average of $20.73 for the entire United States, $16.41 for the state of Iowa, $19.13 for Michigan, $19.57 for Illinois, and $21.98 for Minnesota. This method of computation makes the per capita cost of government in Iowa 80 cents less than in Wisconsin, whereas the per capita cost was $2.08 more according to the other method. The difference is readily explained by the relatively larger rural population of Iowa as compared with Wisconsin.

The census bureau further classifies the cost of government by ten main functions and gives the per capita cost for each. As some of these are relatively unimportant, this statement is confined to the expenditures for the five main functions calling for the heaviest outlay; namely, general government, protection of person and property, construction of highways, charities and correction, and education.

PER CAPITA COST OF GOVERNMENT FOR STATES, COUNTIES, AND CITIES OF 2500 POPULATION AND OVER FOR PRINCIPAL GOVERNMENTAL FUNCTIONS

	General Government	Protection of Person and Property	Highways	Charities and Hospitals	Education
Average for all states	$2.18	$1.86	$1.64	$1.63	$4.37
Alabama	.98	.47	.85	1.07	1.97
North Carolina	.68	.38	.55	.66	2.14
Tennessee	.99	.70	.85	1.14	2.74
Indiana	2.05	1.32	1.50	1.37	3.99
Illinois	2.34	2.65	.95	1.52	3.78
Iowa	1.85	.96	1.50	1.84	3.45
Michigan	2.09	1.56	1.63	1.50	5.27
Minnesota	2.09	1.93	1.13	2.08	5.29
Wisconsin	1.77	1.60	1.18	1.92	5.24
Ohio	2.41	1.79	1.70	1.79	3.61
Missouri	2.10	1.79	1.55	1.26	3.37
New Jersey	2.67	2.78	2.18	1.85	7.25
Colorado	4.65	1.80	2.41	1.43	5.03
New York	3.31	4.03	2.45	2.77	6.15
Nebraska	2.47	.98	1.69	1.00	3.11
California	4.40	3.59	3.51	2.68	4.46

On this basis the per capita expenditure for general government is $1.77 in Wisconsin as against an average of $2.18 for the entire United States, $1.85 in Iowa, $2.09 each in Michigan and Minnesota, and $2.34 in Illinois. The per capita cost for protection of person and property is $1.60 in Wisconsin as against an average of $1.86 for the entire United States, 96 cents in Iowa, $1.56 in Michigan, $1.93 in Minnesota, and $2.65 in Illinois. In 1913 the per capita expenditure for highway purposes was $1.18 in Wisconsin as compared with an average of $1.64 throughout the United States. The per capita cost for the support of charitable and penal institutions was $1.92 in Wisconsin as against an average of $1.63 for the United States, $1.50 in Michigan, $1.52 in Illinois, $1.84 in Iowa, and $2.08 in Minnesota. The per capita cost of education was $5.24 in Wisconsin as against an average of $4.37 for the entire United States, $3.45 in Iowa, $3.78 in Illinois, $5.27 in Michigan, and $5.29 in Minnesota.

It appears, therefore, that the per capita cost for all the main functions of government is less in Wisconsin than the average cost for the same service throughout the United States except in the case of charities and education. Observe that while our state per capita expenditure for education was nearly three times the average for the entire country, the comparison is much more favorable when the counties and local districts are included, the average per capita cost for all educational purposes in Wisconsin being $5.24 as against an average of $4.37 throughout the United States.

The one defect in the census figures is the fact that they do not include local districts containing less than 2500 population, but as these districts represent less than 15 per cent of the total cost of government, and expenditures are very moderate in the rural districts of Wisconsin, except in a few northern towns, the omission would count rather against us than in our favor. The bulletin issued by the state board of public affairs shows the expenditures for the year 1912 by the different groups of political subdivisions in this state. Of more than $54,000,000 expended for public purposes that year, the 286 villages spent only $1,522,128 and the 1216 towns only $5,708,940, while the 71 counties spent $7,916,255 and the 128 cities $19,529,523. The expenditure for strictly state purposes for that year was $7,738,504, while the expenditure of the city of Milwaukee alone was $8,456,883, or three fourths of a million more than the expenditures of the 71 counties, nearly one million more than the cost of state government, and nearly three millions more than the cost of maintaining 1216 towns. Public expenses have increased since that time, but it is believed that the ratio between these different groups of political subdivisions has not materially changed. On the contrary, it is probable that the expense of city government has relatively increased as compared with that of the smaller villages and rural towns. The farmer in the older and better settled portions of the state is your true economist. He spends little for public purposes and gets little in return. Whether his course in this respect is wise or unwise, it is at least consistent. The resident of the city who complains of high taxes can generally look to his own community for the cause.

Taxes in Specific Districts not Comparable

We are frequently confronted by comparison of taxes in Wisconsin with those of adjoining states. Because the tax on a specific description of property in Iowa or Minnesota is less than the tax on a property of like value in Wisconsin, it is assumed that our taxes generally are higher than in these other states, whereas the only thing these facts prove is that taxes in a particular district in Minnesota or Iowa are less than in a particular district in Wisconsin. The fallacy of this reasoning is shown by the fact that like disparity may be found within the boundaries of the same state or county. To illustrate: the per capita cost of government in the city of Berlin as shown by the federal census is $10.96 as against $32 in the city of Ripon. Again, the per capita cost of government in De Pere is $11.79 as against a per capita cost of $37.52 in Richland Center. The town of Eau Galle in Dunn County has a tax rate of less than 7 mills as against 21 mills in the town of New Haven in the same county, and the tax rate in the town of Highland, Douglas County, is 14 mills as against a tax rate of 43 mills in the town of Brule in the same county. Of course these isolated cases have no significance except as showing that one district raises more taxes and spends more money than another. Numberless instances could be cited of heavier tax burdens in specific districts of adjoining states as compared with similar districts in Wisconsin, but they would be equally void of probative force.

It is true that the average tax rate for both Iowa and Illinois is less than that in Wisconsin, for the reason that with substantially the same population and area to care for, Iowa has approximately twice as much wealth, and Illinois, with the same area and two and one-half times the population, has nearly five times our wealth. Public expenditure bears some relation to both population and wealth, and the tax rate would naturally be lower in these states than in Wisconsin. The two states naturally comparable with Wisconsin in respect to climate, topography, character of population, and industrial conditions are Michigan and Minnesota, and the tax burden in this state is lighter than in either of these two. As already shown, the per capita tax burden in Wisconsin is approximately the same as that in Iowa and is lower than that of any other adjoining state.

The foregoing figures furnish conclusive answer to the second question considered and show that while state expenditures alone have increased more rapidly in Wisconsin in the last ten years than in the average state of the Union, when all taxes are considered, the increase is found to be just about the same as the average increase for the United States; and that the cost of government in Wisconsin, measured by unit of population, is less than that of the average state, less than that of any adjoining state, and much less than the average for all the Northern states.

Cause of Increased Taxes

The foregoing figures not only prove that public expenditures have rapidly increased in the last decade, but that the tendency is still upward. This does not mean that in each individual district the taxes of any given year are always higher than those of the preceding year; but it does mean that, considering this state or the United States as a whole, public expenditures steadily increase from year to year with the certainty and uniformity of a natural law. So regular is this movement that the aggregate of all appropriations, levies, and expenditures over any considerable area all tell the same tale. The very uniformity of the movement in the face of vigorous opposition implies that there must be a compelling necessity somewhere. Let us briefly inquire what that necessity is.

The first explanation of the increased cost of government to suggest itself is the increased cost of everything required to carry it on. In last analysis increase in cost of government results from the same cause as increase in the cost of private business. The government purchases supplies and employs labor. The cost of these items has increased in private business; why should it not do so in public affairs? Railroad managers, manufacturers, merchants, and business men of all classes testify to the increased cost of conducting business and the narrowing margin between net and gross earnings. Private families have the same experience. Can you supply your table, procure clothing, provide fuel, and maintain your household for the same amount that it cost ten or twenty years ago? If not, why expect the public to do so? In this respect a growing state is not unlike a growing family. Its expenses naturally and in-

evitably increase even for the same class and amount of service. But a second and more important consideration is that public service has changed in character and enormously increased in amount. People are no longer content with the facilities furnished a decade or score of years ago. They demand and actually have more and better streets and sidewalks, larger parks and playgrounds, finer and more expensive public buildings, brighter lights and purer water, more and better health, police and fire protection, and more and better facilities and protection of every kind.

The modern budget covers many items for community benefit unknown a century ago. The present-day tax bill includes items for medical service, life insurance, old-age pensions, school tuition, and constitutes a license to call on any department of government for any and all kinds of aid and protection. These things cannot be had without money. If they could, self-interest would promptly induce public officers to secure them. No one considers high taxes desirable in and of themselves, and no public officer would voluntarily increase them. He well realizes that high taxes are not popular and does not enjoy the criticism they provoke. *Nevertheless taxes constantly increase with the increasing complexity of civilization as if in obedience to a natural law. How is the phenomenon to be explained? Why must we all have what nobody wants? The obvious answer is that, while nobody wants high taxes, practically everybody wants the things that make taxes high.* For ten months in the year some class of the community, the promoter, the educator, the philanthropist, the æsthete, or the pleasure seeker each, after his kind, clamors for increased expenditure, and scarce a voice is heard in protest until tax-payment time arrives. Then there is a loud outcry, and, except in partisan circles, the matter again subsides for another year.

Herein lies the explanation of high taxes. First, the increased cost of labor and material and of all facilities required for conducting public business; second, the increased activity of government in many fields. Whether all these activities are necessary or worth-while is for the people themselves and their legislative representatives to decide. It is not a problem of tax administration; but if they insist upon the service, the increased cost must follow as a necessary consequence.

A simple illustration with which you are all familiar is found

in the history of the tax commission, which was created as a permanent body in 1899. Its sole duty at that time was to supervise local assessments and study the tax problem. In 1901 the commission was made a state board of assessment and given supervision over county supervisors of assessment. The assessment of steam railroads was added in 1903. In addition to these duties, which the commission still performs, it is now required to assess the property of street railways and electric-light companies operating in connection therewith; supervise the assessment of utilities furnishing light, heat, and power; direct reassessments of towns, cities, and villages on proper showing; entertain and determine appeals from equalizations by county boards; collect statistics and prescribe forms for local tax officials; audit the accounts of towns, cities, and villages and install a system of public accounting at their request; supervise the administration of the income-tax law; directly assess the incomes of all corporations and joint-stock companies, and bear the entire expense of supervising the property tax, which formerly cost the counties $54,000 a year. A mere comparison of the duties now imposed upon the commission with those of a dozen years ago sufficiently shows the fallacy of comparing expense of administration at that time with the present. As a matter of fact, the cost for the same service which the commission performed twelve years ago is not materially greater now than it was then, while the duties subsequently imposed by the income-tax act annually yield approximately $200,000 to the state, or more than the entire cost of all activities of the commission.

A study of the various acts relating to the railroad commission will show the same growth. That body was created to regulate rates on steam railroads. Afterwards its jurisdiction was extended to street railways; then to public utilities such as electric-light, water, and power companies. Later still it was charged with the duty of prescribing the character of service for all public utilities and of supervising the issue of their securities; and in 1913 the administration of the water-power act and the Blue Sky law was added. Criticism of the commission because it cannot perform these increased duties now at the same expense as when first created is as unreasonable as to deny a farmer a telephone or silo in 1916 because he had neither of these articles a dozen years ago.

In the meantime numerous other boards and commissions have either been created or had their powers enlarged ; but notwithstanding their reputed number, the entire cost of all administrative departments, with the executive, judicial, and legislative thrown in, was less than 3 per cent of the total expenditure for public purposes in 1914, and the cost of this one item of general administration in Wisconsin is materially below the average for all the states of the Union and less than for either of the adjoining states.

Under this twofold pressure of increase in the cost of everything employed or used in conducting public business, whether in the form of service or supplies, and in the volume and character of services rendered, increase in the cost of government was inevitable, and it has taken place not only in this state, but throughout the United States and in nearly every town, county, city, and village within its borders.

Is there any Remedy for this Condition, and, if so, what is it?

This question has received earnest attention in recent years, but thus far without definite result. It was hoped that the widespread agitation against increase in taxes and the introduction of the uniform system of accounting, making comparison of the expenditures of different municipalities possible, might operate as a check, but while these aids have been enlightening and valuable, they have not proved a panacea. The only remedy promising positive relief is by closer limitation of the taxing and borrowing powers, and this is advanced with hesitation. Many of the states already have tax-limitation laws, but few of them have proved effective. In nearly all cases the limit prescribed is so high and the terms of the statutes so inflexible as to render them practically useless.

Our own law fairly illustrates the situation. Every school district in the state is authorized to levy a tax of 2 per cent of its assessed valuation for school purposes. The electors of every town are authorized to levy an additional tax of 1¼ per cent of the assessed valuation for town purposes, and the same limitations apply to villages and cities not operating under the general charter law. In each of these municipalities an additional tax of 1 per cent of the assessed valuation may be imposed

for county purposes, and cities operating under the general charter law may levy 3½ per cent of the assessed valuation for all purposes. It will be observed that there is no limit as to the levy for state purposes, nor for the amount that may be levied to pay preëxisting indebtedness. It follows, therefore, that any municipality of this state may impose a tax ranging from 3½ to 5 per cent of the assessed valuation of the property within its borders every year.

When it is considered that the average rate of income from property exclusive of personal service is less than 5 per cent and that the average rate of taxation of general property of the state has never exceeded 14 mills, the uselessness of our present limitations is apparent. The only object of limitation of the tax rate is to protect property owners against reckless or extravagant expenditures by irresponsible electors and governing boards, and it is obvious that our present law affords no protection in that respect. The fact that so few municipalities avail themselves of the full license granted sufficiently indicates that these limitations can be materially reduced without prejudice to any taxing district. They can at least be made low enough to prevent extravagance and abuse. The remedy has the merit of being simple and direct, besides affording a check on extravagant and needless expenditure, and would automatically aid in securing a full value assessment. The very fact that the rate was closely limited would require a higher standard of assessment in order to secure the necessary revenue.

It is obvious, however, that greater expenditures are required in new and rapidly developing districts in the northern part of the state than in the older sections of the country. A rate which would serve as a protection in the latter case would undoubtedly hamper the former. To meet this condition the limitation law should be made elastic by permitting an increased levy in cases of urgent necessity. At the last meeting of the National Tax Association a committee previously appointed for the purpose made a report which represents the latest expert judgment on the subject. The committee recognizes that tax-limit laws have proved ineffective in most parts of the country, but believes that with proper attention to the necessary details they can be made highly serviceable. In order to make a limitation law effective, this committee recommends: (1) that the power to

levy taxes should be concentrated in the governing board of each municipality and taken away from subordinate departments, such as school, park, and drainage boards; (2) that a separate limit should be placed upon the rate for each municipal unit, with a maximum limit on the total; (3) that a limit be placed on the percentage of increase over the levies of former years, and that like limitations be placed on the borrowing power of the municipalities to prevent the practice of borrowing money for current expenses; (4) that in case of emergency or urgent necessity municipalities be allowed to exceed the limits prescribed with the approval of an impartial board of authorization, showing the necessity to exist. A bill containing the essential features of this report was prepared by the tax commission and submitted to the legislature of 1915, but nothing came of it. By failing to give the subject consideration or enact it into law it is believed that the legislature neglected its only opportunity of regulating high taxes.

The figures above cited all unite in showing that public expenditures have rapidly increased in recent years and that the tendency is still upward; that state expenses have increased more rapidly in Wisconsin in the last decade than in the average state of the Union, but that such excess is largely explained by the liberal grants for educational purposes and the construction of the state capitol; that when the state and all its political subdivisions are considered as a whole the per capita cost of government in Wisconsin is less than the average for the entire United States or for any adjoining state; that the increased taxation required to meet these expenditures cannot be ascribed to any single cause or circumstance, but is shared equally by the state and all its political subdivisions with schools and cities in the lead.

While the foregoing figures point to conclusions quite different from those usually entertained, they nevertheless indicate rapidly increasing public expenditures sufficient to call for careful scrutiny and to enlist our earnest efforts to restrict them wherever that can properly be done. The situation does not, however, justify the inference that taxes in Wisconsin are higher or that they have increased more rapidly than elsewhere throughout the country. On the contrary, the increase in our tax burden is only part of a nation-wide movement, and we are far from the head of the procession.

13. Methods of controlling the Movement of Public Expenditures.—A committee appointed by the National Tax Association[1] has presented the following suggestions concerning such control:

1. In its first report made at the eighth annual conference your committee recommended:

That this association adopt a resolution urging Congress to direct the Census Bureau to publish annually for a selected group of states, counties, towns, villages and cities, statistics of expenditure, taxation, public debt and wealth, including in this group—similar to the registration area used in vital statistics—those states and political subdivisions whose financial accounts are published promptly and in such form as to permit of consolidated statement.

We are gratified to be able to report that this recommendation has been in part anticipated by the plan of the Bureau of the Census to publish annually, beginning with 1914, financial statistics of the state governments similar to those which have been for a number of years published for cities of over 30,000 population. Study of these census reports, comment by the press, use of the figures in colleges and universities, will contribute, it is believed, to the awakening of a keener interest in the rapid growth of state and local expenditures. In the opinion of your committee, however, similar statistics should be published for a representative group of counties, villages, towns and smaller cities. To a certain extent accuracy is lost in the attempt to cover all political divisions of a given class within the country; and a financial "registration area" including only those political divisions whose accounts are published in trustworthy and available form would at once signal out those municipalities which are included in the area, stimulate other municipalities to improve their accounts in order that they might be eligible for inclusion, and be of marked service in showing the trend of expenditures and receipts in the rural districts of the country.

2. As contributing materially to the enlightenment of the public on financial questions and tendencies, your committee desires to commend the work of the newer types of state, county and city taxpayers' associations. Some of these associations have represented in the past little more than an organized and

[1] Reprinted, with the consent of the Association, from the *Proceedings of the Ninth Annual Conference of the National Tax Association*, pp. 463–469.

illiberal effort on the part of the participants to reduce their own taxes. Such a characterization cannot be applied to the higher types of associations which are developing rapidly throughout the country and which are devoted not to a blind parsimony in public affairs but to the program of financing needed extensions out of the savings to be accomplished in those departments where waste is prevalent and retrenchment plainly possible. The elimination of waste in public business must, it is probable, come from without, and organized effort must be made by taxpayers and citizens if useless functions and departments are to be eliminated. A praiseworthy characteristic of the better taxpayers' associations is their constructive work in upholding and supporting public officials whose administration has been characterized by efficiency and economy. There is no proper place in the activity of such organizations for a blind antagonism to the public official who does his work efficiently. The legitimate objection is to unwise, wasteful or ill-timed spending.

3. Most important of all, perhaps, your committee would emphasize the necessity for a fearless and thorough scrutiny of school expenditures. We are in many places making a fetich of the school tax, and open-minded examination of school expenditures is in many jurisdictions halted by political cowardice. Officials charged with the duties of investigating and directing legislative attention to the distribution and expenditure of school funds, who are fully cognizant of errors and abuses in the distribution or expenditure of such funds, shrink from raising the issue which it is their duty to face. We have reached in many jurisdictions something perilously close to a conspiracy of silence on this subject.

Your committee does not believe in niggardliness in educational expenditures, and there are doubtless many lines of education and many places in which increased expenditures would be socially profitable. But this truth merely furnishes additional reasons why unwise methods of distributing school funds should be changed, unjustifiable classes of expenditure abandoned, and in all places effective accounting checks placed upon the manner and machinery of school disbursements. Your committee has no particular educational policy to advocate, none to attack. It is patent, however, that abuses are being tolerated which would not be sanctioned by the public if courageously

brought to light by public officials who are cognizant of the facts and charged with the duty of directing attention to them. The school should be dealt with in a spirit of enlightened liberality—but also with intellectual and political honesty.

4. Your committee is convinced also that a grave danger exists in many jurisdictions in the manner in which highway improvements are being financed. Long-time bonds are employed in whole or in part to resurface roads and pay for improvements which will last only a few years. It is doubtful whether debt should be contracted at all for such purposes, but if contracted the life of the obligation should not exceed the life of the improvement. To do otherwise is simply to saddle on the future the cost of improvements in the use and benefit of which the future can have no part.

With respect to the form of public bonds your committee reëmphasizes the advantage of serial bonds as compared with the wasteful and unscientific sinking-fund obligations and methods so frequently employed in American states and cities. The serial bond can usually be placed at a lower rate of interest than a sinking-fund obligation. It is free from most of the possibilities of political abuse and manipulation to which sinking-funds are exposed. It substitutes a plain and certain for an uncertain and complicated liability; and it compels the administration which contracted a debt to begin its retirement immediately.

5. In conclusion your committee again directs to your favorable attention the device of limiting by law public expenditures, public debts and tax rates. Your committee is aware that tax-limit laws have proved ineffective in most parts of the country, but believes that with proper attention to the necessary details they can be made highly serviceable. To make them effective the following conditions should in general be fulfilled:

a. The limitation should preferably be upon the increase *in the total amount of the levy*, although this may profitably be accompanied by carefully adapted limitations upon tax rates or levies for particular purposes.

b. The above limitations must be supplemented by limitations upon public debts. Debts may be limited by a percentage upon the assessed valuation or better by limitation upon the amount of increase which may lawfully be contracted. In all cases there

should be an explicit prohibition of bond issues designed to evade the limitations imposed upon tax levies.

c. It is furthermore essential that the limitation should be elastic. No blanket law may be applied without injury to all the municipalities of a large American commonwealth. The emergencies and necessities of particular localities should be met by providing administrative means for suspending the law when a meritorious case is made out. In general the determination of whether an emergency exists should be left to a disinterested and impartial board so appointed and selected as to make it certain that its members will faithfully carry out the spirit of the law. The state tax commission is, perhaps, the natural department in which this discretionary authority should be lodged. But there is much to be said for the appointment from without of local boards empowered to determine whether the exigencies of a particular situation are grave enough to warrant departure from the letter of the law. Under such circumstances the Norwegian law, we understand, provides that tax levies and expenditures in excess of the ordinary limits shall in each subsequent year be reduced by at least one-tenth until they have reached the normal condition imposed upon the average municipality. This device could in all probability be profitably adopted in this country.

d. As subordinate but nevertheless important provisions, it is recommended that the fiscal periods for which appropriations and tax levies are made should be defined with particular clearness in the statute. If this is not done, confusion is likely to arise and make questionable the period to which given appropriations apply. Where limitations are imposed upon the rate of taxation, they should be placed upon each separate authority having power to levy taxes and should apply only to those taxes levied under that authority; that is, there should be one limit for county taxes, one limit for state taxes, one limit for school taxes (if school taxes are levied by a separate body) and one limit for town or township taxes. There should be no separate limits dealing with distinct funds for purposes of expenditure within each municipality. Full discretion should be given to the governing body of each municipality to distribute the revenues among the purposes of expenditure in the manner which in its judgment will prove most profitable. By so doing extravagance resulting from special funds and complexity of municipal accounting will

be avoided. In this connection it should be borne in mind that limits imposed upon tax rates for state, county and local purposes are frequently unfair in operation. In some states, for instance, there is a limit of—say three per cent—on all taxes levied in cities whether state, county or local. Under such a law it is obvious that the superior jurisdictions (for example, the state and county) are in position to compel the city either to violate the law or to do without necessary municipal expenditures through the unfair encroachment of the superior jurisdictions on the total. Each municipality should be responsible only for its own taxes and expenditures.

In some states school boards, park boards and similar bodies possess independent powers of taxation. In all such cases there should be reserved to the principal governing body the authority to reduce the estimates of these subordinate bodies, in case the total estimates exceed the limits prescribed by law. If such power of reduction is not given, the school board or some similar body may absorb an undue proportion of the total authorized expenditure.

In states where the town meeting is preserved, the electors themselves frequently levy taxes. The power of levying taxes should, it is believed, be vested with the representatives of the people rather than the people themselves, and should be exercised at the latest moment possible prior to the extension of the tax rolls. The town meeting may authorize appropriations ; the town board or legislative body should determine the exact tax levy that must be made to meet these appropriations. In this way a much better balance of revenues and expenditures is possible than can be had where the electors themselves vote taxes for future expenditures which may or may not prove necessary, and which may or may not be financed from sources other than taxation.

Finally, it is important that the law specifically provide for the priority of certain claims where a reduction of estimates is necessary to bring a tax levy within statutory limits. Levies for the payment of indebtedness, sinking-funds, interest and judgments would ordinarily be given such priority.

e. The following provisions from a bill proposed but not passed at the 1915 session of the Wisconsin Legislature are introduced not as models but to suggest some of the details which should be kept in mind in framing legislation designed

to limit increase in public expenditures. The element of elasticity in this bill was embodied in a so-called "board of authorization," the functions of which are described in the following section of the Wisconsin bill:

Section 137*c*. 1. The governor, the secretary of state, and a member of the tax commission designated by it are created a state board of authorization for the purpose of determining whether an emergency or urgent necessity exists by reason of which towns, cities (except cities of the first class), villages, counties, or school districts may make appropriations and expenditures, levy taxes, and contract debts in excess of the limits prescribed by statute. In case of emergency or urgent necessity which in the judgment of the town board, city council, village board, county board, or school board requires the appropriation or expenditure of money, the levy of taxes, or the incurring of debt in excess of the limits provided by law, the said authorities may apply to said boards of authorization for permission to make such appropriations, levies, or expenditures and to incur such indebtedness. As soon as may be after receiving such applications said board shall hear and determine the same in such manner and under such rules as it may prescribe. If said board or a majority thereof shall be of opinion that such emergency or necessity exists, it may authorize the appropriation or expenditure of money, the levying of taxes, or the incurring of debt sufficient to meet such emergency. The said limitations shall be construed to apply to the appropriations, expenditures, tax levies and indebtedness of towns, cities, villages, school districts, and counties made or incurred pursuant to subdivision 5 of section 44, sections 425, 430, 430-4, 476*b*, 495-21, 553*o*, subdivision 4 of section 553*p*, sections 697*a*, 697*g*, 697-38, 697-73, 776, 777, 819, subdivision 25 of section 893*m* (892), sections 914, 919*c*, 925*b*, 925-133, 925-142*a*, 926-11*m*, 926-19, 926-107*m*, 926-178, 929, 931*a*, 937, 959-48, 959-49, 959-78*m*, 1074, 1240, 1244, 1317*m*-4, 1317*m*-5, 1317*m*-12, 1317*m*-13, 1318, 1325*f*, 1421-9, and 1529*b*, and to all other appropriations, expenditures, tax levies, and debts of towns, cities, villages, counties and school districts authorized by law.

2. If application for authority to levy additional taxes shall be denied or allowed only in part appropriations shall first be made for the payment of interest and principal of the indebtedness of such towns, cities, villages, counties, or school districts or for sinking-funds for such purpose, and for judgments, and thereafter the town board, city council, village board, county board or school board shall reduce any or all of the appropriations originally requested to bring the totals within the prescribed limits. This section shall not apply to cities of the first class.

CHAPTER IV

PUBLIC REVENUES: THE VIEWS OF BODIN AND SMITH

14. Bodin's Classification of Revenues. — In 1576 Jean Bodin, in the most extensive survey which had then been made of the subject, classified public revenues in the following manner:

Now there are in general seven ways of raising public revenues,[1] which include all that can be thought of. The first is the landed domain of the commonwealth; the second, conquests from enemies; the third, gifts from friends; the fourth, tributes from subject states; the fifth, public traffic or trading; the sixth, customs duties upon merchants who bring in or carry out merchandize; and the seventh, taxes upon the citizens.[2]

Of these seven branches of revenue Bodin pronounced the first "the most just and certain of all." He contended stoutly that "in order that princes might not be obliged to lay taxes upon their subjects, or invent methods of seizing upon private property, all states and rulers have held it to be an indubitable general principle that the public domains should be holy, sacred, and inalienable, either by grant or by prescription." Moreover, he said, "it is not lawful for princes, even in time of peace, to squander the fruits and revenues of the domains; because they are entitled only to the usufruct of the domains, and ought, after providing for public needs and their own private expenses, to keep the surplus income for times of public necessity." Then, too, he believed that domains, when sold, usually brought less than their true value; and that, most important of all, the money

[1] For public revenues Bodin wrote *fonds aux finances.*
[2] Les six livres de la république, VI, 2.

derived from such sales is not invested, but "most often dissipated and given to those who have least deserved it."

The second, third, and fourth branches of revenue recognized by Bodin are not of great importance to the modern student of finance. Concerning the fifth, Bodin remarked that, although trade was despised by many, "it is more seemly for a prince to be a merchant than a tyrant, and for a gentleman to traffic than to steal."[1] The kings of Portugal, he said, had for a century drawn great riches from the East; while various Italian princes had carried on gainful traffic. Yet he observed that when a prince traded with his subjects the result was often a royal monopoly, by which the subjects were virtually taxed through extortionate charges.

The sixth branch of revenue — duties on imports and exports — Bodin pronounced "one of the oldest and most common resources in all states, and thoroughly just, because it is right that one who wishes to gain a profit from trade with another country than his own should pay duties to the prince." In this passage Bodin reflects the common opinion of his age that duties upon imports and exports are borne by the merchant, not by his customers; and he justifies them on the ground that it is right that a foreigner should contribute to the support of a government which permits him to come within its jurisdiction and trade with its citizens.[2] In fact, he did not regard customs duties as a form of taxation, and looked upon them as a kind of revenue which could be raised without burden to a prince's subjects.[3]

[1] Carafa, on the other hand, had opposed public trading. He said that this was undignified for a prince; that public business would not be so well managed as private; that the welfare of the subjects might be sacrificed to the profit of the prince.

[2] Throughout Europe our modern customs duties were, by a more or less obscure process, evolved from mediæval tolls and charges which travelers, especially merchants, were required to pay, nominally for the service of the sovereign in protecting them or maintaining roads and bridges.

[3] Yet in one place Bodin says that duties on necessities of life may be so heavy as to prove a burden.

Taxes form the last item in Bodin's classification. He considered them justified if "all other means are insufficient and there is urgent necessity of providing for the state"; but argued that no prince had the right to levy taxes on his subjects without their consent, and believed that taxation should be an extraordinary financial resource. Like his predecessors, he thought that in ordinary times the other revenues should suffice for the needs of the prince; and long after his time many writers continued to indulge in the illusion that taxation might be reserved for unusual emergencies.

15. Smith's Classification and Discussion. — Modern discussions of this subject have generally started from Adam Smith's chapter on the "Sources of the General or Public Revenue of the Society." Smith said:

The revenue which must defray, not only the expense of defending the society and of supporting the dignity of the chief magistrate, but all the other necessary expenses of government, for which the constitution of the state has not provided any particular revenue, may be drawn, either, first, by some fund which peculiarly belongs to the sovereign or commonwealth, and which is independent of the revenue of the people; or, secondly, from the revenue of the people.

* * * * * * *

The funds or sources of revenue which may peculiarly belong to the sovereign or commonwealth consist either in stock[1] or in land.

The sovereign, like any other owner of stock, may derive a revenue from it, either by employing it himself, or by lending it. His revenue is in the one case profit, in the other interest.

The revenue of a Tartar or Arabian chief consists in profit. It arises principally from the milk and increase of his own herds and flocks, of which he himself superintends the management, and is the principal shepherd or herdsman of his own horde or tribe. It is, however, in this earliest and rudest state of civil

[1] By "stock" Smith means capital. — Ed.

government only that profit has been made to form the principal part of the public revenue of a monarchical state.

Small republics have sometimes derived a considerable revenue from the profit of mercantile projects. The republic of Hamburgh is said to do so from the profits of a public wine cellar and apothecary's shop. The state cannot be very great of which the sovereign has leisure to carry on the trade of a wine merchant or apothecary. The profit of a public bank has been a source of revenue to more considerable states. It has been so, not only to Hamburgh, but to Venice and Amsterdam. A revenue of this kind has even, by some people, been thought not below the attention of so great an empire as that of Great Britain. Reckoning the ordinary dividend of the Bank of England at five and a half per cent, and its capital at £10,780,000, the net annual profit, after paying the expense of management, must amount, it is said, to £592,900. Government, it is pretended, could borrow this capital at three per cent interest, and by taking the management of the bank into its own hands, might make a clear profit of £269,500 a year. The orderly, vigilant, and parsimonious administration of such aristocracies as those of Venice and Amsterdam, is extremely proper, it appears from experience, for the management of a mercantile project of this kind. But whether such a government as that of England (which, whatever may be its virtues, has never been famous for good economy; which, in time of peace, has generally conducted itself with the slothful and negligent profusion that is, perhaps, natural to monarchies; and, in time of war, has constantly acted with all the thoughtless extravagance that democracies are apt to fall into) could be safely trusted with the management of such a project, must, at least, be a good deal more doubtful.

The post office is properly a mercantile project. The government advances the expense of establishing the different offices and of buying or hiring the necessary horses or carriages, and is repaid with a large profit, by the duties upon what is carried. It is, perhaps, the only mercantile project which has been successfully managed by, I believe, every sort of government. The capital to be advanced is not very considerable. There is no mystery in the business. The returns are not only certain, but immediate.

Princes, however, have frequently engaged in many other mercantile projects, and have been willing, like private persons, to mend their fortunes by becoming adventurers in the common branches of trade. They have scarce ever succeeded. The profusion with which the affairs of princes are always managed, renders it almost impossible that they should. The agents of a prince regard the wealth of their master as inexhaustible; are careless at what price they buy; are careless at what price they sell; are careless at what expense they transport his goods from one place to another. Those agents frequently live with the profusion of princes, and sometimes, too, in spite of that profusion, and by a proper method of making up their accounts, acquire the fortunes of princes. It was thus, as we are told by Machiavel, that the agents of Lorenzo of Medicis, not a prince of mean abilities, carried on his trade. The republic of Florence was several times obliged to pay the debt into which their extravagance had involved him. He found it convenient, accordingly, to give up the business of merchant, the business to which his family had originally owed their fortune, and in the latter part of his life, to employ both what remained of that fortune and the revenue of the state of which he had the disposal, in projects and expenses more suitable to his station.

No two characters seem more inconsistent than those of trader and sovereign. If the trading spirit of the English East India Company renders them very bad sovereigns, the spirit of sovereignty seems to have rendered them equally bad traders. While they were traders only, they managed their trade successfully, and were able to pay from their profits a moderate dividend to the proprietors of their stock. Since they became sovereigns, with a revenue, which, it is said, was originally more than three millions sterling, they have been obliged to beg the extraordinary assistance of government in order to avoid immediate bankruptcy. In their former situation, their servants in India considered themselves as the clerks of merchants; in their present situation, those servants consider themselves as the ministers of sovereigns.

A state may sometimes derive some part of its public revenue from the interest of money as well as from the profits of stock. If it has amassed a treasure, it may lend a part of that treasure, either to foreign states or to its own subjects.

The canton of Berne derives a considerable revenue by lending a part of its treasure to foreign states; that is, by placing it in the public funds of the different indebted nations of Europe, chiefly in those of France and England. The security of this revenue must depend, first, upon the security of the funds in which it is placed, or upon the good faith of the government which has the management of them; and, secondly, upon the certainty or probability of the continuance of peace with the debtor nation. In the case of a war, the very first act of hostility, on the part of the debtor nation, might be the forfeiture of the funds of its creditor. This policy of lending money to foreign states is, so far as I know, peculiar to the canton of Berne.

The city of Hamburgh has established a sort of public pawn-shop, which lends money to the subjects of the state, upon pledges, at six per cent interest. The pawn-shop, or Lombard, as it is called, affords a revenue, it is pretended, to the state of 150,000 crowns, which, at 4*s.* 6*d.* the crown, amounts to £33,750 sterling.

The government of Pennsylvania, without amassing any treasure, invented a method of lending, not money, indeed, but what is equivalent to money, to its subjects. By advancing to private people, at interest, and upon land security, to double the value, paper bills of credit, to be redeemed fifteen years after their date, and, in the meantime, transferable from hand to hand like bank notes, and declared by act of assembly to be a legal tender in all payments from one inhabitant of the province to another, it raised a moderate revenue, which went a considerable way toward defraying an annual expense of about £4,500, the whole ordinary expense of that frugal and orderly government. The success of an expedient of this kind must have depended upon three different circumstances: first, upon the demand for some other instrument of commerce, besides gold and silver money; or, upon the demand for such a quantity of consumable stock, as could not be had without sending abroad the greater part of their gold and silver money, in order to purchase it; secondly, upon the good credit of the government which made use of this expedient; and, thirdly, upon the moderation with which it was used, the whole value of the paper bills of credit never exceeding that of the gold and silver

money which would have been necessary for carrying on their circulation, had there been no paper bills of credit. The same expedient was upon different occasions adopted by several other American colonies; but, from want of this moderation, it produced, in the greater part of them, much more disorder than conveniency.

The unstable and perishable nature of stock and credit renders them unfit to be trusted to as the principal funds of that sure, steady, and permanent revenue, which can alone give security and dignity to government. The government of no great nation that was advanced beyond the shepherd state seems ever to have derived the greater part of its public revenue from such sources.

Land is a fund of a more stable and permanent nature; and the rent of public lands, accordingly, has been the principal source of the public revenue of many a great nation that was much advanced beyond the shepherd state. From the produce or rent of the public lands, the ancient republics of Greece and Italy derived for a long time the greater part of that revenue which defrayed the necessary expenses of the commonwealth. The rent of the crown lands constituted, for a long time, the greater part of the revenue of the ancient sovereigns of European states.[1]

War, and the preparation for war, are the two circumstances which in modern times occasion the greater part of the necessary expense of all great states. But in the republics of Greece and Italy, every citizen was a soldier, who both served and prepared himself for service at his own expense. Neither of these two circumstances could occasion any very considerable expense

[1] Cohn remarks that the "German princes of the sixteenth, seventeenth, and even the eighteenth centuries regarded themselves as great landowners and landlords;" so that, in fact, "the administration of domains and forests was or was becoming the central point of their financial policy." In Prussia, as late as 1740, the prevailing opinion was "that the greatest conceivable stretch of taxation would not alone suffice to support the state and the army;" so that it was believed necessary to enlarge the domains and derive the largest possible revenue from them. In the southwestern states of Germany, also, the governments managed, even until the end of the eighteenth century, to get along without regular taxation in times of peace. Cohn, Finanzwissenschaft, § 59. In France and England the kings followed a less thrifty policy, and after the sixteenth and seventeenth centuries revenues from domains were of little importance. — Ed.

to the state. The rent of a very moderate landed estate might be fully sufficient for defraying all the other necessary expenses of government.

In the ancient monarchies of Europe, the manners and customs of the times sufficiently prepared the great body of the people for war; and when they took the field, they were, by the condition of their feudal tenures, to be maintained either at their own expense, or at that of their immediate lords, without bringing any new charge upon the sovereign. The other expenses of government were, the greater part of them, very moderate. The administration of justice, it has been shown, instead of being a cause of expense, was a source of revenue. The labor of the country people, for three days before and for three days after harvest, was thought a fund sufficient for making and maintaining all the bridges, highways, and other public works, which the commerce of the country was supposed to require. In those days, the principal expense of the sovereign seems to have consisted in the maintenance of his own family and household. The officers of his household, accordingly, were then the great officers of state. The lord treasurer received his rents. The lord steward and lord chamberlain looked after the expenses of his family. The care of his stables was committed to the lord constable and the lord marshal. His houses were all built in the form of castles, and seem to have been the principal fortresses which he possessed. The keepers of those houses or castles might be considered as a sort of military governors. They seem to have been the only military officers whom it was necessary to maintain in time of peace. In those circumstances the rent of a great landed estate might, upon ordinary occasions, very well defray all the necessary expenses of government.

In the present state of the greater part of the civilized monarchies of Europe, the rent of all the lands in the country, managed as they probably would be if they all belonged to one proprietor, would scarce, perhaps, amount to the ordinary revenue which they levy upon the people even in peaceable times. The ordinary revenue of Great Britain, for example, including not only what is necessary for defraying the current expense of the year, but for paying the interest of the public debts, and

for sinking a part of the capital of those debts, amounts to upward of ten millions a year. But the land tax, at four shillings in the pound, falls short of two millions a year. This land tax, as it is called, however, is supposed to be one fifth, not only of the rent of all the land, but of that of all the houses, and of the interest of all the capital stock of Great Britain, that part of it only excepted which is either lent to the public, or employed as farming stock in the cultivation of land. A very considerable part of the produce of this tax arises from the rent of houses and interest of capital stock. The land tax of the city of London, for example, at four shillings in the pound, amounts to £123,399, 6*s.* 7*d.* That of the city of Westminster, to £63,092, 1*s.* 5*d.* That of the palaces of Whitehall and St. James's, to £30,754, 6*s.* 3*d.* A certain proportion of the land tax is in the same manner assessed upon all the other cities and towns corporate in the kingdom, and arises almost altogether, either from the rent of houses, or from what is supposed to be the interest of trading and capital stock. According to the estimation, therefore, by which Great Britain is rated to the land tax, the whole mass of revenue arising from the rent of all the lands, from that of all the houses, and from the interest of all the capital stock, that part of it only excepted which is either lent to the public or employed in the cultivation of land, does not exceed ten millions sterling a year, the ordinary revenue which government levies upon the people even in peaceable times. The estimation by which Great Britain is rated to the land tax is, no doubt, taking the whole kingdom at an average, very much below the real value; though in several particular counties and districts it is said to be nearly equal to that value. The rent of the lands alone, exclusive of that of houses and of the interest of stock, has by many people been estimated at twenty millions, an estimation made in a great measure at random, and which, I apprehend, is as likely to be above as below the truth. But if the lands of Great Britain, in the present state of their cultivation, do not afford a rent of more than twenty millions a year, they could not well afford the half, most probably not the fourth part of that rent, if they all belonged to a single proprietor, and were put under the negligent, expensive, and oppressive management of his factors and agents. The crown lands of Great Britain

do not at present afford the fourth part of the rent which could probably be drawn from them if they were the property of private persons. If the crown lands were more extensive, it is probable they would be still worse managed.

The revenue which the great body of the people derives from land is in proportion, not to the rent, but to the produce of the land. The whole annual produce of the land of every country, if we except what is reserved for seed, is either annually consumed by the great body of the people, or exchanged for something else that is consumed by them. Whatever keeps down the produce of the land below what it would otherwise rise to, keeps down the revenue of the great body of the people still more than it does that of the proprietors of land. The rent of land, that portion of the produce which belongs to the proprietors, is scarce anywhere in Great Britain supposed to be more than a third part of the whole produce. If the land, which in one state of cultivation affords a rent of ten millions sterling a year, would in another afford a rent of twenty millions (the rent being, in both cases, supposed a third part of the produce), the revenue of the proprietors would be less than it otherwise might be by ten millions a year only; but the revenue of the great body of the people would be less than it otherwise might be by thirty millions a year, deducting only what would be necessary for seed. The population of the country would be less by the number of people which thirty millions a year, deducting always the seed, could maintain, according to the particular mode of living and expense which might take place in the different ranks of men among whom the remainder was distributed.

Though there is not at present, in Europe, any civilized state of any kind which derives the greater part of its public revenue from the rent of the lands which are the property of the state; yet, in all the great monarchies of Europe, there are still many large tracts of land which belong to the crown. They are generally forest; and sometimes forest where, after traveling several miles, you will scarce find a single tree; a mere waste and loss of country in respect both of produce and population. In every great monarchy of Europe the sale of the crown lands would produce a very large sum of money, which, if applied to the payment of the public debts, would deliver from mortgage

a much greater revenue than any which those lands have ever afforded to the crown. In countries where lands, improved and cultivated very highly, and yielding at the time of sale as great a rent as can easily be got from them, commonly sell at thirty years' purchase, the unimproved, uncultivated, and low-rented crown lands, might well be expected to sell at forty, fifty, or sixty years' purchase. The crown might immediately enjoy the revenue which this great price would redeem from mortgage. In the course of a few years it would probably enjoy another revenue. When the crown lands had become private property, they would, in the course of a few years, become well-improved and well-cultivated. The increase of their produce would increase the population of the country, by augmenting the revenue and consumption of the people. But the revenue which the crown derives from the duties of the customs and excise, would necessarily increase with the revenue and consumption of the people.

The revenue which, in any civilized monarchy, the crown derives from the crown lands, though it appears to cost nothing to individuals, in reality costs more to the society than perhaps any other equal revenue which the crown enjoys. It would, in all cases, be for the interest of the society to replace this revenue to the crown by some other equal revenue, and to divide the lands among the people, which could not well be done better, perhaps, than by exposing them to public sale.

Lands, for the purpose of pleasure and magnificence, parks, gardens, public walks, etc., possessions which are everywhere considered as causes of expense, not as sources of revenue, seem to be the only lands which, in a great and civilized monarchy, ought to belong to the crown.

Public stock and public lands, therefore, the two sources of revenue which may peculiarly belong to the sovereign or commonwealth, being both improper and insufficient funds for defraying the necessary expense of any great and civilized state, it remains that this expense must, the greater part of it, be defrayed by taxes of one kind or another; the people contributing a part of their own private revenue in order to make up a public revenue to the sovereign or commonwealth.[1]

[1] Smith's discussion of taxation will be considered in a later chapter. — Ed.

CHAPTER V

REVENUES FROM DOMAINS

16. Later Views concerning Domains: Rau. — In England and France, where revenues from landed domains had already sunk to small proportions, the opinions of Adam Smith concerning public landholding gained instant acceptance, and have ever since dominated financial thought. In Germany, Smith's views were accepted by many writers during the first half of the nineteenth century, but after that German opinion gradually drifted back toward the older position, and became more favorable to the retention of domains. About the middle of the nineteenth century a leading economist, Karl Heinrich Rau, presented the following summary,[1] which has become classical in German science, of the reasons for and against the alienation of domains:

At the present day the following are the principal reasons in favor of the alienation of domains:

1. A government is not well fitted to carry on an industry. Private owners, as a rule, make better use of a source of income because they work with greater zeal, give more thought to the improvement of processes, and can manage any branch of industry with vigor, a thing especially important in intensive agriculture. Governments, on the other hand, must maintain an expensive body of lower and higher officials who are less energetic and economical than a proprietor, or are fettered by troublesome administrative regulations. Experience shows conclusively that domains in private hands yield a larger net income. . . .

2. The sale of domains is an easy method of paying off public

[1] From Rau's Finanzwissenschaft, §§ 94–98 (fifth edition, 1864).

debts, if it is considered important to do this on a large scale; while the treasury profits thereby because the purchase price of land is usually so large that the interest on the debt retired exceeds the former income from the domains.[1]

3. The possession of domains gives the government special interests of its own which make it disinclined to undertake many reforms of general benefit to society, such as the abolition of feudal burdens on landed property; or it may at least be unpopular on account of the conflict which arises with the interests of private citizens.

4. Experience shows that domains are in no way necessary to insure a revenue sufficient to meet public expenditure, and that in several states of western Europe in which the domains yield only a small amount, adequate revenue flows regularly into the treasury without pressing too heavily upon the citizens.

Upon the other hand, the retention of domains, even at the present day, may be defended upon other grounds:

1. From the standpoint of general statecraft, domains have been considered an important support of hereditary monarchy, which has sprung from the possession of large landed wealth and must always rest upon it. Income from domains is prized also because it does not depend upon the consent or grant of a parliamentary body, and can be relied upon in times of internal disturbance or social changes. . . .

2. The income from domains arouses no dissatisfaction or feeling of deprivation, because it flows from a business undertaking independently carried on by the government by means of public property which has long been withdrawn from private ownership. Upon the other hand, taxes have to be paid year after year from the incomes of private citizens, and unavoidably lead to many inequalities and much vexation. If the domains should be sold to poor advantage or the purchase money unwisely used, it would then be necessary even to increase the taxes in order to make good the loss of the income from the domains.

[1] If, for instance, domains which yield a net income of 1,000,000 florins can be sold for 30,000,000 florins, and this sum can be used in retiring debts which bear 4½ per cent interest, the government in this way saves 1,350,000 florins in interest payments, which exceeds by 350,000 florins the income formerly drawn from domains.

But with this argument it is necessary to observe that the alleged advantage of income from domains would not be decisive if the public lands were less productive than private estates so that the production of wealth would be smaller. Only when the domains are as well managed as private estates is this argument important. Then in the next place, if the money received in the sale of domains is applied to the extinction of debts or profitably invested, no increase of taxation would be necessary; while if other causes increase public expenditures, the retention of domains could not prevent heavier taxation. In a well-governed state legal precautions would be taken against squandering the money received from the sale of domains, or spending it for current outlays.

3. Even if experience shows that public lands in many cases yield a smaller income than private estates, it cannot be affirmed that this must invariably be the case. In this matter one must take into account the kind of land in question, and its quality; while it must be remembered that the methods of administering it may be improved. . . .

4. The income from domains must increase in the course of time, because the rent of land rises as the prices of its products advance and the soil is better and more scientifically cultivated. (Rau goes on to show that this consideration is offset by the fact that the income from the lands is larger under private management, and that the public treasury will profit, therefore, because the citizens are richer.)

5. Public loans can be more easily floated because the domains afford collateral security acceptable to creditors. This, however, is of little moment, especially in the larger countries with good credit, where well-managed finances and the proven good faith of the government make landed possessions unnecessary as a support for public credit. The concurrence of a parliament in contracting a loan is of greater aid to the public credit than the pledging of domains, a security which is sometimes of doubtful legal force.

6. Domains may be useful because improved methods of cultivation can be introduced upon them, and then the knowledge of such things can be widely extended. . . .

Later German writers generally attach less weight than Rau did to the arguments in favor of alienation. Wagner, for instance, says that Rau erred in giving attention exclusively to the financial aspects of the question, or to the influence of public landownership on the production of wealth, and says that the problem of the distribution of wealth and various questions of social policy should be taken into account. The retention of domains, he thinks, may be defended on such grounds even when the considerations mentioned by Rau seem to tell against it.[1] Into this subject we cannot follow him, since the questions involved are not of a financial character and fall outside of the scope of our studies.

17. The Public Domain of the United States. — By cession from the original states and by subsequent acquisitions of new territory (as in 1803, 1819, 1845, 1846, 1853, and 1867), the United States has, at various times, come into the proprietorship of a public domain of not less than 2,708,388 square miles. The general policy of the government has been to dispose of the land as fast as seemed practicable and desirable. The methods followed and results achieved are described in the following article by Professor Albert Bushnell Hart:[2]

First in amount and importance are the sales. The history of the public lands happens to fall into five tolerably distinct periods, each of about twenty years. From 1784 to 1801, the policy of the government was to sell lands in large quantities by special contract; the result was an average sale of less than one hundred thousand acres yearly. In 1800 was inaugurated a new system of sales, in small lots, on credit; about eighteen millions of acres were thus taken, but more than two and a half millions subsequently reverted to the government under relief acts. In the middle of 1820 began a system of sales for cash,

[1] Finanzwissenschaft, I, §§ 219–220.

[2] Reprinted, by permission of author and publisher, from Hart's Practical Essays on American Government, pp. 239 *et seq.* New York, Longmans, Green, and Co. (1893).

in lots to suit purchasers. Seventy-six million acres were sold in twenty years; but of this large quantity one half passed out of the hands of the government in the two years preceding the panic of 1837. After that revulsion, the preëmption system was adopted, by which the most desirable lands were reserved for actual settlers, at a low price. Except in the years 1856–57, the sales were steady, and kept pace with the growth of the West. The homestead system carried the principle of "land for the landless" still further, and cut down cash sales to an average of a million acres a year. Since 1880, preëmptions have been resorted to again, in many cases for fraudulent purposes; and the total sales average almost four million acres a year. At present, lands are classified by the land office as agricultural, saline, town site, mineral, coal, stone, and timber, and desert lands. From 1854 to 1862, there was a further class of "graduated lands." These were tracts which had long remained unsold, and were offered to abutters at very low prices. The mimimum price for ordinary lands has for many years been $1.25 per acre. Timber lands and lands reserved from railroad land grants are sold at the "double minimum" of $2.50 per acre; mineral lands are valued at $2.50 and $5.00 an acre; coal lands, at $10 and $20 an acre.

It would seem, therefore, as though the sale of a hundred and ninety-two million acres must have brought in a handsome sum to the government. As long ago as 1787, Thomas Jefferson wrote: "I am very much pleased that our Western lands sell so successfully. I turn to this precious resource as that which will, in every event, liberate us from our domestic debt, and perhaps, too, from our foreign one." It is true that the proceeds of the public lands did eventually wipe out the last vestiges of the debt which had existed in 1787. It is true that the lands had, up to June 30, 1883, brought into the Treasury of the United States the smart amount of $233,000,000. It is equally true that, except for the period from 1830 to 1840, the lands have been a drain upon our finances. At the end of the financial year 1882–83, the government was out of pocket, so far as cash outlay and receipts are measures of the value of the lands, in the sum of more than one hundred and twenty-six millions of dollars.

The first great item of expense is the extinguishment of the Indian claim to ownership. Since 1781, the United States government has recognized the right of occupancy, but has asserted its sole prerogative to acquire Indian lands. First and last, up to the end of the fiscal year 1882–83, it had paid two hundred and nine millions of dollars for the interest of the Indian in his lands. . . . A second source of expense has been the purchase money paid for all the annexations since 1802, except that of Oregon. The items in the category taken together make an outlay of upward of eighty-eight millions. Surveys and expenses of disposition add fifty-five millions. If a strict account were to be made up, there should be added to the expenditure a proportion of the general expenses of maintaining the government and the whole cost of the Mexican war.

Unsatisfactory as is the financial result of our public-land policy, we must reflect that the sales account for but little more than a fourth part of the total disposition. Perhaps we shall find the remainder so used as to give some indirect benefit which cannot be reckoned in dollars and cents. . . . (After describing early grants to soldiers and others, the author passes on to consider the homestead grants. — Ed.)

The homestead act of 1862 introduced a new principle into the public-land system; it provided not only for the reservation of farms for actual settlers, but it proposed to give land to all heads of families, citizens of the United States or intending to become such. The effect of the act has been threefold. Under its provisions and those of the similar timber-culture act of 1873, immigration has been stimulated, the revenue from the lands was for many years almost cut off, and one hundred and fifty millions of acres have passed from the public domain into private hands. In some respects, the rapid settlement of the West, which has been greatly favored by the generous policy of the government, has undoubtedly conduced to the welfare of the country, and has made possible our elaborate systems of transportation and distribution on a large scale. It is, nevertheless, a question whether the present generation, as well as posterity, might not have been equally prosperous, if the government had made the conditions of acquirement more rigorous.

To ascribe the depletion of our reserves of land to the bounty

and homestead acts is unjust; the United States has given to the states almost as much as to individuals. Most of the original sixteen states (including Vermont, Kentucky, and Tennessee) were in possession of unoccupied lands in 1802. The new states as they have been admitted have received large gifts of three kinds. To most of them have been granted from one to six townships of saline lands, an aggregate of half a million acres. For all admitted to the Union previous to 1850 have been reserved one thirty-sixth of the public domain within their limits, for school purposes. The fortunate states which have come in since 1850 receive one eighteenth, and a like amount is reserved in each of the territories, except the Indian Territory and Alaska. The total thus set aside is about sixty-eight million acres. For each of the new states and territories has also been reserved a tract of from two to four townships for a university — a total of more than a million acres. In 1862, Congress granted to each state in the Union lands proportioned to its representation in Congress for an agricultural college. Nearly ten million acres were thus appropriated. It is at least doubtful whether a system of endowed public schools is desirable. Many of the states have squandered, lost, or misused the lands acquired for educational purposes. In others the people decline to tax themselves for school purposes, and rely wholly on the fund. But it is even worse with other forms of grants to states. In 1841, a time of reckless disposition of the lands, a grant of five hundred thousand acres was made to each of seventeen of the states, for internal improvements. The largest single gift made to the states up to that time was included in the swampland grants of 1849 and subsequent years. All the "swamp and overflowed lands" within the limits of any state were granted to that state. It was expected that the sale of a part would pay the expense of reclaiming the whole. It does not appear that any great improvements have been made by the states; and the United States is now spending large sums in building levees to protect regions thus presented to the states in 1850. When the six new states were admitted into the Union in 1890 and 1891, they received the most magnificent endowment ever bestowed on republican commonwealths. Part of the area was reserved school lands; part of it was in

the form of new gifts for public buildings, universities, and other purposes; the whole amounted to twenty-three million acres, and the gift was accompanied by a promise that no part should be sold at less than $10 an acre.

Throughout the history of the country there has prevailed the double error that a gift of land cost the government nothing, yet was of very great value to the recipient. Upon the land that is of any worth, the United States has spent money for surveys and administration; yet the states and other grantees have found it hard to turn the gifts into money. A great part of the educational grants have realized not more than a dollar an acre. It would in many respects be preferable for the government to appropriate the proceeds of the lands rather than to give the disposal of the soil to the states. A distribution act was passed in 1841, by which the net amount received for public lands was to be paid to the states; but it was repealed so speedily that only about $700,000 was thus distributed. A much larger sum has accumulated, and has been paid to the states, under the "two, three, and five per cent funds." By agreement with each state as it has entered the Union, the United States consents to pay over a proportion of the net proceeds of the lands within that state. More than $7,000,000 have been allowed under this provision. The deduction is not strictly a gift, since the states in return bind themselves not to tax public land until it has been five years in the hands of a private owner.

In theory, the lands appropriated for internal improvements of various kinds have also been sacrificed in order to make the remainder more valuable. The Ohio five per cent fund in 1802 was intended to be applied to the construction of the Cumberland road, which was to be the great avenue for purchasers and settlers from the Atlantic coast. This was the beginning of the system of internal improvement at the expense of the nation; but, in practice, Congress built the road out of general funds. It was not until 1827, four years after the first river and harbor bill, that direct grants of lands were made in aid of internal improvements. The new and momentous policy began with grants for canals. Between 1827 and 1850 about three million acres had been appropriated to this purpose, principally to secure the

completion of the system connecting the lakes with the Ohio and Mississippi. The jealousy caused by the action of Congress brought about the comprehensive grant of five hundred thousand acres to each "public land state," to which reference has already been made. But the most familiar form of grants for internal improvements dates from 1850. By that year the railroad system had been extended so far west as to penetrate large tracts of unsold lands. Congress aided the extension of the system by assigning to the states of Illinois, Alabama, and Mississippi nearly four million acres, to be used toward the construction of the Illinois Central and Mobile and Ohio lines, reaching from Chicago to the Gulf. Between 1850 and 1872 about eighty similar landgrants were made. The principal lines of communication in Minnesota and Iowa, and important roads in Wisconsin, Illinois, Missouri, Arkansas, Louisiana, Alabama, Mississippi, and Florida, were subsidized. In 1862 a new problem presented itself. It became a political necessity to lay a line of railroad across the continent. Between Iowa and California there were no states to which the grant could pass. Congress, therefore, promised a subsidy of land to corporations which undertook to build the Pacific railroads.

In the ten years following, some twenty-three similar grants were made, in almost all cases for roads running east and west, and intended to form links in transcontinental lines. To satisfy the terms of the acts, about one hundred and fifty-five millions of acres would be necessary. Several companies never built their roads, and earned no grant; others completed the work after the prescribed time. In a few cases Congress has formally declared the grant void, and has restored the land to the public domain. A few grants for canals and for wagon roads, between the years 1863 and 1872, make up the three remaining millions of the grand total promised by the government — a total of a hundred and sixty-two millions of acres. Out of this amount only about fifty millions of acres had been patented to the states and companies in 1883. During the ten years following, there have been legal reversions to the government of fifty million acres out of unpatented landgrants; and large tracts are still disputed.

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Yet so vast is the area of the country that the government might repeat its sales and gratuities, acre for acre, without exhausting its reserves of land in the West alone. In spite of the fact that the states had in the beginning, or have retained, five hundred million acres, and that the United States has parted with seven hundred and thirty million acres, the public domain still comprises nearly a thousand million acres.[1] The real significance of the present alarm about the disappearance of the public lands, lies in the fact that the greater part of the unsold lands are either reserved for the Indians or are unfit for ordinary tillage. Upon the best vacant lands — amounting to about a hundred millions of acres — the Indians are still seated. The area can be reduced by judicious and costly treaties; but it amounts only to about three hundred acres per head; and, if the occupants should take up land in severalty to the amount of 320 acres for each head of a family, they would still retain thirty million acres of valuable lands; they could not be dispossessed without such injustice as would rouse the nation. Experts in the land office assure us that, making all deductions and all allowances, the remaining lands are worth upward of a thousand millions of dollars. There is no evidence in the past policy of the government for believing that we shall actually net one tenth of that amount. The greater part of the region is officially classified as "Desert Lands," and is for sale in tracts of 640 acres, at $1.25 an acre. Nothing but the temporary increase of preëmption has enabled the land office at present to pay its running expenses out of its income. The golden time is past; our agricultural land is gone; our timber lands are fast going; our coal and mineral lands will be snapped up as fast as they prove valuable. There is no great national reserve left in the public lands unless there should be a change of policy. Should disaster overtake us, we must depend, like other nations, on the wealth of the people, and not on that of the government.

It is, of course, true that the lands are still in existence, and have been made many times more valuable by the labor of the

[1] On July 1, 1904, the unappropriated and unreserved public lands amounted to 841,872,000 acres, and the reserved lands to 172,873,000 acres. The lands sold or given away aggregated 794,790,000 acres. — Ed.

occupants. It is further true that large quantities of vacant land are for sale by the railroads and other grantees. There is no immediate danger of a land famine. There is abundant cause for criticism of the system adopted by the United States, but it should rightfully be directed rather against the manner in which the laws have worked than against their purpose. Since 1841 the lands have nominally been reserved for actual settlers; but practice has shown grave defects in the settlement laws — defects which Congress has no will to remedy. No man can legally preëmpt land or take up a homestead more than once; but this limitation is very difficult to guard, and perjury and fraud are alarmingly frequent. No one man can legally acquire more than 1120 acres of land from the government, if any one else wants the land; 160 acres as a preëmption, as much more as a homestead, another quarter section as a tree claim, and a section of 640 acres as a desert-land claim. Actually, single individuals and companies own large estates, which a few years ago were in the hands of the government.

The accumulation of the large tracts is often brought about by fraud, but much oftener through the mistaken generosity of the government or through defective land laws. It is not always necessary to hire men fraudulently to take up land for the company. In Texas, the state has sold its lands in its own way, often in large blocks. The school lands and the scrip for bounty warrants have legally been used for locating wide extending estates. The railroad lands, although not in compact tracts, can be used as a nucleus for a large accumulation; and, in a country where land is cheap and money dear, the patient, long-headed capitalist can buy up valuable claims in a legitimate manner. The chief source of the present trouble in the West lies in the fact that the government never recognized that grazing land must be sold and occupied under different conditions from ordinary arable lands. The first comers have been allowed to take up the water fronts. Any comprehensive system of irrigation of large areas for the benefit of future land seekers has thus been forever prevented. The possessor of the rivers and water-holes has gained control of the country behind his claim. In such a contest, the largest and richest concerns have a great advantage. There was a time when the government

might have laid out, for sale or lease, large tracts of grazing lands, each with a sufficient water front. It is now too late.

The fundamental criticism upon our public-land policy is, not that we have sold our lands cheap, not that we have freely given them away, but that the gifts have in too many cases inured to the benefit of those whom the government meant to ignore. The "land grabber" is, in most cases, simply taking advantage of the chances which a defective system has cast in the way of shrewd and forehanded or unscrupulous men. The difficulty is certainly not in the land office, which, in the midst of perplexing complications, has striven hard to protect our lands. The fault lies at the door of the Congress of the United States, which has the power, but not the will, to correct notorious defects in our system. Still farther back, the fault is with the free citizens of the Republic, who have been too much occupied to insist that there should be a comprehensive land policy, providing for the equitable disposition of all classes of the public lands.

18. The Case of Forests. — It is now generally admitted that public ownership of forests stands upon a very different footing from public ownership of agricultural land. Leroy-Beaulieu, for instance, who supports strongly the view that public ownership of agricultural domains is unwise, holds that the case is otherwise with forests. He says:[1]

Up to this point we have studied only the agricultural domain of the state, but the greater part of the land owned by states consists of forests. These differ very greatly from agricultural holdings. They are much better adapted for state management because they have to be administered on a large scale, methodically, and by scientific rules. The ability of the state to manage forests is better established than its ability to administer agricultural properties. In the former case the state seems to have the natural mission to preserve this form of wealth, which is so necessary to the country and so likely to be destroyed by private individuals. The state, since it is in

[1] Traité de la science des finances, Pt. I, Bk. 1, ch. 4. Reproduced by permission of the author.

modern societies the only immutable thing, the only agent to represent posterity and to guard the interests of coming generations, does not depart from its legislative functions when it preserves forest property the maintenance of which is considered advantageous to the prosperity of the country.

At this point we should not take the purely financial, what the Germans call the "cameral," point of view. Although forests may be a source of revenue to a state, and, as we shall show, a source of increasing revenue, this is merely an incidental consideration; it would not be enough to justify state ownership of forests. And it is no longer necessary to consider the question from the administrative point of view, with reference to the needs of the public service. Formerly one of the reasons assigned for state forest preservation was that the navy needed the most perfect ship timber, which could with difficulty be found in private forests. But now that ships are built chiefly of iron and steel, this argument has lost its force. In truth it never had much weight, since a state could always purchase abroad, by offering a suitable price, the ship timber which it needed. And, finally, the subject should not be studied from what may be called the "democratic" point of view. Sometimes state preservation of forests has been urged in the interests of the consumers, especially of the lower classes, to whom wood is an article of prime necessity, the price of which ought not to be too high. But the state is no more bound to insure to consumers a reasonable price for wood than for grain; and, besides, it could be argued that while the state reduced the price of wood by preserving a large forest area, it was raising the prices of grain and meat by reducing the area devoted to producing these commodities.

The true point of view is that of the influence of the forests upon the climate, the flow of rivers, and the general conditions of production. If it is demonstrated that the complete disappearance or the serious diminution of the forests results in more frequent drouths and turns rivers into devastating torrents, it is evident that the important interest of the regulation of the water supply justifies state ownership of forests. The disappearance of these forest reserves, which regulate naturally the flow of the rivers, would injure the surrounding country,

deprive it of part of its productivity, and decrease its salubrity. Now these facts have been established conclusively. . . . They have been observed in France, particularly in Provence, in Algiers, in various European countries, such as Austria and Italy, and in America also, especially in Brazil.

Experience proves that private owners generally are very much inclined to cut trees, and very little inclined to plant them, at least in large quantities. Forest destruction offers the allurement, often deceptive, of great increase in the value of the land when it is transformed into open fields; and a great number of landowners are seduced by this prospect, especially peasants. Upon the other hand, tree planting and sowing upon a large scale, since they entail an immediate expense which will yield no return until the end of a long period of years, are undertaken only by men of foresight and of easy circumstances.[1]

19. National Forest Reserves in the United States. — The conditions just described have led the United States to establish national forest reserves of which the following brief account has been published by the Forest Service:[2]

Forest reserves are for the purpose of preserving a perpetual supply of timber for home industries, preventing destruction of the forest cover which regulates the flow of streams, and protecting local residents from unfair competition in the use of forest and range. They are patrolled and protected, at government expense, for the benefit of the community and the home builder.

[1] At the present day the forest area of the German Empire is about 13,956,000 hectares. Of this 33.3 per cent belongs to the royal or state forests and 15.6 to various local governing bodies. Private owners, individuals, or associations hold 51.1 per cent. Elster, Wörterbuch der Volkswirthschaft, I, 737. In France the forest holdings of the central government amount to about 1,070,000 hectares, and those of the communes amount to about 2,058,000 hectares. Bastable, Public Finance, 171. From a financial point of view, income from forests is generally not important, except in some of the German states. The Prussian budget for 1903 estimated the gross receipts from forests at 106,854,000 marks, and the net receipts at 60,000,000 marks. Bastable, 172. — Ed.

[2] The Use of National Forest Reserves, 7–11. Published by the Forest Service (1905).

We know that the welfare of every community is dependent upon a cheap and plentiful supply of timber; that a forest cover is the most effective means of maintaining a regular stream flow for irrigation and other useful purposes; and that the permanence of the live-stock industry depends upon the conservative use of the range. The injury to all persons and industries which results from the destruction of forests by fire and careless use is a matter of history in older countries, and has long been the cause of anxiety and loss in the United States. The protection of the forest resources still existing is a matter of urgent local and national importance. This is shown by the exhaustion and removal of lumbering centers, often leaving behind desolation and depression in business; the vast public and private losses through unnecessary forest fires; the increasing use of lumber per capita by a still more rapidly increasing population; the decrease in the summer flow of streams just as they become indispensable to manufacture or irrigation; and the serious decrease in the carrying capacity of the summer range. It cannot be doubted that, as President Roosevelt has said, "the forest problem is, in many ways, the most vital internal problem of the United States."

As early as 1799 Congress provided for the purchase of timber lands to supply the needs of the navy, and in 1817 further legislation directed the setting apart of public lands for the same purpose, and provided penalties for the unauthorized cutting of any public timber. Other acts, from time to time, made similar provisions for setting apart forest land for specific purposes, but the first attempt to secure a comprehensive administration of the forests on the public domain was in 1871, by a bill introduced in the Forty-second Congress, which failed of passage.

In 1876, $2,000 was appropriated to employ a competent man to investigate timber conditions in the United States, and on June 30, 1886, an act was approved creating a Division of Forestry in the Department of Agriculture. On July 1, 1901, this division became the Bureau of Forestry (now the Forest Service), employing practically all the trained foresters in the United States, and engaged in almost every branch of forest work in every state and territory, except the actual administration of the government forest lands. These remained in the Department of the

Interior, which, although possessing complete machinery for the disposal of lands, was provided with neither system nor trained men for conservative forest management.

In the meantime, with the increasing realization that the nation's timber supply must be protected, and with the immense growth of irrigation interests in the West, the necessity for retaining permanent federal control over selected forest areas was recognized by a brief section inserted in the act of March 3, 1891, which authorized the President to establish forest reserves. The first exercise of this power was in the creation of the Yellowstone Park Timber Land Reserve, proclaimed by President Harrison March 30, 1891.

The mere creation of forest reserves, however, without provision for their administration, was both ineffectual and annoying to local interests dependent upon their sources. Consequently the Secretary of the Interior, 1896, requested the National Academy of Sciences to recommend a national forest policy. This resulted in the passage of the act of June 4, 1897, under which, with several subsequent amendments, forest reserves are now administered.

On the theory that the management of land, not of forests, was chiefly involved, this law gave the Secretary of the Interior authority over the reserves, and provided that their surveying, mapping, and general classification should be done by the United States Geological Survey, and the execution of administrative work by the General Land Office.

The result was not satisfactory. The technical and complex problems arising from the necessary use of forest and range soon demanded the introduction of scientific methods and a technically trained force, which could not be provided under the existing system. The advice and services of the Bureau of Forestry were found necessary, but, under the law, could be but imperfectly utilized. The necessity of consolidating the various branches of government forest work became apparent and was urged upon Congress by the President and all the executive officers concerned. Finally, the act of February 1, 1905, transferred to the Secretary of Agriculture entire jurisdiction over the forest reserves except in matters of surveying and passage of title.

The regulations and instructions for the use of the national

forest reserves here published are in accordance with the act last mentioned and with that of March 3, 1905, making appropriations for the Department of Agriculture, which changed the Bureau of Forestry into the Forest Service. They are based upon the following general policy laid down for the Forest Service by the Secretary of Agriculture in his letter of February 1, 1905, to the forester:

"In the administration of the forest reserves it must be clearly borne in mind that all land is to be devoted to its most productive use for the permanent good of the whole people, and not for the temporary benefit of individuals or companies. All the resources of forest reserves are for *use*, and this use must be brought about in a thoroughly prompt and businesslike manner, under such restrictions only as will insure the permanence of these resources. The vital importance of forest reserves to the great industries of the Western states will be largely increased in the near future by the continued steady advance in settlement and development. The permanence of the resources of the reserves is therefore indispensable to continued prosperity, and the policy of this department for their protection and use will invariably be guided by this fact, always bearing in mind that the *conservative use* of these resources in no way conflicts with their permanent value.

"You will see to it that the water, wood, and forage of the reserves are conserved and wisely used for the benefit of the home builder first of all, upon whom depends the best permanent use of lands and resources alike. The continued prosperity of the agricultural, lumbering, mining, and live-stock interests is directly dependent upon a permanent and accessible supply of water, wood, and forage, as well as upon the present and future use of these resources under businesslike regulations, enforced with promptness, effectiveness, and common sense. In the management of each reserve local questions will be decided upon local grounds; the dominant industry will be considered first, but with as little restriction to minor industries as may be possible; sudden changes in industrial conditions will be avoided by gradual adjustment after due notice, and where conflicting interests must be reconciled, the question will always be decided from the standpoint of the greatest good of the greatest number in the long run."

CHAPTER VI

REVENUES FROM PUBLIC INDUSTRIES

20. The Post Office. — The best-established and in many cases the oldest form of public industry is the postal service, which Adam Smith described as "the only mercantile project which has been successfully managed . . . by every sort of government." The history and principles of administration of this branch of public business are thus discussed by President A. T. Hadley, of Yale University:[1]

I. History

The first extensively organized postal service was the *cursus publicus* of the Roman Empire. It was developed in connection with the system of Roman roads, and, like them, was primarily intended to subserve military and administrative purposes. It amounted to nothing more than a fully equipped set of relay stations for the rapid forwarding of official correspondence, not for the use of the general public. Traces of it survived the fall of the old Roman Empire, and lasted well on into the Middle Ages; but not as an institution with which modern postage can be shown to have any historical connection.

The postal systems which sprang up in the Middle Ages were, as might be expected, not centralized, but in the hands of local organizations: commercial cities, universities, or orders of knights. The city post offices were the earliest organized, and in the time of prosperity of the Hanseatic League attained a high stage of development. Originally intended for purposes of trade communication between the guilds and merchants of Westphalia and those on the sea coast, they became an im-

[1] Reprinted, by permission of the author and arrangement with the publishers, from Lalor's Cyclopædia of Political Science, III, 306–310. Published by Maynard, Merrill, and Company, New York (1883–84).

portant convenience to the general public of Northern Germany. The postal arrangements of the universities were developed in a similar way. First intended as a channel of communication between scholars and their homes, the same facilities were soon afforded to others who lived where they could avail themselves of them. The most important example of the third class was the postal service of the knights of the Teutonic order, extending over the northeast of Germany almost as widely as that of the Hanse towns over the northwest.

At the end of the fifteenth century, as centralizing governments grew up and supplanted the feudal system, national postal service was attempted, and ultimately prevailed. In this, as in all other similar matters, France took the lead. The first steps were taken by Louis XI, and they were followed up by Charles VIII. The wars of the sixteenth century checked this development; but it was resumed under Louis XIII; and in 1681 was so far advanced that letter carrying was made a government monopoly, though largely controlled by private hands till the legislation of 1790. In England there are traces of a postal service and postal regulations going back to a very early time; but the organized business of letter carrying seems to date from the reign of James I. It was made a government monopoly by the legislation of 1649 and 1657, although the business was farmed out until 1709.

In the countries ruled by the house of Austria, an international postal system was started under the administration of the Taxis family. At the beginning of the sixteenth century they established regular communication between Brussels and Vienna; soon a line was added to Milan and beyond, and not long after a further line to Madrid. In 1595 Leonard von Taxis received the office of postmaster general of the empire; and in 1615 this dignity was made hereditary. It was much harder to establish a monopoly here than in France or England, owing to the extent of ground to be covered, the full development of special postal services, and the weakness of the imperial authority. The nominal rights granted by the investiture could only be carried into effect by treaties with the individual states; and many of these preferred to maintain postal systems of their own. This was the case in Austria on the one hand, and in

Brandenburg (and thus eventually Prussia), as well as many less important states of North Germany, on the other. The postal service of the Taxis family was thus chiefly exercised in the smaller states of Middle and Southern Germany, where it survived the fall of the empire, and lasted till 1866.

A long time elapsed after the governments took control of the postal service before they made it efficient. The usefulness of the English post office dates from the year 1784, when measures of reform were introduced by Palmer, the postmaster general, with the warm support of Pitt. Previous to his time the mail conveyance had been infrequent, slow, irregular, and utterly unsafe. In the eight years of his tenure of office he doubled the frequency and speed of conveyance, and secured a reasonable degree of regularity and safety, chiefly by the substitution of coaches for single riders as a means of carriage. But, though the service was much improved, the rates continued exorbitant; so much so that a vast deal of private letter conveyance was done, in defiance of government rights. In the years 1830–35 the pressure in favor of low rates began to make itself felt; and the movement in this direction was ably headed by Rowland Hill, whose work on "Postal Reform, its Importance and Practicability" appeared in 1837. His proposal to reduce inland postage to about one tenth of its former figure was so sweeping as to cause a great sensation and not a little opposition; but the idea was carried out in 1840, and the example thus set by England was soon followed by the other civilized nations; though generally with gradual instead of sudden reduction.

The bill which established penny postage also introduced the use of postage stamps. The idea was not a new one; abortive attempts to carry it out had been made in France in 1653 and 1758, in Spain in 1716, in Sardinia in 1819–36. But in connection with the reduced postage and increased correspondence which followed it, stamps proved of indispensable service; and the example of England in introducing them was, within ten years, followed by nearly all prominent states. In the years 1869–74 came the still further reduction in price effected by the use of postal cards, originating in Austria.

The postal system of the United States dates from colonial times, being specially provided for in the postal act of Queen

Anne's reign; and its character was not very distinctly changed by the separation, or by any causes other than the natural growth of the country. Before the passage of the act of 1845, inland rates varied from six to twenty-five cents a sheet. The act of 1845 provided for rates of five and ten cents, according to distance; and in 1847 stamps of these denominations were introduced. In 1851 postage for nearly all home letters was reduced to three cents.[1]

The detailed history of postal development in different countries offers so few peculiarities that it is unnecessary to treat them separately. Everywhere we have, first, gradual improvement of service; then, simultaneously, lowering of rates, equalization for different distances, introduction of postage stamps, abandonment of the sheet as the unit of charge, and substitution of a unit of weight, at first almost always somewhat below the present half ounce (fifteen grams) standard. By the year 1851 the postal legislation and policy of civilized nations, as far as concerns home correspondence, had approached near to its present shape.

Not so with foreign correspondence. For a long time nothing was done to encourage that, even by those administrations that were anxious to extend home facilities. It was not until 1833 that a daily mail was established between London and Paris; and even then there was communication but twice a week with other parts of the continent. There were discriminating rates against foreign correspondence, which were sometimes almost prohibitory. The rate for a letter from London to Dover was 8*d.*; but if it was to be forwarded to France, the charge for the same part of the route in 1834 was 1*s.* 2*d.*; if intended for Germany, 1*s.* 8*d.*; for Italy, 1*s.* 11*d.* The ship charge for carrying a letter to the United States was six cents, or 3*d.*; the rate charged by the British post office for delivering such a letter to the ship was 2*s.* 2*d.* For letters directed to Spain, it was the same; for those to Brazil the inland rate was actually 3*s.* 6*d.* The rates of other countries indicated a similar policy. As international correspondence increased, and with it the demand for more favorable terms, these high charges could not well be reduced without common action on the part of the two nations

[1] Upon October 1, 1883, the rate was reduced to two cents. — Ed.

concerned. Hence resulted a number of postal treaties, among which may be mentioned, as leading ones, the system of treaties (1840-50) between Austria, Prussia, and the smaller German states — many of the latter still represented by the heir of the Taxis family; also the series between France and England. Not the least important and delicate matter in some of these treaties was the provision concerning charges for letters in transit, to be delivered in some third country beyond. By means of these treaties the rates between the different nations of Europe were gradually reduced. Not so successful was the attempt to reduce them between Europe and America. The foreign postage policy of the United States had been for a long time exceedingly liberal, and it was only the conservatism of England that had prevented cheap postage between the two countries. Then at the time when England was making her postal reforms at home, steamships were taking the place of sailing vessels; and the subsidies which England wished to pay the steamship lines made her statesmen unwilling to reduce a postage rate which seemed to furnish such a suitable means of defraying the expense. Then came the adoption of the same system on the part of France, and attempts in the same direction in America; and every effort to support a subsidized steamship line lessened the strength of the demand for cheap transmarine postage. The United States rate for a considerable time was twenty cents, except where special arrangements provided otherwise; and these arrangements were apt to mean higher instead of lower rates. But with the abandonment of the Collins line of steamers, the United States again took strong ground in favor of lower rates; and, at its suggestion, a conference was held at Paris in 1863, relative to common action in the matter of international postage. This conference was only deliberative; it did not do away with the necessity of special treaties, though there was a continued lowering of rates in these. A similar conference, to be invested with greater powers, was invited to meet at Bern, in 1873; but as France, on the ground of financial embarrassments, declined to take part, it was postponed and reconvened in September, 1874, when the leading nations were satisfactorily represented. In spite of some moderate opposition from France, which was hampered by its subsidy system of mail contracts, and in spite

of great lukewarmness on the part of England, public feeling in favor of cheap postage was so strong that, on October 9, a postal union was formed on a general basis of five cents per half ounce letter postage, to go into effect, with some few exceptions, July 1, 1875. Even France agreed that it would ultimately acquiesce in this rate. Other nations, not at first included, joined the postal union in rapid succession, and in 1878 a second congress was held at Bern, which carried out the ideas of the first into the shape of a postal union treaty, embracing the following points: 1, harmonious arrangement of lines for international connection, transit, etc.; 2, avoidance of international competition; 3, proper distribution of expenses, and, if necessary, pooling of receipts; 4, international equality of treatment; 5, equality of standards of weight, etc. These postal treaties have now been agreed to by all Europe and most of the other countries of the world. The postal union has a permanent organization at Bern, with its regularly published series of reports.

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In this historical account, attention has been confined to the letter post as the most important part of the system. The post office has at different times and places attempted the conveyance of newspapers, unsealed packages, money, persons, and telegrams; not to speak of matters like postal savings banks, being quite aside from its main function. In almost all cases it has done so in more or less direct competition with private enterprise: though the English government had, up to the year 1840, a virtual monopoly of newspaper carriage; while in many parts of the continent of Europe the actual competition in forwarding small parcels is not to-day noticeable. The conveyance of money has generally been effected under a form like a registered letter; but in England the habitual use of cheques led to the early development (1838) of the post office money order, which was slow in making its way into other countries. The rapid conveyance of persons from place to place by government posting arrangements, was at one time almost as important, at least in the eyes of the authorities, as the conveyance of letters; but it, of course, nearly fell away with the introduction of railways, except in the few countries, like Norway, which combine considerable demand for communication with the impracticability

of railways. On the other hand, postal telegraphy seems destined to grow in importance. In many countries of Europe the telegraph was from the beginning developed in connection with the post office; while in England it was brought under its control in 1870.

II. Principles of Administration

The question whether the state should control the post office need not be seriously discussed as an open one. Our experience with railroads has shown what we may expect from private management in affairs of this kind — unsteadiness and discrimination of rates, and development of competing and favored points at the expense of all others. When it is impossible to avoid this in transportation, unless by combinations and monopolies no less dangerous than the evil itself, it can hardly be seriously proposed to introduce it into the system of postal communication. On the other hand, the question as to how far the post office should extend its activity to the conveyance of parcels, telegrams, etc., cannot be adequately treated here; partly because the necessity changes so entirely with varying local conditions, partly because special technical reasons are involved, to which justice can be done only in separate articles.

Setting these points aside, we have two distinct series of questions to deal with: first, as to the financial or administrative aims with which the post office should be conducted; second, as to the means to be employed for securing those aims. Of the two, the first is more difficult, and at the same time of more general importance and interest.

We see in the history of the institution that the post office was taken up by governments far more with a view of strengthening their own position than for the convenience of their subjects. This was equally the case whether they used it exclusively for their own business, as in Rome, or for the sake of getting administrative control into their hands, as in France. This carelessness of public interest led to its management under systems of lease or investiture, whatever means would secure money or influence with the least trouble. That state of things was outgrown in the last century, and men attained to the conception (though not always to the reality) of the postal service

as a public interest; to be managed directly by the state for the public advantage. But the particular form of public advantage to be aimed at was not yet settled. The post office might be managed in any one of four ways: 1, as a tax; 2, to yield good business profit; 3, to pay expenses; 4, to best accommodate the public. On the whole, the third of these principles is tending to prevail, but there has been, and is still, much deviation from it.

1. The use of the post office as a means of taxation was an idea belonging distinctly to the earlier period, now outgrown. Yet, in practice, the lowering of rates was so slow that the government monopoly at the charges ruling previous to 1840 had all the characteristics of a tax, and of one placed at the highest limit the business would bear; making itself felt not so much by the amount of money collected as by the means adopted to evade payment, by keeping correspondence within narrow limits or forwarding it by illegal agencies. The discriminating rates against foreign postage were still more obviously of the nature of a tax, and were felt to be so when connected with the subsidy system; so that the abandonment of the principle of managing the post office as a tax cannot be said to have been complete till the final lowering of rates by France and Italy subsequent to the postal congress of 1878.

2. The idea of managing the post office to obtain business profits is much more plausible, and in those branches of the postal service which come into competition with private agencies, such as express companies, is probably sound. But in letter carrying, where there is a government monopoly, it is liable to misapplication in two ways. First, the absence of competition leaves the decision as to what constitutes a good business profit in the hands of the post office authories, who, in the uncertain conditions and bases of calculation, have every motive to aim too high, and thus give the result the character of a tax; and, second, the absence of outside control of rates makes it natural for the authorities to secure the required excess of income over expenditure by doing a small business at high charges, instead of a large business at low charges. As a matter of fact, business profits under a government monopoly are not clearly distinguishable from taxes. Compare the arguments used (1835–50)

against lowering postal rates with the results which actually followed such lowering. The most marked instance of reduction and its consequences may be taken from Rowland Hill's reform, by which postage was reduced to one tenth its former figure. The financial showing did not quite realize Hill's anticipations, partly on account of a change in the legislation respecting newspapers; nevertheless, the department continued to do much more than pay expenses; its gross income reached its former figure in ten years, its net income in about thirty years; and in the last case the department was serving the public by carrying fourteen times as many letters as in 1839. The system of business profits is, however, in large measure maintained both in England and France.[1]

3. The idea of managing the post office simply to pay expenses gained hold in connection with the reforms of 1840. Even those writers who, from a financial standpoint, criticise the suddenness of Hill's change, and prefer the continental and American policy of gradual reduction, do so on account of the evils of suddenly shifting the burdens of taxation rather than from any objection to the principle itself. Yet, while their theorists hold this view, in practice most European states so far keep to the older policy as to secure a slight excess of income over expenditure in this department; perhaps, in general, not more than would meet interest on the cost of buildings. The disadvantages of the profits principle have been already set forth; the corresponding advantages of the cost principle are: first, that it takes away the uncertainty as to the result to be striven for; and, second, that it furnishes a tangible basis on which the rates are likely to be computed, with due regard to the public interest.

4. To carry letters without paying expenses (that is to say, below cost) is to tax the general public for the sake of a special service; usually a thing to be avoided. Yet, there are considerations which sometimes make it necessary to proceed on this principle. In countries like the United States or Russia, there

[1] In England, in 1904, the net revenue of the post office proper was £4,644,000; then after meeting a deficit in the department of telegraphs, the net revenue still stood at £3,660,000. In France, in 1902, the net revenue from posts and telegraph was 66,120,000 francs. — ED.

are strong social and administrative reasons for establishing long routes over sparsely populated districts. These involve a large increase in expense, with no corresponding increase in revenue, whatever rate of postage is charged upon them. They have often caused a postal deficit in Russia, and almost always in the United States. If the expense of these routes causes a deficit in the whole department when the rates of postage are moderate, the additional income which could be obtained by higher postal rates would not be likely to cover it, because higher postal rates mean fewer letters. Thus the government must be prepared to meet the deficit. But — to take another consideration — suppose that the deficit could be met by higher rates. Suppose that in America by such rates a surplus could be obtained in the already self-sustaining East, sufficient to meet deficits in the South and West,[1] or that such surplus could be obtained upon the main routes as to meet deficits upon the minor ones. What then? Such a proceeding would be a tax upon the correspondence of one section for the benefit of another. The interests subserved by such routes are not the postal interests. They are the general interests of the country; and to force the postage returns of other sections to pay for this service is to intensify the unfairness of taxation which it is intended to avoid. Thus the principle now generally favored is, that the post office should aim to pay expenses; but the traditional practice of European administrations is to make it do somewhat more; and the special circumstances of the United States have justified the practice of allowing it to do somewhat less.[2]

How shall the rates be adjusted in accordance with the financial principle chosen? is the second question. Under the older systems of taxation or profit, the rate was carried as high as the business would bear, and often higher, with the result of caus-

[1] In a recent year the gross receipts of all post offices were $139,586,000. Of this sum, $10,000,000 was collected in Massachusetts and Connecticut; $41,300,000 in New York, New Jersey, Pennsylvania, and Maryland; $34,400,000 in Ohio, Indiana, Illinois, Michigan, and Wisconsin. These eleven states furnished $85,700,000, or about 61 per cent of the total post-office revenue. — Ed.

[2] In the United States the postal revenues uniformly exceeded the expenditures from 1789 to 1819; so that during that period the post office earned a profit of $1,642,000. From 1820 to 1852, there were thirteen years in which there was a surplus, and nineteen in which there was a deficit; the entire period of thirty-two

ing much smuggling. On those principles they of course charged much more for long routes than for short ones. Until 1845 the United States minimum charges were as follows: under 30 miles, 6 cents; under 80 miles, 10 cents; under 150 miles, 12½ cents; under 400 miles, 18¾ cents; over 400 miles, 25 cents. Yet, even at this time, before the development of railways to any extent, it was computed that the cost of transmission of letters constituted less than two sevenths of the whole, and the cost of collection and delivery more than five

years showing a very slight deficit; so that practically revenue balanced expenditure. From 1852 to the present time there has generally been a deficit as shown by the following table of the money paid out of the United States Treasury to meet deficiencies in the postal revenues:

(In thousands of dollars)

1852	1,741	1879	3,297
1853	2,255	1880	3,597
1854	2,736	1881	3,297
1855	3,114	1882	6
1856	3,748	1883	21
1857	4,528	1884	140
1858	4,679	1885	6,066
1859	3,915	1886	8,751
1860	11,154	1887	4,746
1861	4,639	1888	3,386
1862	2,598	1889	5,745
1863	1,007	1890	6,100
1864	749	1891	4,441
1865	3	1892	6,260
1866	—	1893	6,727
1867	3,991	1894	10,200
1868	5,696	1895	9,872
1869	5,707	1896	8,830
1870	4,022	1897	12,133
1871	4,126	1898	9,341
1872	4,993	1899	7,902
1873	5,990	1900	6,250
1874	5,922	1901	4,001
1875	6,704	1902	2,490
1876	5,088	1903	3,753
1877	7,013	1904	7,631
1878	5,307		

It will be observed that the deficit had been reduced to small proportions just prior to the reduction of the rate of letter postage in 1883. — Ed.

sevenths. Compared with what it would cost the sender to evade payment, the differential rates were just; compared with what it cost to perform the service, they were absurd. And, as time went on, the absurdity increased. Improved means of communication rendered the whole cost of transmission a less important element; rapid increase of communication between distant places still further reduced differences in the cost of transmission. And with the rising feeling in favor of a system based on expense, not on profit — "freight, not tax," in the words of the day — a gradual equalization of rates for different distances was inevitable. On the continent of Europe, there was, for like reasons, a similar tendency, partially carried out, to do away with weight as an element in letter postage. This idea never took much hold in America, unless we regard the treatment of books and newspapers as an instance of it. There is no inherent reason why the post office should prefer to carry printed matter rather than written matter of the same weight. But printed matter, being habitually sent in large parcels, was, weight for weight, far easier to handle; especially so in the case of papers which went from day to day on the same routes in about equal quantities. Moreover, monopoly rates had never taken firm root here, owing to the competition of private agencies in the delivery of unsealed matter. All these reasons combined to produce the lower rates on those classes of goods.

These practical ideas are followed out in the inland postage of almost all civilized countries, whether the results are such as to more than cover or slightly less than cover the expense. In international postage it is sometimes difficult to carry them out with fairness. The five-cent rate was based on a rough average of transmission expenditures; and countries unfortunately situated or organized may be unable to meet their foreign postal expenses on this rate. The general advantages of belonging to the postal union are a sufficient compensation for such of these inequalities as cannot be satisfactorily arranged.

21. The Post Office and Other Industries. — In 1867 Professor Jevons published the following paper upon "The Analogy between the Post Office, Telegraphs, and other Systems of Con-

veyance in the United Kingdom in regard to Government Control": [1]

It has been freely suggested of late years, that great public advantage would arise from the purchase and reorganization of the electric telegraphs and railways of the United Kingdom, by the government. So inestimable, indeed, are the benefits which the post office, as reformed by Sir Rowland Hill, confers upon all classes of society, that there is a great tendency to desire the application of a similar reform and state organization, to other systems of conveyance. It is assumed, by most of those who discuss this subject, that there is a close similarity between the post office, telegraphs, and railways, and that what has answered so admirably in one case, will be productive of similar results in other parallel cases. Without adopting any foregone conclusion, it is my desire, in this short paper, to inquire into the existence and grounds of this assumed analogy, and to make such a general comparison of the conditions and requirements of each branch of conveyance, as will enable us to judge securely, of the expediency of state control in each case.

* * * * * * *

Much difference of opinion arises, even in a purely economical point of view, upon the question of the limit of state interferences. My own strong opinion is that no abstract principle, and no absolute rule, can guide us in determining what kinds of industrial enterprise the state should undertake, and what it should not. State management and monopoly have most indisputable advantages; private commercial enterprise and responsibility have still more unquestionable advantages. The two are directly antagonistic. Nothing but experience and argument from experience can in most cases determine whether the community will be best served by its collective state action, or by trusting to private self-interest.

On the one hand, it is but too sure that some of the state manufacturing establishments, especially the dockyards, form the very

[1] Reprinted from the Transactions of the Manchester Statistical Society, 1866–67, pp. 89–103. This essay was later included in Jevons's Methods of Social Reform (1883).

types of incompetent and wasteful expenditure. They are the running sores of the country, draining away our financial power. It is evident too that the House of Commons is at present quite incapable of controlling the expenditure of the dockyards. And as these establishments are never subjected to the test of commercial solvency, as they do not furnish intelligible accounts of current expenditure and work done, much less favor us with any account or allowance for capital expenditure, we have no security whatever that the work is done cheaply. And the worst point is, that even if government establishments of this kind are efficiently conducted when new and while the public attention is on them, we have no security that this state of things will continue.

To other government establishments, however, the post office presents a singular and at first sight an unaccountable contrast. Instead of Mr. Dickens's picture of the Circumlocution Office, we are here presented with a body of secretaries and postmasters alive to every breath of public opinion or private complaint, officials laboriously correcting the blunders and returning the property of careless letter writers; and clerks, sorters, and postmen working to their utmost that the public may be served expeditiously. No one ever charges the post office with lavish expenditure and inefficient performance of duties.

It seems then that the extremes of efficiency and inefficiency meet in the public service, and before we undertake any new branch of state industry, it becomes very important to ascertain whether it is of a kind likely to fall into the efficient or inefficient class of undertakings. Before we give our adhesion to systems of state telegraphs and state railways in this kingdom, we should closely inquire whether telegraphs and railways have more analogy to the post office or to the dockyards. This argument from analogy is freely used by every one. It is the argument of the so-called reformers, who urge that if we treat the telegraphs and the railways, as Sir Rowland Hill treated the post office, reducing fares to a low and uniform rate, we shall reap the same gratifying results. But this will depend upon whether the analogy is correct — whether the telegraphs and railways resemble the post office in those conditions which render the latter highly successful in the hands of government, and enable a low uniform

rate to be adopted. To this point the following remarks are directed.

It seems to me that state management possesses advantages under the following conditions:

1. Where numberless widespread operations can only be efficiently connected, united, and coördinated, in a single, all-extensive government system.

2. Where the operations possess an invariable, routine-like character.

3. Where they are performed under the public eye or for the service of individuals, who will immediately detect and expose any failure or laxity.

4. Where there is but little capital expenditure, so that each year's revenue and expense account shall represent, with sufficient accuracy, the real commercial conditions of the department.[1]

It is apparent that all these conditions are combined in the highest perfection in the post office. It is a vast, coördinated system, such as no private capitalists could maintain, unless, indeed, they were in undisputed possession of the field, by virtue of a government monopoly. The forwarding of letters is a purely routine and equable operation. Not a letter can be mislaid but some one will become aware of it, and by the published tables of mail departures and arrivals the public is enabled accurately to check the performance of the system.

Its capital expenditure too is insignificant compared with its current expenditure. Like other government departments, indeed, the post office does not favor us with any statement of the capital value of its buildings, fittings, etc. But in the post-office accounts, we have a statement of the annual cost of buildings and repairs, together with rents, rates, taxes, fuel, and lights. In the last ten years (1856–65) the expense

[1] It will be interesting to note the following comment which President Hadley has made upon the criteria here suggested by Jevons:

"All this is good as far as it goes; but it leaves the heart of the difficulty untouched. Passing over the first of these points, which really begs the whole question, we have before us, not an indication of the conditions under which a government can manage an industry with the best advantage, but of those under which its management is attended with the least danger. Jevons's principles are restrictive and not positive. They show how far you can trust the government without serious danger of financial mismanagement." Hadley, Economics, 398. — Ed.

has varied from £39,730 in 1864 to £106,478 in 1859, and the average yearly expense has been £72,486, which bears a very inconsiderable ratio to £1,303,064, the average cost of the post office staff during the same years. Compared with £2,871,729, the average complete expenditure of the post office during the last ten years, the cost of the fixed property of the department is quite inconsiderable. This very favorable state of things is due to the fact, that all the conveyances of the post office system are furnished by contract, while it is only the large central offices that are owned by government.

Before proceeding to consider the other systems of conveyance, I must notice that the post office in reality is neither a commercial nor a philanthropic establishment, but simply one of the revenue departments of the government. It very rightly insists that no country post office shall be established unless the correspondence passing through it shall warrant the increased expense, and it maintains a tariff which has no accordance whatever with the cost of conveyance. Books, newspapers, and even unsealed manuscripts can be sent up to the weight of four ounces for one penny; whereas, if a sealed letter in the least exceeds one half ounce, it is charged twopence.[1] It is obvious that the charges of the post office are for the most part a purely arbitrary system of taxes, designed to maintain the large net revenue of the post office now amounting to a million and a half sterling.[2]

It will thus be apparent that Sir Rowland Hill's scheme of postal tariff consisted in substituting one arbitrary system of charges for a system more arbitrary and onerous. This was effected by the sacrifice, at the time, of about one million sterling of revenue; but it must be distinctly remembered that it was net revenue only which was sacrificed, and not commercial loss which was incurred.

A telegraph system appears to me to possess the characteristics which favor unity and state management almost in as high a degree as the post office. If this be so, great advantages will undoubtedly be attained by the purchase of the tele-

[1] In 1871 the limit was raised to one ounce, and in 1897 to four ounces. *Cf.* Palgrave, Dictionary of Political Economy, III, 175. — ED.

[2] In 1901–02 the net revenue was £3,999,000. — ED.

graphs and their union under the direction of the post office department.

It is obvious, in the first place, that the public will be able, and in fact obliged, constantly to test the efficiency of the proposed government telegraphs, as they now test the efficiency of the post office. The least delay or inaccuracy in the transmission of messages will become known, and will be made the ground of complaint. The work, too, of receiving, transmitting, and delivering messages, is for the most part of an entirely routine nature, as in the case of the post office. The only exception to this consists perhaps in the special arrangements which will be needed for the transmission of intelligence and reports to the newspapers.

It is hardly necessary to point out in the second place that a single government telegraph system will possess great advantages from its unity, economy, and comprehensive character. Instead of two or three companies with parallel conterminous wires, and different sets of costly city stations, we shall have a single set of stations; and the very same wires, when aggregated into one body, will admit of more convenient arrangements and more economical employment. The greater the number of messages sent through a given office, the more regularly and economically may the work of transmission and delivery be performed in general.

Furthermore, great advantages will arise from an intimate connection between the telegraphs and the post office. In the country districts the telegraph office can readily be placed in the post office, and the postmaster can, for a moderate remuneration, be induced to act as telegraphic clerk, just as small railway stations serve as telegraphic offices at present, the station master or clerk being the operator. A great number of new offices could thus be opened without any considerable expenses for rent or attendance. The government, in short, could profitably extend its wires where any one of several competing companies would not be induced to go.

In all the larger towns the cost of special delivery may, perhaps, be removed by throwing the telegrams into the ordinary postal delivery. It is understood that a scheme for the junction of the telegraphic and postal system has been elaborated

by the authorities of the post office, partly on the model of the Belgian service; and it has been asserted that the scheme would comprehend some sort of periodical deliveries. In the great business centers, at least, very frequent periodical deliveries could be made. For the services of a special messenger, an extra charge might be imposed. Prepayment of all ordinary charges by stamps would greatly facilitate the whole of the arrangements; and it has been suggested, that where there is no telegraph office, a prepaid telegram might be deposited in the nearest post office or letter box, and forwarded by the mail service to the nearest telegraph office, as is the practice in Belgium. It is evident that the number of telegrams will be increased, as the facility for their dispatch, by the united system of posts and telegraphs, is greater.

A low and perhaps uniform tariff would complete the advantages of such a system. It is supposed, indeed, that it would not be prudent at first to attempt a lower uniform rate than one shilling for twenty words, but it is difficult to see how an *uniform* rate of this amount can be enforced, when the London District Telegraph Company for many years transmitted messages for sixpence, or even fourpence.

The question here arises, how far the telegraphs resemble the post office in the financial principles which should govern the tariff. The trouble of writing a telegraphic message of twenty words is so slight that the trouble of conveying it to a telegraph office and the cost of transmission form the only impediments to a greatly increased use of this means of communication. The trouble of dispatching a message will undoubtedly be much decreased in most localities by the government scheme, and if the charge were also decreased, we might expect an increase of communications almost comparable with that of the post office under similar circumstances. Even a shilling rate is prohibitory to all but commercial and necessary communications, the post office being a sufficient resource, where the urgency is not immediate. Accordingly it is found that a reduction of charges increases the use of the telegraphs very much. In the Paris telegraphs a reduction of the charge from one franc to half a franc has multiplied the business *tenfold*.

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But it must be allowed that the working expense of the electric telegraph is its weak point. The London District Telegraph Company has not succeeded in paying dividends, although their low charges brought plenty of business. The French lines are worked at a considerable loss to the government. Belgium is a country of very small area, which decreases the expense of the telegraphs, and yet the reduction of rate has caused a sacrifice of net revenue, only partially made up by the higher profits upon international messages in transit.

It is quite apparent that the telegraphs are less favorably situated than the post office as regards the cost of transmission. Two letters are as easily carried and delivered at one house as a single letter, and it is certain that the expenses of the post office do not increase in anything like the same ratio as the work it performs. Thus while the total postal revenue has increased from £3,035,954 in 1856 to £4,423,608 in 1865, or by 46 per cent, representing a great increase of work done, the total cost of the service has risen only from £2,438,732 in 1856 to £2,941,086 in 1865, or by 21 per cent. In the case of the telegraphs, however, two messages with delivery by special messenger, cause just twice the trouble of one message. The post office, by periodical deliveries, may reduce the cost of delivery on its own principles, but it cannot apply these principles to the actual operations of telegraphy; it cannot send a hundred messages at the same cost and in the same time as one, as it can send one hundred letters in a bag almost as easily as one letter. It is true that the rapidity of transmission of messages through a wire can be greatly increased by the use of Bain's telegraph, or any of the numerous instruments in which the signals are made by a perforated slip of paper, or a set of type prepared beforehand. But these inventions economize the wires only, not the labor of the operators, since it takes as much time and labor to set up the message in type or perforated paper as to transmit it direct by the common instrument. Economy is to be found, rather, in some simple rapid instrument of direct transmission, like the acoustic telegraph, than in any elaborate mechanical method of signaling. There is no reason, so far as we can see at present, to suppose that a government department will realize any extraordinary economy in

the actual business of transmission. The number of instruments and the number of operators must be increased in something like the same proportion as the messages. And as every mile of wire, too, costs a definite sum to construct and maintain in repair, it follows that strictly speaking the cost of transmission of each message consists of a certain uniform terminal cost with a second small charge for wires and electricity, proportional to the distance.

It will be apparent, from these considerations, that we must not rashly apply to the telegraphs the principles so admirably set forth by Sir Rowland Hill, in his celebrated pamphlet on the post office. When the financial conditions of the telegraphs are in many points so different from those of the post office, we cannot possibly look for any reduction of charges, to such an extent as he proposed in the case of the post office. Whatever reduction may be found possible will arise rather from adventitious points in the scheme, the economy in office accommodation, the aid of the post office in delivery, and so forth.

Under these circumstances it would doubtless be prudent not to attempt any great reduction of charges at first, and if we might eventually hope for a sixpenny rate for twenty words, it is certainly the lowest that we have any grounds at present for anticipating. And though uniformity of charge is very convenient, it must be understood that it is founded on convenience only, and it seems to me quite open to question whether complete uniformity is expedient in the case of the telegraphs.

So far, we have, on the whole, found the telegraph highly suitable for government organization. The only further requisite condition is that, as in the post office, no great amount of property should be placed in the care of government officials. If experience is to be our guide, it must be allowed that any large government property will be mismanaged, and that no proper commercial accounts will be rendered of the amount due to interest, repairs, and depreciation of such property. It is desirable that a government department should not require a capital account at all, which may be either from the capital stock being inconsiderable in amount, or from its being out of the hands and care of government officials. Now this condition can fortunately be observed in the telegraph system. The total fixed capital of

the telegraph companies at present existing is of but small amount. I find the paid-up capital of the five companies concerned to be as follows:

Electric and International	£1,084,925
British and Irish Magnetic	621,456
United Kingdom	143,755
Private Telegraph Company	95,822
London District Company	53,700
Total paid-up capital	£1,999,658

The above statement includes, I believe, all the actual working public telegraphs within the United Kingdom, except those which the London, Brighton, and South Coast, and the South Eastern Railway companies maintain for public use upon their lines. With the value of these I am not acquainted.

Omitting the Private Telegraph Company as not likely to be included in the government purchase, and having regard to the premium which the shares of the Electric and International Company obtain in the market, and the greater or less depreciation of the other companies' shares, I conceive that the complete purchase money of the existing telegraphs would not much exceed two and a half millions sterling.[1]

To allow for the improvement of the present telegraphs, and their extension to many villages which do not at present possess a telegraph station, an equal sum of two and a half millions will probably be ample allowance for the present. The total capital cost of the telegraphs will, indeed, exceed many times the value of the property actually in the hands of the post office, but then we must remember that the latter is but a very small part of the capital, by which the business of the post office is carried on. The railways, steamboats, mail coaches, and an indefinite number of hired vehicles, form the apparatus of the postal conveyance, which is all furnished by contract at a total cost in 1865 of £1,516,142. The property concerned in the service of the post office is in fact gigantic, but it is happily removed from the

[1] As a matter of fact, when the purchase was effected in 1870, three or four years after this essay was written, the government paid no less than £10,130,000. This excessive purchase price together with a pressure for low rates has made the venture less successful financially than Jevons anticipated. These facts were discussed by Jevons in a later article. *Cf.* Methods of Social Reform, 293–306. — Ed.

care and ownership of government. Now this condition fortunately can be observed in the government telegraphs.

The construction and maintenance of telegraph wires and instruments is most peculiarly suitable for performance by contract. The staff who construct and repair the wires and instruments is quite distinct from those who use them, and there need be no direct communication or unity of organization between the two. Just as a railway company engages to furnish the post office with a mail train at the required hour each day, so it will be easy for a contractor to furnish and maintain a wire between any two given points. And it is obvious that the cost of a wire or instrument, and even the charge for the supply of electricity, can be so easily determined, and are so little liable to variation, that scarcely any opportunity will arise for fraud or mismanagement.

There is a company already existing, called the Telegraph Construction and Maintenance Company, which is chiefly engaged in laying submarine telegraphs, a work of far more hazardous character, but which it has carried on successfully and profitably. And it is certain that, if it were thought desirable, some body of capitalists would be found ready to construct, hold, and maintain in repair the whole apparatus required in the government service, at fixed moderate charges. Thus would be preserved in completeness those conditions under which the post office has worked with such preëminent success.

It can hardly be doubted then that if the electric telegraphs of this kingdom were purchased by the government, and placed in the hands of a branch of the post office department, to be managed in partial union with the letter post, and under the same conditions of efficiency and economy, very gratifying results would be attained, and no loss incurred. But, inasmuch as the analogy of the telegraphs and post office fails in a very important point, that of the expense of transmission, we should guard against exaggerated expectations, and should not press for any such reduction of rates as would land us in a financial loss, not justified by any economical principles.

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Some persons might possibly be opposed to this extension of government interference and patronage, as being not so much in

itself undesirable, as likely to lead to a greater and more hazardous enterprise — the purchase and reorganization of the railways.

It is well known that opinions have been freely expressed and discussed in favor of extending government management to the whole railway property of the United Kingdom. I should not like to say that this should never be done, and there are doubtless anomalies and hardships in the present state of our railway system, which demand legislative remedy. But after studying Mr. Galt's work on railway reform and attending to much that has been current on the subject, I am yet inclined to think that the actual working of our railways by government department is altogether out of the question while our English government service remains what it is.

The advantages which might be derived from a single united administration of all the railways are doubtless somewhat analogous to those we derive from the post office, but in most other respects the analogy fails completely and fatally. Railway traffic cannot be managed by pure routine like that of the mails. It is fluctuating and uncertain, dependent upon the seasons of the year, the demands of the locality, or events of an accidental character. Incessant watchfulness, alacrity, and freedom from official routine are required on the part of a traffic manager, who shall always be ready to meet the public wants.

The moment we consider the vast capital concerned in railways, and the intricacy of the mechanism and arrangements required to conduct the traffic, we must see the danger of management by a department of the English government. The paid-up capital of the railways of the United Kingdom, including the outstanding debenture loans, amounted in 1865 to £455,478,143; whereas the current working expenses of the year were only £17,149,073, or $3\frac{3}{4}$ per cent of the capital cost. More than half the receipts, or 52 per cent, go to pay a very moderate dividend of about $4\frac{1}{2}$ per cent (4.46 per cent in 1865) on the enormous capital involved. The railways are altogether contrary in condition, then, to the post office, where the capital expense was quite inconsiderable compared with the current expense. And I think I am justified in saying, that until the English government returns reliable accounts of the commercial results of the dockyards and other manufacturing establish-

ments, and shows that they are economically conducted, it cannot be intrusted with the vast and various property of the railways.

It has been suggested, indeed, that a government department would conduct the traffic of the railways by contract; but I am unable to see how this could be safely done. The care of the permanent way might perhaps thus be provided for, though not so easily as in the case of telegraph wires. But the other branches of railway service are so numerous and so dependent upon each other that they must be under one administration. As to the proposal to break the railways up into sections, and commit each to the management of a contractor, it seems to me to destroy in great part the advantages of unity of management, and to sacrifice much that is admirable in the present organization of our great companies. I am far from regarding our present railway system as perfect; but its conditions and requirements seem to me so entirely contrary to those of the post office that I must regard most of the arguments hitherto adduced in favor of state management as misleading.

I may add that should a government system of telegraphs prove successful, and should the public desire to extend state management still further, there is a most important and profitable field for its employment in the conveyance of parcels and light goods. Prussia possesses a complete system of parcel posts, and the Scandinavian kingdoms, Switzerland, and possibly other continental countries, have something of the sort. In this country the railways collect, convey, and often deliver parcels for high and arbitrary charges; a number of parcels' companies compete with the railways and with each other. An almost infinite number of local carriers circulate through the suburban and country roads in an entirely unorganized manner. The want of organization is remedied to a slight extent by the practice of passing parcels from one carrier to another in a haphazard sort of way, but at each step the parcel incurs a new, uncertain, and generally large charge. A vast loss of efficiency is incurred on the one hand by the parallel deliveries of a number of companies in each town, and on the other hand by the disconnected services of the private carriers. A government system of conveyance, formed on the model of the post

office, collecting, conveying, and distributing parcels and light goods, by one united and all-extensive system, at fixed and well-known charges, and carrying out this work by contract with the railways and with the owners of the carriers' carts in all parts of town and country, would confer vast benefits on the community, and at the same time contribute a handsome addition to the revenue. It would tend to introduce immense economy and efficiency into the retail trade of the kingdom, bringing the remotest country resident into communication with the best city shops. It would lighten the work of the post office, by taking off the less profitable and more weighty book parcels; and it would, in many ways, form the natural complement to our telegraph, postal, and money-order system. But a scheme of this sort is of course entirely prospective, and it seems to me sufficient for the present for the government and parliament to consider whether the reasons brought forward by various individuals and public bodies throughout the country in favor of a government system of telegraph communications are not sufficient to warrant an immediate execution of the plan.

22. The Swiss Federal Railways: by A. N. Holcombe.[1]— The results of the first decade of federal ownership of railways in Switzerland are stated by Professor A. N. Holcombe as follows:

"In Switzerland, where the government has sought to please all the people by lowering rates, increasing facilities, and raising wages, the railways which were doing well under corporate management show a deficit after ten years of governmental administration"; and "have become a drain upon the taxpayers." So writes Mr. Logan G. McPherson in his recent book on "Transportation in Europe," pp. 172, 200. Mr. Carl S. Vrooman, on the other hand, in his equally recent book on "American Railway Problems in the Light of European Experience," p. 166, declares that "during the short period of eight years of actual government management considerable real and substantial progress has been made. Rates have been lowered, wages raised, hours of labor shortened, the service improved, and at the end of sixty years or thereabouts the people will be the proprietors of their railways, which actually will have paid for themselves out of profits." The conclusions reached by these two

[1] Reprinted from the *Quarterly Journal of Economics*, Vol. XXVI, pp. 342–362.

writers are noteworthy. Both are trained investigators, and both are conscious of their responsibility to the public for the reliability of their facts and the reasonableness of their conclusions. In the face of such a clash of opinion an independent examination of the evidence seems in order.[1]

The law for the repurchase of the steam railways of Switzerland by the federal government was passed by the Federal Assembly Oct. 15, 1897, and accepted by the people Feb. 20, 1898, by a vote of more than two to one (386,634 to 182,718). There were then five main lines of steam railway in Switzerland, the Central, the North-Eastern, the United Swiss, the Jura-Simplon, and the St. Gothard. The negotiations for the completion of the purchases were protracted by the refusal of the companies to accept the terms originally offered by the federal government. The dispute was carried into the courts, and finally determined by two decisions of the Federal Court, Jan. 18–21, 1899, and July 18–19, 1899. The next two years were devoted to concluding the arrangements with the companies, and to perfecting the organization of the federal railway administration. The *Generaldirektion* of the federal railways met for the first time on July 1, 1901, when it took over the duties of the board of directors of the Central railway. It assumed the active management of the Central and North-Eastern lines on Jan. 1, 1902, of the United Swiss on July 1, of the same year, of the Jura-Simplon on May 1, 1903, and of the St. Gothard on May 1, 1909. The beginning of Swiss federal railway management may therefore be dated from July 1, 1901, although the government was not in a position to put its policies into general effect until two years later.[2]

[1] Public documents relating to the Swiss Federal railways are:

1. Bericht des eidgenössischen Eisenbahndepartements über seine Geschäftsführung im Jahre —— (annual).

2. Bericht und Antrag des Verwaltungsrates der schweizerischen Bundesbahnen an den schweizerischen Bundesrat betreffend das Budget der schweizerischen Bundesbahnen für ——, zu Händen der Bundesversammlung (annual).

3. Bericht der Generaldirektion der schweizerischen Bundesbahnen über die Geschäftsführung und die Rechnungen des Jahres —— an den schweizerischen Bundesrat zu Händen der Bundesversammlung (annual).

4. Statistische Tabellen. Beilage zum Bericht der Generaldirektion (annual).

5. Rechnungen für das Jahr —— (annual).

[2] The best accounts of the events leading up to repurchase, of the popular discussion of the proposal to repurchase, and of the negotiations with the

From the beginning the Swiss experiment in government ownership and operation of railways has interested the students of the railway problem. The early discussions of the nationalization of the Swiss railways shed little light, however, on the general issue of public ownership. Writers on the subject could do little more than speculate upon the success or failure of the federal railways, or narrate the events comprising the process of nationalization with varying sympathies according to their respective temperaments.[1] As the first decade of the Swiss federal railways approaches completion, the evidence bearing upon the record of governmental management becomes more instructive.

Probably the fairest procedure for determining the measure of success obtained by the Swiss government in the railway business is to ascertain first what it aimed to accomplish. The arguments advanced by the Federal Council in advocacy of public ownership were as follows:[2] (1) The desirability of consolidating the independent railway lines of Switzerland in order (*a*) to save the expenses of the superfluous company and general managers' offices, (*b*) to secure the advantages of monopoly and organization on a larger scale in equipment and maintenance of way, and in operation and the security of traffic, and (*c*) to improve the local service by the more generous employment of the profits on the profitable portions of the business for the extension of the service into less profitable places. (2) The reduction of fixed charges by the substitution of the credit of the government for that of the private companies. (3) The application of net profits to the amortization of capital until the

companies and the inauguration of governmental management, respectively, are: G. Keller, Der Staatsbahngedanke bei den verschiedenen Völkern, Bern, 1897; H. Micheli, Le Rachat des chemins de fer en Suisse, *Circulaire du Musée social*, No. 18, le 25 mai, 1898 (translated by J. Cummings and published in American Economic Association Studies, Vol. III (1898), pp. 349–420); and P. Weissenbach, Die Durchführung der Verstaatlichung in der Schweiz, *Archiv für Eisenbahnwesen*, Vol. XXVII (1904), pp. 1259–1327, and Vol. XXVIII (1905), pp. 105–156.

[1] *Cf.*, for example, Henri Haguet, Le Rachat des chemins de fer suisses et ses conséquences, Paris, 1902; and Edgard Milhaud, Le Rachat des chemins de fer, Paris, 1904.

[2] Botschaft des Bundesrates an die Bundesversammlung betreffend den Rückkauf der Eisenbahnen vom 25. März, 1897. This message constituted the platform and campaign handbook of the advocates of public ownership prior to the referendum election in February, 1898.

entire railway system should be owned clear of debt, thus eventually making possible a great reduction of rates (France, Germany, and Austria, it was believed, would be in a similar position by the middle of the twentieth century). (4) The abolition of discriminations of all kinds, and the establishment of uniform and just rates (the message intimated that the lowest rates for each class of traffic then in force on any private road would be extended to all the roads to be acquired by the federal government). (5) The more effective representation of the interests of shippers and of the traveling public as opposed to the interests of stockholders in railway management. (6) The improvement of the conditions of employment of the employees (*a*) by standardizing the various wage scales and labor regulations (the Federal Council intimated that the highest wage scales in force on any of the roads to be acquired would be extended to all the roads to be acquired), (*b*) by better enforcement of federal labor legislation than was possible while the lines were under private management, and (*c*) by maintaining the superannuation and other benefit funds on a sound and liberal basis. (7) The elimination of foreign influence from the management of Swiss railways (apparently in at least three of the leading roads foreign stockholders then held a controlling interest, and such control, in the opinion of the Federal Council, was politically dangerous).

The message of the Federal Council was tinged with a strain of sentiment. There was some appeal to the national pride, which ought to insist upon the popular management of those affairs which are of prime importance to the safety and well-being of the commonwealth, and to the national prejudice, which ought not to tolerate the threatened control of Swiss domestic commerce by aliens. But in the main the Federal Council founded its case upon sober calculations of lower rates and additional facilities for shippers and traveling public, of improved conditions for railway employees, and of better management generally. The arguments of the Federal Council were tersely summed up by a sympathetic American writer.[1] "The nationalization of the Swiss railroads," he writes, "was inevitable, a natural fruit of the spirit of democracy"; but the "direct efficient cause" was "business opportunism."

[1] H. D. Lloyd, A Sovereign People, p. 171.

Let us now consider the results of this policy of "business opportunism." In the first place, the political dangers of the alien control of Swiss domestic transportation, whatever they may have been, were definitively removed. So much nationalization accomplished. Much of the purchase money, to be sure, was borrowed abroad on the credit of the government, but foreign bondholders and foreign stockholders are not of the same genus. The Swiss people by the nationalization of their railways not only assumed the responsibility but obtained the power to manage them in the interests of Swiss shippers, travelers, and railway workers. After nationalization, there could be no danger of the exploitation of the Swiss people as a whole. The only possible danger would be that of the exploitation of one class of people by another. The general public in its political capacity might exploit the railway workers by denying them just compensation and conditions of employment; conversely, the railway workers, by gaining an improper influence over the government of the day, might exploit the general public by obtaining excessive wages at the cost of reasonable rates of transportation. In fact the relations between the state employer and the railway workers have been singularly harmonious and free from friction. The workers have never struck, nor even threatened to strike. The government, on the other hand, has always maintained its authority, and, while treating its employees with liberality, has never given them more than could be publicly shown to be their due.

The conditions of employment on the federal railways were regulated by the laws of June 29, 1900, and Dec. 19, 1902. The various grades of employees were classified, and maximum and minimum rates of pay were prescribed for each class. The highest rates paid on any of the private roads were adopted as the minimum rates for the corresponding classes of the federal service. The new rates went into effect May 1, 1903, and each third year thereafter the pay of every employee who had served through the preceding three years was to be increased by three hundred francs until the maximum for the class should be reached. An eleven-hour day was established (which is less than the usual Continental European working-day), with the further provision that every train-crew should have at least ten hours of unbroken rest in each twenty-four, and all other employees at

least nine hours. More liberal provision than had previously been the rule was made for a weekly day of rest and for annual vacations. The common laborers shared in the improved conditions of employment, but the most highly paid administrative officers suffered, since in view of the salaries paid to other officers in the service of the federal government, it was not possible to continue the fancy salaries sometimes paid by the private companies to favored officials. These changes, the improved conditions of employment even more than the higher wages, tended to increase the operating expenses of the federal railways; but they had been practically promised in advance, and their probable cost had been reckoned with by the advocates of nationalization.[1]

The labor policy of the Swiss railway management is revealed by the conduct of the employees when the pressure of the recent increase in the cost of living began to be felt. The standard wage scale was established upon the basis of the general level of prices and wages in 1899. Since then the rise in the general level of prices has been world-wide. According to Calwer's index number, which most adequately portrays the monetary situation in Switzerland, the rise in the cost of living from 1899 to 1907 amounted to 17½ per cent. The highest rates of wages in effect upon the private railways (which were the basis of the governmental rates) had been established in 1896 and the rise in the cost of living since then amounted to over 27 per cent. The men began to complain, respectfully, but during 1906 with increasing vigor. The government, when confronted by the men with family budgets and other pertinent evidence of the fall in real wages, recognized the justice of their claims, but wished to postpone the revision of their wages until a general act could be prepared that would apply to all federal employees. In December, 1906, the Union of Postal, Telegraph, and Customs Officials, the Union of Swiss Transportation Laborers, and the Union of Swiss Transportation Officials simultaneously petitioned the Federal Assembly for a special supplement to their regular wage during the year sufficient to compensate them for the increase in the cost of living. The Federal Council ultimately recommended that each married employee and each unmarried employee with persons dependent upon him for support, earning less than 4000

[1] *Cf.* Botschaft des Bundesrates an die Bundesversammlung betreffend die Arbeitsverhältnisse der Bundesbahnen vom 1. December, 1899.

francs a year, should receive a supplement to his annual earnings of 100 francs; and that all other employees earning less than 4000 francs should receive 50 francs. The Federal Council took pains in its message to the Assembly to remark on the courteous tone of the employees' petitions and the reasonableness of their request.[1] The payment of this "high-prices-increment" was repeated in 1907 and 1908. In 1909 the scope of the extra payment was extended, and finally a law of June 23, 1910, revised the classification of railway employees and established a general and permanent increase of wages.[2]

This incident in itself is not perhaps of great importance, but it illustrates the good understanding that prevails between the railway management and its employees. The influence which the latter exert in order to bring about an improvement of their conditions of employment has no unhealthy effect upon Swiss politics. It is not so strong as to subordinate the good of the service to their private advantage, and yet strong enough to secure the prompt recognition of their just claims. Nor has governmental management brought with it an extravagant overmanning of the roads. The rate of increase in the number of employees on the federal railways up to the end of 1908 was less than the increase during the same period on the St. Gothard, which remained under private management until the following year, although the rate of development of traffic was greater on the federal lines than on the St. Gothard. The total number of employees at the end of 1909 was 34,575, and there is absolutely no evidence of "politics" in the management. Suitable provision is made for insurance against sickness and accident, pensions are provided in the event of chronic infirmity or old age, and the organization of labor is provided for by the management itself. Thus public ownership has brought with it the adoption of methods that recognize the mutuality and solidarity of labor, and convert the craving for combination and mutual support, so characteristic of modern wage-earners, into a productive asset.

[1] Botschaft des Bundesrates an die Bundesversammlung betreffend die Bewilligung eines Spezialkredites behufs Ausrichtung von Teuerungszulagen für das Jahr 1906 an die eidg. Beamten und Angestellten vom 2. April, 1907.

[2] Botschaft des Bundesrates an die Bundesversammlung betreffend die Besoldung der Beamten und Angestellten der schweiz. Bundesbahnen vom 25. October, 1909.

The management of the Swiss federal railways was organized expressly with a view to enabling representatives of Swiss shippers and the traveling public to participate in the conduct of affairs. The plan of this organization was worked out in advance of nationalization, and set forth in the message of the Federal Council of March 25, 1897.[1] The popularity of the plan was undoubtedly one of the leading factors in the victory of the policy of public ownership. It was desired that the administrative organization should be made independent of political influence and yet that it should be so closely connected with the government that there would be no danger of its becoming a state within a state, a body that might come into conflict with the government itself. Hence the administration of the federal railways forms a separate division of the federal administration, and the finances of the railways are entirely disconnected from the finances of the Confederacy. The supreme railway authority is the Federal Assembly, which has cognizance of the following matters: the ratification of plans for the construction and acquisition of new railways, and of loan operations and plans of amortization; the sanctioning of the classification of employees and of the fixing of schedules of wages; and the approval of the annual budgets, and of the annual accounts and reports of operations. The general control of the management is entrusted to the Federal Council, which prepares all business requiring definitive action on the part of the Federal Assembly, executes the policies of the Assembly and appoints the members of the *Generaldirektion*, and of the district directories, and the government members of the federal administrative council, and of the district administrative councils. The general directory has charge of the employees and the actual operation, and prepares plans and reports for submission to the administrative council. The administrative council scrutinizes the accounts, examines the annual statements and approves the draft of the railway budget. It has charge of the freight and passenger tariffs and classifications, approves the general plan of train schedules, adjusts the relations with other

[1] The law of Oct. 15, 1897, regulating the organization of the administration of the Swiss federal railways, is translated and reprinted in full in Vrooman, American Railway Problems, Appendix 4. See also W. Exner, Studien über die Verwaltung des Eisenbahnwesens mitteleuropäischer Staaten (Vienna, 1906), pp. 43–61.

lines, regulates competitive traffic and renders final decision in regard to construction and additions, both of plant and of equipment. Under these are the district directories and administrative councils for the five districts into which the federal railways are divided.

The feature in the plan of organization to which it has owed much of its popularity among shippers and the general public is the administrative council. This is composed of fifty-five members, twenty-five of whom are chosen by the Federal Council, a like number by the cantons and half-cantons, and five by the district councils. The latter in practice are usually the presidents of the five district councils. The others are chosen with due regard to the interests of agriculture, industry, and commerce, respectively, for terms of three years. The Federal Council proceeds to the election of its quota only after the cantonal and district council elections have been made, and not more than nine of the twenty-five federal appointees may be members of either branch of the Federal Assembly. The district councils consist of fifteen to twenty members, four of whom are chosen by the Federal Council, and the others by the cantons within the district, with due regard to the representation of the various economic interests. The members receive annual passes and a *per diem* for their actual time devoted to the public service. This system of councils was probably suggested by the analogous railway councils, created by von Maybach for the Prussian state railways, which have worked so well in Germany.[1] The district councils meet quarterly, the administrative council monthly. The record of business transacted by the councils is published every year. Thus thorough publicity is combined with the representation of the interests of shippers and the public in such a way as to lead the patrons of the railways to feel that those who pay the rates have a share in the responsibility for their making, and that those who use the railway facilities have a voice in their creation. Neither fiscal exploitation on the part of the federal government, nor personal or local discrimination in favor of privileged interests, can well occur under such a system of management. The security for reasonable rates, in the sense of rates calculated to promote public rather than private interests,

[1] *Cf.* A. N. Holcombe, Public Ownership of Telephones on the Continent of Europe, ch. 3.

seems better than under any possible system of private management. At any rate this mode of organization has given uninterrupted satisfaction to the Swiss people.

As soon as the government had gained control of a sufficient number of lines it proceeded to fulfill its pledges with regard to rates.[1] The principles of the revision of rates were laid down in a message of the Federal Council to the Federal Assembly of Nov. 17, 1899. The fundamental principles of the revision were the standardization of the various schedules in effect on the private roads, full publicity of rates, ample notice of changes, and the coöperation of shippers and railway management in the making of rates. With the latter object in view, the federal railway department sent out copies of the preliminary draft of the revised schedules to the various shippers' associations,—the Swiss *Handels- und Industrieverein*, the Swiss *Gewerbeverein*, the Swiss *Bauernverband*, and the Swiss *Eisenbahnverband*. All these associations cordially responded to the railway department's invitation to hand in their criticisms of the proposed schedules. The schedules were finally considered by the Federal Assembly, and enacted to go into effect May 1, 1903, on the four main lines then in the hands of the government. The law provided an elastic process of rate making for service in the future. Increases or cancellations of rates require three months' advance notice, but the period may be shortened, if material reductions accompany increases of rates, or if international through rates are increased on the external portion of the route only. Reductions of passenger rates must remain in effect at least three months, and of freight rates at least one year, but reductions may be granted for shorter periods if the period is stipulated in advance. These restrictions do not apply to excursion rates. Thus the public enjoys complete security against unfair discrimination (for there have never been any charges of secret rebating or criminal collusion between railway officials and favored shippers) without unduly restricting the power of the federal railways to adapt their charges to special conditions.

The government has retained the system of three classes of passenger service. The third class, however, and under certain circumstances even the second, may be omitted from express trains, and the first class, and under certain circumstances even

[1] Law of June 27, 1901.

the second, may be omitted from accommodation trains. In fact, these omissions are freely made, and the Swiss three-class system works out in much the same way as the American system of Pullman and tourist cars, and day coaches. The schedule of passenger rates adopted for the federal lines was the lowest in effect at the period of repurchase on any of the private lines. The railway traffic and general economic conditions are so different in Switzerland and in the United States that a comparison of passenger rates is fruitless, and the same statement is true of freight rates. The classification of freight is relatively simple. Provision is made for the special classification of raw materials used in agriculture, and of some other commodities. Special rates may be made out of consideration for foreign competition, in order to secure equally favorable treatment for domestic shippers on foreign railways, and to secure transit traffic from competing lines, provided that domestic shippers are not injured thereby. In times of public distress the Federal Council may make special rates on foodstuffs and live stock. The various freight-rate tariffs charged by the private companies were not withdrawn until the new standard rates could be properly adjusted, and it was not until July 1, 1904, that the new rates were put into effect. Thus the pledges of the Federal Council relating to rates, contained in the message of 1897, advocating public ownership, were carried out to the letter, and in view of all the circumstances the period that elapsed was not unduly prolonged.

The law of July 27, 1901, not only established a satisfactory system of rate making, but also provided for the redemption of the pledges for improved service. The number and speed of trains and the supply of rolling-stock has been increased, terminal facilities have been improved, and ways more solidly maintained. The reports of the chambers of commerce of Swiss cities and of other bodies authorized to speak in the name of the economic interests of the country are full enough of specific criticisms of the service and suggestions for its improvement, but there is no disposition to disparage the capacity of the railway administration or to condemn its conduct of affairs. There has never been any dispute among the critics of the Swiss federal railways over the adequacy and efficiency of the service, nor is there any between the two writers mentioned at the beginning of this article. Mr. Vrooman states that "rates have

been lowered, wages raised, hours of labor shortened, the service improved," and Mr. McPherson does not contradict this statement. The difference of opinion is as to who is paying the bills. One writer says the railways are more than paying their way; the other, that they are a drain on the taxpayers. The unsettled question in the matter of the Swiss federal railways is that of their financial standing.

The popular majority which sanctioned the program of public ownership in 1898 had not expected to make of the federal railways a fiscal monopoly. The earning of a large revenue for the government was not among the advantages of nationalization urged by the Federal Council in its message of 1897. The latter had declared, on the contrary, in favor of the application of net earnings to the amortization of the railway loans. The Swiss regarded the funded debt in the light of a mortgage upon their railway property, and determined to own their property clear of such charges before diverting net earnings to the federal treasury. The Federal Council's purpose in advocating the ultimate extinction of interest charges was to facilitate an eventual reduction of rates rather than to secure a fresh source of public revenue. The period of sixty years was selected as that in which the funded debt should be amortized. The annual payments necessary to effect such amortization were accordingly computed, and are made a fixed charge in each annual railway budget. The policy of the railway management was understood from the beginning to be to earn no more profit than should be necessary to meet these amortization charges, remitting surplus earnings to the public in the form of better service or lower rates rather than in that of cash contributions to the federal treasury. There has not yet been any connection between the railway profit and loss account and the general federal revenues.

The item of net earnings in a federal railway statement is accordingly not comparable with a similar item or with anything in an American railway statement. It actually represents the surplus profits over and above the interest charges (averaging about 3½ per cent) on the entire funded debt and the amortization charges on the same. The latter, which in substance are a kind of deferred profit, and would ordinarily be classified under the head of profits, amounted to 4.3 million francs in 1903, and were estimated at slightly over 8 millions in the budget for 1911.

The sum of interest and amortization charges represents not much over 4 per cent upon the funded debt, and is much less than the interest and dividend charges upon any profitable American road. In other words, the cost of the capital devoted to the use of the shipping and traveling public by the Swiss government is materially less than the cost of the capital devoted to the use of the American public by American railways. Other things being equal, the cost of service on the Swiss railways must be less than if private enterprise were employed to render the same service. Hence it would appear not impossible that the Swiss government might reduce rates, raise wages, shorten the hours of labor, and improve the service, as it has done, and still make both ends meet. Under the peculiar Swiss conditions, then, the test of financial success is the proximity of the profit and loss item in the accounts to zero.

There has been a wide-spread impression in recent years, both in Switzerland and elsewhere, that the federal railways have proved a financial failure.[1] This impression is founded largely upon the annual official budgets. Each year since the revised rates of wages and passenger and freight tariffs were put into effect, the railway management itself has estimated that the next year would close with a deficit. Thus in a sense it is true that the federal railways year after year have been having to face deficits. These deficits, however, have been more apparent than real. The actual financial results have regularly been more favorable than the budgetary estimates with the single exception of the year 1908, and the federal railways have regularly earned a surplus over and above the amounts required for the interest and amortization charges except in the two years 1908 and 1909. This is indicated by the table on the next page, computed from the official reports, showing in parallel columns the estimated deficits and the actual results.

Some of these figures are not the same as the corresponding figures in the official budgets and reports. The official budgets do not include with the regular estimates for the year any estimate of the so-called "high-prices-increments" paid since 1906 to the railway employees. Beginning with 1907, I have included such an estimate, based on the sum actually so paid in the

[1] *Cf.* P. Favarger, La Situation des chemins de fer fédéraux en Suisse, *Journal des Économistes*, Décembre, 1910.

Year	Profit (+) or Loss (−) as estimated in Budget	Profit (+) or Loss (−) Actually resulting
1902	. . . .	+4,422,420
1903	. . . . .	+1,030,682
1904	− 1,209,725	+ 60,735
1905	− 2,088,400	+ 651,734
1906	− 4,660,350	+2,548,523
1907	− 2,528,527	+ 429,812
1908	− 2,498,790	−5,823,166
1909	−10,927,330	−4,091,020
1910	− 9,125,000	+7,948,758

preceding year. The official reports often carry over surpluses or deficits into the accounts of the ensuing year, where they serve to conceal the true result of that year's operations. Thus the report for 1910 states the result of the year's operations to be a deficit of 1,535,616 francs, whereas in fact the result was to diminish the accumulated deficits of the two preceding years by the amount shown in the table; that is, the largest surplus in the history of the federal railways. Taking the results of the entire operations up to the end of the decade, the surpluses exceed the deficits. Since, however, a portion of the earlier surpluses were employed for extraordinary amortizations, the official balance sheet at the end of 1910 showed a net deficit of one and a half million francs on the eight years' operations, or a little more than one-tenth of 1 per cent of the present funded debt of the federal railways. The amortization charges for a single year, which are a species of profit, would wipe out this deficit several times over. Since all interest and amortization charges have regularly been paid, this nominal deficit may be disregarded. Indeed, it should have been wiped out by the results of the first quarter's operations in 1911. So near an approach to the ideal zero of surplus profits must be considered a sufficient disproof of the charge of financial failure.

The important concern is whether this state of equilibrium between income and outgo is likely to be permanent. We must therefore inquire into the causes of the series of unfavorable budgets prepared by the railway management and of the two deficits actually incurred.

The reduction of rates, improvement of service, and increase

of wages, as pledged by the Federal Council in its message of 1897, had for their immediate effect, as had been anticipated, a more rapid increase of operating expenses than of traffic receipts. But the advocates of nationalization had contended that this increase would be met out of savings in other directions, especially in the lowering of the cost of capital and in the more economical management of the railways as a consolidated monopolistic system. Hence, unless the advocates of the policy of "business opportunism" were mistaken in their calculations, the causes of the unfavorable budgets must lie elsewhere.

The explanation seems to be simply that the Federal Council had calculated very closely, when it outlined the advantages of nationalization, and abnormal economic conditions could easily disturb the balance of income and outgo. In 1902–03, when the transfer of the four leading private lines was made, Europe generally was suffering from an acute commercial depression. The receipts had already shown a tendency to fall off before the transfers were made. The new governmental management found that the private systems had been allowed to run down during the preceding period of uncertainty more than had been anticipated. Maintenance and renewal requirements were accordingly abnormally heavy, and the immediate outlook for an increase of traffic, despite the promised reduction of rates, was not bright. Hence the unfavorable budgetary estimates for the years 1904–06. The commercial depression, however, proved to be only temporary; traffic, both passenger and freight, increased with unexpected rapidity; and in 1906 an anticipated deficit of nearly five million francs was converted into a surplus of over two and one-half millions. The effect was to stimulate an accelerated increase of expenditures. This is reflected in the budgetary estimates of new construction and equipment to be charged to capital account, as well as in the account of operating expenses. The railway management understood the situation perfectly. Writing in 1906, they stated that "thanks to the development of the passenger and freight traffic, we may hope that in 1906 as in the preceding year operations will be concluded without a deficit, contrary to the anticipations of our budget. If the development of the traffic continues and our anticipations of increased receipts are accordingly realized, the same result will occur in 1907. But it ought not to be overlooked that the con-

tinual increase of expenditures cannot be further held in check, so that any business depression will inevitably upset the balance of our accounts."[1]

The unwelcome business depression came at the end of the following year, the year of the American panic. The operating receipts of the Swiss federal railways were less in 1908 than in 1907, although expenditures were materially greater. The situation was made more acute by the grant of the "high-prices-increments" to the employees. In fact, not only the cost of labor, but that of many other railway supplies had gone up approximately 25 per cent in the last ten years. The St. Gothard, the only important Swiss railway at that time still under private management, suffered as severely as did the federal railways. The federal railway management cut down expenses in every legitimate way, suppressing superfluous trains, and reducing its working force as much as possible without impairing the efficiency of the service. Yet the policy begun in 1906 of voluntarily adding a supplement to the wages of all employees, in order to enable them to maintain a reasonable standard of comfort in the face of an ever-increasing cost of living, was courageously maintained. Had these payments been discontinued, the federal railways might have passed through the crisis without any deficit, but such a backward step was not suggested. The management was told by its critics that it could not restore the equilibrium of its budget without a radical increase of rates, but no such increase was sanctioned. The management adhered to its policy of retrenchment, and relied upon the return of prosperity to revive the surplus.

The vigor of the policy of retrenchment is revealed in the budgetary estimates of capital expenditures for fresh construction during this period. These amounted to 39.7 millions of francs for 1906, to 42.6 millions for 1907, to 49.5 for 1908, 34.6 for 1909, 31.1 for 1910, and 30.7 for 1911. The operating ratio, which was 61.1 per cent in 1902 and 65.5 per cent in 1903, had risen to 72.8 per cent in 1908. It was reduced by 1910 to the same figure as in 1903. In the official report for 1910 (p. 56) the management was able to point to the complete success of its financial policy. The second decade of the Swiss federal railways begins auspiciously with an estimated surplus,

[1] Bericht und Antrag vom 28. September, 1906, p. 51.

the first budgetary surplus since the government's railway policies have been in effect.[1] The truth is that the Swiss federal railway management is to be highly commended for its energetic and sagacious handling of a difficult situation. In any undertaking in which the margin of profit is calculated so closely as in the Swiss federal railways, abnormal conditions may temporarily produce abnormal profits or losses; but over longer periods of time these should offset one another. There is no reason why the equilibrium between income and outgo should not be permanent.

Our examination of the financial history of the Swiss federal railways leads us to certain definite conclusions. Mr. McPherson's statement that the railways have become a drain upon the taxpayers is not supported by the evidence. For Mr. Vrooman's prediction, on the other hand, that the existing railways will have paid for themselves out of profits in about sixty years, there is substantial foundation in the record of governmental management. Without venturing, however, to predict, we may observe that the Swiss federal railways have already reduced rates, improved the service, raised wages, and made a profit. In short, the evidence of the first decade of the Swiss federal railways is that the policy of "business opportunism" is justifying itself.

23. Municipal Industries.—The extension of the "industrial domain" of governments has been very marked, in recent years, in the field of municipal industries. The necessity for increased public control of local monopolies was recognized by John Stuart Mill in his discussion of the cases in which it is possible to justify a departure from the policy of *laissez-faire*. Concerning private corporations or associations engaged in such monopolistic enterprises, Mill wrote:[2]

But although, for these reasons, most things which are likely to be even tolerably done by voluntary associations should, generally speaking, be left to them, it does not follow that the manner in which those associations perform their work should be entirely uncontrolled by the government. There are many cases in which the agency, of whatever nature, by which a service is performed, is certain, from the nature of the case,

[1] Bericht und Antrag für 1911, p. 48. Ibid. für 1912, p. 50.

[2] Principles of Political Economy, Bk. V, ch. 11, § 11.

to be virtually single; in which a practical monopoly, with all the power it confers of taxing the community, cannot be prevented from existing. I have already more than once adverted to the case of the gas and water companies, among which, though perfect freedom is allowed to competition, none really takes place, and practically they are found to be even more irresponsible, and unapproachable by individual complaints, than the government. There are the expenses without the advantages of plurality of agency; and the charge made for services which cannot be dispensed with is, in substance, quite as much compulsory taxation as if imposed by law; there are few householders who make any distinction between their "water rate" and their other local taxes. In the case of these particular services, the reasons preponderate in favor of their being performed, like the paving and cleansing of the streets, not certainly by the general government of the state, but by the municipal authorities of the town, and the expense defrayed, as even now it in fact is, by a local rate.

The characteristics of these monopolistic enterprises, now generally called natural monopolies, were further elucidated by T. H. Farrer nearly a generation after Mill wrote. Farrer's discussion has had much influence upon American writers, and was, in part, as follows:[1]

Is there, then, any general characteristic by which these undertakings, or others of a similar kind, may be recognized and distinguished from undertakings which are governed by the ordinary law of competition.

It is not *large capital*, for though most of them require large capital, some gas and water companies, which are complete monopolies, have capitals of not more than two or three thousand pounds; whilst other enterprises with enormous capitals, *e.g.* banks, insurance offices, shipping companies, are not monopolies.

It is not *positive law*, for few of them have a monopoly expressly granted or confirmed by law; and in most, if not all,

[1] The State in its Relation to Trade, 69–71 (London, 1883).

of the cases where such a monopoly happens to have been so granted or confirmed, it would have existed without such grant or confirmation.

They all agree in *supplying necessaries.* But this alone is no test, for butchers and bakers supply necessaries.

Most, if not all, of them have *exclusive possession or occupation of certain peculiarly favorable portions of land — e.g.* docks, of the riverside, gas and water companies, of the streets. But this is only true in a limited sense of such undertakings as the post office, telegraphs, or even of roads and railways; and a mine, a quarry, or a fishery has equally possession of specially favored sites without generally or necessarily becoming a monopoly.

The article or convenience supplied by them is *local,* and cannot be dissevered from the possessor or user of the land or premises occupied by the undertaking. The undertaking does not produce an article to be carried away and sold in a distant market, but a convenience in the use of the undertaking itself, as in the case of harbors, roads, railways, post office, and telegraphs; or an article sold and used on the spot where it is produced, as in the case of gas and water.

Again, in most of these cases the convenience afforded or article produced is one which can be *increased almost indefinitely,* without proportionate increase of the original plant; so that to set up a rival scheme is an extravagant waste of capital.

There is also in some of these undertakings, and notoriously in the cases of the post office, of telegraphs, and of railways, another consideration, *viz.* the paramount importance of *certainty and harmonious arrangement.* In the case of most industries — *e.g.* in that of a baker — it would be easier to know what to do if there were one instead of several to choose from; but this consideration is in such a case not paramount to considerations of cheapness. In the case of the post office and telegraphs, certainty and harmony are the paramount considerations. The inconvenience would be extreme if we had to consider and choose the mode of conveyance every time a letter is dispatched, or if a telegram sent from any one station could not be dispatched to all other stations.

The following, then, appear to be the characteristics of undertakings which tend to become monopolies:

1. What they supply is a necessary.
2. They occupy peculiarly favored spots or lines of land.
3. The article or convenience they supply is used at the place where and in connection with the plant or machinery by which it is supplied.
4. This article or convenience can in general be largely, if not indefinitely, increased without proportionate increase in plant and capital.
5. Certainty and harmonious arrangement, which can only be attained by unity, are paramount considerations.

24. The Policy of American Municipalities. — The proper policy for municipalities to pursue with respect to local monopolies is now the subject of lively discussion both in the United States and England. From the large and growing literature dealing with the question [1] we shall have room for but a single selection, which summarizes in a judicial manner the situation in the United States:[2]

Municipal ownership of public utilities in American cities, except so far as concerns the water supply, has only recently been recognized as a possibility, much less an issue. Its advocacy, indeed, was frowned upon as savoring strongly of socialistic propaganda. The supplying of water has always been considered a proper function of government. Municipalities have also constructed and owned their sewers, and in some seacoast cities the docks are the property of the city. Into the purely industrial field of public activity, the sale of light, heat, and transportation, the building of model tenements, the ownership of telephones, and the many other industrial functions which European cities have so largely taken over, American municipalities have not, until recent years, attempted to enter.

The reason for the close limitation of the functions of gov-

[1] The following references may be suggested: Major Leonard Darwin, Municipal Trade (New York and London, 1903); E. W. Bemis, editor, Municipal Monopolies (New York, 1899); Municipal Affairs, Vol. VI, No. 4 (1903).

[2] The Recent History of Municipal Ownership in the United States, by Charles Waldo Haskins. In Municipal Affairs, Vol. VI, pp. 524 *et seq.* (1903). Reprinted by permission of the Reform Club.

ernment we are not called upon to discuss. Our present concern is with the evidences of a departure from the traditions of individualism and the development of a considerable body of influential opinion in favor of an extension of the field of city activity. Within the last five years a movement has developed in favor of the ownership of public utilities which promises to accomplish considerable results. It is the purpose of this paper to present some of the leading features of the movement.

Extent of Municipalization

At the close of 1902 the situation of municipal ownership was as follows: Out of 1475 water-supply systems reported for cities of 3000 and over, 766, or 51 per cent, were owned by municipalities, 33 were owned by both city and private company, 661 were owned by private corporations, and 14 were owned jointly. In the larger cities of more than 30,000 inhabitants, out of 135 plants, 88 were owned by the city. As the municipality decreases in size, the proportion of privately owned plants increases, being largest in towns of between 5000 and 30,000 inhabitants. The percentage of water plants owned by the public is largest in the North Central states, and smallest in the South Central states.

Public ownership of the water supply is an accomplished fact, so firmly established and so familiar that it is not usual to argue from its existence to the desirability of extending the system to other public utilities. The supplying of water being so closely concerned with the public health, ranks in the public mind with the provision and maintenance of sewers, the cleaning of the streets, and the inspection of food and milk.

When we turn to lighting and transportation, however, we see that the provision of water is a peculiar and unique fact which finds no parallel in other parts of the field of public service. Out of 981 municipalities which are reported as having gas works, only 20 cities own their gas plants. The five largest of these cities are Philadelphia, Louisville, Richmond (Va.), Duluth, and Wheeling (W. Va.). Excluding Louisville, where the city is only part owner of its gas works, only one large city, Philadelphia, is the owner of its gas plant, and in Philadelphia

the plant has been leased to a private company until 1927. Municipal ownership has made little progress in the field of gas lighting.

Electric lighting is a more recent development than gas lighting, and it is natural to expect that if the sentiment in favor of public ownership is growing, it would find expression in this field. This we find has been the fact. Out of 1471 cities of 3000 reporting systems, 193 were owned outright by municipalities, 85 were owned by both city and private company, and 1190 were owned by private companies. Few of the large cities, however, own their electric lighting plants. Out of 135 systems in cities of more than 30,000 population, 121 were owned by private companies, 10 were owned by both, and only 4 were owned outright by the cities in which they were located. The largest proportion of publicly owned plants is found in towns of from 3000 to 5000 inhabitants, where, out of 579 reported, 111 were owned by the municipality, and in 18 cities plants were owned both by the municipality and a private company.

The largest percentages of publicly owned electric lighting plants were situated in the North Central and South Atlantic states, and a much smaller percentage in the New England and the Middle Atlantic states. It is to be noted, moreover, that Chicago and Detroit are the only cities of the first class owning lighting plants, and that, for most of the larger cities which manufacture electricity, public activity is restricted to the lighting of streets and public buildings, leaving the field of commercial lighting to the private company.

It is when we examine the ownership of street railways, however, the most difficult and costly of these public services to administer, that we see how small is the progress of the municipal ownership movement. Out of 928 companies reported in 1902, only one, in Grand Junction, Col., was owned by a municipality.

To summarize the progress made, we find (1) that waterworks are generally owned by municipalities, and that the proportion is increasing; (2) that a few electric lighting plants in cities and a large number in smaller towns are publicly owned, but that while the number of public plants tends to increase, the proportion to private plants does not increase; (3) that in the

supplying of gas and transportation, American cities have done practically nothing; the abandonment of its gas works by Philadelphia, the only large city which had undertaken the conduct of this service, raising grave doubts as to the desirability of a general municipalization of this service.

Growth of Public Sentiment

It is evident that if there is a movement toward municipal ownership, it is as yet confined to the formation of public opinion, a necessary preliminary to any practical results. An investigation of the evidences of public sentiment shows the existence not merely of a widespread interest in the subject of municipal ownership, but of a growing demand, particularly in the West, that radical action should be taken.

Clergymen and collegians, who may usually be depended on to voice conservative opinion, have in recent years been outspoken in favor of municipal ownership of public utilities. The League of American Municipalities and the National Municipal League have also indorsed the movement. More conclusive evidence, not merely of a growing interest in the subject, but of a conviction that a change is desirable, is furnished by the press. An examination of the files of a number of leading newspapers for two years past shows two tendencies: (1) a universal interest in the subject and a disposition to give an increasing space to its discussion; (2) a growing number of journals which advocate municipal ownership in one form or another. The more conservative journals — even those whose sympathies are on the side of private capital — dignify the movement by an increasing space in their columns.

More significant is the appearance of the issue in politics. Chicago, St. Louis, Detroit, Cleveland, New Orleans, Columbus, Denver, Nashville, and San Francisco are important cities which have within the last four years brought the issue forward in political campaigns.

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Trend of Legislation

Municipal ownership has figured with increasing prominence in the legislation of recent years. An examination of the legis-

lation on this subject for the past ten years shows the following tendencies on the subject of municipal ownership:

(1) Increased authorization of municipalities to erect, lease, purchase, and operate waterworks, lighting plants, and in a few cases street railways;

(2) Permission to issue bonds beyond the present authorized limit, or to tax for the special purpose of building or acquiring municipal plants;

(3) An increasing use of the referendum in deciding purchases or granting franchises;

(4) Limitation of the length of franchises and of lighting contracts, and permission granted to municipalities to regulate rates.

Within the past ten years (1891–1901) the permission to own, erect, and purchase water or lighting plants for cities of varying sizes has been extended to municipalities by twenty-four states. California and Kansas have passed very general laws providing for municipal ownership, and the cities of San Francisco, Fresno, and Pasadena have new charters with municipal ownership clauses. Denver has also obtained extended powers. Permission to furnish heat and power is of special interest in Western states.

The distrust of elected representatives and the desire of the people to safeguard their interests by referring questions affecting public utilities to a popular vote is seen in a growing use of the referendum. Many of the enabling acts above mentioned provide for referring the questions involved to a popular vote. Minnesota provides the referendum for the purchase or erection of water or electric light plants in villages, or in case of an exclusive franchise; Illinois, New Jersey, and Kansas for the building or purchase of waterworks; Iowa in case the municipality wishes to sell a plant; Nebraska for any ordinance on demand of 15 per cent of the voters; and Indiana for any ordinance to purchase a plant on demand of 40 per cent of the voters. A notable example of the referendum is the recent vote of Chicago.

The limitations of franchise take the form of (*a*) submission to popular vote, either required, or upon petition of part of the citizens; (*b*) specifications as to the manner of granting fran-

chises, for example, by advertising, by auction, or by competitive bids; (*c*) limitation of the term of franchises; and (*d*) control of rates.

A feature of especial interest in the present connection is the provision for ultimate municipal purchase. This provision is found in Florida, where the right to purchase is reserved; in Colorado, after 20 years; in Indianapolis, in the charter of 1899, at the end of the franchise; and in Virginia, where the right of purchase is reserved.

In addition to the cases mentioned under the referendum, Tennessee (for cities of 36,000) and South Carolina (by a two thirds vote) require an expression of popular will before a franchise can be granted, and California, Missouri, and Virginia require that franchises should be put up at auction, and sold to the corporation promising the highest percentage of gross earnings. The percentage of earnings paid to the municipality must amount at least to two per cent for the first five years in Missouri, and three per cent in California. Wisconsin requires competitive bids.

Franchises have been limited to 20 years in Kansas and 10 years in Minnesota, where exclusive. Massachusetts has legislated for control of street railways, and special rates are required to be given to school children. The Indianapolis charter requires that street railway companies shall sell six tickets for 25 cents, and universal transfers.

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What does our Experience Show?

What, now, does the recent history of municipal ownership tell us of its success and its probable future? First, it must be admitted that the few experiments which the larger cities have made in operating the more difficult services of gas and electric lighting are not conclusive one way or the other as to the practical expediency of municipal ownership. In other words, it has not yet been definitely established that municipal operation of public utilities results in cheaper and better service than is attained under private ownership, nor, on the other hand, do the results achieved point unmistakably to the conclusion that public ownership is less economical than private ownership. The four most

conspicuous examples of public ownership which have been used in recent discussions to furnish evidence in support of one or the other conclusion, are the Philadelphia gas works, the electric lighting plants of Chicago and Detroit, and the change from private to public ownership of gas and water plants in Duluth. Of these the first is commonly cited to prove the relative inefficiency of public management, and the three last mentioned are advanced in support of public ownership.

The evidence, however, is by no means conclusive. It is true that Philadelphia is receiving a larger revenue from the lease of her gas works than was ever derived from public ownership; that the quality of gas furnished is superior, while the service is on a much higher plane than that rendered by the municipal employees. It has not been proven, however, that a competent administration backed up by a less conservative community might not have secured, by a reconstruction of the gas plant, and a thorough renovation of the administration, a much larger return than is derived from the United Gas Improvement Company, for the earnings of this company are large and increasing, and they might all, conceivably, have been secured for the community. So far as Philadelphia is concerned, there is no doubt that municipal operation was a failure. In view of the peculiar characteristics of the citizenship of that city, however, it is unsafe to generalize from its experience.

The municipal electric lighting plant in Chicago was examined during 1901 by Haskins and Sells, of New York, and the results of the examination reported to the Reform Club were that during the thirteen years, 1887 to 1900, the city of Chicago paid $49,423.11 more for electric lighting than if the lights had been rented from the private companies. This discrepancy is so small as to leave the issue between the two systems in doubt, so far as the face of the returns shows anything of the relative efficiency of the two systems. Certainly the result cannot be urged against municipal ownership.

Moreover, Professor John R. Commons, in a critical review of this report, has suggested certain favorable considerations from another point of view, some of which the accountants could not notice, but which should be included in any estimate of the significance of Chicago's experience. These are in brief: (1) that

the city paid higher wages for shorter days than the private company ; (2) that the great reductions in the rentals paid to the private companies for the lights which they furnish to the city were due to the ability of the city, because of its ownership of a plant, to drive a good bargain with the companies ; (3) Professor Commons claims that the depreciation charges of the accountants were too high ; and (4) that the loss from taxes on the property which the city has owned is excessive because the private companies have paid taxes on a valuation less than half the true value of the property. As a result of this revision of the accountant's report, Professor Commons reduces the estimated cost per lamp from $123.81 to $106.55.

Without expressing an opinion on one side or the other, it is significant that such wide differences exist between the estimates of competent investigators. It is obviously unsafe to draw conclusions from such disputed evidence. The experience of Detroit, Duluth, Wheeling, Grand Rapids, and various smaller cities which have reported, seems to show a saving from municipal ownership. The evidence, however, as above remarked, of these few isolated examples is inconclusive.

Probable Future Development

Moreover, as John Stuart Mill pointed out half a century ago, the question at issue is not between private property as at present managed and public ownership—if this were the only alternative, municipal ownership might be generally approved—but between private property as it might be managed and public ownership. In other words, while the experience of various cities, particularly in Great Britain, may be taken to indicate a balance of advantage in favor of municipal ownership, this is not finally conclusive as to the merits of the question. We should, on the other hand, compare the results of municipal ownership with the results of the present system freed so far as possible from its abuses.

Before indorsing so radical a departure from established practice as is involved in public ownership of gas plants and street railways, we should first consider the possibility of improving the service, lowering its charges, and increasing the contributions of private companies to the public treasury. In a strongly individualistic community like the United States, we should expect that the line of development would be as follows : (1) a recogni-

tion of abuses; (2) a protest against those abuses and a trial of various methods of remedy; and finally, and only if remedial measures failed, a radical departure from precedent in the abolition of private property within those fields where it had been shown unfit longer to exist.

The evidence thus far presented follows this line of development. There is a general recognition of abuses and a vigorous and widespread demand for a change, which has apparently taken the form of a movement toward municipal ownership. It is, however, in the nature of things, altogether probable that this movement will expend itself in accomplishing much-needed reforms. This conclusion is supported by other than inferential evidence. The demand for municipal ownership is already resulting in important concessions to public sentiment on the part of private companies, which promise to accomplish the desired ends without resort to drastic measures. In brief, private companies are offering to accept shorter franchises, to improve their service, to reduce their rates, to increase their contributions to the public treasuries, and to take the public into their confidence. They make these concessions, it is true, under practical compulsion; but they are none the less important on that account.

25. The Commercial Revenues of Frankfort: by Anna Youngman.[1]—American students will find much of interest in the following extract from Professor Youngman's study of the finances of the city of Frankfort:

This study, undertaken with a desire to learn something of the finances and the financial administration of the Prussian municipalities, has resolved itself in large part into a special study of the financial system of the city of Frankfort-on-the-Main. There are several reasons, both general and particular, which seem to justify the selection. To cite first a general consideration: it appeared better to concentrate the attention upon one city, rather than to summarize cursorily the sources of income and the character of the expenditures of a large number of cities, showing bewildering, though frequently unimportant, variations in detail. Furthermore, such a special study can be made to subserve a general purpose, for, despite the, in many respects, large powers of the Prussian communities,

[1] Reprinted from the *Quarterly Journal of Economics*, Vol. XXVII.

they are all subject to the provisions of the *Kommunalabgabengesetz*,[1] which prescribes far-reaching regulations and restrictions in matters of financial legislation. As a result, there has been brought about a measure of uniformity which is at any rate sufficiently great to enable one in a specific instance to detect marked "variations from the norm."

There remain to be stated the particular reasons why Frankfort-on-the-Main was selected for purposes of investigation. In the first place, the city, under the guidance of an able and energetic mayor (that is, the *Oberbürgermeister*), a student of finance, holding very decided opinions concerning matters of municipal taxation, has made some unique experiments in the taxation of real estate, and has itself engaged in real-estate operations of impressive magnitude. Likewise in the development of municipal industries, in the extensive control acquired through ownership of public-service corporations, the city affords material of especial interest. In fact it may be asserted in advance that although Frankfort probably possesses no institutions that are not common to a greater or less number of other Prussian cities, it presents from the point of view of variety and degree of development an advanced type of communal activity. For purposes of generalization this is all the better, as so many more opportunities for comparison or contrast with the practices elsewhere prevalent are offered, and, at the same time, a very satisfactory composite picture for the study in hand is available.

The independent, self-sustaining character of the civic life is another advantage for present purposes. The municipality has not suffered the one-sided development of certain other rich residential cities, such, for example, as the Berlin suburbs; nor has its development been interfered with by the presence of central administrative activities, as in Berlin itself. Moreover, Frankfort has had to contend with all the problems that beset a rapidly growing city—one whose population has more than trebled in the course of thirty years (1880–1910), increasing over 43 per cent during the decade from 1900 to 1910. In 1910 the city had 414,576 inhabitants, in 1880 only 136,831.[2] . . .

[1] Hereafter abbreviated K. A. G.

[2] Statistische Jahresübersichten der Stadt Frankfurt a. M., Ausgabe, 1910–11, p. 11. Part of this increase is due to the incorporation of suburbs; 31,400 due to the incorporation of 11 suburbs, April 1, 1910.

Under such circumstances there is more likelihood of finding a progressive financial policy striving to adapt itself to local changes and to local growth.

It may well be that the developed civic consciousness evidenced by the multifarious municipal activities of Frankfort is in part a product of its long and not remote past as a Free City. It has had centuries of independent political development. It had the beginnings of a separate communal administration before the close of the Hohenstaufen period. Its position as an Imperial City *(Reichsstadt)* was assured before the end of the fourteenth century, and in the fifteenth it had attained to political and commercial importance of the first rank. The partial loss of its prestige as a great trading center was later recompensed by the world-wide prominence which the Rothschilds acquired during the Napoleonic Wars. Primarily through their operations, the city became an important international banking and stock-exchange center—a position which it held during the first half of the nineteenth century. The incorporation of the city into the Prussian monarchy came in 1866, at the time of the war with Austria, and since then the ever-increasing centralization of economic as well as administrative activities in Berlin has, of course, detracted from Frankfort's one-time unique position as an international banking center. Nevertheless the banking interests still play an important rôle, and on account of its expanding trade and commerce the city has also to be reckoned with. Such a history can fairly be expected to give to the inhabitants a somewhat greater initiative than is usually found, and to make them readier to assume new administrative responsibilities involving large expenditures.

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After the taxes and fees the next source of income to be considered is that turned over to the city by the communal undertakings.[1] The German cities in general have gone very far in the way of municipalizing such public-service corporations as water and gas works, electric-light and power plants, slaughter houses, to a lesser extent street-car lines, and other municipal industries of diverse description. In Prussia the communities as self-governing bodies have been given a large liberty in the

[1] The net balances transferred to the treasury amounted to 2,059,700 m. (1904–05), rising to 4,028,000 m. (1909–10) and falling to 3,627,000 m. (1910–11).

extension of their operations to all sorts of industrial and social activities. According to a statement of the *Oberverwaltungsgericht*, the community is permitted to bring within the field of its activity all that furthers the welfare of the whole body of its citizens or the material interests and spiritual development of individuals. It can establish, take over the management of, or lend assistance to institutions performing such public services.[1] To be sure, the state can control community activities in so far as such activities necessitate the contraction of debts (and they usually do), for all contemplated loans must be approved by designated state officials. But that the state has not used its power to the repression of communal activity is best evidenced by the existing high degree of development in the German cities. Indeed, one can say that they have been permitted an extraordinary freedom in the carrying out of their plans, so that many German municipalities to-day present advanced types of so-called communal socialism and have become subjects of international attention. In the front rank of such cities is to be found Frankfort-on-the-Main, sometimes dubbed the "Queen of Municipal Socialism." For purposes of the present study, these numerous undertakings are discussed primarily from the point of view of their relation to and effect upon the municipal finances. It goes without saying that the financial result is only one of many factors to be considered in determining the value of a particular institution. Notwithstanding which, it is a factor which plays a great and frequently the determining rôle where the question arises as to the expediency of a further extension of social activity by the communities.

A further limitation found in the K. A. G. anent the industrial (*gewerbliche*) undertakings of the communities provides that they shall be so managed that the income at least covers the total additional expenditures of which they are the cause, including interest and amortization payments on the capital invested. Exceptions to this rule are, however, permissible, to the extent that a particular undertaking at the same time subserves a public interest which would otherwise not be satisfied. There is some room for debate concerning the necessity of

[1] Der Gemeinde-Sozialismus und seine gesetzlichen Schranken im preussischen Kommunalrecht, by S. Genzmer, Senatspräsident des Oberverwaltungsgericht (*Archiv für öffentliches Recht*, Tübingen, 1909).

providing for the extinction of the so-called "productive" debts (contracted to provide capital for municipal industries, profit-making enterprises). It is sometimes contended that if interest payments are met and depreciation charges allowed for, the citizens can regard any surplus as a disposable source of income which can be used to lighten the burden of present taxation. Considering, however, the rapid extension of the field of municipal activity and the tremendous growth of indebtedness, it is likely that, were no provision made for the extinction of these debts, they would assume such proportions as to constitute a real danger. For, however farseeing the administration, however careful the provision made to prevent depreciation, there is no guarantee that existing productive investments may not become unproductive through the introduction of new industrial methods or systems. Innumerable contingencies may, in the course of time, arise to turn a productive debt into an unproductive one, burdening future generations of citizens for the sake of benefits enjoyed in the past.

In the classification of communal undertakings it is usual to distinguish those branches managed primarily with the view to achieving substantial net earnings from the other institutions in whose management the effort to obtain financial returns, although not always lost sight of, is yet subordinated to the desire to confer certain social services upon the citizens. The classification presents considerable difficulty at times, when the two aims are found combined in such fashion that neither one can be considered paramount. Nevertheless, it is a classification not without practical significance, for in individual cases a decision as to whether a particular undertaking belongs to this or to that category determines very largely the policy pursued in the fixation of tariffs.[1]

The three communal undertakings of Frankfort-on-the-Main which turn into the city treasury a substantial balance are the water works, the electricity plant, and the street-car system. Yet even these undertakings are not managed with the same singleness of purpose that one would expect to find in the case of private corporations. Other than financial considerations play an important and, perhaps, in the case of the water works, an

[1] For general review *cf.* A. Busch, Die Betriebe der Stadt F. a. M., *Schriften des Vereins für Socialpolitik*, 129 (1–3), 1908–09.

even more decisive rôle. As a pure and abundant water supply is a social necessity of first importance, a city might well deem it wise to own its works, even though no net earnings were achieved. In Frankfort water rates are graded in accordance with rental values, with exemptions for the lowest rentals, the desire to encourage consumption by the less well-to-do being recognized as of prime importance. Even the street-car system is not managed solely with intent to fill the city treasury, as will be apparent on later examination. In the case of the electricity works, the management can, no doubt, proceed fairly unhampered by considerations of social expediency.

The other communal undertakings, although usually bringing in returns sufficient to meet interest and amortization payments on the capital outlay, and occasionally returning a net balance above these amounts, are, nevertheless, not managed as similar private capitalistic enterprises would be, not even in those cases where they compete with or have superseded private enterprises. Their efficiency cannot, therefore, be judged with reference to the financial gain obtained or the financial burden which their maintenance entails. For example, the establishment of city stockyards and slaughter houses with compulsory slaughtering and compulsory examination of the animals to be slaughtered is to be regarded as a police measure undertaken in the interests of the public health.[1] The fees are rather in the nature of taxes than of payments in the private economic sense, for, where compulsion takes the place of voluntary payment, the community in its political capacity rather than as *entrepreneur* is functioning.[2] There are further included under communal undertakings functioning in the interests of the public health and comfort the sewage (canalization) system, the removal of garbage, the establishment of public baths, the maintenance of city markets. The city savings bank, designed to meet the needs of the poorer class of citizens, can be regarded as a philanthropic institution, and, in

[1] Gemeindebeschluss betr. den Schlachthauszwang (Bürgerbuch).

[2] On this point *cf.* J. Pfitzner, Die Entwicklung der kommunalen Schulden in Deutschland, p. 194.

It must be conceded that in all cases in which the city has acquired a monopoly, whether legal or actual, the payments for services become, theoretically speaking, taxes (fees). Whenever the inhabitants must take their water from the city water works, must obtain their electricity from the city plant, etc., the sums paid are as much fees as are the sums paid for the use of any other city institutions.

a smaller way, the city pawnshop likewise. Finally, the enormous outlays for harbor improvements which have been made by the city have been incurred for purposes for which private capital would have been unavailable. However important these expenditures may be in furthering the general commercial and industrial interests of the city, they offer no prospects of an adequate direct return upon the sums invested for many years to come.

In the listing of the communal undertakings (*Gemeindebetriebe*) there is an element of arbitrariness which must not be lost sight of. If one wonders why canalization and garbage removal should be included in the list any more than street paving or street cleaning, one also wonders why the cemetery management should be excluded from the list and put under "general administration," when, as is the case in Frankfort, the city is an ardent competitor of the local undertakers, furnishing coffins and funeral robes, as well as making other necessary arrangements for burials. The distinction is, indeed, in part a matter of bookkeeping, depending upon whether or not the particular branch of city activity has a separate and independent account or is subordinated to some department of the general administration. But the segregation has a less superficial justification ; there is usually some solid reason for separating these particular branches of city activity from the general administration. They all approach more or less nearly the character of private undertakings with definite sources of income and calculable expenditures. And all of them might conceivably be private capitalistic enterprises. If the distinctions are not always logically satisfying, the list can at any rate be provisionally accepted and later enlarged to include other municipal undertakings which seem properly to belong here.

Before proceeding to a more detailed discussion a further caution is necessary. The estimates of the profitableness of the investments from a financial standpoint can only be stated approximately. The various communal enterprises have many contracts with one another, the expenditures of one frequently constituting the income of another. In the case of such formal bookkeeping transfers, it may well be that the sums credited and debited would be quite different were the contracting concerns under separate ownership. An analogous case is presented by the contracts between the constituent concerns belonging to

the same trust. Their accounts are kept separate, their mutual contracts, deliveries, etc. are credited and debited to the particular establishments concerned; but there is, nevertheless, an element of arbitrariness about the proceeding which makes the results open to question. Then the amount carried to renewal funds is a very fluctuating quantity, sometimes sufficient to provide for improvements and extensions as well as renewals, or, again, if the financial need be greater than available revenues, the renewal funds may be robbed of their just quotas, and the proceeds transferred to the city treasury.

The city water works[1] have had expended upon them 40,053,000 m., of which 26,444,000 m. remained, April 1, 1911, a part of the city debt. Despite the fact that the management has to meet deficits incurred by the smaller works of the recently incorporated suburbs, the returns are considerable. In 1910–11, 683,500 m. were transferred to the account of the city treasury, while the total returns (including interest and amortization payments) amounted to 2,697,600 m., or 6.7 per cent of the amount of the capital invested. In 1907–08, among 77 German cities reporting, all of which with a few minor exceptions owned their water works, Frankfort showed the largest absolute net returns (including interest and amortization payments), exclusive of Berlin. Even Hamburg had a less net surplus from operations. The capital value of the plant was likewise far in excess of that of any city save Berlin; but the net income expressed as a percentage of the investment value was modest (at that time 7.1 per cent) when compared with 16.6 per cent for Essen, and returns variously in excess of 10 per cent for 22 other cities.[2] The reason is no doubt to be found in the generous provision which Frankfort makes for securing an abundant water supply—the installation of meters being restricted with a view to encouraging the liberal use of water. In consequence, the per capita consumption is about 33⅓ per cent greater than that for the city of Berlin.

Water for drinking is piped from springs in the nearby hills or (largely) from underground sources by pumping, while the

[1] *Cf.* Verwaltungsberichte and Haushaltspläne der Stadt.

[2] Statistisches Jahrbuch deutscher Städte, 1910, article Wasserversorgung, 1907–08. Statistisches Amt, Nürnberg.

water for non-drinking purposes is conveyed directly from the river. In Frankfort proper the water intended for the use of factories and for industrial purposes in general is paid for by meter. In all other cases the payment is regulated according to rental values.[1] For example, in the case of dwelling houses, for each 25 m. or part thereof of the yearly rental value, a water fee (*Wassergeld*) of 1 m. must be paid, with the proviso, however, that dwellings with a rental value of less than 250 m. remain free from the payment.[2] Here is an interesting illustration of a tariff based rather on the ability to pay of those served than on the amount of the service. However rude a measure rental values may be, they permit a certain large discrimination to be made. Special rates are made for rooms or apartments devoted to business or industrial purposes, where water for the conduct of operations is not necessary. A special tariff is also in force for water used in courts and gardens, the area being the basis of measurement. Where the meter system has been introduced, the price per cubic meter varies at different seasons of the year with the amount consumed and with the character of the use.

Wherever the price of water is fixed, as is so largely the case in Frankfort, according to certain standards which give only a vague indication, if that, of the amount consumed, the water supply must needs be large. For the current year, indeed, the management has for the first time to pay a large sum, exceeding 800,000 m., in order to obtain additional supplies from a neighboring water works. As a result the anticipated net returns for 1912–13 have been considerably cut down, and the expediency of a rapid extension of the meter system has in consequence been discussed.

In 1898 Frankfort took possession of its street-car lines[3] (then a horse-car system) paying to the private company in control 2,230,000 m. and contracting to pay further until 1915 a

[1] In the suburbs payment according to meters is general.

[2] Wassergeld, Bürgerbuch, p. 314. For the coming year (1912–13), the rate has been increased $\frac{1}{16}$ for rentals 400–500 m., $\frac{2}{16}$ for rentals 500–1500 m., $\frac{3}{16}$ for rentals 1500–3000 inclusive, $\frac{1}{4}$ for all higher rentals. Dwellings bringing less than 400 m. are, however, entirely freed from payment.

[3] *Cf.* Die Städtische Strassenbahn F. a. M. ("Im Auftrage des Städtischen Elektrizitäts- und Bahnamtes aus Anlass der 10. Hauptversammlung des Vereins, etc.") Betriebsdirektion, 1905.

yearly sum of 326,872 m., as compensation for the unexpired term for which the charter had to run. The city gave out the contract for electrification of the road, and upon its completion, April 1, 1900, took over the management definitively. The net returns, 1910–11, amounted to 1,147,300 m. (exclusive of interest and amortization payments). For the purpose of comparing the returns with those of private corporations, however, other payments which figure as expenses must be included under returns.[1]

For example, the contribution to the erstwhile *Trambahngesellschaft*	326,872 m.
a payment to the city *Waldbahn* (forest railway) to cover a deficit	156,111 m.
and the interest and amortization payments . .	1,015,901 m.
constitute a total of	1,498,884 m.

to which must be added 1,147,340 m., the so-called net earnings, bringing the thus estimated earnings up to 2,646,200 m., or 12.9 per cent of the amount of the capital invested (20,497,000 m.). The contributions to pension funds for employees (236,900 m.) may be regarded as a legitimate item of expense, although the generous provision which is made disturbs the reckoning for comparative purposes, not only in this case, but in that of all other city enterprises. The payments or transfers growing out of contractual relations with other city departments introduce an additional element of uncertainty. The chief expense of operation, for example, is the payment made to the city electric works for the power needed; in 1910–11, 1,139,730 m. (delivered at the rate of 9 pf. per kilowatt hour).[2] The company likewise contributes 165,000 m. to street paving, repairs, street widening, etc., and 70,640 m. to the city treasury for its share of general bookkeeping expenses.

It has further to be considered that for a public corporation, the improvement and extension of the service is frequently emphasized to the detriment of the net returns. To illustrate: in 1910–11 the total income of the company was increased 515,000 m., but at the same time there was a diminution in net

[1] *Cf.* Verwaltungsbericht, 1910–11, and Haushaltsplan, 1912–13, pp. 509 ff.
[2] *Cf.* Haushaltsplan, 1912–13, p. 509.

returns,[1] the cause being assigned to an increase in wages, together with shortening of the working period, to the acquisition of non-paying lines (needed to open up the suburban territory, always with the idea of relieving congestion in the older parts of the city), and finally to the great amount of travel at reduced rates. This last point deserves elaboration for several reasons. The fee system, as has been previously emphasized, is highly developed in German municipalities, and where possible and desirable, charges for the same services are frequently graded according to ability to pay. Frankfort, for instance, in addition to the normal tariff for its city railway, varying with the distance traveled, makes special rates for workingmen for the journey between their homes and places of employment.[2] The reductions are very considerable—about 50 per cent below the normal price—and are only granted to independent, self-supporting workers on the presentation of evidence that the applicant has a yearly income under 2000 m. The number of cards issued in 1910 was 495,255, as against 69,940 in 1904, the first year when the system was tried. Of the total number of passengers carried during the year, 30.6 per cent traveled at these reduced rates. The tariff serves a double purpose, not only making a justifiable reduction for the sake of benefiting the laboring classes, but also encouraging a more extensive distribution of population, helping to relieve congestion within the older districts, and thereby indirectly aiding the efforts which are being both publicly and privately made to provide cheaper and more healthful dwellings for the poorer citizens.

Of 81 German cities listed in the "Statistisches Jahrbuch deutscher Städte" (Statistical Yearbook of the German Cities)[3] 33 owned their street-car systems, among these being 8 cities with over 200,000 inhabitants. The financial condition of these lines was, however, at that time (1907–08) by no means so favorable as that of the Frankfort city railway, 13 companies

[1] The working expenses have risen from 55.4 per cent (1904) of the income from operation to 59.5 per cent; the gross earnings in 1904 were 2,452,000 m.; in 1910, 3,631,000 m. The net earnings (1904), 983,156 m.; 1910, 1,147,340. The net earnings show a decided reduction, however, compared with the previous year, 1,609,600 m., and were smaller than for any year since 1905.

[2] So-called "weekly" cards are issued, good for a single journey on each work day before 7.30 A. M. or for going and returning after 4 P. M.

[3] 17. Jahrgang, article Städtische Strassenbahnen im Jahre 1907, O. Landsberg.

even requiring dotations from the city treasuries. Frankfort, indeed, received the largest returns of any city listed (2,828,000 m.), although its capital was then only one-third as great as that of the Dresden street-railway company, with a return of only 2,740,000 m., and not quite so large as the capital investment of the street railway in Munich, with an income of 1,170,000 m. The returns here used for comparative purposes include not only the sums turned over to the city treasury, but also interest and amortization payments, and the amounts transferred to renewal funds. The so-called "net" returns are too variously conceived to be available for purposes of comparison.[1] And in any case the statistics have to be taken with reservations. The street-car system of Cologne, for instance, debited with an advance of over 334,000 m. from the city treasury, is charged with contributions for the upkeep of the city streets (283,600 m.), and also burdened with the payment of a large sum to its predecessor, a private company, amounting to 1,103,900 m. Excluding these extraordinary payments, the deficit is turned into a net balance. Making allowance for such inequalities, however, Frankfort stands, financially speaking, well at the head of those cities operating their own street-railway systems.

The electricity works is another one of the municipally owned undertakings which bring a considerable sum into the city treasury.[2] The capital expenditure, 16,932,000 m., provided almost entirely through loans, has been in part repaid, to the amount of 2,179,000 m. (March 31, 1911).[3] The net returns transferred to the city treasury in 1910–11 totaled 2,898,800 m., and together with the interest and amortization payments the entire income was 3,774,700 m., or 22.2 per cent of the amount of the capital outlay. It should be noted, however, that for the year in question no transfer was made to depreciation funds[4] —an omission which was due to the desire of the city to find new sources of revenue without increasing the taxes. This vicious

[1] Dresden is credited with a net return of 300,000 m. in 1907; Munich, 472,000 m.; Frankfort, 1,280,000 m., 1906–08. *Cf.* Statistisches Jahrbuch deutscher Städte, 17. Jahrgang, pp. 626–627.

[2] *Cf.* Verwaltungsberichte and Haushaltspläne.

[3] Electric works No. 2, located in the suburb of Bockenheim, has a capitalization of 2,885,000 m. (repaid 427,700 m.). It is able to meet interest and amortization payments, and to turn an insignificant balance, 2860 m., into the treasury.

[4] Nor are any sums written off for depreciation in 1911–12 and 1912–13.

practice constitutes one of the greatest dangers for the future solidity of communal undertakings, and cannot be too strongly deprecated.

The fees charged vary according to the purposes for which the electricity is used[1] (whether for illuminating purposes, or for electric motors, heating, etc.), and also with the amount consumed. The owners of meters likewise pay a monthly rent for their use, and a single payment for installation, usually 50 m., is also required.

In the last year for which comparative statistics are available, 1907, Frankfort was again occupying a leading position among the 59 German cities reported as owning their own electric-light and power plants.[2] The net returns from operating were slightly in excess of those for Munich, and far ahead of those of any other city, Cologne coming next with 1,583,000 m.[3] Notwithstanding this fact the price of electricity in Frankfort is rather below the usual rate charged elsewhere,[4] the most frequent charge for illuminating purposes being 60 pf. per kilowatt hour; for power, 20 pf. (in 30 cases), and frequently 25 pf. (11 cases). The delivery of power to the city railway at a rate of 9 pf. (2 cents) appears relatively rather low, although a number of other cities charge at about the same rate. The sum with which the works are credited for street lighting is quite small, 85,000 m., as the city lighting is largely provided for by a private company: the Frankfort Gas Company. The city owns one small gas works in a recently incorporated suburb, Heddernheim. The returns had to be supplemented, 1910–11, by a small advance from the city treasury, 17,770 m., in order to meet all outlays, including interest and amortization.[5]

[1] Gebührenordnung, Bürgerbuch (Elektrische Gebühren).

[2] Statistisches Jahrbuch deutscher Städte, 17. Jahrgang: Beleuchtungswesen im Jahre 1907, by E. Tretau, Direktor des statistischen Amtes Altona. Returns were received from 83 cities.

[3] These sums also include interest and amortization payments and transfers to renewal funds.

[4] The Frankfort tariff for illuminating purposes: yearly consumption up to 3000 kilowatt hours, at the rate of 50 pf.; for each succeeding 3000 kilowatt hours, 40 pf. per kilowatt hour; for electric motors, etc., 15 pf. per kilowatt hour in May, June, and July, and for the rest of the year, 25 pf. from 5 P. M. to 9 P. M.

[5] That Frankfort does not own the local gas works is due to the fact that the company supplying the city with gas has charter concessions, granted in the 50's, which do not expire until 1959. This private company pays the city for the privilege

Next in order of discussion, following the undertakings which turn over substantial net balances to the city treasury, comes the harbor management. Enormous expenditures have been made for harbor construction and for the acquisition and laying out of adjacent territory to be utilized for factory sites. No adequate return can be expected on the capital outlay for many years, although it is hoped that the indirect financial gain to the city through its increased importance as a commercial shipping port will justify an outlay which makes a very substantial addition to an already large city debt.[1] Until 1886, when the Main was canalized, and opened for traffic from Frankfort to the Rhine, the city could only be reached by small boats, and was of no importance whatever as a river port. Since 1886, however, the river trade has grown steadily until Frankfort now ranks sixth among the Rhine ports. The chief imports, coming for the most part up the river from the Rhine, consist of coal, coke, etc. (50 per cent). The grain trade is also of considerable magnitude—the grain imports, largely foreign, being transferred at Rotterdam to the Rhine vessels. Building materials are the only other important group of wares for the river trade. The existing West Harbor, completed at the same time that the canalization of the Main was finished, represents an outlay of over 7,400,000 m., including expenditures for warehouses, a customhouse, and equipment of various sorts,[2] but excluding the cost of the railway station. The warehouse fees, wharf dues, payments for the use of cranes, wagons, etc., bring in quite considerable sums, so that the West Harbor management, in addition to meeting interest and amortization payments, was credited with a very small balance, 13,000 m. (1910–11). The warehouses and customhouse, for which separate accounts were carried, needed an advance of 86,770 m. in order to cover

of using the streets (over 395,000 m.) and is in turn reimbursed for city lighting (409,000 m.). The city owns shares of the Frankfurter Gas Gesellschaft for which 6,450,000 m. have been expended. For the last purchase, 1910, a loan of 3,000,000 m. was obtained from the city savings bank.

[1] Der Osthafen in F. a. M., Denkschrift über die Erbauung eines neuen Handels- und Industriehafens im Osten der Stadt: Städtisches Tiefbauamt, 1907. *Cf.* also Der neue Osthafen, by Magistratsbaurat H. Uhlfelder.

[2] Rechner-Amt, Sonderabdruck, p. 40. Baurat Uhlfelder estimates the total cost of the West Harbor, together with the warehouses and customhouse, at about 12,000,000 m. I do not know the reason for the great discrepancy in the estimates.

all outlays ; but that advance was simply a bookkeeping transfer from the harbor management proper to the other departments.

The facilities afforded by the West Harbor not being adequate to meet the needs of a growing commerce, the city was led to embark upon an ambitious new project, involving the construction of a second, "East" Harbor, and the purchase and laying out of an enormous adjacent territory, intended to serve as a site for factories and industrial establishments in general. Already, a large part of the contemplated plan has been executed. The lower East Harbor, running about 2.5 km. (somewhat over 1½ miles) eastward from the city, includes an open river harbor, leading into which are two basins parallel with the Main. The tongue of land between the Main and the outermost basin is intended for industries needing immediate water connections (land here has already been taken up by milling establishments). Other locations on the water are variously intended as storage places for coal and other freight, and to the north of the inner basin are located the warehouses, dock-yards, etc. Cranes, wagons, all the machinery for loading and unloading, have been installed by the city. Just back of the warehouse district is a section for factories, without immediate water connection, but very accessible, nevertheless, as broad streets have been cut through, and shipping facilities provided.

The upper harbor district runs eastward from the lower for about 2 km. (1¼ miles). At present only the western end of this upper region, away from the river, and the main connecting streets have been laid out. The harbor facilities proper are to include a basin parallel to the Main, from which three others will branch off. In general this district is intended for industrial sites, and provision is to be made, furthermore, for direct transfers between ships and railway. A section here is also without immediate water connection. The third main division, the Seckbach industrial district, extends northward away from the river, being connected with the harbor region by streets cut directly through, and having also railway connections. Only about two-thirds of this district has as yet been opened up.

The establishment of a harbor for industry (*Industriehafen*) is an interesting experiment,[1] and, viewed in one aspect, it is to be

[1] Frankfort is not a pioneer in this instance. Similar projects have been carried out, first in Bremen, then in Strassburg, Karlsruhe, Kehl, Mainz, Düsseldorf, Mannheim, and Crefeld.

regarded as one of the many attempts which the city makes to cope with the difficulties connected with the high price of city lands. Among the reasons given in favor of the project in question[1] were the limited number of available factory sites in the city, and the high land values which make the establishment of new industries or the development of local branches, especially those needing much land, almost impossible. In many instances, furthermore, proper railway connections could not be had, while a situation near the water or in the neighborhood of quays was seldom obtainable. In the new district it is thought that the excellent water connections will mean a saving of expense in the case of raw materials brought by water, and the concentration of industry will also make possible a cheapening of water, light, and power provided for industrial purposes.

Up to April, 1911, land to the amount of 360,493 qm. had been sold to 35 firms, the proceeds amounting to 9,095,800 m.,[2] an average per qm. of 25.3 m. Of these 35 firms, 4 were new enterprises and 9 were establishments moving into the city from elsewhere. A smaller number of rental contracts have been entered into, bringing a total income of only 61,100 m. Whether the optimistic views of the supporters of the East Harbor project, who anticipate an inflow of capital and a rapid settling of the new territory, will be confirmed remains to be seen. In certain official quarters, at any rate, the attitude is rather sceptical. There must be very urgent reasons at hand to induce outside firms, which can obtain good factory sites for 3 and 4 m. per qm. in other cities, to settle in the Frankfort harbor district, where the cheapest land brings 15 and 16 m., and the best locations on the water 40 m. On the other hand, there are distinct advantages to be got from the presence of a skilled and abundant labor supply, and from the favorable location of the city as a commercial center. And for those establishments operating with large capitals, for which the payment for land (or rentals) is a relatively unimportant item of expense, the higher prices need not always deter.

[1] *Cf.* Denkschrift, pp. 33–34.

[2] *Cf.* Der Neue Osthafen, by Uhlfelder. During the past year about 700,000 m. was obtained through further sales. Terms: usually a first payment of 10 per cent and thereafter 9 yearly payments, interest $4\frac{1}{2}$ per cent. Occasionally a fifteen-year term of payment is granted.

The estimated costs of the completed project (including land purchases and construction costs) are set at 72,000,000 m. Up to the present time, loans amounting to 20,500,000 m. have been used to defray the costs of land acquisition. Much of this land was already city property or belonged to city foundations, which had to be reimbursed for relinquishing their holdings. A much smaller part, but a part acquired on much harder terms, naturally, belonged to private individuals. From these various sources, the Special Fund for City Real Estate (*Spezialkasse für städtischen Grundbesitz*), acting for the East Harbor management, acquired 3,304,300 qm. of land for the project. The debt for construction costs now amounts to 13,800,000 m., making a total outstanding indebtedness for the East Harbor account of 34,300,000 m. The amortization payments on the debt for construction costs began in 1910, but in the case of the debt for land acquisitions these payments do not begin until 1918 (15,000,000 m. loan, 1907) and 1922 (5,500,000 m. loan, 1911) respectively. The rate, however, is higher, 3½ per cent, and the extinction of the debt will therefore be consummated in about the same time as if payments had been allowed for from the period of issue at the usual rate of 2 per cent.[1]

The regulations for the East Harbor provide that it shall be managed as an independent undertaking.[2] The land, furthermore, is to be utilized either through sale or lease (the latter method being preferred),[3] the prices to be so fixed that the entire costs of construction and of land acquisition, including loss of interest, shall as far as possible be covered. At present all returns from sales, all proceeds of rentals, are transferred to a special interest and amortization fund (*Zinsen- und Tilgungsfonds*), from which current interest and amortization payments are to be defrayed. It was estimated that this fund on April 1, 1912, would amount to 11,924,000 m. With the current year, the East Harbor begins existence as an independent city enterprise[4] (*Gemeindebetrieb*), which must depend upon its own sources of revenue, or, where those are not sufficient, upon dotations from the city. Just

[1] [Statement of Stadtrat Dr. Bleicher.]

[2] Grundsätze für die wirtschaftliche Durchführung des Osthafenprojektes, Mar. 6, 1908. *Cf.* Bürgerbuch.

[3] As a matter of fact, most of the land taken up has been sold.

[4] *Cf.* Haushaltsplan, 1912–13, p. 560, and *ibid.*, p. 369.

so long as this independent standing was not recognized, there was danger that the deficits (which are likely to exist for years to come) would be recurrently met by fresh loans, instead of being defrayed out of ordinary sources of income. As it is, the advance from the city for the year 1912–13 is exceedingly meager, 95,000 m. only; and the interest and amortization payments on the debt will have to be taken in large part from the special fund, the contemplated withdrawals amounting to 1,378,000 m. How long this fund will prove adequate to meet the outlays for interest and amortization depends entirely upon the amount and the rapidity of sales. In 1918, too, an increased burden will be put upon it to provide amortization payments at the rate of 3½ per cent on the first debt of 15,000,000 m. A more liberal policy on the part of the city in making yearly advances, and consequently less heavy withdrawals from the fund, might, assuming fairly favorable conditions of sale, enable the latter to satisfy all demands. But in all probability the city will eventually be face to face with the necessity of meeting large deficits through much larger dotations, or else of incurring new debts to meet recurrent expenses.

The *Verbindungs- und Hafenbahn*, which has been greatly extended to meet the needs of the newly opened up district, is also city property. Although the sum of 98,600 m. was obtained in 1910–11 from leasing the road to the state railway, the city had to meet a deficit, amounting, however, to only 45,900 m. No doubt with the increased traffic to be hoped for within the next few years, the deficit may be turned into a surplus.

A communal undertaking recognized to be of great importance to the public health is the canalization system. Indeed, save for the fact that the department is segregated from the general administration and has its own individual sources of income, it seems hardly to belong with the other listed communal enterprises. The system has involved a capital outlay of 26,547,000 m.,[1] the debt incurred having been in large part repaid, however, so that the department, with the aid of a slight advance from the city (88,700 m. in 1910–11), can meet expenses and provide for interest and amortization payments (487,000 m.) on the still

[1] Rechner-Amt, p. 40, Sonderabdruck. Sewage systems of the suburbs and establishments for sewage purification and burning of refuse are included.

existing indebtedness (10,030,000 m.[1] in 1910–11). The fees, amounting to 1,145,300 m. (1910–11), are a very considerable source of income.[2] For new sewage installations, the payment is 30 m. for each meter of street frontage, and since 1897 an additional sum (*Zusatzgebühr*) is raised varying according to the value of the buildings erected on the property concerned. In case of new installations, changes, improvements, etc., the payment follows at the rate of 1 per cent of the building costs, exemptions being allowed for buildings with a value of less than 1000 m. In addition to these extraordinary payments, every occupant of dwellings or rooms connected with the city canalization has to make a yearly payment graded according to rentals. Dwellings with 300 m. rental value or less are freed from the payment. For shops and establishments whose owners are taxed on a lesser income than 6000 m. one-half the rental payment may be made the basis of measurement, provided that that one-half equals at least two-thirds of the amount of the taxable income of the person in question. Again comes an interesting illustration of the grading of fees to the advantage of the small households and of the less well-to-do trades people.

The sewage is purified by a mechanical process before being permitted to flow into the Main. The coarser particles are trapped and burned, the refuse serving as fuel for the generation of electric power, not only sufficient to meet the needs of the plant in question, but enough to bring in a return of 121,700 m. from outside sources, mainly the city water works, and more lately the water works and the electric power plant also.

The transport of garbage[3] is undertaken by the *Fuhrpackverwaltung* (hauling department), which also has charge of the removal of the refuse of industrial establishments, the city markets, the public schools, etc. The same department also does the necessary hauling for the various departments of the city administration which require its services, in this case payment being reckoned according to a fixed scale and the sums debited to the various departments and offices for which services are performed.

[1] Total indebtedness previously canceled 5,497,800 m. to April 1911, Haushaltsplan, 1912–13, p. 23.

[2] For Frankfort, exclusive of the suburbs, the fees amount to 962,700 m.

[3] Verwaltungsbericht, Fuhrpackverwaltung.

The fees[1] for garbage transport are also graded according to rental values. For each 100 m. of rental, or fraction thereof, 50 pf. is paid. Again, the removal is free of charge if the rentals are 300 m. or less. Likewise, reductions similar to those made in the case of sewage payments are granted in the case of business or industrial establishments whose owners are taxed on an income of less than 6000 m.

Frankfort is one of the many German cities which are in possession of their own slaughter houses and stock yards,[2] and which require all slaughtering undertaken within the city limits to be done in the municipal slaughter houses. All meats, whether slaughtered within or without the city, must be examined, unless the latter are labeled to show that they have been subjected to an approved examination; and imported meats must be sold separately in any case. The income consists largely of slaughter-house fees,[3] cold-storage fees, a market fee for the animals brought to the stock yards, and fees for the examination of the stock. The returns from the stock yards and slaughter houses are quite considerable, if interest and amortization payments be considered, although the sums turned into the city treasury are insignificant and frequently a deficit is recorded. The interest and amortization payments amount to 512,700 m. for the slaughter house and stock yards together, which represent an investment value of 9,637,000 m. Adding thereto the slight net balances, the return on the capital investment for 1910–11 amounts to 5.6 per cent.

The city markets return slight net gains (25,540 m. in 1910–11),[4] which, however, are assignable to the special markets and fairs held several times yearly, in accordance with ancient custom, in the open streets. The regular markets do not quite meet all expenses, including interest and amortization payments on the debt, although the deficit is very slight (21,075 m. in 1910–11), and, as has been said, more than covered by the surplus from the special markets and fairs. The total returns, including interest

[1] Gebührenordnung betr. Kehrichtabfuhr, *cf.* Bürgerbuch; also Adressbuch der Stadt.

[2] Of 41 cities with over 100,000 inhabitants, 38 possessed their own slaughter houses (1908). Of 85 cities with a population of 50,000 or more, 81 owned their slaughter houses.

[3] *Cf.* Bekanntmachung betr. Gebührenerhebung auf dem Schlacht- und Viehhof, 16 März 1901.

[4] Haushaltsplan, 1912–13.

and amortization, amount to 134,740 m. and represent a very creditable return of 6.4 per cent on a capital investment of 2,092,000 m., or, excluding the returns from the special fairs, 4.4 per cent. The city owns four market halls, and collects fees for the use of the stands, which vary with the location, the area, and the days used, the fees being higher on Wednesday and Saturday.[1]

The public baths, containing swimming pools, shower baths, etc., a free river-bathing resort, and suburban bath houses, have a deficit of 78,600 m. to show (1910–11), although the income from fees (232,000 m.) is fairly large. The interest and amortization payments on an investment sum of 1,404,052 m. amount to 64,800 m. The bath houses are therefore the only city enterprise[2] receiving an advance which exceeds in amount the sums required to meet the interest as well as the amortization payments on the capital debt. However, since the public baths are designed primarily to meet the needs of the poorer citizens, the fees may properly be reduced below the value of the services paid for.

The city pawnshop, which dates from the beginning of the 18th century, is maintained with the purpose of protecting needy borrowers from excessive exactions.[3] The establishment does not always quite meet expenses, although the attempt is made to obtain an income that will at least cover, but no more than cover, the outlays.[4] The working capital advanced by the city treasury amounted to 746,000 m. (1910–11) for which an interest payment of 25,178 m. was made.

The city savings banks[5] grew out of a small suburban institution which became the property of the city in 1895, when Bocken-

[1] The city has only once arranged to sell food supplies directly to the people, as is frequently the case in other cities, where attempts have been made to relieve the distress caused by high prices by selling fish, milk, etc., even by establishing communal bakeries. In the fall of 1911, however, the municipality bought potatoes which were sold at cost, with the result that the prices which had been extraordinarily high as the result of a bad season fell rapidly.

[2] That is, exclusive of the *Verbindungs- und Hafenbahn*, which is operated by the Prussian State Railway.

[3] In addition to the city establishment, a number of licensed pawnbrokers are certified as being more reliable.

[4] Ordnung für das Pfandhaus der Stadt F. a. M.

[5] Denkschrift aus Anlass des 50jährigen Bestehens der städtischen Sparkasse zu F. a. M. hrsg. vom städtischen Sparkassen-Amt, Januar 1910; also *cf.* Verwaltungsbericht, 1910–11.

heim was incorporated. The operations of the bank were subsequently enlarged to include the whole city, and the deposits increased rapidly until in 1911 they reached the considerable sum of 28,288,000 m.[1] All gains are transferred to the reserve fund which amounted, April 1, 1911, to 515,000 m. The majority of the depositors are servants, day laborers, factory workers, apprentices, assistants, etc., and the size of the average deposit is small (740 m.). In the period from 1901–10 over 1000 accounts averaged less than 60 m., and only 163 over 10,000 m. The largest number varied from 600 to 1500 m. The number of separate accounts for the period averaged 34,860.[2]

A city savings bank has come to be a typical feature of German municipalities, and indeed serves a double purpose, as a secure investment for small savings and as a means of bringing together sums which would otherwise have been hoarded, and would have been unavailable, therefore, for purposes of capital investment. Where the cities use such funds to satisfy in part their own credit needs (either through sales of their bonds to the savings banks or by means of other borrowing operations) there is undoubtedly an element of danger present—a danger that these funds held in trust may be employed too freely in financing the operations of the trustee. In 1908 Dr. Most published a list of the creditors of those German cities having over 25,000 inhabitants. Of the bonds amounting to 2,143,172,000 m. the communal savings banks held 132,286,000 m. belonging to their own cities, 10,900,000 m. belonging to other cities, making 6.7 per cent of the total. Of the other city loans (not funded) amounting to 550,900,000 m., the communal savings banks were credited with 142,580,000 m. (25.88 per cent), loans made to their respective cities.[3] The Frankfort savings bank is not to any

[1] Interest paid depositors at present $3\frac{1}{4}$ per cent.

[2] An old-age savings fund has also been established in connection with the savings bank. It may be participated in by any depositor in the savings bank, not over forty-five, who belongs to the class of lower officials, trade and industrial assistants, laborers, servants living in Frankfort or working there the greater part of the year. The yearly income must not, however, exceed 2000 m. When a depositor has saved 100 m., for example, one-half the interest payment may be credited to the old-age insurance fund, as a first payment. The savings bank contributes an additional sum (100 per cent of late years) and further pays interest on the account at a higher rate than is usual. Nevertheless, the savings have hitherto been very small.

[3] O. Most, Die Schuldenwirtschaft der deutschen Städte. Jena, 1909.

great extent a partner to this questionable practice, as the latest list of its security holdings does not include city bonds. It has, however, recently (1910) made a 3,000,000 m. loan to the city, which has been used to purchase shares of the Frankfort Gas Company. This loan has taken the form of a funded debt, interest payments at 4 per cent, and amortization payments at the rate of 2 per cent.

The bank is undoubtedly an important instrument in furthering the efforts which the city so vigorously makes to increase the facilities for cheap and comfortable living. On March 31, 1911, it had investments in mortgages amounting to 10,946,000 m., bringing in an average return of 4.2 per cent. It is stated that, as usual, the policy followed involved primarily a preference of those lots having the smaller dwelling houses. Among the securities, too (*Wertpapiere*), amounting to 13,000,000 m., are mortgages of the Hellerhof and Franken-Allee building companies, totaling 825,000 m. These two companies are engaged in the erection of small dwellings, and it is the aim of the city to further the efforts of such building companies as far as possible. Likewise, in pursuit of this same policy, loans on mortgage security were granted to various building associations to the amount of 1,105,000 m.

The Department of Supplies (*Materialienverwaltung*) has charge of the ordering of building materials, provision of office supplies for the various departments, and purchase of the service uniforms of the employees of the street railway. In 1908 about 428 firms were engaged in the delivery of materials, the purchases amounting to about 2,520,000 m. Under this department also comes the work of repairing tools, wagons, and other implements belonging to the city. In addition to inspectors and office employees the department has about 110 to 120 laborers under its control.[1]

Although the municipal undertaking department has not yet been segregated from the general administration, it can properly be counted among the community enterprises which have just been briefly described. In 1908 Frankfort took over the management of city burials, all operations even to the provision of coffins being arranged for. In nine other German cities the undertaking business has been municipalized, in some cases to the exclusion

[1] Busch, Gemeindebetriebe. *Cf.* previous reference.

of all private undertaking business. In Frankfort the transportation of the corpses is undertaken by the city alone, but other services may be performed by private undertakers. The fees are graded with reference to the income of the respective families of the deceased and five different classifications are made, the payment required of those families with incomes less than 1500 m. being only one-fifth of the sum charged in those cases where the income exceeds 7500 m. For the lowest grade, a further 50 per cent reduction is made in case four persons are dependent on the income in question. The returns are more than sufficient to meet outlays : 411,500 m. against an expense to the city of 388,-900 m. Of course no allowance is made for interest on the working capital, in this case, as the department belongs to the general city administration.

As Dr. Otto Most has pointed out, the so-called real-estate funds (*Grundstücksfonds*) are rather to be regarded as furnishing working capital for a new branch of communal activity than as funds assembled for the purpose of introducing stability into the city finances. In many instances, notably in Frankfort, the municipalities have become dealers in real estate on an enormous scale, working with an extensive capital provided largely from the proceeds of bond issues. According to the Kommunales Jahrbuch,[1] of 91 German cities with over 50,000 inhabitants, about 50 (in 1910) had established special funds to which city landed property, not serving any particular purpose, had been turned over. Not only do the cities hope thereby to obtain for themselves certain legitimate gains from the rise in real-estate values brought about by communal activity, but they also desire to prevent an undue increase in the price of building lots for smaller dwellings. They wish, furthermore, to control the distribution of population, to relieve congestion, etc., to carry out city building plans with a minimum of friction.

In Frankfort a *Spezialkasse für städtischen Grundbesitz* (Special Fund for City Landed Property) was formed in 1897 to take over the management of certain landed holdings previously administered by the Stadtkämmerei, and also to carry out building plans for those sections of the city not yet laid out. To the fund were transferred all city lands in the unbuilt sections not already devoted to particular administrative purposes, as, for example,

[1] Kommunales Jahrbuch, 1911–12, p. 621.

schools, cemeteries, etc. The land originally transferred covered an area of 955.9 acres and the holdings have been steadily increased by further transfers and by purchases until, April 1, 1911, the holdings amounted to 3621 acres, or over 10 per cent of the entire land area within the city limits. The land bought within the period 1897–1910 amounted to 3186.3 acres; the sales during the same time, 1156 acres.[1] The Spezialkasse was also intrusted with the acquisition of land for the purposes of the East Harbor project. These purchases, however, have now been completed, and the account closed.

In addition to the real estate originally transferred (estimated value, 26,576,000 m.), the Spezialkasse was provided (1898) with working capital from the proceeds of a loan of 6,000,000 m. Since that time the operations of the department have been increased enormously: the estimated value of the land-holdings being placed at 114,461,000 m.[2] and the total value of all property controlled, March 31, 1911, at 123,000,000 m. The Spezialkasse has built up a relatively huge indebtedness within the period in question. In addition to purchases made with funds representing the proceeds of sales, further sums have been provided by a loan of 5,452,981 m. (1910) and a second loan of 15,241,772 m. (1910). There is, too, a large floating debt, representing balances owing for purchases made, amounting to 28,704,000 m.[3] Over 35,000,000 m. of the increase in the value of the land-holdings since 1897 is finally assignable to the fact that sales made during the period brought in a sum exceeding the inventory values of the property by that amount. At present, therefore, the Spezialkasse has property with an estimated value of 123,000,000 m. against an indebtedness amounting to 58,791,000 m.[4]

That the picture is not so cheerful as the statistics would make it appear, goes without saying. That real estate is worth what it happens to bring and that previous estimates are very largely matters of guess work, must be conceded. Furthermore, it is open to ask to what extent the large purchases made by the city

[1] Verwaltungsbericht, 1910–11, Stadtkämmerei, Tabelle, 11.

[2] The property already built upon has a value of 6,400,000 m.; land ready for building, 17,100,000 m.; land shortly to be inclosed, 27,300,000 m.; agricultural land, 46,700,000 m.; land held for public purposes, 13,200,000 m.

[3] Verwaltungsbericht: Rechner-Amt: Städtische Schulden.

[4] Property alienated during the period (1897–1910) for streets and other public purposes, 6,140,000 m.; for schools, 5,250,000 m. in 1909.

have influenced real-estate prices. And if the city, reversing its policy, begins to sell more than it buys, to what extent will that affect the inventoried values of its present holdings? The conviction is sometimes expressed that the policy of the city has made worse the conditions it was intended to improve, that its steady purchases have raised real-estate prices in general, and that living conditions have been made more difficult through the resultant higher rentals.[1] It would need an intimate knowledge of local conditions to enable one to express an independent judgment on this point. One would need to gauge the force of the other factors that make for higher prices. Even the city officials concede, however, that real-estate prices have, to a certain extent, been raised through the city purchases. A rather extreme example in point is afforded by the purchases for the East Harbor account. The properties transferred by the city and the city foundations were taken over at the rate of 4.3 m. per qm. Private individuals were paid at the rate of 17 m. per qm., the plans of the city having, of course, become matters of public knowledge, and its position as bargainer therefore made difficult. The example is not conclusive—no doubt other reasons would account for some part of the price difference. But it was cited by a local official in illustration of the difficulties with which the city had generally to contend in making land purchases.

In view of the fact that the city owns lands covering an area equal to 46.3 per cent of the territory within the city limits—18.3 per cent exclusive of the forest[2]—its dominant position in the real-estate market is assured, especially as other peculiar local conditions have further limited private speculation; namely, the large land-holdings of rich private families who show no

[1] *Frankfurter Zeitung*, 9 Januar 1912.

"In theory all sorts of miracles were to be anticipated from the communal land policy. It was believed speculation would be destroyed, and the community, assured of price dictation in the real-estate market, would be able to solve the problem of living. In practice the opposite has occurred. A stagnation in real estate has resulted and prices are higher than before. So it happens that on the one hand we are suffocated with a too great landed property, while on the other hand, we suffer from a dearth of dwelling accommodations."

[2] For statistics upon which these computations are based, *cf.* Stadtkämmerei, Sonderabdruck, pp. 10 and 23.

It should be said that a relatively small proportion of these holdings are still outside the city limits.

desire to sell. And in the case of smaller holdings, there exists a diffused ownership of scattered parcels, that could only be brought with difficulty under the ownership of a single person, and seldom on favorable terms.

Another important point for consideration is the ability of such a special fund to meet outlays, including interest and amortization payments on its indebtedness, without recourse to fresh loans or demands on the taxpayers. As a matter of fact, the Spezialkasse has been unable to do so—the income having fallen behind the expenses and necessitating a loan of 3,865,500 m. (1910–11). For 1911–12 and 1912–13 loans to meet deficits are estimated at 4,244,460 m. and 3,210,000 m. respectively.[1] Of course it is hoped that present deficits will be more than compensated by future advantageous sales. But, nevertheless, such a progressive debt increase, especially after it has attained such large absolute proportions, is not to be regarded with entire equanimity. The speculative risk involved has to be considered. As Professor Stein, Stadtrat in Frankfort, speaking anent the subject of the real-estate operations of public corporate bodies, puts it: "Landed property is not only to a great degree non-liquid. It has (as the returns from tenants hardly come here into question) the unpleasant characteristic of secretly devouring interest on the capital investment. The growing interest can . . . swallow up profits and can force the communities sooner than one would believe, despite the foundation on a loan basis, either to withdraw sums from the regular income sources, thereby burdening the present generation whom it was hoped to spare, or else to sell their property. Easily, then, under stress of financial pressure comes a disposition to sell at great sacrifices. . . . The first principle of communal land policy must be to sell in order to purchase, to sell in order to keep the building activity at a steady pace, reflecting the growth of population and the extension of the city."[2]

Through the medium of another special fund, the Erbaudarlehenskasse, the city makes loans for buildings to be erected on city property.[3] The land is secured as a rule for a period of

[1] Haushaltsplan, 1912–13, p. 530.

[2] Die öffentlichen Körperschaften als Terrainunternehmer in der Bodenfrage, Stadtrat Prof. Dr. Stein, F. a. M., Vortrag, Leipzig, June, 1911, Wohnungskongress.

[3] Vergebung städtisches Geländes im Erbaurecht (1901), Normalbestimmungen. *Cf.* Bürgerbuch.

sixty-one years for a yearly interest payment of about 2½ per cent of the land value. Then sums to cover the costs of building are loaned to 75 per cent of the entire costs (90 per cent in the case of city employees and teachers, for single-family houses) at an interest rate of 4 per cent, usually. At the end of the period for which the contract is made, the property again reverts to the city, which meantime holds mortgages on the buildings erected. Up to April 1, 1911, 139 contracts had been concluded: 13 with building associations, 102 with public officials and teachers, and 24 with private persons.[1] The entire sum loaned for building purposes amounted to 4,778,000 m., the working capital being provided from the proceeds of a city loan (400,000 m.) and through sums obtained from the city savings bank, the Spezialkasse (loan of 3,236,000 m.) and a widows' insurance fund. The Erbaudarlehenskasse has also invested in the shares of two building companies engaged in the construction of small dwellings. As a result of operations in 1910–11, a very small balance was achieved in addition to the payment of interest on the working capital, and amortization payments on the loan.

The *Strassenneubaukasse*[2] (fund for the construction of new streets), founded in 1893, has charge of the construction of new, and the broadening of existing, streets in the older city district. Here a great work has been accomplished in the tearing down of unsanitary buildings, and in the opening up of congested districts. The costs of the project have been defrayed out of loans obtained from the city, the total outstanding indebtedness (including balances owing of 3,308,600 m.) amounting to 24,886,000 m. (April 1, 1911). In addition a fixed sum from ordinary income is transferred by the city to the account of this fund, 170,000 m., and the returns from the transfer tax to 1½ per cent of the purchase price of the property sold.[3] There is also a certain amount of income obtained from rents, sales of property, etc., for, after the building plans had been completed, the fund was left in control of real estate valued at more than 19,000,000 m. Some of the property is built upon, and is temporarily rented, although it is designed eventually to tear down many of these

[1] Stadtkämmerei, pp. 7 and 20, Sonderabdruck.

[2] *Cf.* Bürgerbuch, Spezialkasse zur Durchführung neuer Strassenzüge in der Altstadt (1893).

[3] Stadtkämmerei, Sonderabdruck, pp. 21, 22.

buildings as unfit. Meanwhile, an unbuilt area of nearly 7 acres, value 11,341,000 m., has yet to be disposed of, and its utilization presents a sufficiently difficult problem for the present. Much of this property was destined for business purposes, shops, etc., as it is in an unsuitable location for dwellings. But the shopkeepers, too, are moving farther west, and only in a few instances has the land been taken up. The city has begun slowly to build on its own account, but the outlook is not extraordinarily favorable and no easy task is anticipated.[1]

Although as an independent fund the Strassenneubaukasse is charged with interest and amortization payments on its debt, it is not to be expected that it should be self-supporting. In addition to the current transfers already mentioned, a further deficit, 835,000 m., was met from the proceeds of loans, 1910–11, and further deficits are similarly provided for in 1911–12 and 1912–13.[2]

The *Allgemeine Grundbesitzverwaltung* or *Stadtkämmerei* (General Administration of Landed Properties) is managed as a branch of the general city administration, although it, too, might very well have been made into a separate department. In addition to having control of the administrative and other public buildings, the department has under its supervision rented buildings valued at over 30,000,000 m. Some idea of the importance of the city as a landlord is to be had, if it be mentioned that, in 1908, 269 apartments were rented out to city employees at rentals about 30 per cent below the normal price for similar accommodations.[3] The returns are not given separately and it is unfortunately impossible to estimate the interest received on the capital invested in these buildings. However, the results for one model apartment house recently built in the suburb of Bockenheim have been obtained. The building cost 300,000 m., the land is valued at 104,310 m., the rentals amount to 21,500 m. Deducting 20 per cent of that amount for repairs and general upkeep, the interest on the capital investment amounts to 4 per cent. In 1907–08, the last year for which comparative statistics were available, the rentals from city-owned dwelling houses alone were stated to amount to 820,200 m., very nearly twice as much as the returns for Munich, the city of next importance in this respect.

[1] [Statement Oberbürgermeister Adickes.]

[2] Haushaltsplan, 1912–13, p. 524.

[3] Busch, Gemeindebetriebe, authority for this statement.

The city forest, a large part of which was acquired in the fourteenth century, is also under the control of the Stadtkämmerei. It covers an area of 8459 a. (mostly wooded), and the returns, obtained largely from the sale of lumber, bring in a net income of 153,250 m.[1]

There has next to be considered an extraordinary source of income without which a vast number of communal activities could never be developed; namely, the sums obtained from loans which generally take the form of bond issues. Contemplated communal loans must, as has been previously stated, receive the approval of the central government, and judging from the heavy indebtedness of the local political units, that approval has not been difficult to secure in the past. For the future, however, as a result of the rapidly increasing debt-burden, the supervising authorities have determined upon a severer policy. It has also been decided to raise the amortization quotas ; the repayment of loans contracted for so-called unproductive purposes must be provided for at the rate of 1¼ per cent at the very least, and for the productive loans 2 per cent is the lower limit.

Frankfort has an extraordinarily large debt for a city of its size—somewhat over 288,000,000 m. for a population of 414,576, of which 234,562,800 m. represents the funded debt.[2] The rest is largely outstanding balances and mortgage indebtedness of the general administration for city lands and of the Spezialkasse. This very large unfunded debt is peculiar to Frankfort, as in other municipalities the amount of the floating debts is quite unimportant. In 1907, when the city had a debt of 222,947,700 m. (population 355,312), the *per capita* indebtedness, 627 m., was far greater than that of any other German city, Freiburg following with 527 m., Charlottenburg, 484 m., Weisbaden, 463 m., and Munich, 431 m.[3] Since that time the *per capita* indebtedness has risen to 694 m. (1911), despite the incorporation of suburbs materially increasing the population of the city (in April, 1910).[4]

[1] Verwaltungsbericht and Haushaltsplan.

[2] *Cf.* Verwaltungsbericht, 1910–11 (Rechner-Amt) and also Haushaltsplan.

[3] Pfitzner, pp. 8 ff. Statistics include unfunded as well as funded debt.

[4] In 1911 a further special loan (not yet issued, however) was authorized for land purchases to the amount of 32,500,000 m.

The prospective funded debt as estimated for March 31, 1912: 241,673,000 m.

The wealthier the city, the easier the terms upon which loans can be obtained, and the more heavily, therefore, can it afford to draw upon its credit resources. That Frankfort has taken advantage of its excellent repute as a borrower to spare its taxpayers is evident from the fact that other cities with well-developed municipal activities of a similar sort, and with higher tax rates, have a smaller *per capita* indebtedness. The question, however, as to whether a corporate body is or is not heavily debt-burdened depends after all upon the disposition which has been made of the proceeds of the loans obtained. When these sums have been invested in such a way that the interest and the required amortization payments can be met (not to mention the cases in which net surpluses are returned), the debt is, of course, no burden and may be a source of additional income. According to the official statistics, the funded debt of Frankfort to the amount of 171,866,000 m. is so invested that it can be drawn on to meet the interest and amortization payments on the loans in question, leaving an unproductive debt of 62,696,000 m.[1] for which interest and amortization payments amounting to 3,328,000 m. have to be met out of current income.[2] The statement, though formally correct, is misleading, for in certain cases what is taken from one pocket is, so to speak, merely transferred to another. The Spezialkasse, for example, though responsible for interest and amortization payments on its large funded debt, has recurrent deficits in excess of these sums, which have to be met by loans. The Strassenneubaukasse likewise receives annual dotations in excess of the sums for which it is debited for interest and amortization payments. Of the 121,465,000 m. of the funded loan invested in communal undertakings (*Gemeindebetriebe*) not all is so placed that interest and amortization payments as well as all other expenses can be covered. The case of the East Harbor, for example, has been discussed. No doubt it will some day prove a productive investment, but for the present it is not so. A number of other undertakings are likewise not entirely self-supporting, it will be remembered, although in general it can be said that these are rather unimportant exceptions

[1] Of this sum, 3,676,300 m. had not been issued up to March 31, 1911. Its issue was contemplated, however, during the ensuing year.

[2] Rechner-Amt, p. 34, Sonderabdruck.

to the rule.[1] Of the remaining funded debt, a large part, nearly 38,000,000 m., was incurred for the construction of administrative buildings, public schools, hospitals, almshouses, museums, and churches. The cemeteries, with a capital indebtedness of 2,755,000 m., bring in substantial returns, and the debts incurred for the building of houses to be rented, 3,402,000 m., included under the general administration, are productively invested, although it is unlikely that amortization as well as interest payments could be covered by the returns.

The percentage distributions of the funded debt as computed from statistics given in the latest Verwaltungsbericht are rather interesting, although for comparative purposes they are not as illuminating as might be expected, especially in the case of the communal industries. The amount of the indebtedness of the latter depends very much upon the date of the establishment of the industry. The statistics are, however, given for what they are worth. On April 1, 1911, the water works accounted for 11.3 per cent of the funded debt; the electricity works were responsible for 7.3 per cent; the street railway, 8.4 per cent; canalization, 4.7 per cent; and slaughter house and stock yards, 3.36 per cent. The debt resting on the harbors was naturally large, because of the recently incurred outlay for the East Harbor—over 17.7 per cent. The debts incurred for "city building," the carrying through of new streets, and the rebuilding of old ones (excluding the operations of the Spezialkasse) were also very large—12 per cent of the total. The funded debt of the Spezialkasse, together with the debts incurred by the general administration for land purchases, reached 19 per cent (to say nothing of the very large unfunded debt). The expenditures for school buildings constituted 7.1 per cent of the public debt; for administration buildings, 3.5 per cent; for almshouses and hospitals, 3.2 per cent.

It is not to be denied that the "unproductive debt," using the term in the narrow business sense, is absolutely large, and that, furthermore, some part of the expenditures, especially those in-

[1] The advance to the canalization department is insignificant. The gas works of Heddernheim would more than meet interest payments without a dotation. The Verbindungs- und Hafenbahn, however, receives an advance nearly equal in amount to the interest and amortization payments. The bathing establishments require an advance exceeding the amount of the interest and amortization payments.

curred for building operations, might better have been met out of current income or out of funds built up by regular annual contributions. For such expenditures, though extraordinary in one sense of the word, are, as a matter of fact, recurrent in the sense that in growing and progressive communities similar outlays have to be periodically made, and can be confidently anticipated. If the city wishes to avoid steadily increasing its debt, other sources of revenue must be found for some of these expenditures. The existing provisions for amortization, although leading to a more rapid extinction of the debt than is usual in many cities, nevertheless hold out no present hopes that the cancellation of existing debts is likely to proceed *pari passu* with the creation of new ones.[1] In 1910–11, the last year for which full statistics are available, over 17,641,000 m. in new loans was issued, the proceeds to the amount of 10,493,000 m. going to the municipal industries; 3,865,500 m. to the Spezialkasse; the rest for various purposes. During the year in question, amortization payments did not quite amount to 4,900,000 m. During the past year a loan increase of over 16,000,000 m. had as offset amortization payments amounting to 5,538,000 m. However excellent its standing, a city cannot indefinitely increase its obligations. Indeed, the extensive exploitation of their credit on the part of the German municipalities brings a complaint from the cities themselves that capital is increasingly difficult to obtain, the general rate of interest now being 4 per cent, whereas earlier 3½ per cent was usual.[2] On the other hand, the business world at large sees in the municipalities dangerous competitors for the capital desired to further the expanding industrial and commercial interests of the country.[3]

Frankfort has established a number of special building funds

[1] *Cf.* Verwaltungsbericht. The amortization rates for the earlier loans, 1 per cent, have been raised of late years, usually to 1½ per cent, more lately to 2 per cent, and for a special loan for land purchases, 1907, to 3½ per cent.

[2] Naturally other more general causes have influenced the rise in interest rates.

[3] Frankfort maintains a city debt registry (*Schuldbuch*). On the relinquishment of the city securities held by investors, the city will take charge of interest payments, etc. A small fee, 50 pf., is required for each 1000 m. The payment of interest follows either directly or through payment into savings accounts, the Reichsbank, post-office or other designated depository. Strict secrecy is observed concerning the amount of individual investments. At the end of March, 1911, 954 accounts with over 31,000,000 m. were recorded.

which are designed to provide the means of defraying construction costs without constant recourse to loan issues. If this policy continues to be vigorously pursued, some part of the "unproductive" debt can for the future be kept within bounds if not actually reduced in amount. The general building fund, for example (*Allgemeine Baufonds*), and the building fund for the common (*Volks-*) and middle schools, receive dotations from ordinary current revenues exclusively: 672,365 m. and 1,500,000 m. respectively in 1910–11.[1] On the other hand, the hospital building fund (*Krankenhausbaufonds*) and the building fund for continuation, trade, and higher schools (*Baufonds für Fortbildungs-, gewerbliche und höhere Schulen*), although receiving sums obtained from ordinary sources of revenue (*aus dem Ordinarium*), depend for the most part upon the proceeds of loan issues. The former fund, for example, 1910–11, received 1,287,450 m. from loans, and only 211,180 m. from the "Ordinarium"; the latter fund obtained 3,286,900 m. (loans) and 572,365 m. (Ordinarium).[2] Among the minor funds, the Fund for Public Improvement and Education (*Volksbildungsfonds*) and the Fund for the Furtherance of Trade, Art, and Science also receive small yearly dotations, fixed at 100,000 m. and 150,000 m. respectively.

Another very important fund is the renewal and reserve fund (*Erneuerungs- und Reservefonds*) belonging to the communal industries. As a result of financial need, the fund has lately been less well endowed, in some cases no transfers whatever being made to this account. The result is that the size of the fund as estimated in 1912 (9,702,000 m.) is less than it was April 1, 1911 (9,988,000 m.),[3] and still less than three years prior to that time when it amounted to 10,100,000 m. The falling off in the renewal funds is matter for serious comment. Where such funds are insufficient, the evil effects upon the city finances are plain: either an unusually heavy drain upon current revenues to meet a suddenly increased need, or else fresh loans to meet expenditures that should have been defrayed out of income. The other alternative, depreciation of the existing capital investment, would mean an economic loss out of all proportion to any slight monetary saving. As to whether or not the fund is at present adequate is a matter for expert decision. As the magistracy states

[1] Haushaltsplan, 1912–13, pp. 69–540.

[2] *Ibid.*

[3] *Cf.* "Anmerkungen," p. 540, Haushaltsplan, 1912–13.

in a preface to the provisional city budget for 1912–13: "It remains to be seen in the course of the following year, to what extent the amount of these sums stands in agreement with the amount written off for depreciation on the investment capital, taking into consideration the amount of the loan capital actually repaid. For the time being a further weakening of this reserve is not to be recommended." In the same preface it is also said: "In the case of the management of particular undertakings, a reduction of the originally contemplated, calculated transfers to the renewal funds has already taken place. In the case of the electricity plant, whose renewal funds show a falling off against 1907, no transfers are made. The same is true of the water works. To the renewal fund of the street-car system, which, despite the opening up of many new lines, is less than it was in 1907, are only made good those expenditures which have been defrayed out of it."[1]

Lastly to the Equalization Fund (*Ausgleichsfonds*) are transferred unexpected surpluses, while from it unforeseen deficits are met. The fund has, however, suffered the natural fate of such institutions, and, as a result of having been turned to account to meet anticipated instead of accidental deficits, it has declined almost to the vanishing point.

Of the 25,567,000 m. required to meet the ordinary financial needs of the general city administration, 21,255,000 m. was covered by taxes (1910–11), while 3,617,000 m. represented balances turned over by the communal undertakings.[2] The ordinary expenditures can only be briefly enumerated, for any one branch of the general administration affords in itself material for an extensive study. The expense incurred for schools is by far the most important single item, as is usually the case in the larger cities: 7,422,000 m. (including sums transferred to the building funds). Next in importance come the expenditures for poor relief, hospitals, and philanthropic undertakings, the advances amounting to over 3,800,000 m. The Tiefbauamt, which has charge of street inspection, street cleaning, bridges, etc., required a sum of 3,120,000 m. (1910–11), and the Hochbauamt, which

[1] Entwurf des Haushaltsplanes der Stadt, 1912–13. Vortrag betr. den Haushaltsplan für das Rechnungsjahr, 1912.

[2] Approximately 550,000 m. was contributed by the Grundbesitzverwaltung and the Cemetery management. The total receipts from all sources, 1910–11, were 50,910,000 m.; the total expenditures, 50,818,000 m.

includes the fire department, building inspection, city gardening, is next in importance with 2,198,000 m.[1] Of late years the expenditures for schools, police, sick and poor relief have increased enormously. Between 1895 and 1910 the increase for schools amounted to 309.98 per cent; for police, 282 per cent; for poor relief, 280.94 per cent; for hospitals, 405.67 per cent. The proceeds of the income tax, on the other hand, from which these expenses are, in general, to be met have only risen 194.4 per cent during the same period, although the tax rate has been increased 42.8 per cent.

Considering the variety and extent of the municipal activities of the city, the amount demanded in taxes is not great: 24,563,000 m. for a population of 414,576 (1910–11). It needs to be remembered, however, that the sum is considerably greater for German conditions than it would be for American, and it gives, furthermore, in all probability, the largest *per capita* taxation (59.2 m.) for the whole of Germany.[2] On the other hand, these statistics afford no good idea of the relative burden of taxation, as the wealth of Frankfort enables it to secure more liberal returns from persons of large income and from the propertied classes to the disburdening of the poorer elements.

The policy which is being pursued at present is so markedly one of expansion—ever increasing taxation, and ever growing indebtedness—that, although the city has much to show for its efforts, on the one hand, it will take time to find out how much it has to pay, on the other hand. Upon the success or failure of its land policy, and of its great harbor scheme, a vast deal depends. If the large indebtedness incurred on these accounts proves to have been wisely contracted, the city may be proud. Meantime fresh loan issues defer the day of reckoning.

[1] The statistics given are based on the estimates for 1910–11. They do not represent the total expenditures of the several departments, but the uncovered expenditures which have to be met from the current income of the city.

[2] Statistisches Jahrbuch deutscher Städte, 17. Jahrgang, p. 362. In 1907–08, Frankfort, with a *per capita* tax of 54.75 m., led the 80 German cities for which statistics were given.

CHAPTER VII

FEES

26. The Nature of Fees: Eheberg's Views. — Ever since the time of Rau[1] most writers have treated fees as a distinct branch of public revenue. There has been, however, no general agreement concerning the precise definition of a fee. Rau himself gave the following definition:[2]

Fees are charged upon occasions when the citizen comes into contact with the government or some of its agencies. They can be considered a special compensation for the expenditure which the particular act of government occasions, and so far resemble a payment made for a service rendered by a private person. But on the other hand, the governmental institution which gives occasion for the collection of a fee is not conducted for the purpose of obtaining such dues; on the contrary, it arises from the duty of the state to seize upon all expedient means of fulfilling its purposes."[3]

[1] Even before Rau, however, Adam Smith had recognized the existence of fees. Smith said, for instance:

"The expense of the administration of justice, too, may, no doubt, be considered as laid out for the benefit of the whole society. There is no impropriety, therefore, in its being defrayed by the general contribution of the whole society. The persons, however, who give occasion to this expense are those who, by their injustice in one way and another, make it necessary to seek redress or protection from the courts of justice. The persons, again, most immediately benefited by this expense are those whom the courts of justice either restore to their rights or maintain in their rights. The expense of the administration of justice, therefore, may very properly be defrayed by the particular contribution of the one or other, or both of those different sets of persons, according as different occasions may require, that is, by the fees of court." Wealth of Nations, Bk. V, ch. 1.

[2] Finanzwissenschaft, § 227.

[3] With this definition we should compare other more recent ones. Roscher says that fees are "payments made for individual acts of government, by those persons who have been the direct occasion of the action." Finanzwissenschaft, § 22. Wagner

The following account of the nature of fees is from a representative German writer, K. T. Eheberg:[1]

Fees are special charges fixed by the state for special demands upon public officials or institutions, and are paid by the persons who have occasioned these demands for the services or action of the government. Accordingly the distinguishing characteristic of the fee, that which differentiates it from a tax, is the fact that a fee is collected in connection with some definite action of public agents and as compensation therefor.

Fees arise only in connection with such public institutions and officials as are maintained for the sake of the general public welfare in order to secure essential public ends. These institutions would have to be maintained in any case even if their services were seldom needed, but their action is occasioned by the demands of particular persons. The occasion for the demands, and therefore for the payment of a fee, may be of two sorts: either the individual calls for the intervention of the public agencies in cases where his personal interest is the same as that of the public, or he seeks in his own interest to obtain special privileges. The first case arises, for example, in connection with many of the fees for administering justice or inspecting weights and measures; the second arises where the individual obtains special advantages through exemption from legal regulations or special concessions, such as patent rights and similar privileges. In all these cases the institution itself, which serves partly public and partly private ends, is maintained wholly or partly at public expense; but the cost of the individual acts is defrayed more conveniently, in whole or in part, by fees collected from those who have occasioned the expense.

From these remarks we can deduce the leading principle for

says: "Fees are charges, arbitrarily fixed by a government in amount and method of payment, which individuals or groups of individuals pay as a special compensation for some service rendered by a public body, or for some expense which the individuals have caused the state in the exercise of its functions." Finanzwissenschaft, § 277. And Seligman gives the following definition: "A fee is a payment to defray the cost of each recurring service undertaken by the government primarily in the public interest, but conferring a measurable special advantage on the fee-payer." Essays in Taxation, 304.

[1] Finanzwissenschaft, §§ 71–73.

determining the amount of a fee. In the first case just described, the expense which the individual has occasioned should be the basis for determining the sum charged him; in the second case, the measure of the fee should be the value of the privilege which is accorded him. In this measurement it is necessary to consider how great the public interest is in the service or act performed. The greater the public interest in the particular branch of administration, the lower should be the fees charged therefor; the smaller the public interest, the higher the fees ought to be. For this reason fees are fixed according to the value of the service, when special legal advantages are granted or an exception is made in the application of a general law.

On account of the varied nature of fees it happens, to be sure, that these two principles for measuring their amount pass over into one another. And since the actual adjustment of fees in different countries is materially affected by historical conditions and by the other public charges, we can in practice demand no more than that the principle just laid down shall be generally followed. In general we can say merely that, as a rule, charges should be no higher than is necessary to meet the average cost of running the office concerned, and that in particular cases the fee may be above or below this average level.

It is contrary to the nature of a fee that the ability of the particular contributor should be considered in determining the amount. That does not prevent us from exempting persons from fees in case of poverty, or straitened circumstances combined with special merit, in order to secure even to the poor the benefit of public institutions, such as courts of justice and schools. Exemption from the fee in the first case is charity; in the second a reward, bestowed upon persons without means at the expense of those better circumstanced.

By the characteristics above mentioned fees can be, at least in theory, sharply separated from all other forms of income. They are distinguished from the economic income of the state by the fact that, with economic income, the use of and resort to the services of the state is free and the price is governed by competition; while with the fee the state, by its power of compulsion, obliges the individual to resort to public agencies and fixes arbitrarily the payment made therefor. And they are dis-

tinguished from taxes by the fact that, with fees, the ruling principle is special payment for special service, of special reckoning in each case between the treasury and the contributors; while, with taxes, the ruling principle is general contributions for general services, that is, general contributions for the expense of maintaining order and promoting the welfare and culture of the people. If the duty to pay taxes follows from the fact of membership in the state, the duty of paying fees arises only as a result of making a special demand upon public institutions.

Of course in practice taxes and fees easily pass over into one another. Not infrequently charges known as fees are so high that there is no relation between the cost of service and the charges in question. Also occasionally charges which are nothing but taxes are called fees, either as a result of their historical relations or because they are actually associated with fees. That is true particularly of duties upon the transfer of property, for this transfer not only is attended with fees, since it requires some action by public officials, but it gives occasion many times for the imposition of taxes.

27. The Fee System of our Federal Government. — Professor T. K. Urdahl, in his detailed study of the fee system in the United States, gives the following account [1] of the fees collected by the federal government:

A. Patent and Copyright Fees

To the public generally the best-known system of fees collected under the federal laws is undoubtedly that connected with the National Patent Office. This office is one of the institutions which were conceived and established by Jefferson in 1790. Before that date some of the states had by legislative acts granted copyrights and patents for short periods of years, but none of them had any complete system. True to the ideas then current, that fees should pay salaries directly, and should only be sufficient to make the public institutions self-supporting,

[1] Reprinted, by permission of the author, from The Fee System in the United States, pp. 141–147. Published in the Transactions of the Wisconsin Academy of Sciences, Vol. XII (1898).

Jefferson made the patent-office fees very low, and allowed all of them to be collected as salaries by the patent-office officials. But the receipts were found to be inadequate to pay expenses; so in 1793 a law was passed which increased the fees to six times the former amount. This continued in force up to 1836, when a new act was passed which provided that patent officials should be paid salaries, and that all the fees collected should be paid into the treasury. The patent-office fees remained about the same for United States citizens, but foreign applicants were compelled to pay much larger sums for patent rights. Provision was also made for the right to extend the life of a patent, and a fee of $40 was to be collected for each extension. This schedule remained in force up to 1861. Congress then passed an act which reduced most of the old fees by one half, but enlarged the fee bill so as to require payments for official acts which up to that time had been free. The discriminations against foreigners were also repealed.

With slight changes this schedule has remained in force up to the present. New duties are gradually taken over by the patent office, because the sphere of invention becomes broader with every new discovery in science, and the technicalities of patents and patent rights become more complicated. New fees are therefore constantly being introduced to pay for the more elaborate and thorough examination which must be taken in the interest of the patentees.

The copyright law has been subject to less change than the patent law, and the fees have remained uniform almost from the beginning. The first act, passed in 1790, fixed the copyright fee at 50 cents, and provided for a reissue on payment of another fee of the same amount. These charges continued unchanged in all the subsequent acts, except that a recent law has taken all the fees out of the librarian's salary and required their payment into the treasury.[1]

[1] The applicant for a copyright is required to deposit two copies of his book with the librarian, the cost of which may in one sense be reckoned as a part of the copyright fee. There are, however, other fees collected by the librarian, which are not absolutely necessary to the validity of the copyright. As such may be mentioned a fee of 50 cents for each copy of the certificate, and one of $1 for recording the assignment of a copyright.

B. Custom-house and Other Import Fees

The very first law levying import and tonnage duties made provision for the payment of all officers connected with the customhouse, by means of fees. Surveyors, weighers, gaugers, inspectors, and collectors, each had their own fees defined by this early act of 1789. Clearance and entrance fees for ships were varied according to the tonnage. For ships of less than 100 tons, the fee was $1.50, while all ships of over 100 tons were required to pay $2. Payments were also made for permits to land goods and for each bond procured. In 1789 the coasting and fishing trades were put under special regulation by means of licenses, for each of which a fee of 50 cents was collected; and in addition a fee of $10 was charged for each certificate of enrollment. Foreign vessels were placed under similar restrictions and compelled to pay for any privileges granted them. This schedule of fees continued in force for two decades, when it was decided to vary the amount according to the importance of the port of entry, and a salary was added to the fees of office in some of the Northern and Northwestern ports. A decade later, in 1831, an act was passed which required all the fees collected in the Northern customhouses to be paid into the treasury, and placed the customs officials of that section on a salary. Up to 1864 most customhouse officials of the Atlantic seaboard received as compensation all the fees collected at their respective offices. The enormous sums which some of these positions yielded finally became known, and as a result Congress passed an act making $9500 the maximum amount which any collector should be allowed to retain, and providing that any excess above this amount should be paid into the treasury. These provisions, however, did not prove satisfactory. So in 1879 a new law was enacted which provided a schedule of fees to be exacted from all who had dealings with the customs service. These multitudes of fees, consisting usually in small, vexatious exactions, were in many cases inadequate to compensate the officers concerned, except in the busy ports, where they aggregated enormous sums. One of the sections of the last-named act provided fixed salaries for naval officers, collectors, and surveyors of the chief ports. There was no reason why this

provision should not have been extended to all the other officers connected with the customs service, especially since action to this effect had been repeatedly recommended by the secretaries of the treasury.

The tariff of 1890, known as the McKinley bill, abolished all fees exacted for oaths except so far as provided in the act itself. It also placed all officers on salaries equal to the amount of fees which each would have been entitled to receive for his services during the year. This was a step in the right direction, but only a very small one, as the salaries were left just as indeterminate and unclassified as ever.

C. Licenses to Vessels

In 1864 a new standard was adopted for estimating the fee or charge for each permit or license to vessels, in that the fee was made to vary from 25 cents to $1 according to the tonnage of the vessel. Fees for permits to vessels belonging to foreigners were fixed higher than those of citizens of the United States. Then came an act in 1871 fixing the license fee as $25 for a vessel of 100 tons burden, and charging 5 cents extra for each ton over that limit. The same change is noticeable in the fees which were allowed for measuring vessels. Similar standards are applied to boat-inspection fees. The first law on this subject was enacted in 1838, and fixed a fee of $5 for the inspection of any vessel, and the same for each boiler inspection. In 1852 vessels were divided according to tonnage into four classes ranging from 1000 tons to less than 125, the fees varying from $35 to $20. This schedule remained in force up to 1884, when inspectors were paid salaries; and the fees, which were fixed at $10 for a vessel of less than 100 tons and 15 cents extra for each additional ton, were collected for the treasury.

D. Miscellaneous Maritime Fees

Numerous other fees were from time to time collected for licenses to carry on maritime and other pursuits. Wreckers and pilots were compelled to obtain licenses at a cost of $5, besides a fee of $1 for each annual renewal of the same. In

1864 this charge was increased to $10 for each license. A few years later the captains, mates, and engineers were placed under the same requirements. From 1872 shipping commissioners were allowed a fee of $2 for each man engaged by them for a crew, and 50 cents for each certified discharge. This law was modified in 1884 in such a way that all the fees of the shipping commissioners were required to be paid into the treasury.

E. Court Fees

Most of the inferior officers of the federal courts were, until quite recently, allowed to retain some or all of the fees connected with their respective offices; nor had any serious attempt been made to reduce the income derived from fees to any fixed amount, until the act of 1853, by which the allowance of deputy marshals was limited to 75 per cent of the fees earned by them. This was followed by an act requiring marshals to give an account of all fees collected, which finally resulted in the act of 1878 fixing the maximum compensation of United States marshals at $6000, to be paid out of the fees earned after the office expenses had been deducted. The clerks of the United States courts have continued to receive fees as salary down to the present; and only slight changes have been made in the original bill regulating their fees, for the most part in increasing the number of acts for which fees might be collected. United States district attorneys have also received the fees collected for their services almost up to the present. It is only within the last year that these positions have become salaried. The territorial court officials still receive many fees for numerous services which are usually performed by other officers in the states. For example, fees for marriage licenses, recorders' fees, and the like are still received by them.

F. Land-office Fees

It is in the land office that we first see the government change from a fee system of compensation to a salary system. The prospect of gradually increasing government land sales made it evident that the fees in many offices would greatly exceed the legitimate compensation for the work performed; and it was

equally evident that no adjustment of the schedules could bring about an equilibrium between work and pay. So, as early as 1818, we find an act which gave the land-office registers and receivers an annual salary of $1500, besides one per cent of the money collected by their respective offices; provided, however, that no salary should exceed $3000 per annum. But even this provision made a position in the land office of a rapidly growing state exceedingly desirable. Hence in 1859 another act was passed which limited the salary of registers and receivers to $2500 in Western and $3000 in Pacific states. The land-office fees constituted a very large part of the original price of the land. In the Pacific states the fees were 13 per cent of the total price, in some of the others they constituted 11 per cent, and in many cases even more. When the surveyors' fees are added to these, one can realize what an important item in the cost of the public land these fees were. It must be borne in mind also that the fees had to be paid, even though the land was obtained by pre-emption, by tree claim, or in any other manner. The land-office fees have at times been used by unscrupulous officials as instruments for carrying on some of the most notorious and fraudulent land swindles, to the injury of actual settlers.

G. Miscellaneous Fees

The consular and diplomatic offices collect each year certain fees for passports, consular papers, and other services. Originally these formed part of the salary of the consul or minister, as did the fees collected in the consular courts; but in 1860 these officials were required to account for all fees received in any way in the exercise of their judicial authority. Many of the fees were diminished in amount and some of them entirely abolished by the act of 1891. Postmasters were also paid originally by means of fees; and a remnant of the old system exists even to-day, in the fact that the salary of postmasters in small towns depends upon the average receipts of their respective offices for the four years preceding. As far back as 1845 an attempt was made to limit the compensation of these officials by an act which provided that none of them should retain more than $5000 per year including his salary. Any excess should

be accounted for and paid into the treasury. This act was soon superseded by the present law. Other fees regulated from time to time by Congress are the municipal fees of all kinds in the District of Columbia. Fees for liquor licenses and for licenses to innkeepers, peddlers, and many other occupations, have been fixed and changed again and again by Congress. One act which illustrates very well the tendency of changing from fees to regular salaries is that of 1842, which expressly prohibits any police official in the District of Columbia from receiving any gift, fee, or emolument other than his regular salary.[1]

28. Some Typical Fees collected in American State and Local Governments. — Fees collected by authority of state or local laws are so numerous that only a few typical cases described by Professor Urdahl[2] can be given here:

1. *Fees for oil inspection.* — First and foremost in importance is the inspection of oil or petroleum, if we may judge by the number of states which have deemed it necessary to enact compulsory oil-inspection laws. The oil-inspection legislation prob-

[1] Elsewhere (p. 191) the author says:

"Federal fees are the only ones of which anything like complete accounts are kept, and even here the reports are not detailed enough to make an exhaustive treatment possible. A special report made by the Secretary of the Treasury to Congress, stating the receipts and expenditures of the federal government for the year 1882, is the basis of the following table, which contains the aggregate of all the fees, excluding postal fees, collected by federal officials of that year":

Consular fees	$613,422.22
Steamboat fees	279,889.36
Registers' and receivers' fees	1,107,671.61
Marine hospitals	406,103.59
Weighing fees	48,638.17
Customs offices	480,728.69
Emoluments (customs)	368,822.74
Emoluments (judiciary)	25,315.39
Patent office fees	917,897.14
Passports	20,115.00
Copying (general land office)	8,247.90
Copyright fees	15,753.04
National health laws	1,647.68
Total	$4,564,390.85

[2] The Fee System in the United States, pp. 155–156, 161–163, 163–166, 174–175, 186–189.

ably originated in the frequent explosions and consequent fires due to the inferior quality of the oil at first put upon the market. The modern oil-inspection laws may roughly be said to begin about 1880. A few instances may be found earlier, but the subject did not become of much importance until the great American oil fields had been discovered and exploited. Indeed, it is the aggressiveness and power of the Standard Oil and other companies, in keeping up the price and lowering the quality of the oil, which may largely be considered the cause of the later legislation on this subject. The consumption of oil increased enormously, until it became a necessity to everybody; and as the quality gradually deteriorated, popular discontent made itself felt in the form of legislation prohibiting the sale of any oil below a certain quality. Public oil inspectors were provided, usually by appointment, whose compensation consisted in fees fixed in amount by law. In general these were determined by the quantity offered for inspection at the time, usually a certain number of cents per barrel. Many states make the fees regressive in amount, in that the charge per barrel decreases as the number of barrels inspected at the time increases, from forty cents for a single barrel to ten or fifteen cents if over ten barrels are inspected at one time; while one state provides that the inspector shall be paid by the hour. The other state laws on the subject fix the fee per barrel ranging in amount all the way from ten to twenty-five cents, with no reduction for large quantities. Nebraska pays its oil inspectors fixed salaries. Minnesota requires all oil-inspection fees to be paid into the treasury, and other states limit the amount which an inspector can receive as his official income to a certain maximum.

2. *Fees for marriage licenses.* — The oldest and most common form of license regulations which has existed, and which exists to-day in some form or other in every state or territory in the Union, is that of the marriage license. This is one of the first and perhaps the most important of the regulations affecting that fundamental institution of human society — the family; and upon the character of this regulation depends the success or failure of the only direct interference which the state exercises over the marriage relation. It is an important function, which most states have neglected to exercise in the interests of society

Only twenty-one states require any returns of marriages to be made to any state officer, and but few commonwealths have compulsory registration of marriages. It would take too long to give even an outline of the public services performed for which the license fee is charged, much less to trace the causes which brought about the legislation. Suffice it to say, that the number and nature of the requirements, as outlined in the statutes of the different states, varies very decidedly. One state requires a statement of the age of the parties and proof of their competency to contract marriage, before the license shall issue; another prescribes that bonds be given as a guarantee that the parties are entitled to marry; another simply prescribes that the license, or the application for a license, be recorded in some office. Louisiana gives the probate judge power to suspend marriage, if any objections are raised, until a hearing has been had. Maine requires a notice of intention to marry to be recorded with the town clerk five days before the license is granted. Maryland requires an examination of the applicant for license, under oath, to ascertain whether any legal impediment to his or her marriage exists. Massachusetts requires notice of intent to marry. Pennsylvania requires parental consent in certain cases. These and many other requirements are deemed important enough to be enacted into law, and for the exaction of fees for the services performed by the officials in carrying them out. The enforcement of these laws, in thirty-five states, is left to a mere clerical official, — the county clerk, county recorder, or some other registering official. In the other states the licenses are dispensed by the county or probate judge. The fees for these services of the officials, and for the license proper, vary from 50 cents to $3. Several states require the fee for the license proper to be paid into the state treasury, and give the officials power to collect extra fees for their services. Most states, however, give the fees as perquisites of office to one or more of the officials concerned. In many of these cases the marriage license fee loses its most important function, namely, that of regulation. It was originally intended to be a payment for a privilege granted only in cases where it appeared advisable. Under this system, the pecuniary interest of the official is in many cases diametrically opposed to his plain duty under the

law. As a matter of fact, it is notorious that marriage licenses are rarely refused in any state. It is largely to this system that we owe the large number of wild and runaway marriages oftentimes contracted by mere children.

3. *Fees for liquor licenses.* — To the great majority of the people, the word "license" will call to mind, or will mean, simply the permit to sell liquor, which is obtained in most states on payment of a certain sum of money. The license legislation on this subject alone, when taken together, shows a greater diversity in the different states than would at first thought seem possible. In most of the original states the license charges, as they exist to-day, are the result of a gradual increase of the amount charged at the beginning of the century. For example, the license fee in Rhode Island has increased from $4 in 1822 to $400 in 1896. Many of the new Western states have of course adopted laws which are taken directly from the statute books of Eastern states, and some of them have attempted new experiments in license legislation. Scarcely two states have exactly the same system. One state grants all the licenses directly through a state official, and receives all the fees into the state treasury; another state leaves both the power to grant the license and the revenue therefrom to the local political units. One commonwealth has a license or excise commission which grants all licenses and turns half the proceeds into the state treasury and grants the other half to the counties and municipalities. In some states the counties are the most important political units, and the county commissioners or county boards are given power to grant all licenses. In others the cities, villages, and towns are given this power, and are allowed to use some or all the revenue derived from this source. But as a rule the state legislature gives the counties, cities, or towns power to grant the license only under the conditions it prescribes. In some states these are allowed a great deal of latitude in imposing restrictions on their grants, and oftentimes, too, in prescribing the amount of the fee. In a few states the localities are given "local option," as it is called, or, in other words, power to allow or entirely prohibit the sale of liquor within their boundaries.

4. *Fees for incorporation of companies.* — An incorporation fee is in most cases collected for filing the charter of articles

of incorporation. Six states charge only $5 and two charge less than this amount, while all the rest charge amounts varying from $5 to $100 for this service. It should be borne in mind, however, that the incorporation fees include all the charges made by the state under various heads, and that the total amount, instead of the individual fees, is the important consideration. The most common and the fairest method of gauging the incorporation fee is to make it proportional to the amount of capital stock. Five states have adopted this method in full, and charge from 10 cents to $1 per thousand dollars of authorized capital stock. Six other states have a slight modification of this system, in that they charge a certain minimum fee for any amount of capital stock up to a certain limit, and then collect from 50 cents to $1 per thousand of capital stock over this amount. A very large corporation would, under this latter system, yield some revenue to the state treasury. These fees were originally designed only to cover the expenses incurred by the state in granting incorporation rights and regulating them when granted.

5. *Fees for judicial processes.* — Sheriffs, constables, clerks of court, and other court officers are, as a rule, remunerated in the same way. In the older states scarcely any changes in this part of the fee system have been accomplished. The result is, that many of the court officials are receiving fees which were designed for conditions existing from fifty to one hundred years ago. Not only are the fees entirely unsuited in amount to the modern conditions, but many of the primitive forms and formulas are clung to with great tenacity. The following example will illustrate this: In the early courts the sheriff was usually the jailer, court messenger, and constable; this custom, once established, has been continued in most of the older states, and as a result the sheriffs pocket enormous amounts of fees for services which they are supposed to perform in these three distinct capacities.

In spite of the numerous and heavy fees the courts are nowhere self-supporting. Not even those courts which deal exclusively with civil cases and have all their docket fees and other fees are able to maintain themselves without heavy drafts upon the state or local treasuries. Reforms to remedy this

have been proposed, now in one state, now in another, but the legislatures of the older states have not been able to rectify even the most glaring inconsistencies. The only states that have attempted any reform or solution of these problems are a few Western commonwealths, which are less hampered, and freer from the influence of old customs, traditions, and institutions. These have succeeded apparently in taking some decided steps in advance of any Eastern state.

Colorado, by an act passed in 1891, divided the counties of the state according to population into six classes, the first class containing all counties having a population of over 50,000, and the sixth class all those of less than 3000. The fees of all county or court officers were graded according to the class in which the county happened to be. It was further provided that all county officers should be paid salaries fixed by law, and that all fees or emoluments of office of every kind should be accounted for and paid into the treasury. Idaho passed an act in 1887 based on a somewhat similar scheme. Here the counties were divided into five classes according to the assessed valuation of property in each, the lowest being $500,000 and the highest, $3,250,000. A maximum and a minimum salary for the several county officers of each class was fixed by law; and provision was made that the fees collected by each, with the exception of those of justices of the peace, should be accounted for and paid into the county treasury. Montana has divided the counties into eight classes, and adopted provisions similar to those already mentioned. Nevada in 1885 fixed by law the salaries of some of the county officers and provided that all fees should be paid into the county treasury. Arizona has still another system. Here the counties are classified according to the number of registered voters in each. Officers in those counties having less than 750 voters receive fees and salary which together shall not amount to more than $600. Counties having less than 1500 voters may remunerate their officers by means of fees and salaries; while officers of counties having more than 1500 voters are, within certain maximum limits, to be allowed the fees of office only. California has a much more elaborate system. An act passed in 1891 divided the counties of the state into fifty-three classes based on population. In the

first class were all counties of over 400,000 inhabitants, while the fifty-third class contained all having less than 2000. The salaries for the county clerks, sheriffs, auditors, recorders, treasurers, tax collectors, assessors, and district attorneys were fixed for each class, and provision made that the fees collected should be paid into the county treasuries. The other officers, — coroners, justices of the peace, constables, and so on — are allowed to receive fees; but it is required that an account be kept, and any excess over the maximum allowed must be paid into the county treasury.

The only one of the older states which has as yet attempted to deal with this question in this way is Kentucky. A law, passed in 1895, fixed certain maximum amounts which might be retained as salaries by the county officers; and provided that all sums received above such amounts should be paid into the treasuries, and heavy penalties were prescribed for false reports by any official. An attempt was made a year earlier to limit the amount which might be retained by city officials out of the fees received.

It would appear as though some one of the above schemes, if thoroughly carried out, would furnish an adequate solution for this grave problem. One thing, however, seems certain; and that is, that the experiments which these Western states are carrying on will be of interest and value to every state in the Union, whatever their result may be. The problem is one which confronts almost every locality, although the abuses are more manifest in some states than in others. Thoughtful men and wise legislators are beginning to take more and more interest in the legislative reforms which are attempted, not only within the Union, but in other countries. If the reforms outlined above should at all meet the expectations of the reformers, it will only be a question of time until the movement will spread over the entire West and even overcome the inertia and conservatism of many Eastern commonwealths. But the reform is bound to come in course of time, even if it is not accomplished by such legislation at a single stroke. It requires no great power of observation to see that a change is gradually going on in every one of the states in the Northwest. One official after another is transferred from the fee to the salaried list. Scarcely

a session of a legislature closes without having accomplished one or more changes in this respect.

29. The Fee System as a Social Force. — Some of the important social effects of our fee system are thus described by Professor Urdahl:[1]

1. *The fee system and the tramp question.* — Tramp life is made possible and even agreeable by private charity and alms, or by state aid and relief. A great deal has been said, and a great stress has been laid, upon the evils of indiscriminate charity and outdoor relief, while scarcely a voice is heard against the direct premium placed upon vagrancy, as a result of the use of the fee system to remunerate certain public officers. The average tramp would be forced either to work or to starvation if he could find no comfortable or convenient county jail in which to spend the long cold winter. Under existing conditions, however, he is often a welcome visitor at these public lodging houses; for both the jailer and sheriff are financially better off for each extra "knight of the road" whom they can induce to accept their hospitality, because the county pays the bill at so much per head, and the larger the number, the greater the profits for the keeper.[2] What wonder that some of our county jails are known far and wide among the vagrant classes for their accommodations! Is it surprising that instances repeatedly occur, where the tramp commits some misdemeanor before the very eyes of the sheriff or constable, with the express purpose of securing a commitment to jail for a period of time?

Counties using this system find the number of tramps increasing year after year, in spite of the fact that the jail or prison is crowded the greater part of the time. This has continued, in many cases, until the expense of maintaining tramps has become unbearable, and a demand is made for a new system. As a result the jailer and sheriff, or both, are given a fixed allowance out of which to feed and support all prisoners,[3] and a certain amount of labor is required of these to relieve the monotony.

[1] The Fee System in the United States, 211–230.

[2] Tramps are often furnished with liquor, tobacco, and newspapers, to induce them to return.

[3] This system is now in force in several counties in Wisconsin

The conditions become changed. The sheriff is no longer interested in having as large a number of tramps as possible within his county. Life within the prison walls is made less attractive; and as a result the stream of vagrants takes another route, through more hospitable districts. A change like the one above described took place in Dane county, Wisconsin; and in four years the cost of maintaining tramps was reduced from $15,000 to $3000. This amount represents the taxes annually levied and actually paid by the public in a single county to support the tramp during that season of the year in which he cannot depend on private charity. In one sense it may be looked upon as a standing bribe to encourage shiftlessness, in the same way that the poor laws of the last century put pauperism at a premium in England.[1]

The jailer and keeper are not the only public officers who are interested in the existence and presence of the tramps. Where the fee system is fully applied, we find every judicial officer more or less interested in having as many tramps brought up for trial as possible. It means, as a rule, a fee for the judge, a fee for the sheriff,[2] and a fee for every other officer who takes part in the trial. It is but natural that inducements should be made for the vagrant to return and be rearrested,[3] to be perhaps again committed to jail for a short time. Indeed, to such an extent have these frauds been carried, that it has been found necessary in some states[4] to pass laws prescribing heavy penalties for conspiracy between tramps and judicial officers[5] to defraud the counties.[6]

[1] A member of the Wisconsin State Board of Charities estimates that the tramps, through the fee system, cost the state over a quarter of a million dollars a year.

[2] The fees of the sheriff for each tramp are said to run from four to six dollars, while those of the judge vary from two to three dollars.

[3] Tramps are often induced to appear before the justice in the forenoon under one name and in the afternoon under another, so as to earn extra fees for each official.

[4] Laws of Wisconsin, 1889.

[5] Some cases have been found where the same tramp was serving three different terms at one time, by being discharged and rearrested and recommitted to jail, so as to earn fees for the sheriff and magistrate.

[6] This state of affairs is not confined to a few states. Inquiries in the different states show that the same frauds have been, or are at present, prevalent in New York, in New England, in the South, in the Middle states, and in the far West.

2. *Fees in police courts and crime.* — Until quite recently both the police force and the municipal courts in most of our large cities were supported more or less by fees and fines, under the mistaken idea that the main function of police officers was to catch criminals, and the function of courts was to pronounce sentence on them when caught. It was also supposed that these public officials would perform their duties more efficiently if impelled by self-interest. This conclusion seems reasonable enough at first blush, but the trouble is that it is based on absolutely false premises. The great and primary function of a police officer is not the apprehension of criminals, but the repression of crime. Paying a police officer according to the number of arrests made is about like paying a teacher according to the number of floggings he has inflicted.

Not only that, but we have a large body of men whose bread and butter depends on having the law violated, although they are themselves its ministers. The idea never seems to have occurred that there was any danger of overofficiousness on the part of any official. The more criminals caught, the better, it is said. True! — but have we any guarantee that the policeman will catch only actual criminals? What is to prevent him from making arrests on slight suspicions, or for trifling and unwarrantable reasons? The same self-interest impels him in the latter as in the former case. As a rule, hungry men are not overscrupulous about the means and methods which will secure them bread. There is every reason to believe that they would sacrifice their most important function, that is, that of repression, to the more profitable employment of making arrests. Indeed, this is amply illustrated by the experience of every city which has changed from fee-paid policemen to salaried officers. An act of the Maryland legislature abolished the fee system in Baltimore in 1862, and as a result the number of arrests for minor offenses decreased from twelve to seven thousand. The decrease in the number of arrests did not result in more lawlessness or more petty offenses, but can be accounted for by the fewer uncalled-for and unnecessary arrests.

3. *Fees and justices of the peace.* — There is, perhaps, no part of the American judicial system which exists with such uniformity in all states as the justice of the peace. And every

where, almost without exception, his remuneration consists in the fees which he collects. This official seems almost indispensable to the local administration of justice, and no state has as yet been able to devise any fair and economical system of compensation other than fees.

The amount of business done by each of these officials varies from time to time and place to place. One justice may have regular daily sessions, while another is scarcely ever called upon to act. All cannot be paid salaries, as it would entail enormous expense to the public; and apparently such a system would be unjust to the magistrate who is called upon to act often. To the casual observer, it would seem, therefore, as though some well-devised scale of fees would be the only just and fair method of remuneration. But a closer investigation will reveal the fact, that other things must be taken into consideration besides the interest of the justice of the peace and the economy of public money. There is such a thing as a "penny wise and pound foolish" policy in public as well as in private economics.

Perhaps no single influence has done more injury through the American courts than the fee system in its effects on the justice of the peace. The men who occupy this position are not as a rule of such a character that they can stand by and unconcernedly see all cases, and in consequence all fees connected with them, go to the rival or neighboring justice. As a rule, they are not men of means, and a fee more or less is of great importance. What is the result? The result is that the decision of a justice of the peace is almost certain to be a discrimination in favor of the plaintiff. Why? Because it is the plaintiff who begins the suit, and he or his lawyer has the option of bringing the case in Justice A's or Justice B's or any other court. If he brings it into Justice A's court, it means a certain number of fees for him, and he must therefore show his gratitude by rendering his judgment for the plaintiff. But suppose the justice has the moral courage to decide the case on its merits, and that as a result his decision is in favor of the defendant. The consequence is that Justice A will receive no more patronage from that lawyer or plaintiff. All the cases, and hence all the fees, which he might have had, are therefore transferred to Justice B, who is more grateful.

These cases are not pure assumptions. They are actual facts which are known and utilized every day by lawyers throughout the land. The many upright and conscientious justices, whose characters are above reproach, are prevented from exerting even the average amount of influence by the vicious system, which from its very nature drives the business into the courts of these disreputable wretches who are willing to barter their judgment for a paltry fee. The system becomes in its essence, in many cases, a legalized method of bribery. The whole administration of justice is perverted in that large class of cases in which the humbler classes of the community are most likely to be affected. Such a system would not be tolerated in the higher courts, while here it is continued year after year without protest, because the cases affected, as a rule, are petty and insignificant in regard to the amount involved.

4. *Fees of the district attorney and the administration of justice.* — One of the relics of barbarism which exists in some states or, perhaps more accurately, one of the barbarous inventions of the nineteenth century, is the system of paying district or state attorneys fees, varying in amount according to the number and character of the convictions secured. This method is not based on the experience of any state, but is like so many other unpractical schemes which are adopted and applied in many Western commonwealths. To be sure, there have been laws in some of the original states which are somewhat similar and may be called antecedents of these. But the differences are broad and far-reaching. A Connecticut statute of 1796 provided that the state attorney should receive fees roughly proportioned to the nature of the trial.[1] For prosecuting a trial for a capital offense he secured $14, for any other criminal case $9, and for any civil case $3.34. This, however, is widely different from the system now in force in California, which pays the attorney $50 for every conviction he secures for a capital offense, $25 for each conviction of felony, and $15 for misdemeanor; and, with the object apparently of especially punishing gambling, the same premium is placed on conviction under the act prohibiting gaming as for a capital offense.

[1] An early law of Delaware gave the attorney-general $10 for the prosecution of a capital offense and $2.40 for drawing an indictment, etc.

In Arkansas the prosecuting attorney receives $75 for a conviction of a capital offense, $25 for felony, $25 for gambling, and $10 for each misdemeanor. In Tennessee the district attorney receives $50 for each conviction for violation of the anti-trust law; while for obtaining a conviction for murder or wearing bowie-knife or violating the law against conspiracies, the fee is $25; for a conviction for perjury, $15; felony, $10; and misdemeanor, $5. In Nevada the fees are relatively the same, but five times as large. In Oregon there is another departure. Here the attorney receives certain fixed fees for convictions, and in case the trial results in acquittal he receives only half the amount.

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All of these methods are fundamentally wrong, and based on a theory which cannot be supported either by facts or by arguments. It is supposed to increase the efficiency of the attorney by offering him a pecuniary inducement to undertake and prosecute cases. But is there not every legitimate incentive to an attorney to do his work well, even when he is paid by salary? His reputation as a lawyer is at stake; the esteem and goodwill of his constituents impel him to prosecute every legitimate case. His success as a lawyer after his term of office expires will depend largely on the way in which he performs his duties of office. He can gain nothing by letting crime go unpunished, and he has everything to lose.

But suppose that the man is of such a character that the paltry fee will stimulate him to action. If it is only the money he is after, what is to prevent him from accepting a higher reward from the criminal for not prosecuting than the state offers for conviction? What is to prevent him from "drumming up" business by beginning suits wherever there is the slightest chance of winning?

5. *The fee system and political corruption.* — Very few people are so ignorant of politics as not to have heard, from rumor at least, of public offices the emoluments of which are so great as to enrich the occupant in a single year. No public office in the gift of the people is of such importance as to yield a regular legal salary of $100,000, even though it requires the highest grade of ability which the country can furnish. This amount

has been received more than once, however, by officers whose duties and abilities were of a comparatively low order. The position of sheriff in a densely populated county, or that of recorder or collector, are offices which do not require a very high grade of attainments; and yet these purely clerical officers have often been paid a higher salary than the President of the United States. Some of these are reported to yield fabulous sums;[1] yet no actual facts can be ascertained as to the real value of such offices, as they are usually kept a close secret among a favored few of the leading politicians of either party. Very often no account of the receipts of office is required by law; hence none is given.

These positions are usually the goal of the ambition of every politician. There is, therefore, the most intense competition, not only within the political parties for obtaining the nominations, but among the people to secure election when once nominated. These lucrative offices furnish the lifeblood of the spoils system and the political machine. The manipulators of the machine, knowing the value of such an office, can levy higher assessments for the corruption fund the greater the amount received from the office. Especially is this the case where a political party practically controls the election. It does not require any great power of observation to see that in all local or state elections, the heaviest pressure is, as a rule, brought to bear on those particular offices in which the remuneration is wholly or partly paid in fees or other perquisites. It is the office of county sheriff in most places which is the center of the political whirlpool. In many Eastern cities the office of prothonotary, clerk of court, or recorder is the most powerful incentive to political activity.[2] The political forces which are set in motion to obtain

[1] The income of the city clerk of Chicago was asserted to be $49,000 for two years. Chicago *Times-Herald*, Jan. 16, 1896, p. 1. The Chicago recorder's income was estimated by an investigating committee to have been nearly $9000 for six months. *Ibid.* Dec. 7, 1896, p. 7. The position of county sheriff in many counties in Wisconsin is said to yield as much as $20,000 a year. Many county clerks earn over $5000 a year in fees. Newspaper reports are current that the collector of taxes under Governor Warmouth at New Orleans received as fees not less than $100,000 a year, for four years.

[2] A prominent New York attorney has furnished the following estimates which are said to be conservative: The position of sheriff of New York county used to yield

these lucrative positions are almost incredible in power and magnitude. Each candidate has a whole army of henchmen in the field, each of these demanding pay either by some position or by money. How is all this possible? Most of these positions have no great amount of honor connected with them or even of influence, except so far as the subordinate appointments are concerned. The mainspring which furnishes the power for all this political machinery lies in the amount of salary which the fees yield to the officer. He can afford to spend $50,000 in money and a year or two of his time to obtain an office that will yield $100,000 a year in revenue. A man can afford to contribute liberally to the party fund who can realize such a sum if his party succeeds. Political office is not the greatest incentive or stimulus which he has. More is at stake. The candidate has usually invested his entire fortune on the issue, often also as much as he can borrow from his friends. Is it any wonder that he strains every nerve to win? Is it surprising that no stone is left unturned which will aid his election? Success means not only a position for a year or two, but it means comparative wealth and prosperity affecting his entire career, and opens the door to future advancement. It is almost in the nature of a wager in which everything is at stake. Under such conditions more or less corruption is inevitable; and the worst of it is, that the people themselves pay the fees which constitute the corruption fund. The history of any of our large cities will furnish numerous examples, and there is scarcely a county in the older states in which the same spectacle has not been witnessed over and over again.

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The only remedy is to enforce the most rigid system of accountability, so that every fee collected is paid into the treasury. It is bad business management to allow an official to pay and appoint his own clerks. No private enterprise could exist for any length of time which employed such methods. A private establishment always pays its subordinates from the general treasury, and keeps a sharp watch over their salaries

$125,000; at present it yields about $25,000. The position of county clerk in New York City used to yield from $80,000 to $100,000; at present it is considered to be worth $25,000. The office of register of deeds is at present worth about $20,000.

and efficiency. The same economy must be applied to public affairs if they are to be well administered.[1] All the corruption is not, as a rule, caused by bad legislation; the laws creating the various offices and making provisions for their emoluments were legitimate and proper at the time when they were enacted. But most of them were enacted very early in the history of the country, and few, if any, radical changes have been made in them. But they have simply outlived their period of usefulness. Economic conditions have changed, while the laws have not been changed to fit them. The fee bill, which would yield barely enough revenue to support the sheriff of New York in 1840, would, if in force in 1890, produce a fortune in a single year. Why? Simply because the business of the office has increased enormously on account of the growth of population. Furthermore, the work can be done at a much lower cost. It is like production on a large scale, in that economies of various kinds can be practiced.

The question immediately arises: Why have the legislatures so often failed to adjust law to economic conditions in this particular more than in others? The answer is evident. Whichever political party happens to be in power is directly interested in having as many lucrative offices to bestow as possible. A party is not likely to diminish the emoluments of an office when, by so doing, it diminishes to just that extent the patronage

[1] Elsewhere (p. 189) Professor Urdahl says: "Scarcely any of the states employing the fee system have as yet required the officers to give any strict account of the total amount received as fees. Even if the new system is introduced, it becomes next to impossible to obtain any figures which will show in dollars and cents the total gain or loss due to the one system or the other. It is quite different with the federal officials, and more especially those connected with the federal courts. These were required comparatively early to give a complete account of every fee received. We have thus full and reliable statistics of the amounts collected as fees in the various courts for a long series of years. These figures show that the cost of maintaining the United States courts has for a number of years been increasing at the rate of over a million dollars a year. On May 28, 1896, Congress passed an act which changed most of the officials connected with the federal courts from the fee to the salary system of compensation. The result is, that the total expenses under the new system for the current year 1897, according to the estimates made by the attorney-general, based on the returns for the first six months, will be $4,861,465, as compared with $6,675,239 for 1896, which was the cost under the fee system. This shows a total saving of $1,813,774 in spite of the fact that the volume of business is on the increase."

which it has to confer. Especially is this the case where no pressure in that direction is brought to bear upon the legislative body. There is likely to be no pressure of this kind for the diminution of the fees of an office or a change in the system, because no body of individuals, as a class, is likely to be especially affected or feel the burden of the system. The fees are paid intermittently, now by one person and now by another; while the great majority of people rarely have any fees to pay at all. There has thus never arisen any popular demand for the publication of the amount of fees collected or for their reduction. As a result, we find that it is only at this late day that the same requirements are beginning to be made in regard to fees as were introduced in regard to taxes one hundred years ago; namely, that their amount should be made public, and that all fees collected should be accounted for. This lack of knowledge of the number of fees collected has tended still further to discourage any agitation for their reduction. But whenever a movement of this kind is started, then all the fee-collecting officers, with all the political influence which they can command, stand ready to work against it.[1] It is not strange, therefore, when everything is taken into consideration, that primitive laws have so long remained in force, and that they are even now with difficulty being displaced with more modern and suitable enactments. The movement seems to be in progress which appears destined to place every fee-paid public officer on a salary or what is equivalent to the same. This, together with civil-service reform, will ultimately remove the greater part of the political corruption connected with purely administrative offices. But from the very nature of American conditions, the movement must be slow and gradual.

30. Revenue from Fees in Frankfort: by Anna Youngman.[2]— The foregoing account of American conditions may be helpfully supplemented by an account of the fee system of a German city:

[1] A bill to abolish some minor sheriffs' fees in the Wisconsin legislature in 1896 was defeated through the lobbying of the sheriffs and their friends. Numerous similar bills have met the same fate. It is a notorious fact, well known to all who are familiar with New York politics, that the recent amendment to the New York fee code failed to pass because of the opposition of sheriffs and other fee-paid officials, whose salaries would have been affected thereby.

[2] Reprinted from the *Quarterly Journal of Economics*, Vol. XXVII.

In addition to the revenues which the communities receive from the regularly recurrent taxes, the payments which take the form of fees and special assessments are important sources of income. Here again the K. A. G. opens a very wide field to the operation of the principle of payment in accordance with benefits received. For public expenditures bringing especial advantages to business men or property owners special contributions may be required and must be collected if otherwise the costs, including interest and amortization payments on the capital sum expended, would have to be met by taxes.[1] Assessments for street construction, sewer extensions, etc. are the most common form of payment. A rather unusual extension of the principle of special assessment for the use of the streets is found in Frankfort, where certain concerns engaged in heavy hauling operations, for example, several breweries and a flour mill, contribute to the cost of upkeep.[2] The practice is unquestionably justified, for why should the community defray all the costs of repairs, hastened by the continuous use of the streets by private individuals and private companies?

The design of Frankfort to assess fire-insurance companies for partial defrayal of the costs of the city fire department did not materialize,[3] as it was felt to be a too far-reaching extension of the principle of assessment.

The K. A. G. also aims to bring about a development of the fee system for the use of public institutions, and, indeed, such fees are made obligatory in case particular individuals or classes are especially advantaged (*i.e.* providing the latter have not been previously forced to defray a part of the costs through special assessments or taxes).[4] The fees are to be fixed in ad-

[1] K. A. G., § 9.

[2] Haushaltsplan, 1910–11, section Tiefbauamt; contributions from companies for the use of city streets, 3965 m., breweries, 3581 m., flour and bread, 300 m.; total, 7846 m.

[3] Adickes-Woell edition, K. A. G., note 2 to § 9.

[4] In the case of communal institutions or undertakings which especially benefit a particular section or a particular class of citizens, heavier tax impositions may take the place of fees or assessments. *Cf.* K. A. G., § 20.

Heavier taxation of individual industrial or commercial establishments may also be permitted.

The principle is even extended to intercommunal relationships and it is provided that whenever a community through its industries, etc., is the cause of the imposition of extra and unusual burdens upon a neighboring community, it can be forced to contribute to the resultant extraordinary disbursements. K. A. G., § 53.

vance according to a set scale. A consideration of persons without means is permissible (*nicht ausgeschlossen*). The chief administrative court of appeal (*Oberverwaltungsgericht*) in interpreting this clause ruled, nevertheless, that a grading of fees for the same services according to ability to pay or other standards was not permissible. This decision led to the passage of a declarative law which stated that it was permissible to grade the fees according to ability to pay, even to the point of entirely freeing certain individuals from payment. Another decision of the court (March '07) gave a restricted meaning to the declarative law also. It was held that a reduction of the normal[1] tariff may be made, but not an increase according to increasing ability to pay, *i.e.* the payment may be reduced below the value of the service by a degression, but it cannot be increased by a progression exceeding the value of the service.[2]

The raising of fees is not obligatory in the case of schools for elementary instruction, of hospitals, nor in general for institutions intended primarily to meet the needs of the poorer classes. For those attending the higher schools a payment is, however, compulsory, and from this source Frankfort obtained in 1910–11 fees (*Schulgeld*) amounting to 1,322,700 m. The city also collects hospital fees from those patients able to pay (in many cases the payments are made from sick funds) granting reductions to persons with incomes under 2100 m. Minor fees are, of course, raised, for building inspection, for example, through the registry offices (*Standesämter*), the Gewerbe- and Kaufmannsgerichte, etc. But a further consideration of fees can best be discussed in connection with the various municipal public-service undertakings.

[1] The normal tariff as defined in the K. A. G., § 4:

The rates are, as a rule, to be so fixed that the costs of administration and upkeep, including the payments for interest and amortization on the capital expended, are covered.

[2] It will later be apparent that the practice in Frankfort hardly conforms to this dictum.

CHAPTER VIII

GENERAL PROPOSITIONS CONCERNING TAXATION

31. Smith's Canons of Taxation. — Few passages in the literature of finance are more celebrated than those with which Adam Smith introduces his discussion of taxation. Smith said:[1]

The private revenue of individuals, it has been shown in the first book of this inquiry, arises ultimately from three different sources: rent, profit, and wages. Every tax must finally be paid from some one or other of those three different sorts of revenue, or from all of them indifferently. I shall endeavor to give the best account I can, first, of those taxes which it is intended should fall upon rent; secondly, of those which it is intended should fall upon profit; thirdly, of those which it is intended should fall upon wages; and fourthly, of those which it is intended should fall indifferently upon all those three different sources of private revenue. The particular consideration of each of these four different sorts of taxes will divide the second part of the present chapter into four articles, three of which will require several other subdivisions. Many of those taxes, it will appear from the following review, are not finally paid from the fund or source of revenue, upon which it was intended they should fall.

Before I enter upon the examination of particular taxes, it is necessary to premise the four following maxims with regard to taxes in general.

1. The subjects of every state ought to contribute toward the support of the government, as nearly as possible in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of

[1] Wealth of Nations, Bk. V, ch. 2.

the state. The expense of government to the individuals of a great nation is like the expense of management to the joint tenants of a great estate, who are all obliged to contribute in proportion to their respective interests in the estate. In the observation or neglect of this maxim consists what is called the equality or inequality of taxation. Every tax, it must be observed, once for all, which falls finally upon one only of the three sorts of revenue above mentioned, is necessarily unequal, in so far as it does not affect the other two. In the following examination of different taxes I shall seldom take much further notice of this sort of inequality, but shall, in most cases, confine my observations to that inequality, which is occasioned by a particular tax falling unequally even upon that particular sort of private revenue which is affected by it.

2. The tax which each individual is bound to pay, ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. Where it is otherwise, every person subject to the tax is put more or less in the power of the taxgatherer, who can either aggravate the tax upon any obnoxious contributor, or extort, by the terror of such aggravation, some present or perquisite to himself. The uncertainty of taxation encourages the insolence and favors the corruption of an order of men who are naturally unpopular, even where they are neither insolent nor corrupt. The certainty of what each individual ought to pay is, in taxation, a matter of so great importance, that a very considerable degree of inequality, it appears, I believe, from the experience of all nations, is not near so great an evil as a very small degree of uncertainty.

3. Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it. A tax upon the rent of land or of houses, payable at the same term at which such rents are usually paid, is levied at the time when it is most likely to be convenient for the contributor to pay, or when he is most likely to have wherewithal to pay. Taxes upon such consumable goods as are articles of luxury, are all finally paid by the consumer, and generally in a manner that is very convenient for him. He pays them by

little and little, as he has occasion to buy the goods. As he is at liberty, too, either to buy or not to buy, as he pleases, it must be his own fault if he ever suffers any considerable inconveniency from such taxes.

4. Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state. A tax may either take out or keep out of the pockets of the people a great deal more than it brings into the public treasury, in the four following ways. First, the levying of it may require a great number of officers, whose salaries may eat up the greater part of the produce of the tax, and whose perquisites may impose another additional tax upon the people. Secondly, it may obstruct the industry of the people, and discourage them from applying to certain branches of business which might give maintenance and employment to great multitudes. While it obliges the people to pay, it may thus diminish, or perhaps destroy, some of the funds which might enable them more easily to do so. Thirdly, by the forfeitures and other penalties which those unfortunate individuals incur who attempt unsuccessfully to evade the tax, it may frequently ruin them, and thereby put an end to the benefit which the community might have received from the employment of their capitals. An injudicious tax offers a great temptation to smuggling. But the penalties of smuggling must rise in proportion to the temptation. The law, contrary to all the ordinary principles of justice, first creates the temptation, and then punishes those who yield to it; and it commonly enhances the punishment, too, in proportion to the very circumstance which ought certainly to alleviate it, the temptation to commit the crime. Fourthly, by subjecting the people to the frequent visits and the odious examination of the tax-gatherers it may expose them to much unnecessary trouble, vexation, and oppression; and though vexation is not, strictly speaking, expense, it is certainly equivalent to the expense at which every man would be willing to redeem himself from it. It is in some one or other of these four different ways that taxes are frequently so much more burdensome to the people than they are beneficial to the sovereign.

The evident justice and utility of the foregoing maxims have

recommended them more or less to the attention of all nations. All nations have endeavored, to the best of their judgment, to render their taxes as equal as they could contrive; as certain, as convenient to the contributor, both in the time and in the mode of payment, and, in proportion to the revenue which they brought to the prince, as little burdensome to the people. The following short review of some of the principal taxes which have taken place in different ages and countries will show that the endeavors of all nations have not in this respect been equally successful.

32. The General Economic Effect of Taxation. — In his Essay on Taxes,[1] David Hume remarked:

There is a prevailing maxim,[2] among some reasoners, *that every new tax creates a new ability in the subject to bear it, and that each increase of public burdens increases proportionably the industry of the people.* This maxim is of such a nature as is most likely to be abused; and is so much the more dangerous, as its truth cannot be altogether denied: but it must be owned, when kept within certain bounds, to have some foundation in reason and experience.

When a tax is laid upon commodities which are consumed by the common people, the necessary consequence may seem to be, either that the poor must retrench something from their way of living, or raise their wages, so as to make the burden of the tax fall entirely upon the rich. But there is a third consequence, which often falls upon taxes; namely, that the poor increase their industry, perform more work, and live as well as before, without demanding more for their labor. Where taxes are moderate, are laid on gradually, and affect not the necessaries of life, this consequence naturally follows; and it is certain, that such difficulties often serve to excite the industries of a people, and render them more opulent and laborious than others, who enjoy the greatest advantages.

[1] Political Essays (1752).

[2] During the seventeenth and eighteenth centuries many writers in England argued that taxes have a tendency to stimulate industry and frugality. See Seligman, Shifting and Incidence of Taxation, 32–39. — ED.

A similar opinion was expressed by J. R. McCulloch nearly a century later:[1]

The writers on finance, patronized by European governments, have mostly labored to show that taxation is never a cause of diminished production; but that, on the contrary, every new tax creates a new ability in the subject to bear it, and every increase of the public burdens a proportional increase in the industry of the people. The fallacy of this opinion, when advanced thus absolutely and without reservation, has been ably exposed by Hume in his Essay on Taxes. But, as already seen, it is undoubtedly true that the desire to maintain and improve their condition stimulates most men to endeavor to discharge the burden of additional taxes by increased industry and economy, without allowing them to encroach on their means of subsistence, or on their fortunes.

The operation of this principle has been strikingly evinced in the financial history of this country since the commencement of the American war. That contest, and the more recent struggle with revolutionary France, occasioned a vast increase of taxation, and an expenditure that has no parallel in the history of the world. The public debt which amounted to about 129 millions in 1775, amounted to about 848 millions in 1817; and, in addition to the immense sums raised by borrowing, the gross produce of the taxes levied in the United Kingdom during the late war exceeded the enormous sum of 1100 millions sterling. And yet the rapid increase of population — the wonderful progress and improvement of agriculture, manufactures, and commerce — the extension and embellishment of towns and cities — the formation of so many new docks, roads, and canals — and the infinite variety of expensive undertakings entered upon and completed in all parts of the country during the continuance of hostilities — show clearly that the savings of the mass of the people greatly exceeded the warlike expenditure of government and the unprofitable expenditure of individuals.

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The constantly increasing pressure of taxation during the war, begun in 1793, was felt by all classes, and gave a spur to industry,

[1] Treatise on Taxation, 7–10 (second edition, 1852).

enterprise, and invention, and generated a spirit of economy which we should have in vain attempted to excite by any less powerful means. Had taxation been very oppressive, it would not have had this effect; but it was not so high as to produce either dejection or despair, though it was at the same time sufficiently heavy to render a very considerable increase of industry and parsimony necessary to prevent it from encroaching on the fortunes of individuals, or, at all events, from diminishing the rate at which they had previously been increasing. Man is not influenced solely by hope, he is also powerfully influenced by fear. Taxation brings the latter principle into the field. To the desire of rising in the world, implanted in the breast of every individual, an increase of taxation superadds the fear of being cast down to a lower station, of being deprived of conveniences and gratifications which habit has rendered all but indispensable; and the combined influence of the two principles produces results that could not be produced by the unassisted agency of either. Without the American war and the late French war there would have been less industry and less frugality, because there would have been less occasion for them. And we incline to think that those who inquire dispassionately into the matter will most probably see reason to conclude that the increase of industry and frugality occasioned by these contests more than sufficed to defray their enormous expense, and that the capital of the country is probably about as great at this moment as it would have been had they not occurred.

But we must be on our guard against the abuse of this doctrine, and must not suppose that, because it holds in certain cases and under certain conditions, it will, therefore, hold in all cases and under all conditions. To render an increase of taxation productive of greater exertion, economy, and invention, it should be slow and gradual; and it should never be carried to such a height as to incapacitate individuals from meeting the sacrifices it imposes by such additional exertions and savings as it may be in their power to make without requiring any very sudden or violent change in their habits. The increase of taxation should never be so great as to make it impracticable to overcome its influence, or to induce the belief that it is impracticable. Difficulties that are seen to be surmountable sharpen the inventive powers, and

are readily and vigorously grappled with; but an apparently insurmountable difficulty, or such an increase of taxation as it was deemed impossible to defray, would not stimulate but destroy exertion. Whenever taxation becomes so heavy that the wealth it takes from individuals can no longer be replaced by fresh efforts, these efforts uniformly ceased to be made; industry is paralyzed, and the country declines. Oppression, it has been said, either raises men into heroes or sinks them into slaves; and taxation, according to its magnitude and the mode in which it is imposed, either makes men industrious, enterprising, and wealthy, or indolent, dispirited, and impoverished.

And elsewhere in his treatise[1] McCulloch offered the following illustration, which has been repeated by many writers:

It is unnecessary, however, to travel beyond the limits of financial history for examples of the powerful influence of taxes in stimulating ingenuity and invention. Previously to 1786 the duties on spirits distilled in Scotland were charged according to the quantities supposed to be actually produced. But as this mode of assessing the duty was found to open a door to extensive frauds, it was resolved to substitute in its stead a license duty, proportioned to the size of the still used by the distiller. Stills being all of the same shape, and the quantity of spirits that each could produce in a year according to its cubic contents having been accurately calculated, it was supposed that this plan would effectually prevent smuggling, and that the officers would have nothing to do but inspect the stills that had been licensed, to prevent their size being increased. On the first introduction of this apparently well-considered system, the license duty on each still was fixed at the rate of 30*s*. per gallon of its contents. The principle, however, on which the duty was assessed was very soon subverted. The stills in use down to this period were very deep in proportion to their diameter, so that after being charged they required at an average about a week before the process of distillation was completed. But the new mode of charging the duty had no sooner been introduced, than it occurred to two ingenious persons, Messrs. John and William

[1] pp. 151–152.

Sligo, distillers, Leith, that by lessening the depth of the still and increasing its diameter, a larger surface would be exposed to the action of the fire, and they would be enabled to run off its contents in considerably less time. Having adopted this plan, they found that it answered their expectations, and that they were able to distil the same quantity of spirits in a few hours that had previously occupied a week. Messrs. Sligo kept this important invention secret for about a year; but it was too valuable to be long concealed, and the moment it transpired, the plan was adopted by other distillers. In consequence government raised, in 1788, the license duty on the still from 30*s.* to £3 a gallon. This increase having redoubled the activity of the distillers, the duty was raised in 1793 to £9 a gallon, in 1795 to £18, and in 1797 it was carried to the enormous sum of £54 a gallon. Still, however, the ingenuity of the distiller outran the increase of the tax; and it was proved, before a committee of the House of Commons in 1798, that distillation had been carried to such perfection, that stills had occasionally been filled and discharged once every *eight* minutes. This, it was supposed, must be the maximum of velocity, and a new license duty was laid on the still on the hypothesis that it could, at an average, be run off in that time, or that it could be filled and emptied once every eight minutes during the season. But the ingenuity of the distillers was not yet tasked to the highest. And it was ascertained that, toward the latter end of the license system, stills of forty gallons had been, at an average, filled and run off in the almost incredibly short space of *three* minutes, being an increase of 2880 times on the rapidity of distillation that had obtained when the license system was introduced in 1786!

Now it will not be alleged, at least with any appearance of probability, that had a duty of 5 or 10 per cent been laid on their income or capital, Messrs. Sligo would have been half so likely to make this important discovery. But being assessed on the still, the duty had the double effect of fixing attention specially on it, and of operating as a powerful incentive to its improvement.[1]

[1] It is important to observe, however, as Bastable has pointed out, that "invention had been stimulated, not by the duty, but by the possibility of escaping it." Thus not the payment of a tax, but the imperfect assessment which left a loophole

33. The Views of Say. — While most economists have been content to emphasize more sharply than Hume and McCulloch did the limitations and possible dangers of the proposition that taxes tend to stimulate industry and thrift, Jean Baptiste Say and a few others have denied that the statement contains the least kernel of truth. Say, for instance, said:[1]

The same causes that we have found to make unproductive consumption unfavorable to reproduction, prevent taxation from at all promoting it. Taxation deprives a producer of a product which he would otherwise have the option of deriving a personal gratification from, if consumed unproductively, or of turning to profit, if he preferred to devote it to a useful employment. One product is a means of raising another; and, therefore, the subtraction of a product must needs diminish, instead of augmenting, productive power.

It may be urged that the pressure of taxation impels the productive classes to redouble their exertions, and thus tends to enlarge the national production. I answer that, in the first place, mere exertion cannot alone produce; there must be capital for it to work upon, and capital is but an accumulation of the very products that taxation takes from the subject: that, in the second place, it is evident, that the values which industry creates expressly to satisfy the demands of taxation, are no increase of wealth; for they are seized on and devoured by taxation. It is a glaring absurdity to pretend that taxation contributes to national wealth, by engrossing part of the national produce; and enriches the nation by consuming part of its wealth. Indeed, it would be trifling with my reader's time to notice such a fallacy, did not most governments act upon this principle, and had not well-intentioned and scientific writers endeavored to support and establish it.

If from the circumstance that the nations most grievously taxed are those most abounding in wealth, as Great Britain for example, we are desired to infer, that their superior wealth arises

for escape, was the real cause for the improvement. Bastable, Public Finance, 286. — Ed.

[1] Traité d'économie politique, Bk. III, ch. 8.

from their heavier taxation, it would be a manifest inversion of cause and effect. A man is not rich because he pays largely; but he is able to pay largely, because he is rich. It would be not a little ridiculous, if a man should think to enrich himself by spending largely, because he sees a rich neighbor doing so. It must be clear that the rich man spends because he is rich, but never can enrich himself by the act of spending.

Cause and effect are easily distinguished, when they occur in succession; but are often confounded, when the operation is continuous and simultaneous.

Hence, it is manifest that, although taxation may be, and often is, productive of good, when the sums it absorbs are properly applied, yet, the act of levying is always attended with mischief at the outset. And this mischief good princes and governments have always endeavored to render as inconsiderable to their subjects as possible, by the practice of economy, and by levying, not to the full extent of the people's ability, but to such extent only as is absolutely unavoidable. That rigid economy is the rarest of princely virtues, is owing to the circumstance of the throne being constantly beset with individuals, who are interested in the absence of it; and who are always endeavoring, by the most specious reasoning, to impress the conviction that magnificence is conducive to public prosperity and that profuse public expenditure is beneficial to the state. It is the object of this third book to expose the absurdities of such representations.

34. The Source of Taxation. — Adam Smith declared that taxes are generally paid out of "the revenue of private people" and do not ordinarily occasion "the destruction of any actually existing capital." Loans, however, he believed to be raised out of the previously accumulated wealth of society so that they are derived from capital and not from revenue.[1] From this suggestion David Ricardo, a generation later, developed his elaborate argument that income, or revenue, should be the normal source of taxation. He said:[2]

[1] Wealth of Nations, Bk. V, ch. 3.

[2] Principles of Political Economy and Taxation, ch. 8 (1817).

Taxes are a portion of the produce of the land and labor of a country, placed at the disposal of the government; and are always ultimately paid, either from the capital, or from the revenue of the country.

We have already shown how the capital of a country is either fixed or circulating, according as it is of a more or less durable nature. It is difficult to define strictly, where the distinction between circulating and fixed capital begins; for there are almost infinite degrees in the durability of capital. The food of a country is consumed and reproduced at least once in every year; the clothing of the laborer is probably not consumed and reproduced in less than two years; whilst his house and furniture are calculated to endure for a period of ten or twenty years.

When the annual productions of a country more than replace its annual consumption, it is said to increase its capital; when its annual consumption is not at least replaced by its annual production, it is said to diminish its capital. Capital may therefore be increased by an increased production, or by a diminished unproductive consumption.

If the consumption of the government, when increased by the levy of additional taxes, be met either by an increased production, or by a diminished consumption on the part of the people, the taxes will fall upon revenue, and the national capital will remain unimpaired; but if there be no increased production or diminished unproductive consumption on the part of the people, the taxes will necessarily fall on capital; that is to say, they will impair the fund allotted to productive consumption.[1]

In proportion as the capital of a country is diminished, its productions will be necessarily diminished; and, therefore, if the same unproductive expenditure on the part of the people

[1] It must be understood that all the productions of a country are consumed; but it makes the greatest difference imaginable whether they are consumed by those who reproduce, or by those who do not reproduce another value. When we say that revenue is saved, and added to capital, what we mean is, that the portion of revenue, so said to be added to capital, is consumed by productive instead of unproductive laborers. There can be no greater error than in supposing that capital is increased by non-consumption. If the price of labor should rise so high, that notwithstanding the increase of capital, no more could be employed, I should say that such increase of capital would be still unproductively consumed.

and of the government continue, with a constantly diminishing annual reproduction, the resources of the people and of the state will fall away with increasing rapidity, and distress and ruin will follow.

Notwithstanding the immense expenditure of the English government during the last twenty years,[1] there can be little doubt but that the increased production on the part of the people has more than compensated for it. The national capital has not merely been unimpaired, it has been greatly increased, and the annual revenue of the people, even after the payment of their taxes, is probably greater at the present time than at any former period of our history.

For the proof of this we might refer to the increase of population — to the extension of agriculture — to the increase of shipping and manufactures — to the building of docks — to the opening of numerous canals, as well as to many other expensive undertakings; all denoting an increase both of capital and of annual production.

Still, however, it is certain that but for taxation this increase of capital would have been much greater. There are no taxes which have not a tendency to lessen the power to accumulate. If they encroach on capital, they must proportionably diminish that fund by whose extent the extent of the productive industry of the country must always be regulated; and if they fall on revenue, they must either lessen accumulation, or force the contributors to save the amount of the tax, by making a corresponding diminution of their former unproductive consumption of the necessaries and luxuries of life. Some taxes will produce these effects in a much greater degree than others; but the great evil of taxation is to be found, not so much in any selection of its objects, as in the general amount of its effects taken collectively.

Taxes are not necessarily taxes on capital, because they are laid on capital; nor on income, because they are laid on income. If from my income of £1000 per annum, I am required to pay £100, it will really be a tax on my income, should I be content with the expenditure of the remaining £900; but it will be a tax on capital, if I continue to spend £1000.

The capital from which my income of £1000 is derived may

[1] (1793–1815.)

be of the value of £10,000; a tax of one per cent on such capital would be £100; but my capital would be unaffected, if after paying this tax, I in like manner contented myself with the expenditure of £900.

The desire which every man has to keep his station in life, and to maintain his wealth at the height which it has once attained, occasions most taxes, whether laid on capital or on income, to be paid from income; and therefore as taxation proceeds, or as government increases its expenditure, the annual enjoyments of the people must be diminished, unless they are enabled proportionally to increase their capitals and income.

It should be the policy of governments to encourage a disposition to do this in the people, and never to lay such taxes as will inevitably fall on capital; since by so doing, they impair the funds for the maintenance of labor, and thereby diminish the future production of the country.

In England this policy has been neglected, in taxing the probates of wills, in the legacy duty, and in all taxes affecting the transference of property from the dead to the living. If a legacy of £1000 be subject to a tax of £100, the legatee considers his legacy as only £900 and feels no particular motive to save the £100 duty from his expenditure, and thus the capital of the country is diminished; but if he had really received £1000, and had been required to pay £100 as a tax on income, on wine, on horses, or on servants, he would probably have diminished, or rather not increased his expenditure by that sum, and the capital of the country would have been unimpaired.

In 1848 John Stuart Mill criticised Ricardo's doctrine at several points.[1] He said:[2]

In addition to the preceding rules, another general rule of taxation is sometimes laid down, namely, that it should fall on income, and not on capital. That taxation should not encroach upon the amount of the national capital, is indeed of the greatest importance; but this encroachment, when it occurs, is not so much a consequence of any particular mode of taxation, as

[1] In a subsequent chapter (sec. 77) a further criticism of Smith and Ricardo is presented. [2] Principles of Political Economy, Bk. V, ch. 2, § 7.

of its excessive amount. Overtaxation, carried to a sufficient extent, is quite capable of ruining the most industrious community, especially when it is in any degree arbitrary, so that the payer is never certain how much or how little he shall be allowed to keep; or when it is so laid on as to render industry and economy a bad calculation. But if these errors be avoided, and the amount of taxation be not greater than it is at present, even in the most heavily taxed country of Europe, there is no danger lest it should deprive the country of a portion of its capital.

To provide that taxation shall fall entirely on income, and not at all on capital, is beyond the power of any system of fiscal arrangements. There is no tax which is not partly paid from what would otherwise have been saved; no tax, the amount of which, if remitted, would be wholly employed in increased expenditure, and no part whatever laid by as an addition to capital. All taxes, therefore, are in some sense partly paid out of capital; and in a poor country it is impossible to impose any tax which will not impede the increase of the national wealth. But in a country where capital abounds, and the spirit of accumulation is strong, this effect of taxation is scarcely felt. Capital having reached the stage in which, were it not for a perpetual succession of improvements in production, any further increase would soon be stopped — and having so strong a tendency even to outrun those improvements, that profits are only kept above the minimum by emigration of capital, or by a periodical sweep called a commercial crisis; to take from capital by taxation what emigration would remove, or a commercial crisis destroy, is only to do what either of those causes would have done, namely, to make a clear space for further saving.

I cannot, therefore, attach any importance, in a wealthy country, to the objection made against taxes on legacies and inheritances, that they are taxes on capital. It is perfectly true that they are so. As Ricardo observes, if £100 are taken from any one in a tax on houses or on wine, he will probably save it, or a part of it, by living in a cheaper house, consuming less wine, or retrenching from some other of his expenses: but if the same sum be taken from him because he has received a legacy of £1000, he considers the legacy as only £900, and feels no more inducement than at any other time (probably feels

rather less inducement) to economize in his expenditure. The tax, therefore, is wholly paid out of capital: and there are countries in which this would be a serious objection. But in the first place, the argument cannot apply to any country which has a national debt, and devotes any portion of revenue to paying it off; since the produce of the tax, thus applied, still remains capital, and is merely transferred from the taxpayer to the fundholder. But the objection is never applicable in a country which increases rapidly in wealth. The amount which would be derived, even from a very high legacy duty, in each year, is but a small fraction of the annual increase of capital in such a country; and its abstraction would but make room for saving to an equivalent amount: while the effect of not taking it, is to prevent that amount of saving, or cause the savings, when made, to be sent abroad for investment. A country which, like England, accumulates capital not only for itself but for half the world, may be said to defray the whole of its public expenses from its overflowings; and its wealth is at this moment as great as if it had no taxes at all. What its taxes really do is, to subtract from its means, not of production but of enjoyment; since whatever any one pays in taxes, he could, if it were not taken for that purpose, employ in indulging his ease, or in gratifying some want or taste which at present remains unsatisfied.

CHAPTER IX

JUSTICE IN TAXATION: PROPORTIONAL *VS.* PROGRESSIVE TAXATION

35. The Views of Say and McCulloch. — Adam Smith, it will be remembered, had laid it down, as the first canon of taxation, that the "subjects of every state ought to contribute toward the support of the government, as nearly as possible in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state. In the observation or neglect of this maxim consists what is called the equality or inequality of taxation." His successors carried on a lively debate as to what constitutes equality, and, particularly, whether a progressive or proportional rate of taxation corresponds most nearly to the demands of justice. Jean Baptiste Say, for instance, argued for progressive rates of taxation. He said:[1]

Taxation, being a burden, must needs weigh lightest on each individual when it bears upon all alike. When it presses inequitably upon one individual or branch of industry, it is an indirect, as well as a direct, incumbrance; for it prevents the particular branch or the individual from competing on even terms with the rest. An exemption, granted to one manufacture, has often been the ruin of several others. Favor to one is most commonly injustice to all others.

The partial assessment of taxation is no less prejudicial to the public revenue than unjust to individual interests. Those who are too lightly taxed are not likely to cry out for an increase; and those who are too heavily taxed are seldom regular in their payments. The public revenue suffers in both ways.

[1] Traité d'économie politique, Bk. III, ch. 8.

It has been questioned whether it be just to tax that portion of revenues which is spent on luxuries more heavily than that spent on objects of necessity. It seems but reasonable to do so; for taxation is a sacrifice to the preservation of society and of social organization, which ought not to be purchased by the destruction of individuals. Yet the privation of absolute necessaries implies the extinction of existence. It would be somewhat bold to maintain, that a parent is bound in justice to stint the food or clothing of his child to furnish his contingent to the ostentatious splendor of a court or the needless magnificence of public edifices. Where is the benefit of social institutions to an individual whom they rob of an object of positive enjoyment or necessity in actual possession, and offer nothing in return but the participation in a remote and contingent good which any man in his senses would reject with disdain?

But how is the line to be drawn between necessaries and superfluities? In this discrimination there is the greatest difficulty; for the terms, necessaries and superfluities, convey no determinate or absolute notion, but always have reference to the time, the place, the age, and the condition of the party; so that, were it laid down as a general rule, to tax none but superfluities, there would be no knowing where to begin and where to stop. All that we certainly know is, that the income of a person or a family may be so confined as barely to suffice for existence; and may be augmented from that minimum upward by imperceptible gradation, until it embrace every gratification of sense, of luxury, or of vanity; each successive gratification being one step further removed from the limits of strict necessity, until at last the extreme of frivolity and caprice is arrived at; so that, if it be desired to tax individual income, in such manner as to press lighter in proportion as that income approaches to the confines of bare necessity, taxation must not only be equitably apportioned, but must press on revenue with progressive gravity.

In fact, supposing taxation to be exactly proportionate to individual income, — a tax, let us say, of 10 per cent, — a family possessed of 300,000 francs per annum would pay 30,000 francs in taxes, leaving a clear residue of 270,000 francs for the family expenditure. With such an expenditure, the family could not

only live in abundance, but could still enjoy a vast number of gratifications by no means essential to happiness. Whereas another family, with an income of 300 francs, reduced by taxation to 270 francs per annum, would, with our present habits of life and ways of thinking, be stinted in the bare necessaries of subsistence. Thus a tax merely proportionate to individual income would be far from equitable; and this is probably what Smith meant, by declaring it reasonable, that the rich man should contribute to the public expenses not merely in proportion to the amount of his revenue, but even somewhat more. For my part, I have no hesitation in going further, and saying that taxation cannot be equitable unless its ratio is progressive.

Upon the other hand, John Ramsay McCulloch contended vigorously for proportional taxation, and was inclined to minimize the importance of considerations of abstract justice in matters of taxation. McCulloch wrote:[1]

There can be no doubt that, were it practicable, the burden of taxation should be made to press on individuals in proportion to their respective revenues. A, with an income of £1000 a year, ought to pay ten times the tax paid by B, who has only £100 a year, and the latter ten times as much as C, who has only a pittance of £10.[2] The state has been ingeniously compared by M. Thiers to a mutual insurance company, where the payments by the members are exactly proportioned to the sums they have insured, or to their interests in the company. And so it should be with the subjects of government. It is established for the common benefit of all — of those who labor with the hand, and of those who labor with the head; of those to whom property has descended, and of those by whom it has been acquired; and is alike indispensable to their well-being and prosperity. And being so, it necessarily follows that every individual should contribute to its support according to his stake in the society, or to his means. This is a plain as well as a sound rule; and it is one that should never be forgotten or overlooked.

[1] Treatise on Taxation, 17–21 (second edition).

[2] It is, perhaps, needless to say that the incomes of the different parties are supposed to be perpetual, or of the same duration.

Practically, however, it is not possible to attain to anything like a perfect equality of taxation; and provided no tax be imposed in the view of trenching on this principle, or of making one class or order of people pay more in proportion to their means than others, the equality of taxation is of less importance. In this, as in most other departments of politics, we have only a choice of difficulties; and what is absolutely right must often give way to what is expedient and practicable. It is the business of the legislator to look at the practical influence of different taxes, and to resort in preference to those by which the revenue may be raised with the smallest inconvenience. Should the taxes least adverse to the public interests fall on the contributors according to their respective abilities, it will be an additional recommendation in their favor. But the *salus populi* is in this, as it should be in every similar matter, the prime consideration; and the tax which is best fitted to promote, or least opposed to, this great end, though it may not press quite equally on the different orders of society, is to be preferred to a more equal but otherwise less advantageous tax. Were Smith's first maxim restricted to taxes laid directly on property or income, it would be quite as true in a practical as in a theoretical point of view. Equality is of the essence of such taxes; and whenever they cease to be equal, they become partial and unjust. But in laying down a practical rule that is to apply to all taxes, equality of contribution is an inferior consideration. The distinguishing characteristic of the best tax is, not that it is most nearly proportioned to the means of individuals, but that it is easily assessed and collected, and is, at the same time, most conducive, all things considered, to the public interests.

The truth is, that the greater number of taxes, including, we believe, every one that is least injurious, are imposed without any regard to the equality of their pressure. They consist of duties payable by those who use certain articles or exercise certain privileges, and by those only. Taxes of this sort, though not proportioned to the abilities of the consumers, are neither partial nor unfair; and provided they be imposed on proper objects, and kept within reasonable limits, they do not appear to be open to any good objection.

We may refer, in illustration of this statement, to the duties

on malt, spirits, wine, and tobacco. These produce a very large annual revenue; and though some of them might, perhaps, be advantageously reduced, they appear — supposing them to be properly assessed — to be, in all respects, unexceptionable. Other duties of this description, such as those on saddle horses, carriages, and livery servants, fall only on the more opulent classes. But this is not the case with the more productive duties; and it must be admitted that the largest portion of the revenue derived from them is paid by the lower and poorer orders. This, however, is not, as has been often alleged, a consequence of the latter being overtaxed, but of their being so very numerous that the produce of taxes to which they generally contribute invariably exceeds the produce of heavier taxes falling exclusively on the richer classes. The duties now under consideration act, in fact, as a species of improved sumptuary laws, having all the useful with few or none of the injurious influences of these regulations. . . .

But though it will, perhaps, be generally admitted that reasonable duties on spirits, tobacco, and such like articles, cannot be justly objected to, it may be contended, with some show of reasoning, that duties on necessaries, or on bread, butchers' meat, salt, tea, sugar, etc., are unjust and unfair, because of their being indispensable to the consumption of the poor as well as the rich. The injury, however, which is done to the poor by moderate taxes on necessaries is more apparent than real; for, as will be afterward shown, wages are, in most cases, increased proportionally to the amount of such taxes. And it commonly, also, happens that the quantity of an article used previously to its being burdened with a moderate duty, may be diminished, or something else be substituted in its stead, or the duty be defrayed by the exercise of greater economy or industry, without entailing any very serious privations on the consumers.

Without, however, insisting on these considerations, we deny that taxes on necessaries can be fairly objected to on the ground of their being unjust. They may, if carried to too great a height, be oppressive, and they may sometimes, perhaps, be inexpedient; but the charge of injustice is not one that can ever be truly made against them. Government has nothing to do with the means of the parties who buy taxed articles. It has

done its duty when it has imposed equal and moderate taxes on the articles best suited to bear taxation. Providence has not been charged with injustice because the corn and other articles used indifferently by the poor and the rich cost the one class as much as they cost the other. And, such being the case, how can it be pretended that governments, in laying equal duties on these articles, commit injustice? A rich man will, of course, pay taxes, and everything else, with less inconvenience than one who is poor. But is that any reason why he should be unfairly treated? or mulcted of a part of his fortune, by being subjected to peculiarly high rates of taxation? Riches are an evidence of superior good conduct; for, in the vast majority of cases, they are the result either of their possessors having themselves been, or of their having succeeded to progenitors who were, comparatively enterprising, industrious, and frugal. The distinction of rich and poor is not artificial. It originates in, and is a consequence of, the differences in the character and economy of individuals. A government which should attempt to obliterate this ineradicable distinction by varying duties so as to increase their pressure on the more opulent classes would be guilty of flagrant injustice. And it would, by discouraging the exercise of those virtues which are most essential to the public welfare, do its best to sap the foundations and weaken the springs of national prosperity and civilization.

So long, therefore, as duties are imposed on proper objects, and not carried to too great a height, we have yet to learn on what grounds they can be fairly objected to. A revenue must be raised by one means or other; and we are sanguine enough to believe that it will be sufficiently demonstrated in the sequel that such portion of it as may be raised by consumption duties will be the least onerous.

And, elsewhere,[1] McCulloch turned his guns upon Say's arguments in favor of progressive taxation:

It has been contended by Say, and some other economists, that taxes on income should be imposed on a graduated scale, and made to increase according to the increase of the incomes subjected to their operation. And the countenance which has been so frequently and cordially given to proposals for the intro-

[1] Treatise on Taxation, 139–141 (second edition).

duction of property and income taxes by the more dangerous class of politicians has originated in their supposing that they might be made to embrace a plan of graduation. And, though in the last degree objectionable, it is not to be denied that there is something exceedingly plausible in this plan. A tax of £10 is said to be more severely felt by the possessor of an income of £100, or of a property of that amount, than a tax of £100, or £1000, by the possessor of an income or of a property of £1000 or £10,000; and it is argued that, in order fairly to proportion the tax to the ability of the contributors, such a graduated scale of duty should be adopted as should press lightly on the smaller class of properties and incomes, and increase according as they become larger and more able to bear taxation. We take leave, however, to protest against this proposal, which is not more seductive than it is unjust and dangerous. No tax on income can be a just tax unless it leaves individuals in the same relative condition in which it found them. It must of course depress, according to its magnitude, all those on whom it falls; and it should fall on every one in proportion to the revenue which he enjoys under the protection of the state.[1] If it either pass entirely over some classes, or press on some less heavily than on others, it is unjustly imposed. Government, in such a case, has plainly stepped out of its proper province, and has assessed the tax, not for the legitimate purpose of appropriating a certain proportion of the revenues of its subjects to the public exigencies, but that it might at the same time regulate the incomes of the contributors; that is, it might depress one class and elevate another. The toleration of such a principle would necessarily lead to every species of abuse. That equal taxes on property or income are more severely felt by the poorer than by the richer classes is undeniable. But the same is true of every payment which does not subvert the existing relations among the different orders of society. The hardship in question is, in truth, a consequence of the inequality of fortunes, and to attempt to alleviate it by adopting a graduated scale of duties would really be to impose taxes on the wealthier part of the community for the benefit of their less opulent brethren, and

[1] That is, of course, supposing all revenues reduced to the same denomination, or to perpetuities.

not for the sake of the public revenue. Let it not be supposed that the principle of graduation may be carried to a certain extent, and then stopped.

Nullus semel ore receptus
Pollutas patitur sanguis mansuescere fauces.

The reasons that made the step be taken in the first instance, backed as they are sure to be by agitation and clamor, will impel you forward. Having once given way, having said that a man with £500 a year shall pay 5 per cent, another with £1000 10 per cent, and another with £2000 20 per cent, on what pretense or principle can you stop in your ascending scale? Why not take 50 per cent from the man of £2000 a year, and confiscate all the higher class of incomes before you tax the lower? In such matters the maxim of *obsta principiis* should be firmly adhered to by every prudent and honest statesman. Graduation is not an evil to be paltered with. Adopt it and you will effectually paralyze industry and check accumulation; at the same time that every man who has any property will hasten, by carrying it out of the country, to protect it from confiscation. The savages described by Montesquieu, who to get at the fruit cut down the tree, are about as good financiers as the advocates of this sort of taxes. Wherever they are introduced, security is at an end. Even if taxes on income were otherwise the most unexceptionable, the adoption of the principle of graduation would make them about the very worst that could be devised. The moment you abandon, in the framing of such taxes, the cardinal principle of exacting from all individuals the same proportion of their income or of their property, you are at sea without rudder or compass, and there is no amount of injustice and folly you may not commit.

36. The Views of John Stuart Mill. — In his Principles of Political Economy[1] Mr. Mill considers at some length what constitutes equality in taxation:

For what reason ought equality to be the rule in matters of taxation? For the reason, that it ought to be so in all affairs of

[1] Bk. V, ch. 2, §§ 2–4.

government. As a government ought to make no distinction of persons or classes in the strength of their claims on it, whatever sacrifices it requires from them should be made to bear as nearly as possible with the same pressure upon all; which, it must be observed, is the mode by which least sacrifice is occasioned on the whole. If any one bears less than his fair share of the burthen, some other person must suffer more than his share, and the alleviation to the one is not, on the average, so great a good to him as the increased pressure upon the other is an evil. Equality of taxation, therefore, as a maxim of politics, means equality of sacrifice. It means apportioning the contribution of each person toward the expenses of government, so that he shall feel neither more nor less inconvenience from his share of the payment than every other person experiences from his. This standard, like other standards of perfection, cannot be completely realized; but the first object in every practical discussion should be to know what perfection is.

There are persons, however, who are not content with the general principles of justice as a basis to ground a rule of finance upon, but must have something, as they think, more specifically appropriate to the subject. What best pleases them is, to regard the taxes paid by each member of the community as an equivalent for value received, in the shape of service to himself; and they prefer to rest the justice of making each contribute in proportion to his means, upon the ground that he who has twice as much property to be protected, receives, on an accurate calculation, twice as much protection, and ought, on the principles of bargain and sale, to pay twice as much for it. Since, however, the assumption that government exists solely for the protection of property, is not one to be deliberately adhered to; some consistent adherents of the *quid pro quo* principle go on to observe, that protection being required for person as well as property, and everybody's person receiving the same amount of protection, a poll tax of a fixed sum per head is a proper equivalent for this part of the benefits of government; while the remaining part, protection to property, should be paid for in proportion to property. There is in this adjustment a false air of nice adaptation, very acceptable to some minds. But in the first place, it is not admissible that the protection of persons and that of prop-

erty are the sole purposes of government. The ends of government are as comprehensive as those of the social union. They consist of all the good, and all the immunity from evil, which the existence of government can be made either directly or indirectly to bestow. In the second place, the practice of setting definite values on things essentially indefinite, and making them a ground of practical conclusions, is peculiarly fertile in false views of social questions. It cannot be admitted, that to be protected in the ownership of ten times as much property is to be ten times as much protected. Neither can it be truly said that the protection of £1000 a year costs the state ten times as much as that of £100 a year, rather than twice as much, or exactly as much. The same judges, soldiers, sailors, who protect the one protect the other; and the larger income does not necessarily, though it may sometimes, require even more policemen. Whether the labor and expense of the protection, or the feelings of the protected person, or any other definite thing be made the standard, there is no such proportion as the one supposed, nor any other definable proportion. If we wanted to estimate the degrees of benefit which different persons derive from the protection of government, we should have to consider who would suffer most if that protection were withdrawn: to which question if any answer could be made, it must be, that those would suffer most who were weakest in mind or body, either by nature or by position. Indeed, such persons would almost infallibly be slaves. If there were any justice, therefore, in the theory of justice now under consideration, those who are least capable of helping or defending themselves, being those to whom the protection of government is the most indispensable, ought to pay the greatest share of its price: the reverse of the true idea of distributive justice, which consists not in imitating but in redressing the inequalities and wrongs of nature.

Government must be regarded as so preëminently a concern of all, that to determine who are most interested in it is of no real importance. If a person or class of persons receive so small a share of the benefit as makes it necessary to raise the question, there is something else than taxation which is amiss, and the thing to be done is to remedy the defect, instead of recognizing it and making it a ground for demanding less taxes.

As, in a case of voluntary subscription for a purpose in which all are interested, all are thought to have done their part fairly when each has contributed according to his means, that is, has made an equal sacrifice for the common object; in like manner should this be the principle of compulsory contributions: and it is superfluous to look for a more ingenious or recondite ground to rest the principle upon.

Setting out, then, from the maxim that equal sacrifices ought to be demanded from all, we have next to inquire whether this is in fact done, by making each contribute the same percentage on his pecuniary means. Many persons maintain the negative, saying that a tenth part taken from a small income is a heavier burthen than the same fraction deducted from one much larger: and on this is grounded the very popular scheme of what is called a graduated property tax, *viz.* an income tax in which the percentage rises with the amount of the income.

On the best consideration I am able to give to this question, it appears to me that the portion of truth which the doctrine contains arises principally from the difference between a tax which can be saved from luxuries, and one which trenches, in ever so small a degree, upon the necessaries of life. To take a thousand a year from the possessor of ten thousand, would not deprive him of anything really conducive either to the support or to the comfort of existence; and if such *would* be the effect of taking £5 from one whose income is £50, the sacrifice required from the last is not only greater than, but entirely incommensurable with, that imposed upon the first. The mode of adjusting these inequalities of pressure which seems to be the most equitable, is that recommended by Bentham, of leaving a certain minimum of income, sufficient to provide the necessaries of life, untaxed. Suppose £50 a year to be sufficient to provide the number of persons ordinarily supported from a single income, with the requisites of life and health, and with protection against habitual bodily suffering, but not with any indulgence. This then should be made the minimum, and incomes exceeding it should pay taxes not upon their whole amount, but upon the surplus. If the tax be 10 per cent, an income of £60 should be considered as a net income of £10, and charged with £1 a year, while an income of £1000 should be charged as one

of £950. Each would then pay a fixed proportion, not of his whole means, but of his superfluities. An income not exceeding £50 should not be taxed at all, either directly or by taxes on necessaries; for as by supposition this is the smallest income which labor ought to be able to command, the government ought not to be a party to making it smaller. This arrangement, however, would constitute a reason, in addition to others which might be stated, for maintaining taxes on articles of luxury consumed by the poor. The immunity extended to the income required for necessaries, should depend on its being actually expended for that purpose; and the poor who, not having more than enough for necessaries, divert any part of it to indulgences, should like other people contribute their quota out of those indulgences to the expenses of the state.

The exemption in favor of the smaller incomes should not, I think, be stretched further than to the amount of income needful for life, health, and immunity from bodily pain. If £50 a year is sufficient (which may be doubted) for these purposes, an income of £100 a year would, as it seems to me, obtain all the relief it is entitled to, compared with one of £1000, by being taxed only on £50 of its amount. It may be said, indeed, that to take £100 from £1000 (even giving back five pounds) is a heavier impost than £1000 taken from £10,000 (giving back the same five pounds). But this doctrine seems to me too disputable altogether, and even if true at all, not true to a sufficient extent, to be made the foundation of any rule of taxation. Whether the person with £10,000 a year cares less for £1000 than the person with only £1000 a year cares for £100, and if so, how much less, does not appear to me capable of being decided with the degree of certainty on which a legislator or a financier ought to act.

Some indeed contend that the rule of proportional taxation bears harder upon the moderate than upon the large incomes, because the same proportional payment has more tendency in the former case than in the latter to reduce the payer to a lower grade of social rank. The fact appears to me more than questionable. But even admitting it, I object to its being considered incumbent on government to shape its course by such considerations, or to recognize the notion that social importance is or

can be determined by amount of expenditure. Government ought to set an example of rating all things at their true value, and riches, therefore, at the worth, for comfort or pleasure, of the things which they will buy: and ought not to sanction the vulgarity of prizing them for the pitiful vanity of being known to possess them, or the paltry shame of being suspected to be without them, the presiding motives of three fourths of the expenditure of the middle classes. The sacrifices of real comfort or indulgence which government requires, it is bound to apportion among all persons with as much equality as possible; but their sacrifices of the imaginary dignity, dependent on expense, it may spare itself the trouble of estimating.

Both in England and on the Continent a graduated property tax has been advocated, on the avowed ground that the state should use the instrument of taxation as a means of mitigating the inequalities of wealth. I am as desirous as any one, that means should be taken to diminish those inequalities, but not so as to relieve the prodigal at the expense of the prudent. To tax the larger incomes at a higher percentage than the smaller, is to lay a tax on industry and economy; to impose a penalty on people for having worked harder and saved more than their neighbors. It is not the fortunes which are earned, but those which are unearned, that it is for the public good to place under limitation. A just and wise legislation would abstain from holding out motives for dissipating rather than saving the earnings of honest exertion. Its impartiality between competitors would consist in endeavoring that they should all start fair, and not in hanging a weight upon the swift to diminish the distance between them and the slow. Many, indeed, fail with greater efforts than those with which others succeed, not from difference of merits, but difference of opportunities; but if all were done which it would be in the power of a good government to do, by instruction and by legislation, to diminish this inequality of opportunities, the differences of fortune arising from people's own earnings could not justly give umbrage. With respect to the large fortunes acquired by gift or inheritance, the power of bequeathing is one of those privileges of property which are fit subjects for regulation on grounds of general expediency; and I have already suggested, as a possible mode of restraining the accumulation of large

fortunes in the hands of those who have not earned them by exertion, a limitation of the amount which any one person should be permitted to acquire by gift, bequest, or inheritance. Apart from this, and from the proposal of Bentham (also discussed in a former chapter) that collateral inheritance in case of intestacy should cease, and the property escheat to the state, I conceive that inheritances and legacies, exceeding a certain amount, are highly proper subjects for taxation: and that the revenue from them should be as great as it can be made without giving rise to evasions, by donation during life or concealment of property, such as it would be impossible adequately to check. The principle of graduation (as it is called,) that is, of levying a larger percentage on a larger sum, though its application to general taxation would be in my opinion objectionable, seems to me both just and expedient as applied to legacy and inheritance duties.

The objection to a graduated property tax applies in an aggravated degree to the proposition of an exclusive tax on what is called "realized property," that is, property not forming a part of any capital engaged in business, or rather in business under the superintendence of the owner: as land, the public funds, money lent on mortgage, and shares (I presume) in joint-stock companies. Except the proposal of applying a sponge to the national debt, no such palpable violation of common honesty has found sufficient support in this country, during the present generation, to be regarded as within the domain of discussion. It has not the palliation of a graduated property tax, that of laying the burthen on those best able to bear it; for "realized property" includes the far larger portion of the provision made for those who are unable to work, and consists, in great part, of extremely small fractions. I can hardly conceive a more shameless pretension than that the major part of the property of the country, that of merchants, manufacturers, farmers, and shopkeepers, should be exempted from its share of taxation; that these classes should only begin to pay their proportion after retiring from business, and if they never retire, should be excused from it altogether. But even this does not give an adequate idea of the injustice of the proposition. The burthen thus exclusively thrown on the owners of the smaller portion of the wealth of the community, would not even be a burthen on that *class* of persons

in perpetual succession, but would fall exclusively on those who happened to compose it when the tax was laid on. As land and those particular securities would thenceforth yield a smaller net income, relatively to the general interest of capital and to the profits of trade, the balance would rectify itself by a permanent depreciation of those kinds of property. Future buyers would acquire land and securities at a reduction of price, equivalent to the peculiar tax, which tax they would, therefore, escape from paying; while the original possessors would remain burthened with it even after parting with the property, since they would have sold their land or securities at a loss of value equivalent to the fee simple of the tax. Its imposition would thus be tantamount to the confiscation for public uses of a percentage of their property, equal to the percentage laid on their income by the tax. That such a proposition should find any favor is a striking instance of the want of conscience in matters of taxation, resulting from the absence of any fixed principles in the public mind, and of any indication of a sense of justice on the subject in the general conduct of governments. Should the scheme ever enlist a large party in its support, the fact would indicate a laxity of pecuniary integrity in national affairs, scarcely inferior to American repudiation.

Whether the profits of trade may not rightfully be taxed at a lower rate than incomes derived from interest or rent, is part of the more comprehensive question, so often mooted on the occasion of the present income tax, whether life incomes should be subjected to the same rate of taxation as perpetual incomes; whether salaries, for example, or annuities, or the gains of professions, should pay the same percentage as the income from inheritable property.

The existing tax treats all kinds of incomes exactly alike, taking its sevenpence (now sixpence) in the pound as well from the person whose income dies with him, as from the landholder, stockholder, or mortgagee, who can transmit his fortune undiminished to his descendants. This is a visible injustice; yet it does not arithmetically violate the rule that taxation ought to be in proportion to means. When it is said that a temporary income ought to be taxed less than a permanent one, the reply is irresistible, that it is taxed less; for the income which lasts only

ten years pays the tax only ten years, while that which lasts forever pays forever. On this point some financial reformers are guilty of a great fallacy. They contend that incomes ought to be assessed to the income tax not in proportion to their annual amount, but to their capitalized value: that, for example, if the value of a perpetual annuity of £100 is £3000, and a life annuity of the same amount being worth only half the number of years' purchase could only be sold for £1500, the perpetual income should pay twice as much per cent income tax as the terminable income; if the one pays £10 a year, the other should pay only £5. But in this argument there is the obvious oversight, that it values the incomes by one standard and the payments by another; it capitalizes the incomes, but forgets to capitalize the payments. An annuity worth £3000 ought, it is alleged, to be taxed twice as highly as one which is only worth £1500, and no assertion can be more unquestionable; but it is forgotten that the income worth £3000 pays to the supposed income tax £10 a year in perpetuity, which is equivalent, by supposition, to £300, while the terminable income pays the same £10 only during the life of its owner, which on the same calculation is a value of £150, and could actually be bought for that sum. Already, therefore, the income which is only half as valuable, pays only half as much to the tax; and if in addition to this its annual quota were reduced from £10 to £5, it would pay, not half, but a fourth part only of the payment demanded from the perpetual income. To make it just that the one income should pay only half as much per annum as the other, it would be necessary that it should pay that half for the same period, that is, in perpetuity.

The rule of payment which this school of financial reformers contend for, would be very proper if the tax were only to be levied once, to meet some national emergency. On the principle of requiring from all payers an equal sacrifice, every person who had anything belonging to him, reversioners included, would be called on for a payment proportioned to the present value of his property. I wonder it does not occur to the reformers in question, that precisely because this principle of assessment would be just in the case of a payment made once for all, it cannot possibly be just for a permanent tax.

When each pays only once, one person pays no oftener than another; and the proportion which would be just in that case, cannot also be just if one person has to make the payment only once, and the other several times. This, however, is the type of the case which actually occurs. The permanent incomes pay the tax as much oftener than the temporary ones, as a perpetuity exceeds the certain or uncertain length of time which forms the duration of the income for life or years.

All attempts to establish a claim in favor of terminable incomes on numerical grounds — to make out, in short, that a proportional tax is not a proportional tax — are manifestly absurd. The claim does not rest on grounds of arithmetic, but of human wants and feelings. It is not because the temporary annuitant has smaller means, but because he has greater necessities, that he ought to be assessed at a lower rate.

In spite of the nominal equality of income, A, an annuitant of £1000 a year, cannot so well afford to pay £100 out of it, as B, who derives the same annual sum from heritable property, A having usually a demand on his income which B has not, namely, to provide by saving for children or others, to which, in the case of salaries or professional gains, must generally be added a provision for his own later years; while B may expend his whole income without injury to his old age, and still have it all to bestow on others after his death. If A, in order to meet these exigencies, must lay by £300 of his income, to take £100 from him as income tax is to take £100 from £700, since it must be retrenched from that part only of his means which he can afford to spend on his own consumption. Were he to throw it ratably on what he spends and on what he saves, abating £70 from his consumption and £30 from his annual saving, then indeed his immediate sacrifice would be proportionally the same as B's: but then his children or his old age would be worse provided for in consequence of the tax. The capital sum which would be accumulated for them would be one tenth less, and on the reduced income afforded by this reduced capital, they would be a second time charged with income tax; while B's heirs would only be charged once.

The principle, therefore, of equality of taxation, interpreted in its only just sense, equality of sacrifice, requires that a person

who has no means of providing for old age, or for those in whom he is interested, except by saving from income, should have the tax remitted on all that part of his income which is really and *bonâ fide* applied to that purpose.

If, indeed, reliance could be placed on the conscience of the contributors, or sufficient security taken for the correctness of their statements by collateral precautions, the proper mode of assessing an income tax would be to tax only the part of income devoted to expenditure, exempting that which is saved. For when saved and invested (and all savings, speaking generally, are invested), it thenceforth pays income tax on the interest or profit which it brings, notwithstanding that it has already been taxed on the principal. Unless, therefore, savings are exempted from income tax, the contributors are twice taxed on what they save, and only once on what they spend. A person who spends all he receives pays *7d.* in the pound, or say 3 per cent, to the tax, and no more; but if he saves part of the year's income and buys stock, then in addition to the 3 per cent which he has paid on the principal, and which diminishes the interest in the same ratio, he pays 3 per cent annually on the interest itself, which is equivalent to an immediate payment of a second 3 per cent on the principal. So that while unproductive expenditure pays only 3 per cent, savings pay 6 per cent; or more correctly, 3 per cent on the whole, and another 3 per cent on the remaining 97. The difference thus created to the disadvantage of prudence and economy, is not only impolitic but unjust. To tax the sum invested, and afterward tax also the proceeds of the investment, is to tax the same portion of the contributor's means twice over. The principal and the interest cannot both together form part of his resources; they are the same portion twice counted: if he has the interest, it is because he abstains from using the principal; if he spends the principal, he does not receive the interest. Yet because he can do either of the two, he is taxed as if he could do both, and could have the benefit of the saving and that of the spending, concurrently with one another.

It has been urged as an objection to exempting savings from taxation, that the law ought not to disturb, by artificial interference, the natural competition between the motives for saving

and those for spending. But we have seen that the law disturbs this natural competition when it taxes savings, not when it spares them; for as the savings pay at any rate the full tax as soon as they are invested, their exemption from payment in the earlier stage is necessary to prevent them from paying twice, while money spent in unproductive consumption pays only once. It has been further objected, that since the rich have the greatest means of saving, any privilege given to savings is an advantage bestowed on the rich at the expense of the poor. I answer, that it is bestowed on them only in proportion as they abdicate the personal use of their riches; in proportion as they divert their income from the supply of their own wants, to a productive investment, through which, instead of being consumed by themselves, it is distributed in wages among the poor. If this be favoring the rich, I should like to have it pointed out, what mode of assessing taxation can deserve the name of favoring the poor.

No income tax is really just, from which savings are not exempted; and no income tax ought to be voted without that provision, if the form of the returns, and the nature of the evidence required, could be so arranged as to prevent the exemption from being taken fraudulent advantage of, by saving with one hand and getting into debt with the other, or by spending in the following year what had been passed tax free as saving in the year preceding. If this difficulty could be surmounted, the difficulties and complexities arising from the comparative claims of temporary and permanent incomes, would disappear; for since temporary incomes have no just claim to lighter taxation than permanent incomes, except in so far as their possessors are more called upon to save, the exemption of what they do save would fully satisfy the claim. But if no plan can be devised for the exemption of actual savings, sufficiently free from liability to fraud, it is necessary, as the next thing in point of justice, to take into account in assessing the tax, what the different classes of contributors *ought* to save. And there would probably be no other mode of doing this than the rough expedient of two different rates of assessment. There would be great difficulty in taking into account differences of duration between one terminable income and another; and in the most

frequent case, that of incomes dependent on life, differences of age and health would constitute such extreme diversity as it would be impossible to take proper cognizance of. It would probably be necessary to be content with one uniform rate for all incomes of inheritance, and another uniform rate for all those which necessarily terminate with the life of the individual. In fixing the proportion between the two rates, there must inevitably be something arbitrary; perhaps a deduction of one fourth in favor of life incomes would be as little objectionable as any which could be made, it being thus assumed that one fourth of a life income is, on the average of all ages and states of health, a suitable proportion to be laid by as a provision for successors and for old age.

Of the net profits of persons in business, a part, as before observed, may be considered as interest on capital, and of a perpetual character, and the remaining part as remuneration for the skill and labor of superintendence. The surplus beyond interest depends on the life of the individual, and even on his continuance in business, and is entitled to the full amount of exemption allowed to terminable incomes. It has also, I conceive, a just claim to a further amount of exemption in consideration of its precariousness. An income which some not unusual vicissitude may reduce to nothing, or even convert into a loss, is not the same thing to the feelings of the possessor as a permanent income of £1000 a year, even though on an average of years it may yield £1000 a year. If life incomes were assessed at three fourths of their amount, the profits of business, after deducting interest on capital, should not only be assessed at three fourths, but should pay, on that assessment, a lower rate. Or perhaps the claims of justice in this respect might be sufficiently met by allowing the deduction of a fourth on the entire income, interest included.

These are the chief cases, of ordinary occurrence, in which any difficulty arises in interpreting the maxim of equality of taxation. The proper sense to be put upon it, as we have seen in the preceding example, is, that people should be taxed, not in proportion to what they have, but to what they can afford to spend. It is no objection to this principle that we cannot apply it consistently to all cases. A person with a life income and

precarious health, or who has many persons depending on his exertions, must, if he wishes to provide for them after his death, be more rigidly economical than one who has a life income of equal amount, with a strong constitution, and few claims upon him; and if it be conceded that taxation cannot accommodate itself to these distinctions, it is argued that there is no use in attending to any distinctions, where the absolute amount of income is the same. But the difficulty of doing perfect justice, is no reason against doing as much as we can. Though it may be a hardship to an annuitant whose life is only worth five years' purchase, to be allowed no greater abatement than is granted to one whose life is worth twenty, it is better for him even so, than if neither of them were allowed any abatement at all.

37. Wagner's Socio-political Theory of Taxation. — A radically different point of departure is represented by the eminent German economist, Adolph Wagner, who distinguishes between the purely fiscal and the socio-political theories of justice in taxation. In earlier times, Wagner says, financial problems were treated from the purely fiscal point of view, that is, with a view solely to raising a sufficient revenue to meet the needs of the government. But the modern view, he says,[1] is, or should be, different:

The modern science of economics not only recognizes the mutual dependence of public and private economic activity, and their mutually complementary character; it also renounces the optimistic view of the present organization of private industry, and recognizes the great evils in the system of free competition. It has come to know that the organization of productive industry by private initiative, the existing institution of property — especially in land and productive capital, and the distribution of wealth which takes place upon this basis, have a decisive social influence. It knows that through this process the power and relations both of individuals and of classes are determined in modern economic society. At the same time our science recognizes the influence which the state exercises directly or indirectly

[1] Finanzwissenschaft, Vol. I, § 27.

upon the distribution of wealth and position of social classes, by the form which its activity takes, by the manner in which it spends its revenues, by the kinds of taxation it adopts, and by the creation of public debts.

From this knowledge our science has developed two demands. In the first place, the state should so order its expenditures, tax system, and loans as to remove certain economic and social evils which have attended them in the past. And in the second place, the state, by adopting appropriate policies, should remedy evils which are not due to its previous action in financial or other matters. From this second demand it follows that, in the domain of public finance, expenditures should increase in order to enable the state to assume new functions; and that taxation, in addition to serving the purely financial purpose of providing sufficient revenue, should be employed for the purpose of bringing about a different distribution of wealth from that which would result from the working of free competition upon the basis of the present social order. It is the modern "social problem," influencing both scientific and public affairs, which is here beginning to work this transformation in the science of finance.

Later on Professor Wagner discusses, from his "socio-political" point of view, the question of justice in taxation. He says that one's views on this subject will depend upon what one thinks of that distribution of wealth which free competition would bring about upon the basis of the existing economic order. Thus he continues:[1]

One who considers the present economic order unconditionally just, and the only justifiable order, as the liberal school of the Physiocrats and Smith did, must logically consider the existing distribution of wealth, which results from this order, as the only righteous and just distribution. This conclusion the keener thinkers of the school have drawn and definitely formulated. For a person of this opinion the existing distribution of wealth is, therefore, a fact admitting of no further discussion and to be accepted with all of its consequences. One of these consequences

[1] Finanzwissenschaft, Vol. II, § 159.

is that the expenditure of the same amount of money presses with unequal severity upon persons with different incomes and in different economic circumstances; or, conversely, that the ability of these persons to bear the same expenditure varies according to the conditions just mentioned. It follows, then, that taxation should not alter the existing distribution, which is considered to be just. In this view of the case, therefore, taxation will be confined strictly to the purpose of raising sufficient revenue; and the socio-political theory of taxation, which has already been stated, will be rejected.

The consequences of this view, so far as the concept of justice and the demand for universality and equality in taxation are concerned, is briefly as follows:

1. The duty of all to pay taxes (universality) is interpreted literally. Every citizen is required, as a matter of principle, to pay taxes, whether his income is small or large, whether it is derived from invested property or from personal exertions. There should be no exemption of the "minimum of subsistence."

2. Equality in taxation is believed to be proportionality of taxes to income; that is, every one should pay in taxes the same proportion of his income. The result is proportional taxation, or levying the same per cent upon all incomes, and the rejection of progressive taxation of the larger incomes, as well as the equal taxation of funded and unfunded incomes. . . .

The theory thus briefly, but sufficiently, sketched may be called the purely financial or fiscal theory of taxation, in order to distinguish it from the theory now to be presented. The correctness of the conclusion concerning universality and justice of taxation is not to be questioned if the premise is conceded to be true. This premise is the justice of the distribution of wealth brought about by free competition. The conclusion stands or falls with the premise.

Again referring to my earlier discussion of competition in my Grundlegung,[1] discussion which cannot be repeated here, it is to be said that the premise cannot be admitted to be true, — at least in the universal application given it by the liberal school of economics. . . . Therefore the conclusion that the distribution established by competition is not to be disturbed by taxa-

[1] Grundlegung der politischen Oekonomie, especially Bk. V, ch. 2. — ED.

tion, is not universally true. We need, rather, beside the purely financial theory of taxation, to establish a second, — the socio-political, by which a tax becomes something more than a means of raising revenue, and is considered a means of correcting that distribution of wealth which results from competition. This is to be brought about particularly by discriminating as sharply as possible between "earned" incomes and incomes resulting from chance or speculative gains. . . . And then, with the incomes drawn from ordinary industry, we must distinguish more sharply between income derived from labor and income derived from property; and we must consider that the larger gains, and the accumulation of property which they render possible, usually result more or less from good fortune as well as from the personal contributions of the recipients. Furthermore, only from the socio-political standpoint can due consideration be given to the undeniable fact that the larger incomes represent greater ability to pay taxes than the smaller incomes represent, and that income from property indicates greater ability than income from labor. And, finally, from this standpoint, can be justified the policy of favoring classes of persons with small and precarious incomes or incomes derived wholly from labor, by means of certain exemptions from taxation. Such exemptions necessarily lead to higher taxation of the wealthier classes, but they are, from this standpoint, quite as justifiable as the institutions already maintained, at public expense, for the benefit of the poorer classes, such as schools.

So far as concerns the postulates of universality and equality in taxation, the results of the socio-political theory are as follows:

1. Universality is not interpreted literally, even for those who are members of the state. It permits the exemption of persons with small incomes, especially incomes derived from labor, from taxation in general or from the operation of certain taxes. This is the social demand for the exemption of a minimum of subsistence.

2. Equality is, in this theory, considered to mean taxation as far as possible in proportion to ability to contribute, which increases more rapidly than the absolute amount of a person's income or property increases. Therefore the socio-political

theory demands progressive taxation of larger incomes and the rejection of mere proportional taxation. Furthermore it demands heavier taxation of funded incomes than of incomes derived from labor. . . . And, in strictness, only upon this socio-political theory can the taxation of inheritances find adequate justification. For, according to it, the rights of property and inheritance are not mere matters of course and wholly independent of the action of the state, as the liberal school believes them to be. These things are, on the contrary, a product of the legal activity of the state.

38. Professor Seligman's Criticism of Wagner's Theories. — The socio-political theory of taxation is vigorously criticised by Professor Seligman in his work on Progressive Taxation:[1]

The foremost scientific advocate of the socialistic theory of progression is the German economist, Adolph Wagner. Wagner distinguishes between the purely fiscal period in the history of public finance, and the socio-political period. The essence of the first period consists in the simple endeavor on the part of the government to raise a revenue adequate to its needs. The essence of the second period consists in the predominance of social reasons over purely fiscal reasons. The state is no longer satisfied merely with raising an adequate revenue, but now considers it a duty to interfere with the rights of private property in order to bring about a more equitable distribution of wealth. The fiscal policy looks merely to the needs of the administration; the socio-political policy looks at the relations of social classes to each other, and the best methods of satisfactorily adjusting these relations. The fiscal policy necessarily results in proportional taxation; the socio-political policy results in progressive taxation. The ethical demands of modern civilization are everywhere preparing the way for a transition from the old fiscal period to the incipient socio-political period. It is these ethical or social reasons alone which can logically serve as a basis for progressive taxation.

[1] Progressive Taxation in Theory and Practice, 66–70. In Publications of the American Economic Association, IX (1894). Reprinted by consent of the author and the Association.

This distinction of Wagner is, however, entirely baseless. It is not true historically that the tax policy of various nations has been adjusted solely with reference to purely fiscal reasons. All governments have allowed social considerations in the wider sense to influence their revenue policy. The whole system of protective duties has been framed not merely with reference to revenue considerations, but in order to produce results which should directly affect social and national prosperity. Taxes on luxuries have often been mere sumptuary laws designed as much to check consumption as to yield revenue. Excise taxes have frequently been levied from a wide social, as well as from a narrow fiscal, standpoint. From the very beginning of all tax systems these social reasons have often been present. The attempt to sharply distinguish such periods historically is, therefore, unsuccessful.

But, on the other hand, it is not allowable to confound this undoubtedly social element in all fiscal policy with what Wagner calls the socio-political, or what may be called more correctly the socialistic, element. From the principle that the state may modify its strict fiscal policy by considerations of general national utility to the principle that it is the duty of the state to redress all inequalities of fortune among its private citizens is a long and dangerous step. It would land us not only in socialism, but practically in communism. If this were one of the acknowledged functions of government, it would be useless to construct any science of finance. There would be only one simple principle: confiscate the property of the rich and give it to the poor.

The difference between the social element and Wagner's socio-political idea is the difference between social reform and socialism. We may indeed deprecate the existing conditions which affect the distribution of wealth. But where so much is spoken of just and unjust arrangements, it is necessary to come to an understanding exactly what justice means. Justice, in so far as the action of the state is concerned, consists in holding the balance equal; in giving none an undue advantage; in affording each individual equal rights before the law and equal opportunities to develop his own talents and resources. Justice indeed demands that the state should do nothing consciously and purposely to increase inequality of wealth; but it cannot demand

that the state should do away with inequality of wealth. Justice in the sense of equality may demand great changes in the existing forms of taxation; but that is a question by itself. It involves the problem of the equal treatment of all, as over against historic inequality and its survivals in the tax systems of the world to-day. In that sense indeed there is room and need for social reform; but it is a reform which consists in checking the continuance of old unequal laws, not in fostering the growth of new unequal laws. Legal justice means legal equality; but a legal equality which would attempt to force an equality of fortune in the face of inevitable inequalities of native ability would be a travesty of justice.

We may indeed grant the crying need for social reform. But in so far as the government is concerned the possibility of social reform lies rather in the general attitude of the legislator in social and industrial matters. And even in so far as finance is concerned, the chief social reforms are in the domain of outlay and expenditure rather than in that of revenue. The desirable social reforms consist in extending the benefits of governmental activity to the poor and needy, and in enabling even the lowest classes to participate, as far as possible, in the advantages of progressive civilization. Even here it is a question how far it is desirable to go; and the answer depends not alone on fiscal reasons, but also on wider considerations of general governmental policy. But at all events, the so-called socio-political theory is untenable in so far as it implies a conscious effort on the part of the state to levy higher taxes on the rich in order to reduce them to the level of the poor.

39. Professor Seligman's Views concerning Progressive Taxation. — Rejecting *in toto*, therefore, the theories of Wagner, Professor Seligman, after an exhaustive examination of the literature on the subject, presents his own views as follows:[1]

We have thus far learned the chief arguments urged for and against progressive taxation. We have seen the inadequacy of the socialistic and compensatory theories in favor of, and the weakness of the benefit theory in opposition to, the doctrine of

[1] Progressive Taxation, 190–200.

progression. And we have analyzed more closely the equal-sacrifice doctrine, and found that it is unable to serve as the basis of a definite and infallible scale of progression. Are we, then, to abandon progressive taxation in theory? It seems to me not, and for a convincing reason. We must revert to the fundamental conception of faculty or ability, which is, after all, the best standard we have of the measure of general obligation to pay taxes. What does the faculty theory in its wisest interpretation teach us in the matter?

President Walker's definition of faculty is well known.[1] Faculty, says he, is "the native or acquired power of production." But if we analyze faculty more closely, in the sense in which we instinctively use the word in tax matters, we see that it means something more than that. It not only implies native or acquired power of production, but includes at least also the opportunity of putting these powers to use, the manner in which the powers are actually employed, and the results of their use as measured by periodical or permanent accretion to the producer's possessions. We have seen how the original idea was that represented by President Walker, but how this was soon supplanted by the more real and practicable tests, first of property (or permanent accretion), then of income (or periodical accretion). But, furthermore, faculty connotes an additional conception. It means not only powers of production or results of powers of production, but also the capacity to make use of these powers or these results — the capacity, in other words, of enjoying the results of the exertions. It is this latter conception which has been developed by recent writers, although they have carried it to an extreme just as one-sided as that represented by the advocates of the earlier theories. The elements of faculty, then, are twofold — those connected with acquisition or production, and those connected with outlay or consumption. What is the application to the matter in hand?

If we regard only the first set of elements, it is evident that the possession of large fortunes or large incomes in itself affords the possessor a decided advantage in augmenting his possessions. The facility of increasing production often grows in

[1] F. A. Walker, The Bases of Taxation. *Political Science Quarterly*, III. (1888), p. 14.

more than arithmetical proportion. A rich man may be said to be subject in some sense to the law of increasing returns. The more he has, the easier it is for him to acquire still more. The initial disadvantages have been overcome. This was pointed out already by Adam Smith, when he said: "A great stock, though with small profits, generally increases faster than a small stock with great profits. Money, says the proverb, makes money. When you have got a little, it is often easy to get more. The great difficulty is to get that little."[1] While the native power of production remains as before, this "acquired power" has greatly augmented. Hence, from this point of view, faculty may be said to increase faster than fortune or income. And this element of taxable capacity would not illogically result in a more than proportional rate of taxation.

On the other hand, the elements of faculty which are connected with outlay or consumption, bring us right back again to the sacrifice theory. While the idea of faculty includes that of sacrifice, the two ideas are not coextensive. Faculty is the larger, sacrifice the smaller, conception. Faculty includes two sets of considerations, sacrifice only one. Now, while the sacrifice theory in itself, as we have seen, is not sufficient to make us demand any fixed scale of progression, its influence in the other direction is certainly not strong enough to countervail the productive elements of faculty, which seem to imply progressive taxation. In fact, we may go further and say that the sacrifice theory, or consumption element in faculty, can certainly not be used as an argument necessarily leading to proportional taxation. It does not lead necessarily to any definite scale of progression; much less can it lead necessarily to a fixed proportional taxation. But if we never can reach an ideal, there is no good reason why we should not strive to get as close to it as possible. Equality of sacrifice, indeed, we can never attain absolutely or exactly, because of the diversity of individual wants and desires; but it is nevertheless most probable that in the majority of normal and typical cases, we shall be getting closer to the desired equality by some departure from proportional taxation. In certain individual cases even regressive taxation might accomplish the result best, in other individual

[1] Wealth of Nations, Bk. I, ch. 9.

cases proportional taxation would be the most serviceable. But if we take a general view, and treat of the average man — and the state can deal only with classes, that is, with average men — it seems probable that on the whole less injustice will be done by adopting some form of progression than by accepting the universal rule of proportion. A strictly proportional rate will make no allowance for the exemption of the minimum of subsistence. It will be a heavier burden on the typical average poor man than on the typical average rich man. It will be apt to be relatively more severely felt by the average man who has only a small surplus above socially necessary expenses, than by the average man who has a proportionally larger surplus. It will, in short, be apt in normal cases to disproportionately curtail the enjoyments of different social classes.

Hence, if we base our doctrine of the equities of taxation on the theory of faculty, both the production and the consumption sides of the theory seem to point to progressive taxation as at all events neither more illogical nor more unjust than proportional taxation. It may, indeed, frankly be conceded that the theory of faculty cannot point out any definite rate of progression as the ideally just rate. In so far there seems to be some truth in Mill's contention that progressive taxation cannot give that "degree of certainty" on which a legislator should act; as well as in McCulloch's assertion that when we abandon proportion we "are at sea without rudder or compass." It is true that proportion is in one sense certain, and progression is uncertain. But their argument proves too much. An uncertain rate, if it be in the general direction of justice, may nevertheless be preferable to a rate which, like that of proportion, may be more certain without being so equitable. Half a loaf is better than no bread. Stability is assuredly a good thing. But it is highly questionable whether a stability which is necessarily unjust is preferable to an instability that works in the general direction of what is recognized as justice. All governmental actions which have to do with money relations of classes are necessarily more or less arbitrary. The fines imposed by the courts, the fixing of the rates of import duties or excise taxes are always, to a certain extent, inexact. And in truth, a strict proportional tax, if we accept the point of view mentioned above, is really

more arbitrary as over against the individual taxpayers, than a moderately progressive tax. The ostensible "certainty" involves a really greater arbitrariness.

So, also, the other arguments often advanced against progression seem to be in some measure destitute of foundation.[1] The common objection that progression is confiscation because it must finally end by swallowing up the whole capital may be completely obviated, as we have seen, by making the rate of progression itself degressive,[2] so that it would become impossible to reach one hundred per cent or any like percentage of large fortunes.

The objection that it is a fine put on industry and saving is really not applicable to progressive taxation as such, but rather to the whole system of taxation on property or income. The logical conclusion from this would be the demand for taxation only on expense; and even that would be to a certain extent a tax on industry. But it is hard to see why industry and saving should not be taxed, if it increases our capacity to pay taxes; and it is still harder to see how we can avoid taxing industry. Furthermore, it is a mistake to assume that larger fortunes are always the result of individual saving. The argument, in short, is not an argument against progression, but against taxation in general. If a moderately progressive tax is really more equitable than a strictly proportional tax, progression will be less of a fine on thrift and industry than proportion would be.

Finally, the argument that progressive taxes are not productive of revenue is not of great weight. The contention has never been urged that progressive taxes yield less than proportional taxes, but simply that they do not yield more. Now, as it has already been pointed out in a previous chapter, the function of progressive taxation is not so much to obtain increased revenues as to apportion the burden more equally among the taxpayers. If it is conceded that the progressive tax is more equitable than the proportional tax, it is utterly immaterial whether it yields more revenue or not.

[1] The objections commonly urged are well summed up in Bastable, Public Finance, 308–313 (third edition).

[2] A degressive rate is one which increases up to a certain point, and thereafter remains constant. — Ed.

It is possible, therefore, to draw only this very vague conclusion as to the general legitimacy of the principle of progressive taxation. The practical application of the principle depends on a series of important considerations.

In the first place we are confronted by the question of incidence. If the theory of general diffusion of taxation be true, then it makes no difference whether we levy a proportional or progressive tax. For, since the tax would ultimately be shifted to the consumer, the taxpayer would not be injured, while the consumer would bear the tax only in proportion to what he consumed. It is a singular fact that this illogical procedure of the advocates of the diffusion theory has always been overlooked. For the most heated opponents of progressive taxation have been, like Thiers, advocates of the diffusion theory of taxation without perceiving the absurdity of their position. The diffusion theory of taxation, however, we know to be entirely unsound.[1] Nevertheless, in so far as taxes really are shifted at all from the taxpayer, the problem of progression loses its importance. For if taxes are actually shifted, the rate in the first instance is of no essential consequence. It is only in so far as we assume that so-called direct taxes remain where they are put, that the considerations of faculty or ability are of any weight. How far this assumption is true has been investigated in another place. For the purpose of the theoretical discussion it may be taken for granted that the problem of progression *versus* proportion must be treated on the hypothesis that the assumption is true. But when we come to construct a progressive rate in practice, we must be careful to ascertain how far the assumption conforms to reality. A progressive rate of taxation which does not reach individual faculty at all is as unnecessary as it is illogical.

Secondly, the defense of progression rests on the theory that it is applicable to general taxation, taken as a whole. It rests on the assumption that taxes are paid out of revenue, and that the whole system is framed with this end in view. But it is

[1] See my monograph on The Shifting and Incidence of Taxation, Publications of the American Economic Association, Vol. VII, Nos. 2 and 3. (This work has since been brought out in a second edition, revised and enlarged, New York, 1899.) — Ed.

obviously an immensely difficult task to shape a whole system of taxation so that the average general rate will be a moderately progressive one. Actual systems of taxation are of the most varied kinds. In some taxes it is impracticable to introduce a progressive scale, as they are by their very nature proportional, as, *e.g.*, tithes or poll taxes, — for a graduated poll tax is really not a poll tax at all, but a class tax. In other cases the taxes in actual life are even regressive, as, *e.g.*, many of the indirect taxes. It would be impossible thoroughly to carry out the principle of general progression unless we had a single universal income tax. But no scientific writer to-day favors a single income tax, or a single property tax, or for that matter a single tax of any kind. Thus, in advocating the system of progression, we must have regard to the facts of the individual case, and to the general sentiment of the community. In the United States, for instance, the general property tax in its practical operation is largely regressive, especially in so far as personalty is concerned. The tax reformers, as we shall see, have quite enough to occupy their attention in trying to make the rate really proportional, before bothering themselves with the more ideal stage of progression. But it is all the more worthy of consideration whether other taxes may not properly be levied according to the progressive principle. It is more than likely that a number of moderate progressive taxes would after all still simply result in securing an average proportional rate for the whole system of taxation. And we have seen that some defenders of proportion in theory admit the legitimacy of certain progressive taxes as a compensation for other really regressive taxes. In practice, then, we may frequently demand progressive taxes without being at all so extreme or so "communistic" as many persons believe.

Thirdly, the defense of progressive taxation rests on the assumption of faculty as the basis of taxation. Now while this is true of taxation as a whole, for general state purposes, it is questionable whether the principle of benefits is not of some weight in problems of purely local and municipal finance. A discussion of the contest between these two principles and the limits of their relative applicability to different phases of public revenues would take us too far astray here. But it may be

said that it is coming more and more to be recognized that within the domain of the taxing power the principle of benefits should be followed to some extent in strictly local finance.[1] If this is true, the principle of progression will be of rather more limited application to some of the charges employed for the support of local government; for the theory of benefits, as we have seen, leads logically to proportion, not to progression. Thus the practical sphere of the applicability of the progressive principle would be even more circumscribed.

Finally, it must not be overlooked that high rates of progression may engender or augment attempts at fraud and evasion. That this is possible cannot be denied. But, as has already been pointed out, the danger is apt to be greatly exaggerated. We know that there is certainly more fraud in the countries of proportional taxes like America than in the home of progressive taxes like Switzerland or Germany. Still it may be conceded that with progressive rates there would probably be even more fraud than actually exists, even though the fears of the doubters in Australia and Switzerland have not been realized. Much depends on the manner in which progression is applied, and the particular tax to which it is extended. Still more depends on the rate of the progression. The higher the progression, the more likely that the results will be perceptibly bad. But the objection is really one against the abuse, not the use, of the progressive principle.

If, therefore, we sum up the whole discussion, we see that while progressive taxation is to a certain extent defensible as an ideal, and as the expression of the theoretical demand for the shaping of taxes to the test of individual faculty, it is a matter of considerable difficulty to decide how far or in what manner the principle ought to be actually carried out in practice.

Theory itself cannot determine any definite scale of progression whatever. And while it is highly probable that the ends of justice would be more nearly subserved by some approximation to a progressive scale, considerations of expediency as well as the uncertainty of the interrelations between various parts of

[1] For a discussion of these points, see my article on The Classification of Public Revenues, *Quarterly Journal of Economics*, Vol. VII, pp. 311 *et seq.* (See also the author's Essays in Taxation, 265–304 (second edition, New York, 1900). — Ed.

the entire tax system should tend to render us cautious in advocating any general application of the principle. It remains to investigate as to how far the principle is applicable to the conditions surrounding us in America to-day.[1] But, in last resort, the crucial point is the state of the social consciousness and the development of the feeling of civic obligation.

[1] In the following chapter of his monograph, Professor Seligman considers the practicability of progressive taxation, especially in the United States, and comes to the following conclusion:

"We see then that while progression of some sort is demanded from the standpoint of ideal justice, the practical difficulties in the way of its general application are well-nigh insuperable. Progression is defensible only on the theory that the taxes are so arranged as to strike every individual on his real income. But in default of a single tax on incomes, which is visionary, practicable tax systems can reach individual incomes only in a very rough and roundabout way. Under such practical conditions it is doubtful whether greater individual justice will be attained by a system of progression than by the simple rule of proportion; and it is questionable whether the ideal advantages of progression would not be outweighed by its practical shortcomings. For the United States at all events, the only important tax to which the progressive scale is at all applicable at present is the inheritance tax. For the future development of the idea we must rely on an improvement in the tax administration, on a more harmonious method of correlating the public revenues, and on a decided growth in the alacrity of individuals to contribute their due share to the common burdens." — ED.

CHAPTER X

CAPITATION TAXES

40. The Poll Tax in American Commonwealths. — Although the poll tax has been abandoned in most of the countries of Europe,[1] it is still found in about half of the American states.[2] Sometimes it is a distinct state tax; sometimes it is associated with the general property tax; sometimes it is merely a local tax, and used for such local purposes as the care of highways. It is found in most of the New England and the Southern states, but less frequently in the Central or Western states. In many cases the tax is poorly collected, as may be illustrated by the experience of Wisconsin. In that state the poll tax is a local tax which in towns and villages is "to be collected for highway purposes only." In 1898 the Wisconsin Tax Commission reported that the law "has become practically a dead letter in many portions of the state"; that "more than half the towns and villages in the state and about two thirds of the cities did not collect any poll tax in 1897"; and that in eight counties "not a dollar of poll tax was collected." The net result was stated as follows:

> Of the 1137 towns and villages in the state only 493 made any attempt to collect any poll taxes, and the total amount which they collected was $95,871.75. Of the 111 cities only 39 report any poll tax raised, and the total amount obtained was the comparatively small sum of $12,578.37.[3]

[1] Capitation taxes are employed in France and some of the Swiss cantons. The French personal tax (*impôt personnel*) will be described in the next chapter.

[2] The experience of the American states is described by Seligman in his monograph on Finance Statistics of American Commonwealths, in Publications of American Statistical Association, 1889.

[3] Report of the Wisconsin State Tax Commission, 1898, pp. 68 and 107.

41. The Poll Tax in Massachusetts. — The Commission of 1897 gave the following account of the working of the poll tax in Massachusetts:[1]

The Commonwealth of Massachusetts levies a poll or capitation tax on every male inhabitant of the Commonwealth above the age of twenty years, whether a citizen of the United States or an alien, and upon every female citizen of said age requesting to be assessed therefor. The poll tax of the old, poor, and infirm may be abated at the discretion of the assessors.

The assessors are required to canvass their respective cities and towns, and after diligent inquiry to make true lists of every male person above the age of twenty years residing in their city or town, and of all women of the like age who request to be assessed. In cities and towns of more than five thousand inhabitants the assessors are required to prepare and to have printed street lists arranged by voting precincts, designating all buildings used for residences, and giving the age, name, and occupation of every person assessed for a poll tax. These lists are sent to the registrars of voters, though it is not necessary for registration that the voter's name be entered upon this list. The registrars, on their part, are required to make a return to the assessors of the names of all persons who have registered with them and whose names are not upon the assessors' lists. The assessors, having obtained a list of all those liable for a poll tax, proceed to assess upon them the state and county taxes. The state tax is assessed upon the number of polls in each place until such assessment amounts to $1 upon each poll, the remainder of the tax being then assessed upon property. In like manner the county taxes are assessed upon the polls up to the sum of $1 on each poll, the remainder there also being assessed on property. The effect is that the rate of the poll tax is in almost all cities and towns $2 per year. In six localities only is there a less rate. In the city of Chelsea and in the towns of Winthrop and Revere the poll tax is only $1. This arises from the fact that the city of Boston assumes the entire county tax for the county of Suffolk; hence in these places the poll tax is limited to the state tax of $1.

[1] Report of the Commission on Taxation, pp. 3–5.

In three towns the amount of the total poll tax levied in the manner described above is less than $2, namely: Savoy, $1.80; Gay Head, $1.50; and Prescott, $1.97.

In former years payment of the tax was a condition of the exercise of the franchise. For that reason it was for the most part paid, — if not directly by the person upon whom it was assessed, then paid on his behalf by the political organization to which he belonged. By an amendment of the Constitution in 1891 the provision making the payment of the tax a prerequisite to voting was repealed. Since that time it has been difficult to collect the tax from those not subject to the tax for property. The amount in each case being small, the tax is now in the cities very largely uncollectible, except from persons who are also taxed for property.

Although the poll tax is thus, strictly speaking, a state and county tax, it is not to be inferred that the financial resources of the state or of the counties are affected by the difficulty of collecting it. The cities and towns pay over their respective shares of the state and county taxes, without regard to the success of their collection of the poll tax. They are accountable for contributing their apportioned quotas to state and counties, first by the poll tax and then by taxes on property. What they do not succeed in raising by the former tax they must make up by the latter.

The number of male persons assessed for poll tax in 1896 was 723,736; the number of persons assessed for poll tax only was 511,659; the amount of the tax assessed on polls was $1,434,629.[1]

42. The Poll Tax in North Carolina. — The poll tax has played a more important part in the history of North Carolina than in probably any other state in the American Union. Until the time of the Revolution North Carolina never employed any direct tax except that upon polls, in the assessment of which adult white males and adult colored males and females were included. Indirect taxation, moreover, was not very important, being confined for the most part to light duties on imported

[1] For 1904 the assessment upon polls was $1,676,726. — ED.

spirits; so that the poll tax was almost the sole reliance of the finances of the colony.[1] During the Revolution the newly organized state began to tax a few kinds of property, chiefly land and buildings; but the poll tax continued, until the middle of the nineteenth century, to furnish about half of the state revenue.[2] Professor G. E. Barnett gives the following account of the working of the poll tax in North Carolina:[3]

In origin the poll tax is coincident with the beginnings of taxation in North Carolina. Until near the middle of the century, it furnished more revenue than the general property tax. This was in large measure due to the fact that the taxes on slaves could be collected by sale of the slaves. The great importance of the tax is clearly shown by the fact that all of the constitutional amendments of 1835 concerned the poll tax. These amendments provided that the capitation tax should be equal throughout the state, and that all free males over twenty-one and under forty-five years of age, and all slaves over twelve and under fifty years of age, should be subject to a capitation tax, and that no other person should be subject to such a tax. The capitation tax on slaves was in lieu of any other tax on such property.

In 1852 a part of the revenue derived from the poll tax was applied to the support of a state asylum for lunatics and idiots. In the constitution adopted in 1868, the poll tax was devoted to the support of the public schools and of the poor.

The state treasury no longer derives any revenue from this source, but the proceeds of the tax form a part of the school and poor fund of the county in which it is collected. Since,

[1] See Bullock, Essays in the Monetary History of the United States, 178, 192.

[2] Maryland and Virginia, during the colonial period, employed poll taxes very extensively; but had lucrative sources of revenue in import duties and export duties on tobacco. In these states property taxes were introduced during the eighteenth century, — in Virginia during the French and Indian War, and in Maryland during the Revolution, — and the poll tax thereafter was relegated to the background. In Maryland, in fact, poll taxes were discontinued entirely.

[3] Studies in State Taxation, edited by J. H. Hollander, Johns Hopkins Studies in Historical and Political Science, Series XVIII. Reprinted by consent of editor, author, and publisher.

however, the rate is prescribed by the General Assembly, it may properly be considered a commonwealth tax.

Rate. — The provision of the constitution authorizing the poll tax is mandatory. It declares, "The General Assembly shall levy a capitation tax on every male inhabitant in the state over twenty-one and under fifty years of age, which shall be equal to the tax on property valued at $300." The Supreme Court has recently held that if a revenue act does not preserve this proportion, the tax on both property and poll is void.

The present state poll tax is $1.29. The counties also have the privilege of levying a poll tax, but the state and county tax together must not exceed $2.00. Not more than one fifth of the revenue thus raised can be appropriated to the support of the poor. By the Constitution of 1868, the county commissioners are empowered to exempt from this tax any persons who are too poor or infirm to pay it.

Collection. — Much difficulty is experienced in the collection of the tax. The law provides that, "if any poll tax or other taxes shall not be paid within sixty days after the same shall be demandable it shall be the duty of the sheriff, if he can find no property of the person liable, sufficient to satisfy the same, to attach any debt or other property incapable of manual delivery due or belonging to the person liable or that may become due to him before the expiration of the calendar year." By means of such attachments in the hands of employers and others, many poll taxes which would not otherwise be collectible are paid. But even with the aid of this device the tax is poorly collected. The auditor in his report for 1896 estimates that only two thirds of the whites and one half of the negroes above the age of twenty-one pay poll taxes. So difficult is the collection of this tax that in 1897 the General Assembly enacted that persons or corporations failing to pay any tax laid on them by law shall be guilty of a misdemeanor and punished by a fine not exceeding $500 or imprisoned not exceeding six months. This law was aimed, of course, at the man without property, the citizen who is liable only to the poll tax. Taxes due by any citizen with property are collectible without fines or imprisonment. It is quite possible that this act did not fall within the constitutional provision prohibiting imprisonment for debts, but the law does not seem

to have been practicable and was repealed by the General Assembly of 1899.

The amount raised by the poll tax is next in amount to that raised by the general property tax. In 1898 the return from state and county poll taxes amounted to $365,738.27, or nearly one half of the sum raised for public schools, exclusive of sums raised in the larger towns for graded schools. Besides the poll tax levied by state and county, incorporated towns also impose poll taxes in North Carolina. In some cases, in fact, in most of the larger towns, the municipal poll tax is far in excess of the combined state and county poll tax.[1]

Criticism.—The poll tax of North Carolina is clearly a regressive tax of a very heavy kind. It amounts frequently to doubling the rate on small property owners. Let us suppose, for instance, two property owners, one owning property worth $10,000 and another owning property worth $300. If we levy on each a property tax of $1\frac{2}{3}$ per cent (an average municipal tax in North Carolina) and a poll tax of $5, this amounts to taxing the richer man at a rate slightly above $1\frac{2}{3}$ per cent, while the poorer man has to pay a $10 tax, or at the rate of $3\frac{1}{3}$ per cent. If a poor man has no property and thus escapes the payment of the poll tax the very existence of this tax is an inducement to him never to acquire any property, since from his first savings, the state, county, and city take away as much as the savings bank would pay him, if he had $300. If he only saves $100, they take far more than such a bank would pay him. That this is a real and an important consideration is revealed by statistics from Wake County given by the auditor in his report for 1896. Over 60 per cent of the taxpayers of this county pay on less than $500 of real and personal property, and the auditor estimates that 80 per cent of the taxpayers of the entire state pay on less than $500 worth of property.

On such persons the poll tax weighs heavily. The richer man does not feel it, the man with no property largely escapes it, but upon the small property owner it hangs like an incubus.

[1] The rates in some of the largest cities in North Carolina are as follows: Raleigh, $3.70; Winston, $4.05; Charlotte, $3; Wilmington, $3.96. These are the municipal poll taxes; to them must be added the state and county taxes, nearly always equal to $2.

It is not a tax proportioned to ability. It is not even, according to the theory of the general property tax, proportioned to wealth. In what manner its advocates would justify the retention of the tax is not clear. To most people who favor poll taxes, the old idea of paying the state for a service rendered, probably constitutes the best argument in its behalf.

As has been said above, the poll tax is mandatory and no General Assembly can refuse to levy it. There is urgent need of a change in the constitution permitting the tax to be laid only on persons not paying an equal sum on property. While such a tax would be theoretically far from a just tax, it would yet be an improvement on the present system and would lift the dead weight which hangs so heavily on the small property owner.

43. The Poll Tax in Mississippi and Georgia. — In other Southern states poll taxes have retained considerable financial importance. Dr. C. H. Brough writes as follows concerning poll taxes in Mississippi:[1]

Although Mississippi is aristocratic in its economic substratum, its attitude in regard to the poll tax has always been democratic. The landowners never objected to bearing the burdens of this tax, and they used it as an instrument to encourage slavery. This was accomplished, as we have seen, by a discrimination in the rate charged "free males of color" and white males. After the abolition of slavery and the enfranchisement of the freedmen, this discrimination was abolished and a uniform rate levied without regard to color or previous condition of servitude. The poll which, during the reconstruction period, was as high as $6 *per capita*, is now fixed at $2, and is imposed on all males between the ages of twenty and sixty years.

The importance of the poll tax in Mississippi may be appreciated from the fact that it is the principal fiscal device of the school districts in the state during the four months' public school term. Furthermore, the payment of the poll tax is made an implied condition of suffrage by that provision in the state constitution requiring two years' residence and the payment of all

[1] Studies in State Taxation.

taxes during that time, as two of the necessary qualifications of an elector.

No concealment need be made of the fact that the poll tax is used in Mississippi as a means of disqualifying the negro in national elections and controlling his vote in local elections. That the poll tax is more important in the state as an adjunct of suffrage than as a source of revenue is revealed by the fact that in 1897 out of a capitation of $529,694, only $250,057 was collected. Property owners are willing to pay a penalty for their ownership of property, in order to maintain white rule to protect their property. However barbarous the poll tax may be as a fiscal anachronism, social conditions in Mississippi are not yet ripe for economic reform in this direction.

And of the poll tax in Georgia, Dr. L. F. Schmeckebier writes:[1]

Capitation taxes yield the second largest amount derived from taxation. Every male inhabitant of the state, between the ages of twenty-one and sixty years, is subject to a poll tax of $1 per annum. Blind persons, cripples, and maimed and disabled confederate soldiers are exempt from this tax. No city or county, or any other corporate authority, is allowed to assess or collect any capitation tax whatever, except a street tax, and that after an opportunity is given to work upon the streets. The payment of the poll tax is requisite for the exercise of the suffrage, and this is a source of political demoralization. The negro especially refrains from paying his poll tax, and waits for the politician to pay it for him, which is ordinarily done. There is no way of enforcing the collection of the tax from persons who do not own property, except as a qualification for voting, and thus the tax always tends to fall on those who already own property. Furthermore the constitution of the state requires that a voter shall have paid all taxes required of him since 1877. Thus payment for the current year is not sufficient to qualify, but the voter must pay all taxes in arrears. There is a large class of citizens who sometimes pay and sometimes do not, and when they do pay, they do so merely for the purpose of voting. But

[1] Studies in State Taxation.

before they can do this they must register and swear that they have paid all taxes since 1877, and hence the tax is a constant incentive to perjury. The pernicious effect of such a system hardly needs any comment. About 60 per cent of the tax is generally collected. The census of 1890 showed a voting population of 398,122 and the yield of the tax in 1898 was $234,431.99. The proceeds are used "for educational purposes in instructing children in the elementary branches of an English education only."

CHAPTER XI

THE GENERAL PROPERTY TAX

44. The Conclusions of the New York Tax Commission of 1871 and 1872. — The chief financial resource of American states has for a long time been a general tax upon all property[1] within the reach of the taxing power. This general property tax, as it is called, has never worked satisfactorily, and its shortcomings have led to the appointment of numerous tax commissions[2] to investigate the problem of state and local taxation. The reports of some of the more important of these commissions are valuable sources of information concerning the workings of the general property tax. Our first selection is from the Second Report of the Commissioners appointed to revise the Laws for the Assessment and Collection of Taxes in New York[3] (1871 and 1872):

The property of New York, made subject to taxation, divides itself into two classes, *real* and *personal.*

Real Property, embracing, according to the usual acceptance of the term, lands and buildings, being visible and tangible, presents no inherent difficulty in the way of ascertainment, valuation, and assessment. The New York system of taxation in respect to these objects might, therefore, be reasonably supposed to work with some degree of uniformity and equality; but so far from this being the case, it would be difficult, nay, probably impossible, to find any two contiguous towns, cities,

[1] Certain exemptions are granted, however, to property used for religious, benevolent, or charitable purposes.

[2] The work of such commissions is described by J. W. Chapman, State Tax Commissions (Baltimore, 1897).

[3] The Commissioners were David A. Wells, Edwin Dodge, and George W. Cuyler.

or counties in the state, in which the valuation of such property approximates in any degree to uniformity. So far as the commissioners can ascertain, the average aggregate valuation varies from 20 per cent of actual value as a mininum, to 50 per cent as a maximum; with a probable total average for the whole state of a rate not in excess of 40 per cent. The lowest valuations, furthermore, do not, as might be supposed, occur in the poorest and most sparsely settled counties of the state, but rather in the richest and most densely populated; and it is also curious to note, that comparing the real estate valuations of the several counties of the state in the years 1860 and 1870, with the census returns of their population at the same periods, it will be found that some counties which have increased their population and railroad facilities, have decreased their valuations, while other counties, which have actually diminished in population, have increased their valuations.

The increase in the assessed valuation of the real property of the entire state for the ten years, from 1861 to 1870 inclusive, was 47½ per cent; but deducting the valuations of New York and Kings counties, the increase was only 8½ per cent, although the increase in the population of these two sections, during the same period, was not very unequal; the increase in New York and Kings counties having been 269,722, and for the remainder of the state, 232,301. Now as the law of the state is clear and explicit, that the valuations shall be uniform, it is evident that the law in this respect has become a dead letter and wholly inoperative.[1]

[1] In their First Report, submitted in 1871, the Commissioners give the following account of the methods of assessing real estate:

"In New York the state tax is apportioned among the counties on the basis of their respective valuations of real estate, and the same rule prevails among the towns of the different counties. Hence arises the double competition between the assessors of counties in the aggregate, and of the towns in each county, for the lowest possible valuation. Having completed his official labors, each assessor in the state subscribes an oath, of which the following is the material portion:

"'We do severally depose and swear that we have set down in the foregoing assessment-roll all the real estate in ——, according to our best information, . . . and that we have have estimated the value of said real estate at the sums which a majority of the assessors have decided to be *the full and true value thereof, and at which they would appraise the same in payment of a just debt due from a solvent debtor.*'

"And the law further provides 'that every assessor who shall willfully swear false in taking and subscribing said oath, shall be guilty of and liable to the penalties of will-

But if such be the inequality and illegality of the methods of taxing *real property* at present followed in the state of New York, the results which have attended the attempts to tax *personal property* under the same system are infinitely more farcical and disgraceful. The evidence of this failure is most conclusive, and the reasons why, under the existing system, nothing but failure in respect to the taxing of this description of property can be anticipated, are of a character that admit of being readily understood and verified. Thus the total equalized valuation of all the property of the state of New York for the year 1871–72 is $2,076,454,000, of which but little more than one fifth (21.48 per cent), or $445,918,000, was returned under the head of personal property.

In their previous report the commissioners presented evidence tending to show that the aggregate value of the real property of the state and the aggregate value of its personal property closely approximated. They furthermore presented a schedule of property of the class *personal* within the state, founded on exact data, or careful estimate, whose aggregate amount nearly equaled in value the entire amount of all the property of the state, real and personal, returned for taxation during the year 1870–71. They would also recall the opinion authoritatively expressed in the constitutional convention of 1868, that 30 citizens of the state could be named whose aggregate wealth (mainly personal) was very considerably in excess of the valuation for that year of all the personal property of the entire state. But without again entering into details, the commissioners would now say, that another year's experience has led them to this general conclusion, that the authorities of the state, under a law

ful and corrupt perjury.' Let us now see what are the acknowledged facts in respect to the valuation of real property in New York, and some of the other states, where a substantially like oath is made imperative.

"In some instances in New York the valuation of real estate for taxation is reported as low as 20 per cent of its real value. In a majority of cases in the country the rate varies from 25 to 35 per cent, and rises in the cities to 50 and possibly 60 per cent as a maximum. In short, there cannot probably be found a single instance in the whole state, unless possibly in the case of certain unoccupied lands, the property of non-residents, where the law as respects the valuation of real property is fully complied with, and where the oaths of the assessors are not wholly inconsistent with the exact truth."

(professedly executed) requiring the assessment of *all* personal property at its full value, do not in fact succeed in assessing a proportion equal to 30 per cent of the recognized *low* valuation of the real estate; or more than 15 per cent of the *real and true* value of all such property immediately located within the state, and as such subject to the state authority. So much in proof of the evidence of the failure of the existing laws relative to local taxation to do what they were designed and purport to do. So much also in evidence that the existing system of local taxation, by its own gravitation and surrounding influences, has, with the exception of incorporated capital, practically come down to a tax upon real estate.

The reasons why nothing but failure in respect to the valuation and assessment of personal property under the existing system can be anticipated are in the main as follows:

In the first place, much of the property termed "personal," and which under the system operative in New York and most of the other states it is made obligatory on the assessors to value and assess, is incorporeal and invisible, easy of transfer and concealment, not admitting of valuation by comparison with any common standard, and the *situs* or locality of which, for purposes of assessment and taxation, involves some of the oldest, most controverted, and yet unsettled questions of law. Of such a character are all negotiable instruments, *i.e.*, national, state, municipal, and corporate bonds; written obligations of indebtedness on the part of individuals; book accounts, annuities, money at interest, cash on hand, and the like, the whole constituting by far the largest proportion of the so-called personal property of the country.

It is obvious, therefore, that the law contemplates the doing of an act; namely, the valuing and assessing of that which is invisible and incorporeal, which cannot be done without the fullest coöperation, through communication of information, of the taxpayer himself; and yet for the imparting of which the two most powerful influences that can control human action, namely, love of gain, and the desire to avoid publicity in respect to one's private affairs, coöperate to oppose.

And in the case also of much of the so-called "personal property" that is visible and tangible, as furniture, books, works

of art, jewelry, musical instruments, and the like, it is clear that its valuation, with any approximation to fairness, must be not only the work of time, but must require an amount of experience rarely in the possession of any one individual.

Whenever, therefore, a system contemplating the taxation of personal property, generally, has been projected, its authors have been led, as it were by instinct, to the conclusion that its execution with any degree of effectiveness must depend upon the employment of extraordinary and arbitrary measures. Thus, the old Romans, who first established the taxation of personal property at the period of the decadence of the empire, and who were not troubled with any restrictions of a constitutional character, or any very nice notions about personal liberty or general morality, clearly perceived this, and accordingly invested their tax officials with the power of administering torture as a means of compelling information and enforcing payment.

The board of officials of Illinois, who last year, under authority, prepared a new tax code for their state, and based their work on the hypothesis that the only way to make a better system was to enlarge and make more effective the old, also perceived this; and accordingly prepared a code, which one of the highest authorities in that state characterized in the following language:

"Without exception it is the most objectionable law that was ever proposed, and we can imagine no act which will become so justly odious and detestable. It provides for the establishment of a distinct branch of the government, which may be properly styled the grand inquisitorial and confiscatory office, clothed with powers and functions, which, if enforced, would have produced a revolution in Austria or Turkey." — *Chicago Tribune.*

The officials of the state of Massachusetts, also, in attempting to carry out a system which provides for the valuation of that which is intangible, and the assessment of what is invisible, acknowledge the necessity of the employment of extraordinary measures, and accordingly resort to a method of procedure which has no parallel except in the records of the Middle Ages and of the Inquisition, and constitutes, in itself, a satire upon any claim to the enjoyment of a wholly free and enlightened government. For, failing to obtain satisfactory information about the private affairs of any individual, the chief assessors

and their subordinates, to the number of some fifty, meet in secret session, in a large upper chamber set aside for the purpose, and appropriately termed the "dooming chamber," when the citizen in question, without being present either by counsel or in person, is arbitrarily doomed to the payment of any sum which a majority of those present may think proper; and from which "dooming" there can be no appeal.

Now the old pagans, the officials of Illinois, and the Boston assessors have undoubtedly been consistent in following the only line of action calculated to render their ideas of raising revenue by taxing all descriptions of property in any degree effective; and the people of the state of New York ought clearly to understand that the same course is the only one open to them which can, by any possibility, make their existing system anything different from the farce which every intelligent person must acknowledge that it now is.

45. The General Property Tax in the United States:[1] **by Charles J. Bullock.**—The status of the general property tax nearly forty years after the preceding account was written is considered in the following extract:

The census tells us that in 1902 the people of the United States paid taxes amounting approximately to $1,378,700,000. This was a *per capita* charge of $17.45, and was probably not less than one-twelfth of the current product of the industries of the country. Thirty-eight per cent of the total was claimed by the federal government, which collected $518,100,000, in the form of customs and excise duties. The remainder, amounting to $860,600,000, represented the taxes levied for state, county, and municipal purposes.

In ordinary times the federal revenues receive little attention, since they come from indirect taxes, which, for the most part, are paid "insensibly" in enhanced prices for commodities of common consumption. Without doubt they do not merit this neglect, since they offer many problems of great interest and importance. Yet neglected they are; and neglected they probably will be so long as they retain their present form. We complain bitterly if local taxes on property increase $1 upon each

[1] Originally published in the *Boston Transcript*, Jan. 13, 20, and 27, 1909.

thousand of the assessors' valuation; but the federal revenues may rise from $544,274,000 to $594,454,000, as they did between 1905 and 1906, without the average man knowing or caring about the addition of $50,000,000 to the nation's tax bill.

But with state and local taxation the situation is very different. In 1902 approximately $137,300,000 was derived from corporation, inheritance, and license taxes, which come from a comparatively small number of contributors and are not directly felt by the general body of taxpayers; while $16,600,000 was received from poll taxes levied generally at fixed rates which do not change with variations in public expenditure. But such revenues supplied less than 18 per cent of the sum which the state and local governments needed to raise by taxation; and the balance, amounting to $706,700,000, was secured by a direct levy upon the property of the people. This was equivalent to a *per capita* charge of nearly $9 and constituted 51.3 per cent of all the taxes collected for national, state, and local purposes. The amount which each taxpayer contributed was plainly stated in his annual tax bill and could be in no way ignored. Every increase of local outlays—and most increase in state expenditures—tends to increase the direct taxes upon property, which are levied at rates that vary according to public needs. It is not strange, therefore, that to an American the word "taxation" is usually synonymous with a tax on property; and that reform in taxation means some sort of a change in the general property tax.

In New England the property tax dates to early colonial times; in New York it was introduced after the colony passed under British control; in New Jersey, Pennsylvania, and South Carolina, taxes upon various classes of property were in operation before the close of the seventeenth century. In Maryland, Virginia, and North Carolina opposition of the large landholders to a tax on land led to the extensive use of poll taxes or of export and import duties; but the exigencies of the Revolutionary period compelled these states to establish permanent taxes on property.

The federal Constitution prohibited any state from taxing exports and imports, so that after 1789 it was necessary for the various commonwealths to abandon customs duties. Thus the property tax came more and more to the forefront; and, as new states were formed, it spread rapidly westward. From 1790 to 1860 it was virtually the sole reliance of many commonwealths,

and was everywhere the mainstay of county and municipal revenues. By 1860 it was universally accepted as the American form of taxation, and was firmly embedded in most of the state constitutions.

And yet it was a fiscal device once common in Europe, with which the early colonists had been familiar in the country from which they came. In England, where it was known as the subsidy, it had developed all the faults which followed its introduction into the New World. In 1592 one writer stated that not more than five men in London were assessed upon goods in excess of £200, and in 1601 Walter Raleigh complained that "the poor man pays as much as the rich." With changes in form and name the tax continued to the end of the eighteenth century. Adam Smith tells us that in his time, while land was probably assessed at one-half its actual value, personal estates were not assessed at more than a fiftieth part of theirs ; and that in some towns the whole tax was assessed upon real property, "as in Westminster, where stock and trade are free." So complete was the escape of personal property that the tax had come to be known as the "land tax," and in 1798 it was made a fixed charge upon the land. This marked the disappearance of the property tax from the British statute book.

In most other countries of Europe the outcome was the same. The general property tax was tried and found wanting ; and to-day it is employed as a main source of revenue only in some of the Swiss cantons, where, however, it is usually supplemented by income taxes. In Holland property is still taxed, but at a moderate rate, and conjointly with a tax upon income. In Prussia and some other German states a very light property tax is imposed, as a supplement to a general tax on income ; but the rate is exceedingly low—in Prussia only one-twentieth of 1 per cent—so that it is neither an appreciable burden on taxpayers nor an important source of revenue to the government. Far from being an American invention, therefore, the general property tax is a discarded European device which has been fastened upon us rather by historical accident than by reason of its peculiarly American and democratic qualities. Modern tax systems are based upon the principle that it is necessary to discriminate between the various classes of property or business, and to employ different methods and rates of taxation in dealing with

them. Our American states and some of the Swiss cantons stand substantially alone in their effort to tax all kinds of property at a uniform rate.

In the conditions that existed in this country in the seventeenth and eighteenth centuries the faults of the property tax were far less glaring than they are to-day. Land, houses, cattle, and small stocks of merchandise constituted the wealth of the people, and these things were tangible and could be found and valued with some certainty and fairness. Moneyed capital and various forms of intangible property existed, of course, and sometimes managed to elude the vigilance of the assessors—as the preambles of not a few colonial statutes testify. But such forms of wealth were far less important than they became in the nineteenth century, and the evils arising from the attempt to tax them at the same rate as other property were not so serious. Alexander Hamilton, indeed, remarked that "personal property is too precarious and invisible a fund" for the national government to reach "in any other way than by the imperceptible agency of taxes on consumption"; but the tax laws of the various states showed a general purpose to apply the property tax to all forms of personalty, intangible as well as tangible.[1] With the growth of banks and the formation of turnpike, bridge, and canal companies after 1789 the shares of corporations were added to the forms of property subject to taxation, and the first efforts were made to reach corporate securities.

The nineteenth century brought a rapid multiplication of corporations and a marked growth of moneyed capital, so that the amount of intangible property greatly increased. Not a few states established special taxes on banks and insurance companies or devised new methods of assessing the property of corporations. But the general property tax remained unchanged in general outline. In 1860 it probably yielded 90 per cent of the state and local revenue, and, as already remarked, was accepted everywhere as the American form of taxation.

This is not to say that no dissatisfaction existed. Experiments were made with various methods of valuing property, complaints were heard that money and stocks and bonds escaped taxation, and country districts protested that they were overtaxed. In

[1] There were exceptions, however. Some states confined taxation largely to visible objects.

1843 Connecticut appointed the first tax commission of which we have knowledge to investigate her tax laws and ascertain what changes were needed to make them more just in their practical operation. Other evidences of discontent are not wanting, but there was little disposition, if any, to question the beneficence and practicability of the general property tax. The common solution for all difficulties was to make the tax more effective by securing a more complete return of all property subject to taxation. The trend of public opinion in the United States in 1851 is well reflected in the constitution adopted by Ohio, which provided that "laws shall be passed taxing by a uniform rule all moneys, credits, investments in bonds, stocks, joint-stock companies or otherwise; and also all real and personal property, according to its true value in money."

One reason for the general acquiescence in the property tax was that during the first half of the century both state and local expenditures were small, so that the burden of taxation was comparatively light. After 1850 the growth of cities increased the cost of local government, and during the Civil War both state and local outlays advanced at an unprecedented rate. After the close of the war the growth of state expenditures was checked, but local outlays steadily increased until the business depression following the panic of 1873 led to a period of enforced retrenchment.

In 1850 the total taxes levied in the state of New York for all purposes amounted to no more than $6,312,000; by 1860 they had increased to $18,956,000, and in 1870 reached the figure of $50,328,000. In Ohio the aggregate taxes, state and local, amounted to $4,227,000 in 1850, $10,817,000 in 1860, and $23,463,000 in 1870. In Massachusetts between 1861 and 1874 they rose from $8,284,000 to $33,674,000, the *per capita* charge advancing from $6.69 to $20.87. For the country at large the census shows that the aggregate taxes levied on property amounted to $94,186,000 in 1860, approximately $3 *per capita*; while in 1870 they were not less than $280,591,000 or $7.28 *per capita*.[1]

A small part of the revenue needed to meet the greater cost of government came from new taxes, levied chiefly upon corporations; but probably nine-tenths of it was obtained by increasing the taxes on property. The $94,186,000 raised by *ad valorem*

[1] In Boston the *per capita* tax levy was $3.60 in 1820, $6.30 in 1840, $14.20 in 1860, and $36.10 in 1870.

levies on property in 1860 represented an average tax rate of $7.80 per $1000 of the assessed valuation throughout the United States, while the $280,591,000 collected in 1870 meant a rate of $19.80 per $1000. In Massachusetts, according to Amasa Walker, the tax rates in the various towns and cities prior to the Civil War were seldom less than $6 per $1000, or more than $10; but the changed conditions after 1861 raised the taxes so that few towns and cities had a lower rate than $10 and some had as high a rate as $35. From official statistics it can be computed that the average tax rate in the state in 1861 was $8.29 per $1000, and that in 1874 it was $15.18.

Obviously such a marked increase in rates intensified greatly the shortcomings of the property tax. Inequalities that could be borne when the rate was $5 or $6 per $1000 became intolerable when the rate advanced to $15, $20, and even $30. For property yielding 6 per cent interest, a tax of $6 per $1000 was equal to 10 per cent of the income. This was a heavy rate for any direct tax, but could be paid without impoverishing the taxpayer, and might be submitted to, even though one knew that his neighbor, owning an equal amount of property, went almost scot-free. But a tax of $20 per $1000 claimed over 30 per cent of the income, and a tax of $30 claimed 50 per cent. Such a burden would be borne by no one who could manage to evade it; and those unable to escape would hold it an intolerable grievance that many of their neighbors were almost untaxed.

Under the circumstances the liveliest discontent was aroused; and taxation, state and local, speedily acquired the status of a "problem." Between 1867 and 1874 six states appointed tax commissions to investigate the subject, and their example was subsequently followed by many others. From 1867 to 1897 not less than twenty-six commissions are known to have existed, and during the last decade there must have been at least a score more. The reports of these bodies disclose much diversity of opinion at many points, but upon one thing they are substantially unanimous—existing methods of taxing personal property are satisfactory to no one.

The discouraging feature of the situation is that the later reports give little evidence that progress has been made toward a satisfactory solution of the problems of state and local taxation. Most of the states have introduced inheritance taxes and not

a few have established special taxes on corporations. In some considerable revenue is now obtained from liquor licenses; and the Southern states impose license taxes on other forms of business. But, as we have seen, 82 per cent of the total taxes levied for state and local purposes come from the general property tax; and in respect of this principal source of revenue we are but little better off than when the first commissions were appointed. Tax laws, it is clear, change but slowly. The farmers oppose one project, the corporations another, the assessors another; irreconcilable diversity of local interests is encountered; business adjusts itself in some fashion to the established system, and dislikes the prospect of readjustment; and any reform must overcome an astonishing amount of ignorance, selfishness, and stupid inertia. Thus it has come about that, after forty years' discussion, the United States has the most crude, inequitable, and unsatisfactory system of local taxation—if, indeed, we can call system that which more resembles chaos—that can be found in any important country in the civilized world.

The objects upon which the property tax falls may be divided conveniently into three classes: real estate, tangible personalty, and intangible property. In the United States at large, real property constitutes about three-fourths of the aggregate. Of the $35,338,000,000 of property subject to local taxation, only $8,923,000,000 is classified as personal estate. In the assessment of personal property we have no means of ascertaining the precise proportion which tangible wealth bore to intangible, but it was probably not less than 70 per cent of the total. In Massachusetts, where considerable intangible property is assessed, tangibles constitute about 55 per cent of the personal assessment; but in many states so little intangible wealth is taxed that the proportion of tangible personalty rises to 75 or 80 per cent.

While the results vary somewhat from state to state, according to the intelligence with which tax laws are drawn and administered, the general outcome is the same; the weight of taxation falls mainly upon things that are visible and tangible, and chiefly upon real estate. In spite of the great increase of personal property during the last half-century, real property constitutes an ever-increasing proportion of the property assessed for local taxation. In 1850 the real property assessed in the entire country

was valued at $3,899,000,000, and the personal property at $2,125,000,000. In 1902 realty was assessed at $26,415,000,000, and personalty at only $8,932,000,000. In New York during this period the assessment of realty increased from $564,649,000 to $5,297,000,000, while that of personalty advanced from $150,720,000 to no more than $672,149,000. In Massachusetts personal property constituted over 36 per cent of the total local assessments in 1850, and less than 22 per cent in 1906; in Boston its proportion was 44 per cent in 1822 and 19 per cent in 1906. Local and temporary exceptions to the rule can be found; but experience shows conclusively that, under the present system of property taxation, a larger and larger proportion of the burden falls upon real estate.

Since real property is always assessed and yields a large revenue, it is often assumed that this part of our tax system has worked tolerably well; and the subject is sometimes dismissed summarily, perhaps with a reference to Adam Smith's remark that "the quantity and value of the land which any man possesses can never be a secret, and can always be ascertained with great exactness." But although the value of land can be ascertained, it will not be discovered unless the assessment is entrusted to competent hands; while in the valuation of many kinds of improvements very serious problems are often encountered.

This important and difficult work is performed by boards of assessors locally elected or appointed. Sometimes chosen for political reasons, assessors are seldom selected with a view to their special qualifications for the position, and such knowledge of their duties as they possess is generally obtained during their term of office. Usually they are underpaid, receiving less than a competent man could earn in his ordinary vocation. They are always subject to more or less local pressure, particularly when elective officers, and in only a few commonwealths, and that recently, have the state governments exercised the least supervision over the work of assessment. Careless and slipshod work, diversity of practice, ignorance of the exact provisions of the law, and stupid persistence in obsolete methods are some of the least evils that arise; the worst are willful violation of the plain requirements of the law and actual corruption which has been known to make the office of assessor a highly lucrative position. Usually it is the system rather than the individual that is at

fault; and the average assessor can fairly claim that he does about as well as any other man would do under similar circumstances. In some cities conditions are far better than in the country at large, but the general result is that we have a system of local option, each locality enforcing, ignoring, or deliberately violating the law as it may elect to do.

The outcome is that ordinarily real estate is grossly undervalued. In the entire country the true value of taxable real estate was estimated to be $46,324,000,000 in the year 1900; but the assessed value in 1902 was but $26,415,000,000. In Nebraska the true value was $813,900,000 in 1900, and the assessed value in 1902 was $116,200,000; in Massachusetts, where the discrepancy was less than in any other state, the estimated true value was $2,559,300,000 and the assessed value, $2,434,800,000. Between such extremes as these, the other states present all degrees of underassessment.

If the percentage of undervaluation were the same in all counties or towns of any state, and the same for all parcels of realty in each county or town, no harm would be done; but the fact is exactly the reverse of this assumption. In New York, in 1883, it was found that the average valuations of real property were as low as 18 per cent of the true value in some counties and as high as 100 per cent in others. In 1886 the valuations in the counties of Illinois were found to range from 5 to 100 per cent of the true value. In the cities of California, in 1902, the average valuations varied from 26 to 95 per cent. Illustrations might be multiplied, but the result would always be the same; and so long as undervaluation is permitted, real property will not be assessed at a uniform percentage of its true value in all parts of the same state.

Not less than half of the general revenue of the state governments comes from the property tax, and it is clear that the burden will be unfairly distributed if property is assessed at 10 per cent of the value in one county and at 100 per cent in another. It is clear also that local assessors have a strong inducement to value real property at a low figure, since they thereby reduce the share of the state tax which falls upon their own towns or counties. To remedy such evils "boards of equalization" have been created in many states, and empowered to "equalize" the distribution of the state tax; in Massachusetts this work was

entrusted to a tax commissioner. But such boards have never reached the root of the difficulty, since they have no control over the original assessments and must proceed largely by guesswork. Politics sometimes vitiates their work, unseemly contests between urban and rural interests absorb time and attention, and it long ago became notorious that "equalization fails to equalize." The result is that the burden of state taxation is distributed unfairly, some localities being overtaxed and others undertaxed.

In any locality where undervaluation prevails, the assessors are supposed to follow a general rule, and to assess real property at some uniform percentage of its true value. The average taxpayer, at any rate, assumes that this is done, and it is often maintained that, so far as the local tax burden is concerned, it is no one's business whether a town or county assesses property at 10, or 50, or 100 per cent of its true value. The law may expressly prescribe valuation at the "true value in money" or the "fair cash value"; but "what does a tax law amount to among neighbors, anyhow?" Interference with such practices is hotly denounced as a violation of the sacred right of local misgovernment, and it is contended that the state should go no further than to readjust the quotas of the towns or counties in each state tax.

But experience demonstrates to an absolute certainty that it is impossible to undervalue all real property at anything approaching a uniform percentage. An examination of several hundred thousand parcels of real estate in Wisconsin has recently shown that in districts where the average ratio of the assessed value to the true value is consistently maintained at 65 or 70 per cent, individual parcels are assessed as low as 20 per cent and as high as 120. In 1894 an investigation in Chicago disclosed that seventy of the costliest commercial buildings were assessed upon an average at 9.67 per cent of their true value; while it appeared that eighty cheap residential properties, worth from $400 to $4000, were assessed, upon an average, at 15.9 of their value. Among the commercial buildings the assessments ranged from 4.35 to 17.37 per cent of the true value, and among the small dwelling houses they ran as low as 12 per cent and as high as 40. At one extreme we find an office building worth $1,677,000 and assessed at $73,000, while at the other we find a hovel which was assessed at $100 and actually sold for $250.

In Adams County, Ohio, it has just been ascertained that 931 parcels of real estate were assessed, upon an average, at 43.4 per cent of their true value; and that 191 of them were assessed at an average value of 11.3 per cent, while 121 were assessed at an average value of 120.7. In Brown County the average valuation of 706 pieces of real estate was 53.3 per cent of the true value, while the individual properties were assessed as low as 12.3 per cent and as high as 116.6; and in several other counties selected for investigation similar inequalities were brought to light. The moral seems to be that when assessors, with the best of intentions, attempt to undervalue property at a uniform rate they will assess some parcels of real estate from ten to twelve times as high as they assess others.

There is a simple reason for the failure of this uniform-undervaluation plan to work as anticipated—even among friends and neighbors. If the practice is to assess realty at its true value, the assessor has a definite mark at which to aim, and the citizen a definite standard by which he can compare his assessment with his neighbor's; but when the opposite practice prevails, assessor and taxpayer alike are left in uncertainty. Absolute accuracy, of course, is not to be expected, but errors can be more readily detected if the standard is full valuation. If two buildings worth $100,000 each are assessed, the one for $20,000 and the other for $18,000, the discrepancy seems to be but $2000; in reality it is $10,000, since it represents one-tenth part of the tax burden.

In some states conditions are worse than others because systematic reassessment of realty is undertaken only at long intervals. In the intervening years assessors may make certain changes, but the invariable result is that gross inequalities arise from fluctuations in real-estate values. In Ohio, for instance, revaluation takes place only once in ten years; and the report of a recent commission shows that between the decennial inquests farm lands change to building lots, and commercial centers of growing cities completely shift, so that fearful injustice ensues. Yet in states where annual assessment is the rule, as in Massachusetts, investigation has disclosed valuations ranging from 52 to 133 per cent of the true value of realty in the same city. Infrequent valuations aggravate the evil, but are by no means the only cause of it.

The first step toward effective supervision of local assessments was taken by Indiana in 1891, when a State Board of Tax Commissioners was created. Unlike the ordinary boards of equalization, this body was given the power needed to make state control a reality; that is, power to compel local assessors to comply with the requirements of the law. In 1899 a Board of Tax Commissioners was established in Michigan, and since then similar boards have been created in several other states.

The results achieved by boards of this type have been very striking. In Indiana the total assessment of real estate was increased 44 per cent in a single year; in Michigan it advanced the first year nearly 22 per cent; in Wisconsin it increased from $528,572,000 in 1899 to $1,086,111,000 in 1902; in West Virginia a general reassessment of property under state supervision raised the valuation of real estate from $168,480,000. in 1904 to $475,174,181 in 1906; and in the state of Washington in 1906 the assessment of all property was increased 62 per cent. This effective state control of local assessments is perhaps the most important and encouraging development in American taxation in recent years. It should be followed by an effort to improve the character and increase the compensation of local assessing boards throughout the country.

The suggestion is often made that undervaluation of real property can be ended only by a complete separation of the sources of state and local revenue. It is thought that so long as a state tax is levied upon the property assessed by local officials, the temptation to undervalue real estate will be too strong to be resisted, since each town or county will hope thereby to reduce its quota of the tax levied for state purposes. But this argument overlooks the fact that the desire to reduce the local quota of the state tax is not the only reason for underassessment. Besides the state tax, the county taxes need to be equalized; and in the country at large the taxes levied on property for county purposes are about 75 per cent larger than those levied for the support of the states; in 1902 the figures were, respectively, $143,265,000 and $82,320,000. It is clear, therefore, that the complete separation of state and local revenues would not remove all temptation to undervaluation. The evil is more deep-seated than advocates of separation realize. Not the least of the reasons for the existing practice is the fear of the taxpayers that if property is

assessed at its true value, tax rates will not be correspondingly reduced and the politicians will simply have more money to spend. Upon the other hand, the experience of tax commissions of the modern type shows that effective state supervision of local assessors is likely to secure the desired results, even without separation of the sources of revenue. For many reasons it is desirable that the state levy upon property should be light, and the bulk of the state revenues obtained from taxes on corporations and inheritances; but there is no reason for supposing that with proper control of local assessments, the mere existence of a state tax will perpetuate the evil of undervaluation.

Machinery, merchandise, and live stock make up the greater part of the tangible personal property assessed for local taxation; but farm implements, agricultural products, household goods, personal effects, boats and vessels, and a few minor objects are also included in this category. Both in the requirements of the law and the practice of assessors the greatest diversity is found in the various states.

Machinery is sometimes heavily taxed, as in the manufacturing cities of Massachusetts, where the tax rates run as high as $16, $18, or $20 per $1000, and the valuations are placed at a high figure. In Fall River, for instance, out of a total valuation of about $83,000,000, $31,000,000, or nearly 40 per cent, consists of personal property. More than nine-tenths of this personalty is tangible property, chiefly machinery; and since the tax rate last reported was over $18 per $1000, it is evident that the city imposes very heavy burdens upon the machinery employed in her leading industry. Upon the other hand, some states virtually exempt machinery. In Pennsylvania it is taxable only when of such a fixed character as to be regarded as part of the building; and even then the local assessors deal very leniently with it. In New Jersey manufacturing plants and all their equipment were formerly taxed at no more than 25 or 30 per cent of their true value, and the "Industrial Directory" of that state held this out as an inducement to manufacturers. Many states could exempt machinery entirely without appreciable loss to their local revenues; but in others, such as Massachusetts, this action would entail difficult readjustments in manufacturing districts. At present the diversity of practice places a decided handicap upon manufac-

turers in any state where machinery is heavily taxed; in such cases the best solution may be to tax this class of property at a fixed, uniform rate of moderate amount—say $8 in the thousand.

In the taxation of merchandise we find again the widest diversity of conditions. Pennsylvania does not tax merchandise, but has a mercantile tax upon gross receipts. In Massachusetts the law requires that merchandise be assessed at its fair cash value on the first of May, a date when retailers' stocks are unusually large; but in practice the assessors estimate the value according to such general indications as they can get of the volume of business and probable profits. In most states the assessment is supposed to be based upon the average amount of goods carried throughout the year. In Chicago some years ago the assessors adopted the practice of assessing business establishments rather upon the total volume of business transacted than upon the amount of personal property employed therein. Although the laws generally require a sworn statement from the taxpayer, assessors are usually content to make informal inquiries and then value the stock according to their best judgment. In practice this means guesswork, more or less intelligent, as the case may be. Five or six states allow an offset for debts, as in the case of other personal property; but usually no allowance is made for indebtedness.

The results vary greatly. In cities a large part of the personal property listed for taxation often consists of merchandise. In Boston, for example, in 1907, personal property was assessed at $242,606,000, and of this amount $97,493,000 was located in two wards which are the heart of the mercantile district. Upon the other hand, in the entire state of Ohio the assessed value of "merchants' and manufacturers' stock" declined from $70,442,000 in 1870 to $52,446,000 in 1906. When the tax falls upon stocks of retailers, it is readily shifted upon customers; but if the merchant is engaged in wholesale trade, interstate competition may make such shifting difficult and produce complications similar to those noticed in connection with the taxation of machinery.

Live stock usually contributes a substantial sum, but important exemptions are everywhere allowed, chiefly for young animals under the age of six months or a year. In states where the live stock or dairy industries are important the assessment of domestic animals is naturally large. In Wyoming real estate and the

property of various corporations were assessed at $23,000,000 in 1902; while live stock was assessed at $16,552,000, and all other personal property at $3,785,000. This of course was an exceptional case. Yet in Iowa, the same year, real estate and corporate property were assessed at $463,700,000, and all other property at $109,900,000. Of this last sum, live stock represented $41,900,000, or nearly 40 per cent of all taxable property other than realty and the property of corporations. In Wisconsin at the same time all the personal property was assessed at $283,587,000, of which live stock constituted $72,793,000. In Texas the assessed value of all property other than real estate and the property of corporations was $273,000,000, and live stock represented $117,346,000 of this sum.

The other items of tangible personal property are household goods, personal effects, wagons and carriages, agricultural products, and boats and vessels. They are seldom a substantial part of the total assessment. Household goods up to a certain figure are often exempted, the exemptions ranging from $150 in Alabama to $1000 in Massachusetts. Wearing apparel, provisions, fuel, tools, and wagons usually receive certain exemptions. Growing crops, hay needed to winter stock, and crops of the preceding year are also exempted in various states; and when the date of assessment is May 1 or June 1 the amount of produce taxed in the hands of farmers is naturally small. In seaboard towns boats and vessels sometimes contribute heavily. In the city of New Bedford in 1861 the total assessment was $23,191,000, of which personal property constituted $14,005,000, or over 60 per cent. The greater part of this personal assessment represented the value of the vessels owned in that enterprising port; and even to-day this class of property contributes a substantial sum to the local revenues. Ships engaged in the foreign carrying trade are in some states accorded exceptional favors, as, for instance, by the provision that they shall be taxed upon the income they yield rather than upon their capital value. In Massachusetts they are now taxable at about one-fifth of the rate imposed on other property.

On the legal principle that personal property follows the owner and is taxable at his domicile, most of the states undertake to tax their citizens upon all personal property wherever situated—*i.e.*, within or without their borders. At the same time they

generally lay claim to all tangible personalty within their jurisdiction, whether owned by residents or non-residents, so that this class of property, when located outside the state where the owner resides, is usually liable to double taxation. This injustice is avoided by some states which have expressly exempted personal property of their citizens permanently located and taxed in other jurisdictions; in others the same rule has been established by judicial interpretation. But in intent, if not always in actual operation, the laws of most states sin against the most elementary rule of fair dealing. In New England, Massachusetts is a conspicuous offender. Against this form of spoliation there long seemed to be no constitutional safeguard, even though the courts rarely construed a statute in such a way as to enforce double taxation unless the language was too clear to permit of doubt concerning its intention. Recently, however, the Supreme Court of the United States has laid down the rule (199 U. S. 194) that a state cannot tax tangible property permanently located outside its borders. Over such property, the court declares, a state has no jurisdiction; and to tax it is equivalent to depriving a citizen of his property without due process of law.

Imperfect as our methods of taxing real estate and tangible personal property may be, they are perfection itself when compared with our attempts to tax intangible property. This consists of money, credits, and securities.

Under modern conditions mere cash, money on hand, is a comparatively unimportant item in the inventory of the average taxpayer; but money on deposit[1] would be a large one if it were assessed with even approximate accuracy and certainty.

The uniform result is widespread evasion. In Ohio the deposits in all banks exceed $500,000,000, and a large proportion must belong to persons subject to taxation in that state; yet the amount of money on hand or on deposit which was returned to the assessors in 1906 was but $59,984,000. In Madison County, which had a population of 20,000, not less than $634,000 of money was assessed in 1906; while in Hamilton County, which

[1] In some states savings deposits are specially favored. In Massachusetts, for instance, they are exempted from taxation, and the savings banks are taxed at the rate of five mills on the dollar upon their deposits. Various exemptions reduce the average rate paid by the banks to two and one-half mills.

had a population of 409,000, the assessment was $1,258,000. This was equivalent to a *per capita* return of $31 in the agricultural county, as compared with a return of $3 in the county which contained the city of Cincinnati.

In Illinois, in 1897, Cook County, which had one-third of the real-estate valuation of the entire state and more than one-third of the population, returned one-tenth of the money assessed for taxation. In the capital city of the state of Washington, in 1903, a widow who had received $2000 of insurance money after the death of her husband returned more money for assessment than all the other taxpayers, including corporations. In that entire state in 1906 the bank deposits alone were estimated at $115,505,000, while the total assessment of money and credits was $6,168,000.

Credits generally include all debts due from solvent debtors, but in a few states accounts not bearing interest and the book accounts of merchants already taxed on their stock in trade have been exempted. The unfairness of taxing credits without allowing persons to deduct their debts is so apparent that such deduction is usually permitted. The result is, however, to throw open the door to evasion through the simple process of contracting fictitious debts and other devious devices. Apart from the single item of mortgages on real property, which are matters of record,[1] the assessment of credits is usually small. In Wisconsin, for instance, a vigorous attempt to reach money and credits raised the total valuation of such property from $25,865,000 in 1900 to $73,055,000 in 1902; but in the latter year not less than $50,000,000 of the entire assessment consisted of mortgages, and a considerable part of the balance was made up of money, so that the amount of credits other than mortgages was comparatively insignificant. Wholesale evasion, with its attendant inequalities in the assessment of individuals and localities, is the general rule. In Ohio the total amount of credits, including mortgages, taxed in 1870 was $93,316,000, and in 1906 the assess-

[1] This is not to say that taxable mortgages are always assessed. Sometimes little effort is made to discover them. In 1889 the mortgage indebtedness of Wisconsin was ascertained to be $82,461,000, and the whole assessment of money and credits was but $6,513,000. Even the strictest inquisition will not prevent evasion, since it is easy to loan money in the name of friends or relatives residing in other states, or even to organize a corporation under the laws of another state for the purpose of making such loans.

ment had fallen to $77,230,000, although the wealth and population of the state had greatly increased. For the year last mentioned in Preble County, which had a population of 23,713, the return of taxable credits was $2,169,000; while Hamilton County, with a population of 409,000, returned $1,676,000. The *per capita* return was $91 in the rural county, and $4 in the urban. In Holmes County the assessment of credits was $43 *per capita*, and in Cuyahoga County, which included the city of Cleveland, the assessment was less than $5. In the state of Washington the entire return of money and credits was but $6,168,000 in 1906, while the mortgage indebtedness resting upon real property in the state was $120,000,000. And elsewhere, investigation shows, the results are uniformly and monotonously the same. Only the smallest fraction of the taxable credits is listed by the assessors, and most atrocious injustice is inflicted upon the few taxpayers who cannot or will not escape.

The taxation of securities is hardly more successful. A rigorous dooming law makes it possible to place arbitrary assessments upon persons whose general scale of living gives evidence of the possession of taxable property; but it tends to drive taxpayers out of any district where the practice prevails, or leads them to protect themselves by making false or misleading returns. Generally the tax a man pays is in inverse proportion to the securities he owns, since small estates are assessed far more severely than large. A person holding $25,000 of stocks or bonds may be taxed upon $10,000 or $15,000, while one who owns $1,000,000 of such property is likely to escape with an assessment of $50,000 or $100,000. When an assessment reaches $150,000 or $200,000 the assessor usually feels that he has done his full duty, since he knows that a further increase is likely to drive the taxpayer into some other jurisdiction where there is not even a pretence of enforcing the law. Sworn returns are made chiefly by executors and trustees, who have less inducement to evade taxation, and are sometimes in a position where it is impossible to do so. Thus it comes about that the tax falls with its full weight mainly upon widows or orphans, the most helpless class in the community. If ever there was a system repugnant to the moral sense of decent men the existing methods of taxing securities are such a system.

The taxation of intangible wealth is so much of a farce that

this class of property is usually a very small part of the total assessment. In 1902 the census obtained statistics of the money, credits, and securities[1] assessed in many of the states, and the results are highly instructive.

In fourteen states such property constituted from 1 to 5 per cent of the total assessed for taxation; in ten the proportion ranged from 6 to 9 per cent, and in three it exceeded 10 per cent. In states where mortgages were exempt from taxation the proportion was less than 5 per cent, and in those which showed the highest proportion of intangible property the principal item undoubtedly was mortgages. Figures recently compiled for one other state, Massachusetts, show that in that commonwealth the intangible property locally assessed in 1906 was 9.4 per cent of the total.[2]

Between individual taxpayers there is not the remotest approach to equality and justice in the distribution of the burden. Everywhere one hears of small estates, generally belonging to widows or held by trustees, that pay a tax amounting to 30, 40, or even 50 per cent of the income from the property; while large estates go virtually untaxed. Official reports tell us that the system is "a farce, sham and humbug"; that "a more unequal, unjust, and partial system could not well be devised"; that the tax is virtually "a tax on ignorance and honesty"; that "grievous wrongs are inflicted upon those least able to bear them"; that the law is made "the cover and excuse for the grossest oppression and injustice." Nowhere in the civilized world can there be found a more crude, unscientific, ineffective, and inequitable method of raising public revenue.

Even worse than the injustice of the system are the moral and political evils it produces. Almost everywhere taxpayers are, or may be, required to make sworn returns of their taxable property; and in proportion as this requirement is actually enforced one of two results is likely to ensue. Wealthier taxpayers consult their lawyers, and by innumerable devices are able to submit

[1] These figures do not include, of course, assessments of corporate properties levied directly upon the corporations themselves. We are not concerned here with the taxation of corporations, but merely with the taxation of securities assessed in the hands of the owners.

[2] Certain statistics are available also for two other states, Pennsylvania and Maryland. These are not given here because in both cases intangible property is taxed by a method different from that followed elsewhere.

statements which are technically correct but actually misleading; others, knowing nothing of such devices, resort to downright perjury as the only alternative to paying a tax that would take one-third or one-half of the income from good securities. The former method is the least objectionable of the two, but it places the taxpayer in the position of circumventing the law, and does not foster habits of good citizenship; the latter is the cause of fearful demoralization. Here again official documents abound in testimony to the evils of the system. It is declared to be "debauching to the conscience and subversive of the public morals—a school of perjury promoted by law"; it "puts a premium on perjury and a penalty on integrity"; it "debauches the moral sense," produces "widespread demoralization," and encourages "evasion and dishonesty." This is a severe arraignment, but no one familiar with the facts can doubt its truth.

One of the most severe laws ever contrived for the purpose of enforcing the taxation of intangible property has been in operation in Ohio for many years, and that state affords perhaps the best example of the iniquity and impracticability of the existing system. Besides requiring sworn returns of personal property, the law of Ohio authorizes any county auditor to summon a recalcitrant citizen before a judge of the probate court, and makes it the duty of the judge to punish the citizen for contempt if he refuses to answer any question which the auditor may ask concerning his personal property subject to taxation. Nor is this all. The auditor may summon any other person, including the cashier of any bank, whom he may suppose to have knowledge of any taxpayer's affairs, and may compel him to testify under oath. Such an investigation may extend back over a period of five years; and the law provides that, in case of proved evasion or false statement, five years' back taxes may be collected, with an addition of 50 per cent, as a penalty. Since the average tax rate in Ohio at the present moment is 2½ per cent of the capital value of taxable property, it will be seen that, with the penalty included, the amount that may be recovered from a man who evades taxes for a period of five years amounts to no less than 18.75 per cent of the entire value of his property. When such methods proved ineffective, the legislature finally authorized county officials to employ special agents to ferret out property escaping taxation, these agents, known as tax inquisitors, receiving as com-

pensation a percentage of the taxes recovered by their efforts.

The chief result of these drastic methods was to drive wealthy citizens out of the state. Washington, D. C., received some of them, and many others migrated to New York and other states. The city of Cleveland is estimated to have lost millions of capital, and the value of high-class residential property in Euclid Avenue and in its vicinity depreciated 40 or 50 per cent.[1] The immediate result of the tax-inquisitor system was to increase by a few millions the assessment of intangible property throughout the state, but that effect was merely temporary, and for many years past the total assessment has either remained stationary or shown a tendency to decline. In 1870 the intangible property assessed in the entire state was $136,273,000; by 1880 it had declined to $131,562,000. Then, under the operation of the tax-inquisitor law, the assessment increased until it amounted to $162,500,000 in the year 1893; but since that time it has declined until in 1906 the total was only $147,900,000. The larger proportion of this property is assessed in the country districts, and only a small proportion in the cities. Hamilton County, which contains the city of Cincinnati, returned $17,460,000 in 1866, and but $4,434,000 in 1906. Cuyahoga County, containing the city of Cleveland, returned in 1906 only $6,913,000; while Crawford County, with only 8 per cent of the population of Cuyahoga, returned $2,135,000, and Preble County, with less than 6 per cent of the population of Cuyahoga, returned $3,091,000. It is not easy to find words fit to characterize such a travesty upon all principles of political justice.[2]

In Massachusetts a less barbarous tax law has, by reason of better administration, yielded more substantial results than Ohio has achieved. In 1906 the assessment of intangible property in the former state was approximately $317,000,000, as against $147,900,000 in the latter. The showing was even more favorable to Massachusetts than these figures would indicate, since her

[1] From an address delivered by Mr. R. B. Smith before the Bankers' Club of Cincinnati in 1904, I take the following: "Thousands of the wealthiest men in Ohio have been driven out of it by its tax laws. In Cincinnati the names of a large number will readily occur to anyone familiar with its affairs. Can anyone recall the name of a single individual of means and leisure who has settled here within the last twenty years?"

[2] In 1906 the Supreme Court of Ohio held that the tax-inquisitor law was unconstitutional. An attempt has been made recently by county authorities to revive the system in Cuyahoga County, but the legality of this action was contested.

population was little more than two-thirds that of Ohio, while over one-third of the Ohio assessment must have consisted of mortgages, which are not taxed in Massachusetts. Yet no well-informed man supposes that the state reaches more than 10 or 20 per cent of the exceptionally large amount of intangible wealth belonging to her citizens; indeed, there is reason for thinking that the proportion is less rather than more than 10 per cent. The inequalities that ensue are as shocking as those encountered in other states, especially in towns and cities in which the assessors are the most faithful in the pursuit of estates disclosed in the courts of probate, or in "dooming" persons of moderate means who for various reasons are unable to change their place of residence. All the zeal of the assessors, however, does not prevent the gradual transference of the burden of taxation from personal to real property, precisely as in other states. In 1850 personal property appears to have borne 36.6 per cent of all the local taxes, and in 1906 it bore no more than 21.6 per cent.[1]

46. The Taxation of Property and Income in Massachusetts:[2] by Charles J. Bullock.—The history of the general property tax in one of the oldest of the American states and the important modifications made in 1916 are set forth in the following extract:

In principle the general property tax was established in Massachusetts by the well-known law of 1634 which provided that in all "rates and public charges" the towns should tax everyone according to his estate and with reference to "all other his abilities whatsoever." The first detailed tax law, enacted in 1646, established a system of taxation upon "visible estate" real and personal, supplemented by a tax upon incomes of laborers, artificers and others, which in time developed into a tax upon incomes not derived from property. With these levies upon estates and incomes went the poll tax which had existed in the colony from the very beginning. The act of 1646, therefore, definitely established a system of direct taxation upon property, income, and polls, which continued in operation without fundamental changes until 1862, and for the most part lasted until the twentieth century.

[1] Since 1861 the *per capita* assessment of personal property has declined. In that year it was $249.86; in 1905 it was $236.98. Outside of fourteen very wealthy towns the *per capita* assessment declined from $247.55 to $219.05.

[2] Reprinted from the *Quarterly Journal of Economics*, Vol. XXXI, pp. 1–61.

The operation of this tax system in the seventeenth century has been exhaustively studied by Professor Day,[1] who finds that it was customary to levy upon polls from 35 to 40 per cent of the direct taxes imposed for colonial and local purposes. In some communities the proportion was frequently greater than this, sometimes rising to 50 and even 60 per cent of the tax levy. Property, therefore, paid but 60 or 65 per cent of the direct taxes, and sometimes contributed 50 per cent or less.

Until the very end of the century the property tax was confined to *visible* estates, which term, however, probably included money. In practice this meant that land, buildings, and live stock accounted for nearly the whole of the assessments. Since land values were low and there were few expensive buildings in the colony, the proportion of the taxes falling upon live stock was very heavy. Professor Day finds that such property often accounted for one-half, two-thirds, and even three-fourths of the whole assessment placed upon estates, with the result that personalty frequently paid a larger proportion of the taxes than did realty. It may be estimated roughly that of every £100 of direct taxes levied in a representative Massachusetts town in the seventeenth century, some £35 to £40 was levied upon polls, and that the remaining £60 to £65 was contributed by real estate and live stock in proportions which varied but may not have been very unequal.[2] Personal property other than live stock constituted in most towns an unimportant part of the assessment, and incomes usually were a negligible factor.

The eighteenth century brought new conditions which gradually wrought material changes in the practical operation of the tax system. The proportion of direct taxation falling upon polls slightly decreased, since it became the general rule to levy one-third of the direct taxes upon polls and two-thirds upon property. Peculiar conditions sometimes made the poll taxes considerably higher or a little lower than this figure, but in the average town conditions probably conformed pretty closely to the intention of the law.

[1] E. E. Day, History of the General Property Tax in Massachusetts, 1630–88. (Unpublished thesis, in Harvard University Library.)

[2] In Boston, for instance, Day finds that in 1676 real estate accounted for 62 per cent of the total assessment of property, while in 1687 personalty accounted for 53 per cent.

The great change, however, was the advance of real estate to a commanding position upon the tax rolls. The frontier of settlement had been pushed forward into the Connecticut valley, and eastern Massachusetts was becoming a fairly populous and prosperous community. Land values were rising, and houses better than American architects ordinarily produced in the nineteenth century were becoming common. As a result, the assessed value of real estate steadily rose, and personal property became of much less relative importance. In 1792 the assessment placed upon realty was £713,600, that upon personalty was £144,400, while property "doomed" by the assessors, which was largely personalty, was assessed at £81,100. If we assume all the "doomed" property to be personalty, we may compute that personal property accounted for 24 per cent of the total assessment and real estate for 76 per cent.[1] Since one-third of the direct taxes was levied upon polls, we may compute that of every £100 of taxes levied in a Massachusetts town £33⅓ fell upon polls, £50⅔ fell upon real estate, and £16 fell upon personalty including income which was almost everywhere a negligible factor.

Wolcott's Report enables us to divide the £144,400 of property recorded as personalty into its component parts. Of this sum £66,300 represented live stock, £42,600 represented other tangible personalty, and £35,500 intangibles. What the £81,100 of "doomed" personalty consisted of we can only conjecture; but we may believe that it was composed chiefly of merchants' stocks, money at interest and other intangibles, and perhaps incomes. In considering these figures it should be remembered that at this time property was placed upon the assessment roll at 6 per cent of its true value, with the exception of unimproved real estate, which was assessed at 2 per cent.

Money was, doubtless, included in the visible estates for which inhabitants of Massachusetts were taxable in the seventeenth century. At the very end of that period money at interest is mentioned by the annual tax acts, and during the eighteenth century intangible property became subject to taxation. When corporations developed, their shares were taxable, like other personalty; but, as a gentle reminder to local assessors, the tax act for 1793 specifically mentioned bank stock. During the next

[1] See Wolcott's Report on Direct Taxes. State Papers, Finance, Vol. I, p. 451.

decade shares of bridge or turnpike companies and other moneyed corporations received similar mention. The commercial development of the state was greatly increasing the amount and the importance of this class of property, and the growth of a considerable body of public securities at the same period tended to the same result. In 1790 Massachusetts had merchant princes whose fortunes were counted by the hundred thousands, and in some cases approached the figure of $1,000,000. The money made in commerce soon overflowed into banking and manufacturing, and into bridge, turnpike, and canal companies, with the result that the amount of intangible personal property rapidly increased.[1]

From 1800 to 1850 the financial problems confronting Massachusetts were few and comparatively simple. When the federal government in 1790 assumed the greater part of the state debt, the burden of state taxation was reduced to an almost nominal figure.[2] By 1850 conditions had somewhat changed, but the pressure of taxation was still comparatively light. In Boston the tax rate for that year was $6.80, and this figure was probably not far from the average for the state at large. In interpreting these figures it is necessary to consider the further fact that real-estate assessments were undoubtedly at a lower percentage of the true value than they are at the present day. While the matter has not been fully investigated, such evidence as we have indicates that in the average city or town prior to 1860 realty was probably not assessed at more than 50 per cent of its true value.

Under such conditions an easy-going administration of the tax laws sufficed to place a substantial amount of personal property upon the assessment rolls. In Boston in 1794 over 57 per cent of the assessment appears to have consisted of personal property.

[1] This period is being exhaustively studied by Dr. H. H. Burbank, and will be treated in his book dealing with the history of the general property tax in Massachusetts since 1775.

[2] I have treated this subject in my monograph upon The Finances and Financial Policy of Massachusetts, chs. 2–4. The local governments were as yet undertaking few new functions, so that their expenses were comparatively light. The result was that the pressure of taxation was light and the general property tax met fairly well the requirements of the period. In Boston the tax levy of 1820 amounted to no more than $3.60 *per capita* and the tax rate was but $3.50. In 1840, after Boston had been a city for eighteen years and had greatly increased her expenditures, the tax levy was but $6.30 *per capita* and the tax rate $5.50.

In 1810 the proportion of personalty was over 45 per cent, in 1822 it was over 44 per cent, and as late as 1860 it was nearly 41 per cent. The *per capita* assessment of personal property in Boston was approximately $540 in 1804, and $635 in 1860. For the state at large no figures are yet available between the years 1792, when we have Wolcott's Report, and 1850, when we have the figures of the United States census. In the former year, as we have seen, if the property "doomed" by the assessors is counted as personal, 24 per cent of the total assessment consisted of personalty. In 1850 the census figures showed a total assessment of $551,000,000 of which nearly $202,000,000 was personal property, the percentage of personalty being 36.6. It appears, therefore, that between 1792 and 1850, at the time when intangible property first became an important factor in Massachusetts, the proportion which personal property bore to the total assessment rose from 24 to 36.6 per cent.

What proportion of the increased assessment of personalty consisted of intangibles and what proportion consisted of merchants' stocks, machinery, live stock, and the very important item of ships and vessels, has not yet been ascertained. It may be that intangible property accounted for only a small part of the increase; but so far as our present knowledge goes, we can say that there is no evidence that it was the growth of intangible property in Massachusetts which broke down the general property tax. Upon the contrary, during the period when intangibles became an important factor in the situation, the assessment of personal property showed both an absolute and relative increase. With low tax rates the assessors succeeded in reaching a sufficient amount of personal property to account for 40 per cent of the total assessments during the period.

An important change in the distribution of the whole tax burden occurred in 1814 when the proportion of direct taxes assessed upon polls was reduced to one-sixth of the total levies. In 1850 we may estimate[1] that of every $100 of local taxation, $16.67 was levied upon polls, $52.80 was levied upon real estate, and $30.50 was levied upon personal property and income, the

[1] If the bank tax, which yielded the state $354,700 in 1850, were added to the local taxes, the proportion of personal property in the total would be increased by perhaps six or seven dollars. But as we have no data concerning the taxes raised for local purposes, no accurate calculation can be made on this point.

latter still being a negligible factor. If these figures are compared with those computed for 1792, it will be seen that the proportion which real estate formed of the total assessment had slightly increased, and that the decrease in the levy upon polls was made up chiefly by the increase in the assessment of personal property.

The twenty-four years following 1850 were the critical period in the history of the general property tax in Massachusetts. The tax had met fairly well the requirements of the first half of the nineteenth century, but proved wholly inadequate for subsequent needs. All the evidence justifies the conclusion that it was the increase of public expenditures which caused the breakdown.

The growth of cities, the emergence of new public needs, the unusual demands of the Civil War, and the period of public and private extravagance which continued until the panic of 1873, combined to produce an unprecedented increase in expenditures. The outlay of the state government was $566,100 in 1850, while in 1860 it had increased to $1,193,000, and in 1868 had risen to $5,159,000. Thereafter it decreased to some extent, but at the end of a period of severe retrenchment stood at $3,907,000 in 1880. Local expenditures followed the same general course. For 1850 no data are available, but we know that in 1861 the taxes levied upon property in Massachusetts amounted to $7,145,000, and that by 1874 they had risen to $27,830,000. The total taxes of all descriptions levied in the commonwealth amounted to $8,284,000 in the former year and to $33,674,000 in the latter; while the *per capita* tax burden had risen from $6.69 to $20.87.[1] To make the situation worse, both state and local debts had shown a portentous increase, so that interest and sinking-fund charges were certain to complicate the financial problem of the future.

The only possible result was a sharp increase of tax rates. In Boston the rate advanced from $6.80 per $1000 in 1850 to $9.30 in 1860 and to $15.60 in 1874. In the entire state the average tax rate, which was $8.29 in 1861, was $15.18 in 1874. The strain of such high rates was greater than the existing system could possibly endure, and therefore taxation immediately became a "problem" in Massachusetts.

[1] These figures may be found in The Finances and Financial Policy of Massachusetts, pp. 46, 63, and 135.

One of the first readjustments required in the tax laws was a reduction of the poll tax. Since 1829 the law had provided that one-sixth of the state tax should be assessed upon polls, and that the same proportion should be followed in local taxes, provided, however, that the total poll tax levy for city, town, and county purposes should not exceed $1.50. If one-sixth of the heavy taxes levied for state purposes during the Civil War had been levied upon polls, and the assessments for local purposes had approximated $1.50, the aggregate poll taxes would have risen to high figures. Therefore in 1862 it was enacted that the aggregate poll tax for all purposes, state and local, should not exceed $2, with a possible exception in the case of highway taxes separately assessed. Even under this law the poll tax, which in 1861 had averaged $1.62, increased to $2.50 and $3 in many towns in 1864 and 1865; while such a rate as $4.25 was reported in one instance. For the entire state the average poll tax in 1865 was $2.11. With the tax limited in this manner, increases in local taxation thereafter fell wholly upon property; and the poll tax became a factor of decreasing importance.

The principal change that occurred during this period was the introduction of an extensive system of corporation taxes. In 1812 Massachusetts had imposed a tax of 1 per cent upon the capital stock of state banks, and twenty years later had levied a retaliatory tax upon the agents of foreign insurance companies chartered in states that taxed the agents of Massachusetts companies. The bank tax soon yielded a handsome revenue, and was the mainstay of the state's finances during the Civil War. It seems to have been looked upon as a tax upon the privilege of issuing notes, since the shares of the banks remained taxable in the hands of the stockholders. The insurance taxes never produced enough revenue to make them of financial significance. Up to 1862 Massachusetts had made no fundamental departure from the general property tax; and, except for comparatively unimportant exemptions, all property was subject to local taxation.

But in the year just mentioned a law was enacted which exempted from taxation deposits in savings banks, and then imposed upon the banks themselves an excise tax of one-half of 1 per cent. Although this rate was subsequently increased, then reduced, then increased, and finally restored to the original

figure, it was always less than the average rate imposed upon other property in Massachusetts; and as local tax rates increased, it finally fell to less than one-third of the average rate of taxation. It therefore established a separate classification for savings-bank deposits, justified no doubt upon the theory that such property was entitled to special consideration, but marking none the less a deliberate departure from the principle of the general property tax. It also raised interesting and important constitutional questions.

The earliest tax laws of the colony of Massachusetts had been based upon the English system of local taxation. That system had been based upon the principle of equal, proportionable, and ratable taxation according to the abilities of the citizens, but had not always employed the same measure of ability.[1] The earliest Massachusetts tax laws provided in almost identical language for equal and proportionable rating of the inhabitants of Massachusetts, and selected visible estates as the measure of the citizens' contributions. It, therefore, naturally happened that the province charter of 1691 contained a provision authorizing the general court to levy "proportionable and reasonable assessments, rates, and taxes." What the word "proportionable" meant to the person who inserted it in the charter, we do not know; but we do know that the word was never so construed as to prevent the province from classifying property for taxation. On the contrary, the provincial tax laws repeatedly classified property and continued to do so down to the time of the Revolution. Real estate was usually required to be assessed at six times the annual income. Live stock was assessed at arbitrary valuations fixed by law, and other personal property practically according to the judgment and discretion of the assessors.

The constitution adopted by Massachusetts in 1780 took over from the provincial charter the provision that the general court should have the power to levy "proportional and reasonable assessments, rates and taxes." If it had stopped there, it might never have been so construed as to prevent classification of the objects of taxation, because the colony and province had always levied excise and import duties, and the state continued to do so.

[1] Cannan's History of Local Rates in England gives sufficient evidence concerning the sources upon which the authors of the earliest Massachusetts laws drew.

It would probably have been evident to any court that the framers of the constitution had not intended to invalidate the existing system of excise and customs taxes, and it is therefore unlikely that the constitutional requirement that taxes shall be "proportional" would have been construed so strictly as to make excise and customs duties unconstitutional. But after conferring upon the general court the same taxing power that the province of Massachusetts had always exercised, the framers of the constitution inserted an additional provision authorizing the levy of "reasonable duties and excises." This action may have been due to a fear or belief that, without specific authorization of duties and excises, the general court might be unable to levy such imposts. But this caution was probably unnecessary. The taxation system of Massachusetts had never been proportional in any mathematical sense, and it had always included excise and customs duties, to which it would have been practically impossible to apply any requirement of proportionality. The excise clause, therefore, was probably unnecessary, and could have no other effect than to oblige the courts to find a reason for the inclusion of the word "proportional" in the clause relating to direct taxes and for its exclusion from the clause relating to duties and excises.

Whatever the framers may have intended, the second tax act[1] enacted after the adoption of the constitution provided that all property except unimproved lands should be assessed at 6 per cent of its real value, and that such lands should be assessed at 2 per cent. This was obviously a classification of property, and it continued to be the law of the commonwealth until its repeal in 1828 without any question being raised concerning its constitutionality. Another law of 1781[2] levied a duty upon coaches, chariots, and carriages, and required the inhabitants of the commonwealth under oath to make returns of such property to the local assessors. This was in everything except name a direct tax upon property, and could not have been upheld as an excise or duty except under such a broad construction of those terms as to render meaningless the distinction between the taxing power and the excise power. It also passed without question.

The meaning of the word "proportional" was considered by the Supreme Court for the first time in the case of *Portland*

[1] Ch. 16 of 1781. [2] Ch. 17 of 1781.

Bank v. *Apthorp* (12 Mass., 252), which involved the constitutionality of the tax levied upon state banks in 1812. The court upheld this tax as an excise, but took occasion to say that it could not be sustained as a tax because it was not proportional. Although this was a mere dictum, it inevitably carried great weight fifty years later when the next case arose; and yet if the dictum of the court was correct, it followed that the province of Massachusetts had never had anything remotely resembling a proportional system of taxation, and that the legislature of the state only a year after the adoption of the constitution had established an unconstitutional classification of real estate which was still in force, and under the guise of an excise had levied an unconstitutional tax upon certain other classes of property.

When the savings-bank tax came up for consideration, the court, following the reasoning of *Portland Bank* v. *Apthorp*, upheld it[1] as an excise or duty on the franchises of the banks, even though, unlike the bank tax of 1812, it was in lieu of local taxation of the deposits. The earlier decision had merely upheld an excise that was in addition to the property tax. The latter, however, made it possible for the legislature, wherever it could levy a valid excise, to exempt from local taxation the property which in effect had been excised. The door was opened, therefore, for a considerable extension of the excise power, and the legislature soon took advantage of the opportunity. Another important effect of the decision was to commit the court to the general line of reasoning followed in the earlier case, and to make it probable that, if the question ever arose, the dictum laid down in *Portland Bank* v. *Apthorp* would become a decision to the effect that a tax, in order to be constitutional, must be proportional in the strictest sense of that word.

Cases involving this question were not long in coming before the court, and it was presently held that the constitution required taxes on property to be so laid that, "taking 'all the estates lying within the commonwealth' as one of the elements of proportion, each taxpayer should be obliged to bear only such part of the general burden as the property owned by him bore to the whole sum to be raised."[2] Thus the tax clause of the con-

[1] 5 Allen, 428, 431, and 433.

[2] *Oliver* v. *Washington Mills*, 11 Allen, 275. See also 12 Allen, 298 and 312; 118 Mass., 386; 133 Mass., 161; 134 Mass., 424; 195 Mass., 607.

stitution was finally interpreted in such a manner as to make it prescribe strict uniformity in taxation.

In 1864 the general corporation tax was enacted, and, like the savings-bank tax, was sustained by the court as a valid excise. As is well known, it left the real estate and machinery of corporations subject to local taxation, and then imposed upon corporations a franchise tax which was to be assessed upon the so-called "corporate excess," or the amount by which the value of the capital stock exceeded the value of the real estate and machinery locally assessed. As the shares of the corporations were thereafter exempt from local taxation and the corporation tax was administered by the state, the law of 1864 introduced another radical change in the tax system of Massachusetts. But since the rate of taxation on the corporate excess was the average rate levied upon property in the commonwealth, the law involved no departure from the principle of the general property tax, and in this respect differed radically from the tax on savings banks. Except for the arrangement by which double taxation of the stock and of certain tangible property of corporations was avoided,[1] the only real change wrought by the law of 1864 was that thereafter the state dealt directly with corporations and the stockholders were exempted from local taxation. The change effected, therefore, was chiefly of an administrative character, and there was no intention that corporations should pay either more or less taxes than the general mass of property subject to local taxation.

The establishment of the national banking system was followed by the conversion of state into national banks, and this required changes in the tax law. The final outcome was the establishment in 1873 of the present tax upon the shares of national banks, which, being levied at the local rates of taxation, results theoretically in taxing banks in the same manner as other property. In 1874, therefore, Massachusetts was collecting from the savings bank, the general corporation, and the national-bank taxes $4,875,000 of revenue, which was over seven times the revenue derived from the old bank tax in 1861. The system had begun to be diversified, but except in the case of savings banks no de-

[1] Manufacturing corporations had been relieved from double taxation in 1832 by a law (ch. 158 of 1832) which provided that, in assessing the stock of such corporations, the local assessors should make a suitable deduction for the value of real estate and machinery already taxed.

parture had been made from the principle of the general property tax.

Without doubt the new taxes were more effective in reaching corporate property than the old methods of local assessment, so that perhaps the greater part of the revenue derived therefrom in 1874 represented an increase of financial resources. But this increase had not been sufficient, as we have seen, to prevent a rise of local tax rates under which conditions were rapidly going from bad to worse.

Boston was probably the first and also the chief sufferer. Mr. Thomas Hills, an able and determined advocate of the general property tax, was made one of the principal assessors in 1865, and in 1866 became chairman of the board. He increased greatly the efficiency of the assessing department, and inaugurated a vigorous search for taxable property under which Boston valuations rapidly increased. In 1860 the real estate of the city had been assessed at $163,891,000 and the personal property at $112,969,000. In 1865 these figures had been increased, respectively, to $201,628,000 and $170,263,000. By 1870 Mr. Hills had raised the real-estate assessment to $365,593,000 and the personal to $218,496,000; and in 1872 had raised the former to $443,283,000 and the latter to $239,440,000. Account must be taken, of course, of the annexation of Roxbury and Dorchester, which added materially to the total valuation; but even when this is done, the results secured by Mr. Hills were sufficiently striking.

But things were not working out as expected because personal property was rapidly migrating from Boston. Removals to the suburbs had been going on for many years, as is evidenced by the fact that before the middle of the eighteenth century it was necessary to amend the tax laws by providing that merchandise employed in any city or town should be taxable in that place and not at the domicile of the merchant. But under Mr. Hills there ensued a veritable hegira under which the attractive suburbs of Boston were rapidly built up at the expense of the city's tax rolls. The most striking case was that of Nahant, which in 1865 had assessed $513,000 of real property and $12,710 of personal, its tax rate standing at $15 per $1000. In 1870, however, thanks to Mr. Hills, its realty was assessed at $985,000 and its personalty at $4,160,000, while its tax rate had dropped to $2.50 per $1000. Between 1869 and 1873 not less than $13,900,000 of taxable per-

sonal estate was removed from Boston to eight suburban towns and to Newport, Rhode Island. Naturally enough, in time, such removals more than offset the diligence of Mr. Hills and his minions. The assessment of personal property reached high-water mark in 1874, when it stood at $244,554,000. Thereafter it steadily decreased until it reached low-water mark in 1879 at $184,545,000. But even in 1874 Mr. Hills had failed to increase the proportion of the taxes paid by personal property. In 1860 personalty constituted over 40 per cent of the total assessment, and in 1865 formed even a larger percentage. But in 1874, although the total personal assessment had increased by some $74,000,000, the assessment of real estate had been raised 175 per cent, with the result that personal property formed less than 31 per cent of the total assessment.

In the entire state, as we have seen, personal property had constituted over 36 per cent of the local assessments of $551,000,000 in 1850. By 1874, however, it accounted for 29.6 per cent of the total assessment of $1,831,600,000. Allowance should be made for the fact that the savings bank, the general corporation, and the national-bank taxes had removed a large amount of property from the category of "taxables," but only a small proportion of such property had ever been placed upon the assessment lists, and therefore the corporation taxes made comparatively little difference with the local assessments. In 1861, for instance, the deposits in the savings banks of Massachusetts amounted to $44,785,000, and of this sum the local assessors had taxed only $9,655,000. No similar comprehensive data concerning local taxation of the stock of Massachusetts corporations and of national banks are available; but in 1864 when, under the operation of the general corporation tax, the shares of Massachusetts corporations were exempted from taxation, the local assessments upon personal property decreased only from $343,500,000 to $324,600,000. In 1873, also, when the bank tax went into operation, the local assessments upon personal property decreased from $565,294,000 to $537,388,000. While, therefore, the total assessment of personal property for local taxation in 1874 would have been somewhat larger but for the changes wrought by the new corporation taxes, there had been a gradual shifting of taxation from personalty to real estate. Even if we estimate the reductions caused by the corporation taxes at the

very generous figure of $70,000,000, there would still remain a shrinkage of some 2 per cent in the proportion which personal property bore to the total local assessments. For a time, however, this tendency was probably offset by the fact that the new corporation taxes succeeded in reaching taxable values which would have eluded local assessment.

Since the poll tax was now fixed at what was practically a uniform charge of $2, the burden of taxation had shifted very greatly from polls to property. In 1874 polls were assessed for $877,700 in a total of $33,556,000, or for no more than 2½ per cent, which contrasts strikingly with the proportion of 16⅔ per cent established by the law of 1814.[1] The taxes paid by corporations amounted to $4,875,000 in 1874, and constituted 14½ per cent of the total. Local taxes upon personal property amounted to $8,229,000, or 24.6 per cent; and those assessed upon real estate were $19,573,000, or 58.4 per cent. Thus it appears that the reduction in the proportion of the taxes falling upon polls had been made up by the new corporation taxes; polls and corporations were paying in 1874 fully 17 per cent of the total taxes, whereas polls were required to contribute 16⅔ per cent under the law of 1814, and somewhat less than that under the law of 1829. But the corporation taxes were in effect taxes levied upon property, so that what the figures really show is that the proportion of the total taxes falling upon property had increased from 83⅓ per cent in the early part of the nineteenth century to 97½ per cent in the year 1874.

If we assume that the whole of the corporation taxes were levied in respect of personal property,[2] and therefore combine them with the taxes levied locally upon personalty, we find that the total contribution of personal property was $13,105,000, or 39.1 per cent of all the taxes levied in the commonwealth. This

[1] Of course the limitation placed by the Act of 1829 upon the local levy on polls tended to reduce appreciably the proportion of the total taxes falling upon polls, but up to 1850 the increase in the amount of taxes levied had probably not been sufficient to reduce the poll tax to a negligible factor.

[2] In fact, some part of the general corporation tax represented real-estate values, since, under a decision of the Supreme Court, the right of way of railroads and some other classes of public-service corporations is exempt from local taxation. This decision had relieved such property from taxation up to 1864, but after that it merely increased the taxable corporate excess upon which the general corporation tax was levied. See *Quarterly Journal of Economics*, Vol. XXI, pp. 185 and 218.

left 58.4 per cent of the total taxes to be paid by real estate. Compared with 1850, therefore, we find that the contribution of personal property to the total public revenue, state and local, had increased to 39.1 per cent, while the contribution of real estate had increased to 58.4 per cent.

Following the critical period which ended in 1874 came thirty-three years of comparative calm during which disintegration of the general property tax gradually and quietly continued. In 1874 dissatisfaction with the working of the tax laws led to the appointment of the first special commission to investigate the subject. This commission was composed of able men and submitted in January, 1875, a report which is replete with information. It was, however, dominated in its thought by Mr. Hills, who seems to have been the most influential as well as the most active member. The report recognizes existing evils, but does not understand their cause. It assails vigorously the proposal, made by the New York tax commission of 1871, to exempt personal property from taxation, and recommends merely changes in various details of the tax laws. For the evils attending the taxation of personal property the commission could make no more hopeful recommendations than that certain changes be made in the provisions of the law relating to offsets for indebtedness and the matter of domicile.[1] It was unfortunate for the commonwealth that its tax laws could not be radically altered in 1875, but the principle of the general property tax was undoubtedly approved by all but a small minority, and that minority had little more to propose than exemption measures designed to relieve certain kinds of personal property from taxation. All things considered, it seems probable that Mr. Hills and his associates voiced very faithfully the prevailing opinion of the state.

In the years that followed, discussion of tax problems was confined principally to the subject of double taxation. An organized effort was made to bring about the exemption of mortgages secured by Massachusetts real estate; and this was practically accomplished in 1881, when the present law upon that subject was enacted. Under that act a note secured by a mort-

[1] Report of the Commissioners appointed to inquire into the Expediency of revising and amending the Laws relating to Taxation and Exemption, pp. 101, 121. H. Doc. 15 of 1875.

gage of taxable real estate in Massachusetts is exempt from taxation as personal property; and the interest of the mortgagee in the real estate is taxable to him as real estate in the place where the land lies, while the mortgagor is taxable only for his equity in the property. Since, however, the law does not prohibit contracting out, mortgages invariably provide that the mortgagor shall assume all taxes; and the practical result is that real estate is taxed to the mortgagor at its full value, while the mortgage note is exempt. This law had the effect of exempting from taxation about $48,000,000 of mortgage debts reported as assessed for taxation in 1881. But the assessment of personal property throughout the state decreased by only $3,600,000 in 1882, and the following year it was $6,900,000 larger than it had been before mortgages were exempted.[1]

Advocates of the general property tax interpreted these figures as meaning that the loss of $48,000,000 of taxable mortgages was offset by the natural increase of other personal property, and reasoned as if the assessment for 1883 might have been not $6,900,000 but $54,900,000 greater than the assessment for 1881 if mortgages had not been exempt. In fact, however, things would not have worked out that way. The exemption of mortgages nominally relieved $48,000,000 of personal property from local taxation. But, in reality, very few of the owners of such property had previously been assessed for their entire personal estates as the law directed, or had made returns of their taxable property. Except in cases where a person's property consisted largely of mortgages and he could therefore make a return to his assessors that reduced his taxable personalty below the amount for which he was assessed in 1881, taxpayers who had been "doomed" for a given amount of personal property in 1881 had no interest in coming forward in 1882 with statements of their taxable personalty. They were presumably assessed for as much personal estate as in 1881, and therefore received no benefit from the mortgage exemption. The situation was like that which developed later when, in order to encourage forestry, new plantations were exempted from taxation for a stated period of years. This exemption was of absolutely no benefit to the

[1] These figures, as well as those given above concerning the operation of the corporation taxes, may be found on pp. 36–38 of the Report of the Commission on Taxation of 1907.

average farmer, because his farm was usually assessed for somewhat less than it was worth and the assessors could add to the rest of the farm all that they were obliged to take off from the plantation. We are not to suppose, therefore, that, if mortgages had not been exempted in 1881, the assessment of personal property in 1883 would have increased by $54,900,000 instead of $6,900,000 as it actually did.

After 1881 few changes in the tax laws occurred for many years. Until 1906, indeed, the only significant development was the introduction, in 1891, of a tax upon collateral inheritances and successions. In point of fact, tax legislation in Massachusetts was in a state of deadlock.

Advocates of change, who were increasing in numbers, labored to secure the exemption of foreign corporation stocks, and sometimes urged the total exemption of all intangible property. Upon the other hand, the assessors of the state, who numbered considerably more than 1000, had been organized by Mr. Hills and others into a state-wide association which was able to offer determined resistance to any and all exemption measures.

Advocates of the existing system proposed various measures to make the tax laws more effective, of which the most important were the appointment of assessors by some state authority and the taxation of personal property at a uniform rate which should be the average imposed upon real estate subject to local taxation. Either of these measures would have wrought havoc to the state, since the time had passed when it was possible to enforce the taxation of personal property at the prevailing local rates or at an average state rate. Such taxation would have meant confiscation of one-third or one-fourth of the taxpayers' incomes and would have led to wholesale removals of property from Massachusetts. As things stood, the tax laws resulted in what was aptly described as a "system of confiscation tempered by favoritism." The legislature was not disposed to grant further exemptions that might increase the burdens falling upon taxable property; and, upon the other hand, it probably realized that the existing laws were not capable of strict enforcement, and therefore was not disposed to adopt the drastic measures favored by the assessors.

In 1893 a joint special committee of the legislature was appointed to revise the laws relating to taxation, and the following

year reported against radical changes in the taxation of property.[1] But conditions were going from bad to worse, so that in 1896 a special commission was appointed to inquire into the expediency of revising the tax laws. The following year this commission submitted a noteworthy report which grappled squarely with the problem confronting the commonwealth. It investigated searchingly the practical operation of the existing system, and recommended that intangible property be exempted from taxation. It realized, however, that a substitute or substitutes should be found for the tax upon intangibles, and therefore recommended that the inheritance tax should be extended to direct inheritances, and that a habitation tax should be introduced which should be levied upon house rentals in excess of $400.[2]

Although this plan provided substitutes for the existing tax upon intangible property, the legislature was not ready for radical departures from the existing system, and therefore the recommendations of the commission bore no immediate fruit. But the report effectively exposed the evils of the existing system, and pointed out their cause. It therefore served as the starting-point for subsequent discussion, and proved to be a document of great educational value. In 1906 another joint-special committee on taxation was appointed which recommended no radical changes in the property tax but advocated the taxation of direct inheritances, which was finally carried into effect by an act of 1907.[3] A minority of the committee, reverting to the recommendations of the commission of 1896, advocated the exemption of intangible property from taxation but proposed no substitute.

Meanwhile, the general property tax was steadily disintegrating and producing conditions which were certain to lead ultimately to revision of the tax laws. Public expenditures, which had

[1] Sen. Doc. 9 of 1894. The above statement relates to the majority of the committee. Minority reports favored the exemption of stock of foreign corporations and the exemption of state and municipal bonds.

[2] Report of the Commission appointed to inquire into the Expediency of revising and amending the Laws of the Commonwealth relating to Taxation, p. 120 (Boston, 1897). The Commission also recommended that the state should retain in its treasury the revenue from the general corporation tax, and should then assume county expenses.

[3] Report of the Joint-Special Committee on Taxation (Boston, 1907).

greatly declined during the period of retrenchment following 1874, were again upon the increase. The total taxes of all descriptions levied in the commonwealth had decreased from $33,674,000 in 1874 to $25,714,000 in 1879, but by 1890 they had risen to $39,731,000, and by 1905 had reached the imposing total of $72,121,000. The *per capita* tax burden, which in 1874 had been $20.87, in 1905 was $24.01, and local tax rates were again increasing. From 1874 to 1879, during the period of enforced economy, the average tax rate in the state had declined from $15.51 per $1000 to $12.78. During the next fifteen years the average hovered around $15, but by 1900 it had risen to $16.14, and in 1905 it stood at $17.25. Under such conditions the evils which were serious enough in 1874 were gradually becoming intolerable.

One result of the heavier pressure of taxation was an increase in real-estate valuations, especially in the cities. The mere desire to obtain revenue without undue increase of tax rates would have led, in any event, to somewhat higher valuations; but this tendency was increased by the operation of the law of 1875 limiting city debts, and that of 1885 limiting city tax rates. Under these acts many cities were obliged to increase real-estate valuations in order to provide the necessary margin for loans and to keep tax rates within the specified limit. If this had resulted merely in changing the old-fashioned practice of valuing property at "about" one-half or two-thirds of what it was worth, it would have been a matter for congratulation. But in some cities it finally resulted in valuations so high as to be clearly excessive. There are to-day within the metropolitan district not a few municipalities in which it is difficult to sell real estate for its assessed valuation and transfers are frequently made at much lower figures.

Tangible personal property was seriously affected by the high rates of taxation, but in many cases had a comparatively easy method of escape, namely, incorporation. Merchants and manufacturers who found themselves more heavily taxed upon their goods, wares, or merchandise than their competitors in other states could incorporate under the laws of the commonwealth and come under the general corporation tax. Under this tax real estate and machinery remained subject to local taxation, and the rest of the property of corporations was supposed to be fully

reached by the tax which the state levied upon the so-called "corporate excess." In practice, however, it developed that whereas an individual or a firm was taxable upon all property without deduction of debts except against the item of credits, the corporation was able to deduct the whole of its indebtedness from its assets taxable under the corporation tax. This circumstance, with others, brought it about that in 1902 the manufacturing and mercantile companies subject to the corporation tax owned merchandise valued at $143,604,000, and had a taxable corporate excess of no more than $104,238,000. It is clear, therefore, that the effect of the corporation tax was even at that time to enable incorporated companies to reduce the tax upon their merchandise, or at any rate to reduce it below what it would be if the local assessors assessed it at its true value. In 1903 a maximum limit was placed upon the corporate excess, which had the effect of enabling many concerns to secure a further reduction of their taxes. While in individual cases the corporation tax was fully as heavy as the local tax upon unincorporated enterprises, and in some cases even heavier, there can be no doubt that, upon the whole, manufacturing and mercantile concerns found incorporation an easy method of escape from increasing burdens of local taxation.[1] In extreme cases it was possible to arrange matters so that an incorporated mercantile concern secured exemption from local taxation upon its merchandise, and then, after deducting its debts, had no corporate excess to be taxed by the state.

Other kinds of tangible personalty did not fare so well. Live stock is employed in an industry where incorporation is highly uncommon. Machinery is expressly excepted from the operation of the corporation tax, and is very heavily taxed in some localities. In textile centers it sometimes forms a very large percentage of the total valuation, as may be seen by looking at the assessments of personal property in such cities as Fall River and

[1] The operation of the tax upon the corporate excess of manufacturing and mercantile companies is so complicated that it cannot be adequately treated in this paper. I may refer to my article upon the taxation of corporations in Massachusetts, published in the *Quarterly Journal of Economics* for February, 1907. The subject has been fully discussed in recent annual reports of the tax commissioner and in a special memorandum prepared for the legislative committee on taxation in May, 1916 (H. Doc. 2133 of 1916).

New Bedford.[1] In some cases it is supposed that manufacturers and assessors have working agreements under which machinery is assessed at a certain proportion of its actual value, and in other localities it is probable that machinery is taxed upon something less than a full valuation. But, upon the whole, it is reasonable to conclude that machinery is very heavily taxed in Massachusetts, and probably more heavily than in most other states.

Intangible personalty found several avenues of escape. In the first place, it tended more and more to leave communities where tax rates were high, and to concentrate in a number of attractive residential towns where taxpayers could virtually fix their own assessments. Between 1871 and 1891 not less than $75,000,000 of personal estates assessed in Boston through the diligence of Mr. Hills were removed to fifteen favorite towns. In the former year these towns had assessed $26,750,000 of personal property; in the latter their personal assessments had advanced to $52,558,000, —an increase of $25,808,000. Even if we assume that during the interval there had been no increase of personal property except the $75,000,000 gained by the removal of certain taxpayers from Boston, it would appear that the local assessors had taxed but one-third of these estates. In 1882 one town received an estate assessed in Boston at $800,000, and in the following year increased its assessment of personal property by no more than $281,000, but was able nevertheless to reduce its tax rate from $11 to $7 per $1000.[2]

In this connection it should be noticed that the method which the state followed in distributing among the cities and towns the revenue from the corporation and the bank taxes tended still further to give taxpayers the whip hand over the assessors. The general principle was to divide this revenue according to the residence of the stockholders;[3] and this brought it about that

[1] Of a total valuation of $106,691,000 in 1915, the personal property of Fall River accounted for $42,707,000, or slightly over 40 per cent. In New Bedford, in the same year, out of a total valuation of $111,346,000, personal property accounted for $41,845,000, or approximately 37 per cent. These percentages are to be compared with an average of about 25 per cent in the total assessment in the state. Fall River and New Bedford do not tax very large amounts of intangible personal property, so that it is probable that the greater part of the taxable personalty in those cities consists of machinery.

[2] See Report of the Commission on Taxation (1908), pp. 45–46.

[3] In 1898 the first departure from this principle was made when it was provided that the tax paid by street railroads should be distributed among cities and towns

when a wealthy taxpayer changed his residence the town to which he removed received an increased share of the corporation and bank taxes. The result was that assessors knew that strict enforcement of the tax on intangible property would not only lead to the removal of such property to some other jurisdiction but would decrease the amount of corporation and bank taxes received from the state treasury.

As years passed, the distribution of intangible property, and of the corporation and bank taxes, became more and more favorable to the wealthy towns. In 1865, before the process of concentration had begun, the fourteen wealthiest towns had derived a revenue of $6.87 *per capita* from local taxes on personal property and the corporation and bank taxes, while in the rest of the state the revenue from these sources amounted to $5.81. Twenty years later these fourteen towns were receiving $14.28 *per capita*, while the average for the rest of the state had fallen to $4.48. In 1905 the revenue of the fourteen towns had increased to $24.01 *per capita*, while that of the rest of the state amounted to $5.35, a trifle more than the figure for 1885 but materially less than the amount received in 1865. Somewhat similar conditions can doubtless be found in other states and countries, but it is probable that the student of taxation would have difficulty in finding elsewhere such extreme concentration of taxable resources as was gradually brought about in Massachusetts after 1865. The only possible result was the creation of inequalities by which the rates of taxation in the cities and industrial towns were greatly increased, while they were lowered to almost nominal figures in a handful of wealthy communities.[1]

But overburdened taxpayers had still another method of escape; they could change their investments. Prior to 1862 this opportunity had not been open to them, since practically every form of investment was taxable. But when savings deposits were exempted from taxation, it was possible for people of means to make increased use of the savings banks. That this was done almost from the outset, there can be little doubt;[2] and it is cer-

where the tracks were located. Subsequently, the distribution of the tax on other corporations was modified in the interest of the industrial towns where such enterprises were located.

[1] This subject was first carefully studied by the Tax Commission appointed in 1896. See Report, pp. 63–68.

[2] See the Report of the Tax Commission appointed in 1874, pp. 61 *et seq.*

tain that no small part of the very large deposits of Massachusetts savings banks to-day are held by people of means. Another door was opened by the great increase of the federal debt during the Civil War, which supplied investors with upward of two billions of non-taxable securities. The establishment of the corporation tax in 1864 placed the stocks of Massachusetts corporations in the list of so-called non-taxables. At first this may not have affected the situation, but in time there was created an artificial demand for tax-exempt stocks which were bought in large quantities by trustees and some others who were not in a position to change their domicile and could not well avoid making returns of personal property. The exemption of mortgages in 1881 created another class of untaxed investments, so that altogether a rather wide range of opportunities was open to persons acquainted with the provisions of the law.

In many cases untaxed securities were bought for permanent investment, so that no evasion of the tax laws was either contemplated or practised. But it was now possible to invest temporarily in non-taxables for the purpose of escaping assessment upon taxable securities. This could be done only a day or two before the date of assessment in any year, and there developed a regular spring demand for securities that could be held over assessment day and then returned to their former—perhaps one might say actual—owners. In other cases the practice was different but the result the same. Comparatively few investors ordinarily made returns of their personal property, and intangibles were usually taxed by "doomage." This meant that assessors would begin with a small assessment, and then, if the taxpayer did not make a declaration of his property, would subsequently increase it. In time the assessment might reach a figure that would compel the taxpayer to seek relief, and this could be had by shifting his investments from taxables to non-taxables until he could make a full return of his personal property under oath. Such a statement would probably satisfy the curiosity of the assessors for a number of years, so that after making it the taxpayer could at the first favorable opportunity sell his non-taxables and reinvest in taxable securities. There has probably been comparatively little downright lying in the taxation of personal property in Massachusetts; perjury is an ugly thing, and the law did not make it necessary. Intangible property never-

theless managed to evade assessment, and could do so in many cases without change of the taxpayer's domicile.

The next result was that personal property paid a constantly decreasing proportion of the local taxes. In 1907, out of a total local assessment of $3,512,000,000 in the state of Massachusetts, personal property accounted for no more than $766,600,000, or 21.8 per cent; whereas in 1891 it had constituted 25.2 per cent of the total valuation, and in 1871 had constituted 33.8 per cent. At the end of this period it can be estimated that about half of the personal property actually taxed consisted of intangible personalty.[1]

In the distribution of the total burden of state and local taxation some changes had occurred since 1874. In 1907 polls were assessed for $1,758,000 of taxes, or 2.4 per cent of the entire amount. The tax, however, was not so easy to collect as in former years, and the actual contribution made by polls was somewhat less than the percentage just stated. Since 1874 the liquor license tax had come into operation, and this, with some minor business taxes, amounted in 1907 to $3,453,000, or 4.7 per cent. The collateral inheritance tax introduced in 1891 now yielded $772,000, or about 1 per cent of the total. The corporation taxes amounted to $9,761,000, or 13.2 per cent. The taxes levied locally upon personal property stood at $12,386,000, or 16.8 per cent; while those levied upon real estate amounted to $45,794,000, or 61.9 per cent. Comparison with the figures for 1874 shows that polls were assessed in 1907 for substantially the same proportion as in 1874, that personal property and corporations accounted for 30 per cent of the total against 39 per cent in the former year, and that real estate paid 61.9 per cent of the total taxes against 58.4 per cent at the beginning of the period. The net result was that the proportion of the taxes paid by personal property and corporations had decreased by some 9 per cent, and that this had been made up by business and inheritance taxes, which now contributed 5.7 per cent, and by an increase in the real-estate taxes of something more than 3 per cent.

A new chapter in the history of taxation in Massachusetts opened in 1908. In the previous year the inheritance tax was

[1] See Report of Commission on Taxation (1908), pp. 40 and 67. Compare also the data found on pp. 50–51 of the Report of the Commission of 1896.

extended to direct inheritances, and this brought the whole property of inhabitants of the state under review by the tax commissioner's department. Up to that time the local assessors had not infrequently gained information from probate returns. But since no tax was imposed upon direct inheritances, it was often possible for executors to avoid disclosing the amounts of probated estates, a request from all the heirs that no inventory be filed being sufficient to accomplish this end. With a direct-inheritance tax in operation it was no longer possible to avoid filing inventories, and this fact alone would have altered materially taxation conditions in the commonwealth.

Another law enacted in 1908 hastened the inevitable crisis. The tax commissioner, in 1898, had been given certain supervisory powers over the local assessors,[1] and thus the first step had been taken toward the establishment of central control over the assessment of property. The commissioner, however, was given but a single assistant to carry on the work of supervision, and there was no direct-inheritance tax which enforced the filing of inventories of all estates; so that prior to 1908 his supervisory power had not been effective enough to alter materially the situation. But in that year a law was enacted[2] by which the powers of the tax commissioner were extended, and he was authorized to appoint three supervisors of assessors to assist him in the performance of his new duties.

The act stopped short of authorizing him directly or through the supervisors to revise local assessments, and merely authorized him to direct the local authorities to assess property in the manner prescribed by law. In case local assessors failed to comply with such directions, the commissioner could merely notify the mayor of the city, or the selectmen of the town, of such failure, a provision which becomes almost humorous when one recalls that in many of the towns the selectmen are also the assessors. The tax commissioner was indeed authorized to cause an assessor guilty of any violation of law for which a penalty was imposed to be prosecuted in the county courts, but for various reasons this did not meet the needs of the case. It therefore happened that in some instances the local officials refused to obey the directions of the commissioner; but in a majority of

[1] Ch. 507 of 1898. [2] Ch. 550 of 1908.

cases his recommendations met with substantial compliance, so that the Act of 1908 proved fairly effective. It at least created machinery by which information coming to the probate courts under the operation of the direct-inheritance tax was systematically gathered by the supervisors of assessors and transmitted to the taxing authorities of the cities and towns. After 1907, therefore, the local taxing authorities were continually supplied with more information about taxable personalty than they had ever possessed before, and in some cases more than they desired to possess. Up to this time the general property tax had been undergoing a gradual process of disintegration; it might have lasted many years longer if no provision had been made for stricter enforcement. But the law of 1908 rapidly produced conditions under which a fundamental change in the system soon became inevitable.

Another factor that contributed to the same result was the growth of private agencies for collecting and distributing information concerning the ownership of corporation stocks. Foreign corporations doing business in Massachusetts were required to file lists of their stockholders with the secretary of state, and these lists supplied a mine of interesting information. Others could sometimes be reached by examining lists filed in other states, or by purchasing a share of stock and then demanding the right to examine stock books. In recent years, therefore, Massachusetts assessors have been able to procure, if they desire it, a large amount of information concerning taxable corporation stocks; and the result has been a fuller assessment of such property than was formerly possible.

There naturally followed a substantial increase in local assessments of personal property. From $766,600,000 in 1907 the figures advanced to $930,817,000 in 1910, to $1,033,000,000 in 1912, and to $1,195,100,000 in 1915. During the entire period of eight years the total increase was $428,500,000, which was practically equal to the total increase in local assessments of personal property between 1861 and 1907. The table on the following page shows the facts for significant years.

It will be seen that, after declining for fifty-seven years, the proportion of personal property in the total valuations increased from 21.8 per cent in 1907 to 25.1 per cent in 1915. This was a substantial achievement for the supervisors of assessors, but its

STATISTICS OF TOTAL AND PERSONAL PROPERTY ASSESSMENTS IN MASSACHUSETTS

Year	Total Valuation	Valuation of Personal Property	Percentage of Personal Property
1850	$551,106,000	$201,977,000	36.0
1861	861,500,000	309,400,000	35.9
1874	1,831,600,000	542,300,000	29.6
1881	1,642,200,000	498,300,000	30.2
1907	3,512,600,000	766,600,000	21.8
1915	4,769,900,000	1,195,100,000	25.1

effect was not what was anticipated. In the first place, the property thus listed tended to disappear from the tax rolls in a comparatively short time through changes in investments or domicile. Prior to 1908 domiciliary changes had been mostly within the state, and the tax laws had probably driven little property out of Massachusetts, although they had doubtless prevented a certain amount from coming here. But after that year removals became increasingly frequent, and presently threatened serious injury to the commonwealth. Precise data on the subject are, of course, very difficult to obtain; but by 1914 it was estimated, and generally believed, that the property removed from Massachusetts in that year was not less than $100,000,000. Whatever the exact amount may have been, it was now large enough to attract public attention and to affect materially the attitude of lawyers and bankers who were in a position to know what was going on.

The second natural result was to increase greatly the demand for non-taxable investments; and, inevitably, a greater demand began to create a greater supply. The manufacture of non-taxable preferred stocks of Massachusetts corporations became a regular industry; and, as was natural under the circumstances, some of the new securities proved to be of doubtful solidity. In 1907 the number of new corporations organized under the business corporation law was 1234, having a total capital of $63,372,000. By 1912 the number of such corporations was 1453, having a capital of $213,466,000. Thereafter there was somewhat less activity among promoters, but both the number of companies and the total capital remained much larger than had ever been known. In 1913, 1914, and 1915 the business corporations organized were,

respectively, 1504, 1604, and 1700; while the figures of the total capital were, respectively, $172,103,000, $123,211,000, and $113,509,000. Unfavorable business conditions may have been partly responsible for the decrease that followed 1912, but another probable cause was a growing distrust of the new securities.

A third result was to stimulate greatly migration to the favored residential towns. Whenever the assessors in the ordinary city or town, acting upon the information furnished by the supervisors, increased materially the assessment of personal property, some favored town immediately acquired new inhabitants. The average rate of taxation in the state was gradually increasing from about $17 per $1000, the figure for 1907, to $18, and finally $19. But in the wealthy residential towns tax rates were often less than $10 per $1000, and valuations were low. Such conditions could not be permanent.

Some of the developments in particular localities during this period deserve to be mentioned. The town of Norwood in 1908 had a tax rate of $26.50, and at that juncture the assessors received information concerning $2,000,000 of taxable estates, which amounted to more than one and one-half times the existing assessment upon personal property. If matters had taken the usual course, these estates would have been taxed for a sum that would have absorbed fully half of the income, and would presently have been removed from the town. But under exceptionally fortunate and able leadership Norwood decided to try to assess all property at its full value, and thereby reduce the rate of taxation to a tolerable figure which would not drive any citizen away. Accordingly, in 1909 the valuation of real estate was increased from $4,739,000 to $7,680,000, while that of personalty was raised from $1,361,000 to $6,118,000. This resulted in an increase of over 125 per cent in the total valuation and, together with a reduction in the tax levy, reduced the rate of taxation to $8.50. For the moment the crisis was averted. But the tax rate was still higher than intangible property could bear permanently; and in subsequent years the assessment of personal property gradually declined, while, despite further increases in the valuation of realty, the tax rate began to increase. In 1915 the assessment upon personalty was half a million less than in 1909, while the tax rate had increased to $12.80. Norwood had shown that exceptional conditions might enable an industrial town to enforce

the tax laws without inviting immediate disaster; but its subsequent experience demonstrates that not even such conditions will avail in the long run.

Stimulated by the example of Norwood or urged by the supervisors of assessors, a few other localities sought to enforce strictly the existing tax laws, but with very different results. The city of Malden in 1909 increased the assessment of personalty from $6,734,000 to $12,751,000, and reduced its tax rate from $19.20 to $15.70; but by 1912 the assessment of personalty had declined to $8,438,000, and the tax rate had returned to the figure for 1908. Meanwhile, a number of wealthy residents had changed their domicile, and the city had lost a substantial amount of revenue from corporation taxes. Between 1909 and 1911 the city of Quincy increased the assessment of personalty from $5,813,000 to $7,830,000, and reduced its tax from $20.40 to $19.50. But two years later the personal assessment had sunk to $6,254,000, while the tax rate had advanced to $23.70. Salem tried the same experiment between 1909 and 1912, increasing its personal assessment from $9,821,000 to $10,617,000, and reducing its tax rate from $18.60 to $18. But in 1913 nearly a million of personal property disappeared from the tax roll, and the tax rate advanced to $20.50. Such examples were sufficient to deter other localities from attempting to emulate the example of Norwood.

The other side of the picture may be seen by turning to some of the small residential towns. In 1908 Dover had assessed $470,000 of personal property and $931,000 of realty, and had a tax rate of $9.80. In the following year the assessment of personal property jumped to $4,296,000, and the tax rate fell to $4.30. This suddenly acquired wealth was thereafter retained, and, in fact, increased to $6,925,000 in 1914, in which year the tax rate was $5.50. The town of Rowley in 1912 assessed $170,000 of personal property, and had a tax rate of $13. But in the next year the assessment of personalty rose to $2,088,000, and the tax rate decreased to $5.50. Though subsequently changes occurred, Rowley continued to tax a large amount of personalty, and remained in affluent circumstances.

The most striking case was that of the town of Orleans, which in 1910 had taxed $181,000 of personal property at a rate of $15 per $1000. The next year the assessment of this class of property increased to $968,000, and the tax rate fell to $3. With its

reputation thus established, the town continued to increase its taxable wealth until in 1915 the valuation of personalty amounted to $3,941,000, and the tax rate was prevented from reaching the vanishing point only by liberal outlays for improvements. In this case corporation and bank taxes were an especially important factor in the situation. In 1910 Orleans had raised $10,259 from taxes upon property, and had received only $1085 from the state treasury on account of corporation and bank taxes. In 1911 the levy upon property declined to $4557, while the revenue from corporation and bank taxes increased to $10,302. In 1914 the taxes upon property had increased to $11,509, as a result of the inflow of personal estates, while the revenue drawn from the state treasury had risen to $24,883. In that year Orleans enjoyed a revenue of $37,108 from all sources, including polls, whereas in 1910 it had an income of $11,982.

In 1915 Orleans showed a tax rate of $3 per $1000, the lowest in the state, and seven other towns had tax rates that were less than $10; fifty-two towns showed rates ranging from $10 to $14.80; nine cities and one hundred forty-seven towns showed rates ranging from $15 to $19.90; while twenty-six cities and one hundred and eleven towns had rates that ranged from $20 to $30. These inequalities persisted in spite of certain changes in the distribution of the corporation taxes, by which the revenue from mercantile and manufacturing corporations was allotted to the localities where the plants were situated and business carried on. Further changes in the distribution of the corporation and bank taxes might improve somewhat the position of the cities and the ordinary agricultural or manufacturing towns, but the distribution of taxable personal property had become so unequal as to make the situation worse than it had been prior to the introduction of the direct-inheritance tax and the enactment of the law creating supervisors of assessors. In 1905 the fourteen towns previously mentioned had received $24.01 of revenue *per capita* from corporation taxes and the local tax on personal property; while in the rest of the state the revenue was but $5.35 *per capita*. In 1915 the figures were, respectively, $29.50 and $7.54.[1] Nothing but a radical change in the laws relating to taxation held out any prospect of relief.

[1] It is worth while to notice the changes that occurred over the whole period from 1865 to 1915. In the former year fourteen favored towns derived a *per capita* revenue

From 1907 to 1915 only slight changes occurred in the distribution of the total burden of taxation. Of the total of $112,280,000,[1] polls were assessed for $2,055,000, or 1.8 per cent, which is to be compared with 2.4 per cent for 1907. Liquor licenses and minor business taxes contributed $3,678,000, or 3.3 per cent, which is 1.4 per cent less than in the earlier year. Corporations paid $12,484,000, or 11.1 per cent, as against a percentage of 13.2 eight years earlier. The inheritance tax yielded $3,104,000, or 2.8 per cent of the total, which is an increase of 1.8 per cent over 1907. The taxes assessed upon personal property stood at $22,180,000,[2] which was 19.8 per cent of the total, the proportion of personalty being 3 per cent greater than at the beginning of this period. Finally, real-estate taxes contributed $68,776,000, or 61.2 per cent, which was 0.7 per cent less than in 1907.

As was to be expected, the introduction of a tax upon direct inheritances led to renewed efforts to secure a better method of taxing personal property. In response to a petition from leading business interests, and upon the recommendation of the governor, another tax commission was authorized in 1907. In the following year this commission recommended[3] changes in the distribution of the corporate franchise tax, the exemption of future issues of county and municipal bonds, the appointment of supervisors of assessors, and the introduction of a flat tax upon intangible property—the so-called "three-mill tax."

The first proposal was promptly carried into effect by a law which provided that thereafter the taxes paid by manufacturing and mercantile corporations and distributed among the several cities and towns should be divided equally between the localities where the stockholders resided and those in which the business was carried on.[4] Since previously the whole amount not retained by the state had been allocated to the towns where the stockholders were domiciled, this act tended to mitigate somewhat the growing inequality between the wealthy residential

of $6.87 from the stated sources, and the rest of the commonwealth $5.81. In 1915 the figures were, respectively, $29.50 and $7.54. Thus the fourteen towns had gained $22.63, while the rest of the state had gained $1.73.

[1] From this total automobile licenses are excluded.

[2] In this item is included $76,644 of revenue paid into the state treasury under the operation of the bond-registration tax.

[3] Report of the Commission on Taxation appointed under the provisions of ch. 129 of the resolves of 1907 (Boston, 1908).

[4] Ch. 614 of 1908.

towns and the rest of the state. Subsequent acts[1] turned over to the towns where business was carried on the whole of the revenue from ordinary business corporations except that part, representing the proportion paid in respect of stock owned by non-residents, which was retained by the commonwealth. The result was that between 1905 and 1915 the whole amount of revenue received from corporation taxes by the fourteen favored towns previously referred to decreased from $10.36 *per capita* to $6.20, whereas in the rest of the state it increased from $1.62 to $1.93. In 1916 a final act[2] provided that the taxes paid by all remaining classes of corporations, except that part representing non-resident stock, should be allocated to the cities and towns where the business is carried on. This leaves only the revenue from the bank tax subject to the old rule of distribution according to the domicile of the stockholders.

The second recommendation of the commission also was accepted. In 1905 the state treasurer had urged that future issues of bonds of the commonwealth should be exempt from taxation. He showed that of $84,580,000 of registered bonds then outstanding 70 per cent were held outside the state, 24 per cent were held by corporations and institutions within the state but exempt from taxation thereon, and only 6 per cent were in the hands of individual inhabitants subject to local taxation.[3] The legislature, accordingly, passed an act exempting future issues of state bonds,[4] under which it was estimated that the state gained one quarter of 1 per cent in the interest rate upon the next issue.[5] The cities and towns now came forward with the request that their securities also should be made tax exempt, and the legislature exempted from taxation future issues of county and municipal bonds.[6]

This step was stoutly opposed by most of the remaining advocates of the general property tax. But the practical situation confronting the cities and towns called loudly for a change. No investor would purchase a bond yielding 4 per cent interest with the expectation of paying a tax amounting to 1½ or 2 per cent, and accordingly city and town treasurers withheld from the assessors information concerning the ownership of municipal

[1] Chs. 456 of 1910 and 198 of 1914.
[2] Ch. 299 of 1916.
[3] Treasurer's Report, 1905, pp. 6–7.
[4] Ch. 493 of 1906.
[5] Treasurer's Report, 1906, pp. 8–9.
[6] Chs. 464 and 594 of 1908.

bonds. In some cases, indeed, they made it their policy to inform investors that this was their practice. Little or no revenue was actually derived from the tax upon municipal bonds, while the fact that such bonds were legally taxable tended to limit somewhat the demand and so to increase the rate of interest. Neither the state nor the towns could expect a reduction of interest equivalent to the average rate of taxation, since so many of the bonds were held by corporations and exempted institutions and so few of the remainder were ever taxed, but it is probable that the broader market opened to public securities in consequence of exemption resulted in an immediate reduction of about one quarter of 1 per cent in the interest basis.

In time the exemption of municipal securities opened the door to serious abuse. The city and town officials soon learned that there was a regular demand for tax-exempt securities just before the first day of April in each year, and began to accommodate their offerings to this situation. In January, February, and March increasing quantities of short-term notes maturing after April 1 began to come into the market, which commanded very low rates of interest. In 1911 the total amount of short-term notes issued by the towns was $9,700,000, while by 1915 it had risen to $15,363,000, an increase of approximately 60 per cent. But the striking fact was that the notes issued in January, February, and March, which were those utilized over the first day of April, increased from $2,580,000 to $5,180,000, or more than 100 per cent; while the amount of notes issued in April, May, and June, which could not be so utilized, remained practically stationary, the increase being less than 10 per cent. Complete data for the cities are not available, but the issues of notes recorded in the leading financial papers show the same conditions that developed in the towns. In 1911 these papers reported the issue of $4,667,000 of city notes during the months of January, February, and March, while in 1916 they reported a total of $9,870,000, an increase of over 110 per cent. The March issues, which were especially sought around tax day, rose from $1,460,000 in 1911 to $5,590,000 in 1916, an increase of nearly 300 per cent. Interest rates upon these issues were very low, sometimes falling below 2 per cent, and in some cases reaching such figures as 1.3 per cent, or even one quarter of 1 per cent; while one city actually received a small premium for accommodating

an investor with $100,000 of notes maturing just around tax day. Thus an exemption intended to apply to permanent investments in municipal securities came to be a means of facilitating temporary changes in investments with a view to evading taxation.

The third recommendation of the commission resulted in the enactment of the law, already discussed, by which three supervisors of assessors were appointed and provision was made for distributing among the local boards information about property uncovered in the probate courts. This proposal originated in connection with the plan for a flat tax on intangible property, but was presented separately by the commission with the suggestion that the establishment of a three-mill tax upon intangible property "will remove all reasonable ground of objection to the proposal for state supervision of the assessment of property." Since it has been supposed by not a few people that the supervisor law was proposed with the deliberate intention of forcing a crisis in taxation affairs, it is important to recall the fact that it originated in connection with a plan for establishing a fair and practicable method of taxing intangible property.

The fourth recommendation was that intangible property should be exempted from other taxation, and should then be taxed at the uniform rate of three mills upon each dollar of the fair cash value, or $3 per $1000. Since such a tax would be levied at the same rate in every city and town, taxpayers would have no inducement to change their domicile; and since it would substitute a reasonable for a confiscatory exaction, it could be strictly enforced without driving people out of the state. It was based upon a plan which had been tried in Pennsylvania and Maryland with no little success, and was subsequently adopted by Minnesota, Iowa, Rhode Island, and North Dakota. The commission realized, however, that it was open to objection upon constitutional grounds, and therefore recommended that the legislature secure the opinion of the Supreme Court concerning its constitutionality. In case the opinion of the court should be adverse, the commission pointed out that the constitution of the commonwealth ought to be amended.

In due course the legislature submitted the question to the Supreme Court, which pronounced the three-mill tax unconstitutional.[1] Thereupon, an amendment was proposed striking out

[1] 195 Mass., 607.

of the constitution the requirement that taxes must be proportional, but this failed to secure the two-thirds vote required in the House of Representatives. The following year a similar amendment passed the legislature, but with a provision that it should be referred to a special commission for further investigation. This commission submitted to the next legislature an adverse report,[1] which in 1910 resulted in the defeat of the proposed amendment, so that the project of a three-mill tax had to be abandoned.

Opposition to the proposed constitutional amendment was based upon a number of grounds. In the first place, Mr. Hills, Mr. Henry Winn, and most of the local assessors opposed it because they still desired to have all property taxed at the same rate. Many of them would have favored the taxation of personal property at the average rate prevailing throughout the commonwealth, but they were unwilling to make any further concessions. A second group of remonstrants would have favored the establishment of a uniform tax upon intangible property at some such rate as $10 or $12 per $1000, but contended that a rate of $3 was altogether too low and would tend to increase the burden upon other classes of property. A third ground for objection was the belief that a reduction of the tax upon bonds and upon stocks of foreign corporations would affect adversely the value of nontaxable securities. And, finally, a fourth reason for opposition was the fear that the removal of the requirement that taxes must be proportional would open the door to favoritism and to radical legislation.

Taxation conditions in Massachusetts were then so bad that it is probable that the opposition of the first two classes of remonstrants would not have availed to defeat the amendment. But the arguments advanced by the other objectors raised a number of new questions which seemed to many people to require further time for consideration, and divided the forces which otherwise might have favored a better method of taxing intangible property.

In 1911 Governor Foss directed the attention of the legislature to the subject of taxation,[2] and recommended the establishment

[1] Report of the Commission Appointed to Investigate the Laws Relating to Taxation (December, 1909).

[2] See H. Doc. 1900 of 1911. Also Sen. Docs., 255 of 1912 and 39 of 1913.

of a state income tax and the adoption of a better method of taxing wild and forest lands. Prior to 1910 it would probably have been useless to propose in Massachusetts such a measure as a state tax upon incomes, since here, as elsewhere, the people had long been accustomed to the taxation of property and were inclined to regard an income tax as inquisitorial. But the situation suddenly changed when Congress submitted to the states the sixteenth amendment to the federal constitution. This brought up for consideration the whole question of income taxation, and required every one in active political life to define his attitude upon it. Those who advocated immediate ratification of the amendment could not urge that a state income tax would be inquisitorial; while those who opposed such ratification usually did so upon the ground that the income tax should be reserved for the states, and were not in a position to argue that Massachusetts ought not to employ it. Governor Foss's proposals, therefore, met with very general support; his amendment authorizing a special forest tax was immediately adopted, and nothing but differences of opinion concerning the proper form of an income-tax amendment prevented acceptance of his other recommendation.

These differences, however, proved difficult to harmonize; the more so because they offered a convenient reason for opposition to any change in the method of taxing intangible property. They turned chiefly upon the questions, whether the amendment should authorize a progressive income tax, and whether it should provide that property taxed upon its income should be exempted by constitutional requirement from other taxation. In 1912 and 1913, as in 1911, controversy over these points was chiefly responsible for the defeat of proposed income-tax amendments.

But while such controversy continued, conditions were becoming increasingly serious. Orleans had a $3 tax rate, other favored towns were receiving large accessions of taxable personalty every spring, and it was becoming evident to the people of the rest of the state that they could not hope to retain even their existing revenue from intangible property. Moreover, removals of large amounts of personalty to neighboring states were becoming increasingly common, and were causing well-founded alarm. These conditions finally led the mayor and the assessors of Boston to favor the income-tax project, and elsewhere tended

to disintegrate the opposition of local assessors. Moreover, the tax commissioner had become convinced of the necessity of reform, and the annual reports of his department were dealing vigorously with the subject in a manner which could not fail to impress both the legislature and the public. Finally, Wisconsin in 1912 introduced a state income tax which proved an immediate success and furnished an impressive object lesson to Massachusetts.

In 1911, at the suggestion of Governor Foss, the tax commissioner instituted an investigation of the data furnished by the inheritance-tax returns, and found that in estates passing through the probate courts the personal property amounted to between three and four times as much as the realty. From September 1, 1907, to August 31, 1908, the returns of all estates, whether taxable or not, showed that the real property brought under review was valued at $22,462,000 and the personalty at $70,715,000. From September 1, 1908, to December 1, 1911, the returns showed real property amounting to $97,734,000 and personal property valued at $368,741,000. Upon the assumption that the total personalty of the inhabitants of Massachusetts was more than three times the total realty, and that at least one-half of the personalty was taxable under existing law, the tax commissioner estimated that there must be from $4,000,000 to $5,000,000 of taxable personal property within the commonwealth, whereas the local assessors in that year had assessed but $984,300,000.[1] Up to that time it had been possible to argue that, although much intangible property evaded taxation, the assessors were able to secure the greater part of it. But thereafter it was usually accepted as a fact that the untaxed personalty, chiefly intangibles, was three and perhaps four times as great as the amount actually taxed. This tended to give a somewhat new turn to discussions of the tax problem.

In 1914 the need for a change in the method of taxing intangible property became so apparent that, without waiting for a constitutional amendment, the legislature established a registration tax upon certain classes of bonds.[2] It provided that holders of bonds secured by mortgage upon tangible property actually taxed in Massachusetts or elsewhere might register such bonds with the tax commissioner and pay a registration tax of three mills on the dollar. Bonds so registered were to become exempt

[1] See Sen. Doc. 255 of 1912, pp. 2–3.

[2] Ch. 761 of 1914.

from other taxation. As a property tax, of course, this measure would have been wholly invalid, but the legislature acted upon the theory that it might be upheld as a valid excise. Doubts about the constitutionality of the measure were sufficient to prevent most investors from taking advantage of the act, but substantial amounts of bonds were registered with the tax commissioner up to the repeal of the law by the Income Tax Act of 1916.

Agitation for a better method of taxing intangible property was becoming increasingly active and influential. In 1908 a committee of prominent citizens was organized to advocate the adoption of the three-mill tax, and the following year the Boston Chamber of Commerce took up the subject in vigorous fashion. In 1910 a state-wide organization known as the Merchants' and Manufacturers' Committee on the Tax Laws came into the field, so that the movement was no longer confined to Boston and its immediate vicinity. In 1914 the Massachusetts Tax Association was organized, with Lucius Tuttle as its first president and a board of directors representing many of the important business interests of the commonwealth as well as organized labor. Upon Mr. Tuttle's death, Ex-Governor Curtis Guild succeeded to the presidency, and an active campaign was instituted under most favorable auspices. With the coöperation of Governor Walsh and the tax commissioner's department, a constitutional amendment permitting the levy of a proportional income tax, but not requiring that property taxed upon its income *must* be exempted from other taxation, was drafted and submitted to the legislature, which ratified it by decisive votes in both branches. This amendment passed the legislature of 1915 even more decisively, and in the following November was adopted at the polls by an overwhelming vote. The way was now open for a reform of the tax on personal property.

The legislature of 1915, anticipating the ratification of the amendment, authorized the appointment of a special commission on taxation which was instructed to investigate the advisability of changes in existing tax laws and to draft an income-tax act. In January, 1916, this commission[1] submitted the draft of a well-considered act which, under the impetus of the overwhelm-

[1] Report of the Special Commission on Taxation (1916).

ing ratification of the income-tax amendment at the polls, was enacted after much discussion but with little effective opposition.

The income-tax law of 1915 was designed primarily to provide a better method of taxing intangible property. It therefore exempts such property from local taxation, and imposes upon its income a tax of 6 per cent, from which, however, $300 of taxable income is exempt for persons whose total income from all sources does not exceed $600. But for the tax levied since 1646 upon personal, trade, and professional incomes, the law of 1916 might have been confined to the income from intangible property. Since, however, that tax was in existence and was not likely to be repealed, it was necessary for the new act to take cognizance of this fact. It would have been clearly undesirable to have two income taxes: one levied by the state and strictly enforced; the other levied by local assessors and almost a dead letter. The obvious and expedient solution was the transfer of the old local tax to the commonwealth, and therefore the law of 1916 includes a tax upon income from personal, trade, and professional earnings. Finally, the act imposes a tax of 3 per cent upon profits derived from dealings in intangible personal property.

The new law, therefore, is much narrower in scope than the federal income tax, which applies to income from all sources, and somewhat narrower than the Wisconsin income tax, which reaches practically all incomes except dividends from certain classes of corporations. It follows, however, what was undoubtedly the line of least resistance for Massachusetts. There was no popular demand for a new method of taxing real estate and tangible personal property, and the problem before the legislature was that of finding a better method of taxing intangible personalty. The result is a perfectly logical adjustment by which personal, professional, and trade incomes and income from intangible property are taxed by the state; while tangible property continues to be subject to local taxation upon its capital value.

Following antecedent practice, the Massachusetts income tax is imposed upon "inhabitants" of the commonwealth. It is, therefore, a personal tax payable by people who are inhabitants of the commonwealth at any time between the first day of January and the thirtieth day of June in any year. Persons who are not inhabitants within the meaning of that word as defined

by the Supreme Court are not subject to the tax, even though they may carry on business in Massachusetts; and, upon the other hand, inhabitants of Massachusetts are taxable upon income derived from business carried on outside of the commonwealth. The working of this feature of the law will be watched with interest.

The tax upon the income from intangible property substitutes a reasonable and uniform tax for one levied at rates that ranged from $3 to $30 per $1000. Under the old system many people evaded taxation, some compounded with the local assessors for a reasonable tax, and still others paid one-fourth or one-third of their incomes. The intention is that the new tax shall be enforced upon every one, and the act accordingly provides adequate methods of administration.

The first thing, of course, is the requirement of sworn returns of income from taxable intangible property, which must be made on or before the first day of March in each year and relate to the income of the preceding calendar year. Failure to file such a return renders a taxable person liable to an additional tax of $5 for every day he is in default. Continued failure after receipt of a notice from the tax commissioner makes a person liable to be assessed by the commissioner for twice the amount of his taxable income, and subjects him to a further penalty of fine, imprisonment, or both. Conviction for refusal to make a return works the forfeiture of a person's right to hold public office within the commonwealth for such a period, not exceeding five years, as the court may determine. Similar penalties are provided for making fraudulent returns, the law making no distinction between persistent refusal to file a return and the filing of a return found to be fraudulent. Since the enforcement of the act is to be wholly in the hands of the state tax department, these penalties should prove adequate.[1] No careful lawyer or responsible banker will advise a client or customer to trifle with the new law; and there is every indication that the income tax, with its requirement of sworn returns, has been accepted by the business community, and

[1] The act, of course, makes suitable provision for preventing disclosure of the details of tax returns. It provides, however, that the names of the persons who have filed returns shall be open to public inspection. It permits taxpayers to file their returns either with the tax commissioner or with the income-tax assessor of the district in which they live.

will be strictly complied with. It will not be people of wealth, but those of smaller means and little or no business experience, who will cause most difficulty.

The tax upon the income of intangible personalty applies only to such property as was formerly subject to taxation; thus incomes from mortgages upon taxable Massachusetts real estate, deposits in savings banks, tax-exempt state and municipal bonds, national bank stock, and the stock of Massachusetts corporations are all exempted. The same is true of income from so-called "stocks" of most of the voluntary associations which are so common in Massachusetts. In general, owners of securities will find that they are taxable only upon income derived from sources that were taxable under the old law. About the only exception is found in the case of trusts or other voluntary associations not owning real estate exclusively, or shares in Massachusetts corporations, and not doing business principally in Massachusetts.

A very important and interesting feature of the tax on the income from intangibles is that it provides for a deduction on account of indebtedness. The property tax had authorized such deduction only against certain credits; that is, it allowed the taxpayer to deduct money he owed from debts due him. The new law does not indeed permit the deduction of interest paid upon any and all debts from the income received by the taxpayer from taxable intangible property. To do so would have been wrong in principle and would have opened the door to wholesale evasion. Deduction of all debts from taxable income is necessary as well as proper under a general income tax applicable to income from all sources, but under a partial income tax it is manifestly impossible. The new law, therefore, follows what may be called the principle of granting the taxpayer a proportional offset or deduction. It provides in effect that, from the income received from taxable intangible property, the taxpayer may deduct such a proportion of the interest paid on his total indebtedness as the income which he derives from taxable intangible property bears to his total income.

The provisions of the law at this point are necessarily complicated, but their practical operation may be shown by the three following cases: a person receiving $99,000 of income from taxable intangible property and $1000 of income from other sources may deduct from his taxable income derived from intangible

property 99 per cent of the interest paid upon his indebtedness; a person receiving $50,000 of income from taxable intangibles and $50,000 from other sources will be able to deduct one-half of the interest which he pays upon his debts; and, finally, a person receiving $1000 from taxable intangible property and $99,000 from other sources will be permitted to deduct but 1 per cent of the interest upon his obligations. These cases do not take account of all the provisions of the law and are intended merely to illustrate the principle which is eminently fair and in practice should offer no serious difficulties.

Another departure from former practice is the provision which grants an exemption of $300 of income from intangible property to persons whose total income from all sources does not exceed $600 during the year in respect of which the tax is assessed. Under the old law a person owning taxable securities received no exemption, and in many cases where small estates were uncovered in the probate courts great hardship arose. There was, indeed, a provision that the assessors might exempt the polls and any portion of the estates of persons who by reason of age, infirmity, or poverty were deemed to be unable to contribute toward the public charges. But this did not meet the needs of the case, since a person with a capital of $5000 or $10,000 was not in a position to plead "poverty." Thus it came about that persons deriving small incomes from taxable property were frequently taxed for 20 or 25 per cent of such incomes. The new law not only reduces the rate of taxation to 6 per cent of the income from intangibles, but provides an exemption of $300.

The tax imposed upon income derived from annuities and from "professions, employments, trade, or business" will be levied at the uniform rate of 1½ per cent. This is a trifle less than the average of the local tax rates to which such incomes were subject under the old law. It is expected, however, that the assessments made by state authorities will be so much more complete that the revenue will be considerably greater than formerly. The new law continues the exemption of $2000 of professional, personal, or trade incomes, and provides the further exemption of $500 for a married person and $250 for each child under the age of eighteen years, or for a parent dependent upon the taxpayer for support; but provides that the total exemption shall in no case exceed $3000. Income from annuities received no exemptions

under the old law, but under the new has an exemption of $300 if the total income of the annuitant from all sources does not exceed $600.

In its provisions concerning professions, employments, trade, or business, the new law is noteworthy because it carefully defines taxable income. The old law merely provided that the "income" from such sources should be taxed, and that income derived from property subject to taxation should not be taxed. The Supreme Court held, however, that this permitted the taxation of the entire income of a merchant even though his merchandise might be subject to local taxation,[1] so that in fact double taxation of merchandise and the income derived therefrom was possible. The new law imposes the tax upon the net income of a business, determined substantially as any good accountant would compute it; and then provides that a taxpayer may deduct from such net income a sum equal to 5 per cent of the assessed value of the tangible property, real and personal, owned by him and used in the business.

The tax of 3 per cent imposed upon profits derived from dealings in intangible personal property is levied upon all inhabitants of the commonwealth whether or not they are engaged in the business of dealing in such property. It also applies to dealings in all classes of securities, taxable and non-taxable. The tax is to be levied upon the "excess of the gains over the losses," and is to be assessed annually. But the law provides that trustees or other fiduciaries shall be assessed at the time a trust is terminated unless it continues for more than five years, in which case the assessment shall be made at least in every fifth year.

This provision of the act occasioned considerable discussion. Without it, gains from dealings in intangible property would have been taxable at the rate of 1½ per cent if they formed part of the income of any business carried on by inhabitants of the commonwealth; but they would not have been taxable to individuals who speculated in securities. Now an income tax differs from a property tax in that it exempts from taxation property yielding no income, which, if it has any value, would be taxable under a property tax. It is obviously the intention of the new law that persons who speculate in non-dividend-yielding stocks shall be

[1] *Wilcox* v. *Middlesex County Commissioners*, 103 Mass., 544.

taxed upon their speculative gains, even though they may not be engaged in the business of buying or selling intangible property. That the rate was placed at 3 per cent instead of 1½ per cent was perhaps due in part to the desire to tax the "speculator"; but it is also explicable on the ground that intangible property is now exempt from taxation as property, so that persons who deal in it may fairly be required to pay a somewhat heavier rate than persons who deal in merchandise or other taxable tangible property.

As already stated, the administration of the income tax is placed in the hands of the state tax commissioner. It was not to be expected that the tax would work well if administered in approximately three hundred and fifty different ways by approximately three hundred and fifty local boards of assessors; and Massachusetts acted wisely in turning the work over to the commonwealth. During the fifty years of its existence, the tax commissioner's department has been administered in a manner that has commanded general confidence, and all that needed to be done was to add to its equipment a new bureau charged with the assessment and collection of the income tax.

The tax commissioner accordingly is authorized to appoint an income-tax deputy who will have general charge of the taxation of incomes. He is also to divide the state into districts, and to appoint an income-tax assessor for each district. Thus the administration will be in some measure localized, but the number of districts will probably not exceed ten or twelve, and responsibility will rest with a single ultimate authority, the state tax commissioner. Under this arrangement there will undoubtedly be intelligent and even-handed enforcement of the law in every city and town, so that taxpayers will have the assurance that all citizens are being treated alike. The tax commissioner is authorized to make necessary rules and regulations for the assessment and collection of the income tax, and will undoubtedly be given a generous allowance for necessary expenses. Upon the administrative side, therefore, the law of 1916 seems to make adequate provision for strict enforcement of the tax upon incomes.

Information at the source is also required in certain cases. Every employer of labor must report to the tax commissioner the

names and addresses of all regular employees who are inhabitants of Massachusetts, and have received wages, salaries, or other compensation in excess of $1800 during the previous calendar year. Also corporations doing business in the commonwealth and voluntary associations having transferable shares are, unless their stocks fall within the class of tax-exempt securities, required to report the names of their shareholders. They are further required to report the names of all inhabitants of Massachusetts to whom they have paid annuities or interest upon their bonds, notes, or other evidences of indebtedness, except interest on coupon bonds and incomes exempt from taxation under the act. Neither of these requirements is unduly burdensome, so that no such difficulties will arise as have developed under the federal income tax.

A final provision of interest is that concerning the taxation of personal property in the year 1917 when the new law goes into effect. Since intangible property is hereafter to be exempt from local taxation, many taxpayers will be entitled to reductions of the local assessments upon their personalty; but since tangible personal property to-day is frequently under-assessed, it is important that such persons should not receive greater reductions than they are entitled to. The law, therefore, provides that in 1917 no local assessment of personal estate shall be reduced below the amount assessed in 1916, unless the taxpayer makes a return of his tangible personal property. This means that, in order to benefit by the exemption of intangible property or income formerly subject to local taxation, taxpayers must file with their local assessors in 1917 a return of their taxable personality. For the average citizen this would mean household furniture in excess of $1000, automobiles, carriages, horses, and live stock; and for merchants and manufacturers it will mean a return of merchandise and machinery. In this manner there will be secured a much fuller assessment of tangible personalty than ever before; so that the new law, by providing a just and practicable method of taxing intangibles, will remove many of the difficulties that have hitherto attended taxation of tangible personalty. In this respect it is probable that the experience of Massachusetts will be the same as that of the few other states that have adopted fair and efficient methods of taxing intangible property.

The new law is calculated to yield a revenue somewhat greater than is now derived from intangible property and taxable incomes, and there can be little doubt that it will fulfill expectations. It should be remembered, however, that Massachusetts has been taxing some $500,000,000 or $550,000,000 of intangible personalty, so that the results of the new act cannot be as spectacular as those secured in other states where intangible property had formerly contributed little or nothing.

The intangible property taxed in 1914 probably paid somewhat less than the average rate of taxation because of its concentration in wealthy towns. If we estimate that it paid $16 per $1000, it yielded a revenue of $8,000,000 to $8,800,000. The amount of incomes now taxed is not known, but it probably does not exceed $20,000,000, and the taxes collected from this source cannot exceed $350,000 or $400,000. The new income tax, therefore, must yield from $8,000,000 to $9,000,000 in order to offset the loss of revenue occasioned by the exemption of intangible property and income from local taxation. It ought to do so, since all the estimates show that there are in the state enough taxable intangibles, and professional, personal, or trade incomes, to give the desired result. This calculation assumes that the exemption of intangibles and income from local taxation will decrease local assessments of personal property by some $550,000,000. But this will not be the case, because of the provision that such assessments shall not be less in 1917 than in 1916 unless taxpayers bring in returns of their taxable property. The law, therefore, is certain to produce a larger revenue from tangible personal property, an important factor of safety in calculations of the probable result of the new income tax.

Greatly in favor of the new act is the fact that it was adopted only after some years of serious discussion which familiarized the people of the commonwealth with the evils of the existing system and the need of having reasonable and enforcible tax laws. It represents a fairly general consensus of opinion reached after thorough consideration, and therefore promises to solve the most vexatious of taxation problems. This has been the experience of other states that have introduced reasonable methods of taxing intangible property, and there is little ground for doubt about the result in Massachusetts.

47. The General Property Tax in Switzerland:[1] by Charles J. Bullock.—With the foregoing accounts of the working of the general property tax in the United States it is useful to compare the following account of the position and operation of this tax in Switzerland:

For an American the property taxes of the Swiss cantons have peculiar interest. Switzerland is the only country of Europe in which direct taxes upon property hold such a position in the fiscal system as they occupy in the United States. It has a federal form of government, and therefore, like the United States, must adjust federal finances to state and local, while readjusting the latter to the conditions created by the formation of a federal union. In political institutions, also, fundamental similarity exists, since both countries are democratic. Evidently, then, the property taxes of the Swiss cantons operate under conditions closely resembling those with which the American student is familiar; they are in most, though not all, cases the mainstay of the state and local finances; they have been adjusted more or less perfectly to the relations that exist under a federal system of government; and they have been shaped in accordance with the popular will of some of the most democratic communities in the world.

I

The property tax in Switzerland is a very old institution; it is also, as we now find it, mainly the product of the nineteenth century. In the Middle Ages the German emperors levied direct taxes upon the property of their Swiss subjects. In the thirteenth and fourteenth centuries, as various cantons secured fiscal autonomy, property taxes were employed whenever occasion demanded, as in Schwyz, for example, where as early as 1294 there was a tax on the capital value of property, and each citizen was required to make "a loyal and true" declaration of his entire fortune. These imposts were, however, an occasional and extraordinary form of revenue, since in ordinary times the governments were expected to subsist upon the income from public property and the produce of indirect taxes. Glarus and Geneva seem to have been the first cantons to make direct taxes upon property a regular and ordinary resource; in the former the

[1] Reprinted from the *Proceedings of the Fourth Annual Conference of the National Tax Association*, pp. 53–84.

present general property tax, and in the latter the *taxe mobilière*, have been in continuous operation since the last half of the seventeenth century. Elsewhere the property taxes remained an extraordinary expedient, and early in the eighteenth century completely disappeared. In 1798 the Helvetic republic introduced taxes on land and movables; but when the cantons regained their autonomy in 1803, most of them abolished these taxes,[1] and undertook to finance themselves in the eighteenth-century fashion. But conditions were changing, and with the growth of democratic institutions were to change still more until direct taxation in some form or other became an absolute necessity. Then, and only then, were direct taxes upon property or incomes reëstablished. Zurich led the way in 1832, and by 1856 had been followed by eleven other cantons. Between 1867 and 1879 four others reintroduced direct taxation; Solothurn, the last to reconcile itself to the new order of things, postponing its evil day until 1894, when a series of deficits compelled the people to accept a combined property and income tax. Except in two cantons, therefore, the existing Swiss property taxes are of comparatively recent origin, and are a reluctant concession of Swiss democracy to the financial exigencies of the nineteenth century.

The present status of these taxes is both similar to the status of the property tax in the United States and at the same time different from it. In Switzerland, as in our own country, the revenues of the federal government are derived chiefly from indirect taxes; and direct taxation is reserved for the use of the state and local governments. There is not, however, in Switzerland such a separation of the federal from the state and local taxes as prevails in the United States. The Swiss alcohol monopoly is administered by the Confederation, but the profits, which correspond to our tax on spirits, are divided among the cantons in proportion to their population; and the same is true of an unimportant tax on commercial travelers. The military exemption tax, imposed upon all persons liable to military service who do not perform such duty in any year, while regulated by federal law, is administered by the several cantons; and the proceeds—a very substantial sum—are divided equally between the cantons and the Confederation.

[1] Glarus, Geneva, and six other cantons continued to levy property taxes. The last mentioned were newly created cantons which had no other resources.

Prior to the establishment of a federal bank under the Act of 1905, most of the cantons derived a substantial revenue from a tax on the note issues of the cantonal banks. Since that event these issues have gradually disappeared, and with them the revenue from the bank taxes; but the cantons, by way of compensation, are now receiving from the federal treasury an annual grant of over two million francs, which will be assumed by the federal bank as soon as it is able to do so. And finally, the Confederation, out of the surplus accruing from very productive duties on imports, has granted subventions to the several cantons for the development of agriculture, promotion of education, conservation of forests, and the improvement of roads and rivers. As a result, the cantons now receive from the federal treasury, and from the military tax collected under federal law, a considerable part of their income. In 1900 not less than 13 per cent of the gross revenues of the cantons, and a materially larger percentage of the net revenues, came directly from the federal treasury or from the military exemption tax. It goes without saying that such an arrangement materially lightens the pressure of cantonal taxation, even though, under the subvention system, the federal grants are usually conditioned upon further expenditure by cantonal or local authorities.

It is further to be observed that the weight of cantonal and, more particularly, local taxation is considerably reduced by revenues derived from public property and industries. The income-yielding property of the cantons does not greatly exceed, if it exceeds at all, the cantonal debts; and the income from this source is largely, if not wholly, offset by interest payments. From the cantonal banks substantial profits are realized, while from forests the revenues are small, since most of the public forests of Switzerland are owned by the local governing bodies and not by the cantons. The net result is that in some of the richer cantons the pressure of state taxation is materially reduced by the revenue from such sources, and that the average canton is more favorably situated than the average American state. Among the local governing bodies conditions differ widely. In the cities the income-yielding property is generally much less than the municipal debts; but municipal industries, with the exception of street railways, usually yield a substantial profit and sometimes a very large one. In rural districts, on the other hand, communal in-

dustries are less important, but income-yielding properties far exceed communal indebtedness.

A large part of the forest area of Switzerland is owned by the communes, and the revenues from forests and other productive property materially lighten the weight of local taxation. There are, in fact, not a few communes where the income from public property and miscellaneous sources suffices to defray all local expenses, and communal taxation is unknown. Lest, however, I give you a false idea of average conditions, I hasten to add that the number of communes levying no taxes is steadily decreasing, and that in many localities taxes are exceedingly high. Both cantons and communes, it appears, are increasingly dependent upon taxation, since other revenues have not in general kept pace with the growth of public expenditures. But up to the present the federal subventions and the revenues from public property or industries have made the financial conditions materially different from those which prevail in the United States, where both state and local governments are dependent almost exclusively upon taxes.

Not only is taxation a relatively smaller factor in the revenues of Swiss state and local governments but its sources are far more diversified than in the United States. In 1902, according to our last census, not less than 82 per cent of the tax revenues of American state and local governments was derived from *ad valorem* assessments upon property. For Switzerland no similar statistics are available, but it is certain that the property tax, while usually more important than any other, furnishes a much smaller proportion of the aggregate tax revenues than in our own country. The various imposts employed are numerous and difficult to classify, but for our purpose it will suffice to divide them into personal, sumptuary, license or privilege, transfer, income, and property taxes.

Our first group includes poll, household, and habitation taxes. Cantonal poll taxes are usually levied at moderate rates; but local poll taxes are sometimes very high, and, what is more, are rigorously collected. In the canton of Zurich there are many communes where the local poll tax ranges from 8 to 14 francs, to which must be added the cantonal tax of 1½ francs; and there are other cantons in which these figures are approached or even exceeded. In Vaud, where the tax is graduated according to the resources of the taxpayer, the rates in some places rise to 500 or

600 francs. Household taxes, imposed on heads of households, are in use locally in a number of cantons, and range from 1 to 16 francs per household. Where poll and household taxes coexist, as is frequently the case, every head of a household, even though he be a small farmer or common laborer, may have to pay a poll tax of from 10 to 16 francs and a household tax of from 8 to 14. The habitation or rental tax is used by the canton of Geneva and some of the larger cities of other cantons. Altogether it is evident that these taxes on persons, though not found everywhere, have in Switzerland a scope and rigor quite unknown in our own country, with the possible exception of a few of the Southern states.

Sumptuary taxes on servants, horses and pleasure carriages, billiard tables, automobiles, bicycles, and dogs are extensively employed by the canton of Geneva; and elsewhere are represented chiefly by taxes on automobiles, bicycles, and dogs, with here and there a tax on billiard tables or pianos. With these we may include the monopoly of the sale of salt, from which all of the cantons derive a certain amount of revenue. The produce of these taxes is nowhere very important, but it helps to reduce the pressure of direct taxes on property or income. In Geneva, at the present time, personal and sumptuary taxes furnish about 10 per cent of the tax revenue of the canton.

License or privilege taxes are represented in all cantons by peddlers' licenses and the very interesting licenses for hunting and fishing; also by innkeepers' licenses and licenses to sell intoxicating liquors at retail, which in most cantons, on account of the customs of the people and political power of the licensees, are not as high as they ought to be, and very far below the rates now charged in many American states. Some cantons, too, impose taxes, or concession fees, on water-power privileges, and are beginning to derive a substantial revenue therefrom. And finally, in lieu of a tax on business profits, a few cantons impose a general license tax, modeled more or less closely after the French *patente*, on all occupations, industries, or professions.

In practically all cantons certain transfer taxes yield a substantial revenue, and in a few a general system of transfer and transaction taxes affords a very large income. First in importance are the taxes on inheritances and gifts, which are found in nearly every canton and are relatively more productive than the inheritance taxes of the American states; in 1900 they yielded

about one sixth as much as all the direct taxes levied by the cantons. Then come taxes on transfers of real estate, which are found in about two thirds of the cantons, and sometimes, as in Geneva, Vaud, Bern, and Zurich, afford a very large revenue. Two thirds of the cantons also impose stamp taxes on various commercial or legal transactions, and three tax transfers on the stock exchanges. In 1900 the cantons derived from transaction and transfer taxes other than inheritance taxes over one sixth as much as they received from all direct taxes; with the inheritance taxes included, the yield of the transfer and transaction taxes amounted to approximately one third of the direct taxes.

Geneva, which has developed these imposts into a general system of registration duties, after the French model, derives about as much revenue from them as it does from direct taxes; in 1909 the canton received 3,353,200 francs from transfer and succession duties and 3,437,800 francs from taxes on real and personal property. In all such comparisons, I should add, it is to be remembered that the taxes of the Swiss cantons constitute a very large proportion of the total levied for state and local purposes, whereas in our own country the revenues of the states are but a small fraction of the combined county and municipal revenues. When Geneva, therefore, raises a third or more of her cantonal revenues by transfer taxes, she greatly lightens the burden resting upon property subject to taxation; whereas the average American state, in a similar case, would not very greatly reduce the total taxes falling upon property.

The income tax is employed by twenty out of the twenty-five cantons. Usually it is designed to reach only incomes not derived from taxable property, such as business profits in excess of the current rate of interest on the invested capital, wages, salaries, and professional earnings. But in four cantons it extends to all incomes, so that there exists in these cases a so-called double taxation of property and the income therefrom. In one canton, Bern, the property tax is applied only to real estate and the mortgage indebtedness resting thereon, and the income tax reaches all incomes other than those derived from land and mortgages.

The result is that the function and financial importance of the income tax vary greatly from canton to canton. Where its function is merely to reach personal, industrial, and professional

incomes, which pay nothing under the property tax, the tax on incomes produces, on an average, perhaps one third as much as the tax on property. Its precise yield depends not only upon the comparative rates of income and property taxation but also upon the comparative completeness of the assessment of incomes and property. Where about one half of the taxable property evades assessment, as in Zurich, and there are large industrial or commercial centers in which the income tax is reasonably productive, the yield rises to 60 or 70 per cent of the income from the tax on property; and where the conditions are reversed, as in Fribourg or Vaud, the income tax may yield but 12 or 15 per cent of the amount collected from property.

Upon the other hand, in the four cantons where the function of the income tax is not only to reach personal, industrial, and professional incomes but also to bring about the so-called double taxation of property and income, the yield usually exceeds that of the property tax. In Baselstadt, for instance, in 1909, the cantonal and local income taxes yielded 4,081,000 francs, while the property tax, which is not used for local purposes, yielded but 2,124,000 francs. According to their function, therefore, according to the comparative rates of income and property taxation, and according to the relative completeness of income and property assessment, the Swiss income taxes produce from 12 to 190 per cent of the yield of the taxes on property. In general, it may be said that in the average canton a substantial revenue is derived from taxes on incomes, and that the burden resting upon property is thereby materially reduced. The situation is clearly different from that of the American states, in which the income tax seldom exists, and never produces enough revenue to make the average taxpayer or public official conscious of its existence.

This excessively long introduction will have justified itself, perhaps, if it has made clear the fact that, although the status of the Swiss property taxes greatly resembles that of the property taxes of the American states, there are nevertheless important points of difference. Federal grants and subventions lighten the weight of cantonal and local taxation; revenues from property and public industries further reduce it; the burden that remains is not thrown almost wholly upon property, as in the United States, but is distributed among a variety of direct and

indirect taxes, so that the share finally falling to the property tax, while usually the largest,[1] is relatively much smaller than in our own country. This fact I consider to be of capital importance. As will later appear, it goes far toward explaining the further fact that in Switzerland the property tax has not in general produced such intolerable conditions as attend its operation in the United States.

II

The constitutional status of the property tax in Switzerland is not unlike its status in our own country. The cantons are, generally speaking, sovereign in the matter of internal taxation, but, like the American states, are limited by certain provisions of the federal constitution. There is, in the first place, the general guarantee of the equality of all Swiss before the law, which somewhat resembles the Fourteenth Amendment to our federal Constitution. This has been invoked in at least one case of alleged discrimination in taxation, but has not yet received the wide extension given to the Fourteenth Amendment by our Supreme Court. There is also a general guarantee of freedom of industry and commerce from restrictive taxation, which in theory, and to some extent in practice, prohibits taxes so laid as to operate as a restraint on the trade or occupation concerned. And then, of far greater practical and theoretical importance, there is a clause authorizing such federal legislation as may be needed to prevent double taxation. As yet no such legislation has been enacted; but the federal court, somewhat against its will, has been obliged to take cognizance of a large number of cases brought before it, and has formulated certain general principles which now control cantonal legislation at a number of points. The court has ruled that real property is taxable only at its situs, so that the cantons have no power to tax land outside their borders. Movables have been declared taxable only at the domicile of the owner, but this principle has been modified so far as to make taxable at its situs capital invested in a branch establishment, industrial or commercial, and the investment of a limited partner in a *société en commandite*. With joint-stock

[1] In Geneva the extraordinary development of transfer and miscellaneous taxes reduces the property taxes to an almost subordinate position. In Baselstadt, Solothurn, and Tessin the so-called double income tax is more important than the property tax.

companies, however, the court has held that to tax the companies at their seat and then tax the shareholders at their domiciles is not double taxation in the sense contemplated by the federal constitution. Other decisions concern persons successively domiciled in two cantons during a given year, and hold that only a proportionate part of any tax shall be paid in each canton. In general, the court has held to the theory that the double taxation contemplated by the constitution is that arising from intercantonal relations, and not that resulting from the legislation of a single canton.

The constitutions of the several cantons, like those of most American states, contain more or less extensive provisions concerning taxation. The constitution of Baselland contains about all the law that exists in that canton concerning the taxation of property and income; at the other extreme are constitutions that merely prohibit progressive taxation, fix the proportions that shall subsist between different taxes, limit the rates of direct taxation, or prescribe other general regulations. So far as I have yet found, none of them contains a requirement that everything must be taxed in the same way and at the same rate. In general, it is within the power of the cantonal authorities to classify property for taxation, and this is not infrequently done. Compared with the average American state, the Swiss canton is somewhat less trammeled by constitutional limitations, and therefore better able to adjust its tax laws to present-day needs.

The laws of the various cantons naturally enough differ at many points, but, like those of the American states, exhibit a general family resemblance. They either make all property subject to taxation, and then proceed to allow certain exemptions, or else proceed by process of specification, exempting all that is not made specifically taxable. By the one process or the other such things as personal effects, household goods, artisans' tools, and agricultural implements are usually exempted in whole or in part. Thus far the laws run like those of the American commonwealths, but now begin exemptions quite foreign to the practice of most of our states. Cattle are wholly exempted in several of the cantons. In French Switzerland two cantons tax no personal property except interest-yielding investments. Bern exempts all personalty other than mortgages, preferring to reach the income therefrom through her income tax. Appenzell (I. Rh.)

knows nothing of the general property tax, and confines direct taxation to real estate. A most interesting class of exemptions concerns real property. Geneva exempts buildings used for agricultural purposes, Schwyz exempts capital necessary for agricultural operations, and three other cantons tax agricultural buildings at only one half or three quarters of their value. One provides that all buildings shall be valued at two thirds of their actual worth. Personal exemptions granted to the sick, aged, or infirm, and to widows and orphans, find their counterparts in the United States; but I know of no American state that, like Lucerne, accords a special exemption to heads of families; or, like St. Gall, acts upon the theory that the property of widows and orphans is more likely to be discovered than that of other persons, and therefore provides that it shall be assessed at only three quarters of its value. About half the cantons, finally, exempt a certain minimum amount of property, real or personal, the exemption ranging from 200 to 5000 francs; so that in many cases even small estates in land are freed from taxation.

The deduction of debts is permitted on a far larger scale than in the United States, and it may be said that in Switzerland people are usually taxed upon their net fortunes. In cantons where the rates of taxation are progressive, this is the only logical course, since the absurdity of taxing a person progressively upon his debts is apparent to anyone possessed of even a rudimentary sense of humor. A distinction is, however, made in most cantons between mortgage and other debts, and the treatment accorded the former is less liberal than that extended to the latter. Ordinary debts, not secured by mortgage, can be deducted from the gross value of one's entire estate in all cantons except Fribourg, where, however, the tax rate is proportional, and interest-yielding investments are the only form of personalty subject to taxation. Valais permits such deduction for the cantonal tax, but not for local taxation; Tessin forbids it if the creditor lives outside the canton; and Geneva limits it to 50,000 francs. Concerning mortgage debts, the laws of the cantons vary about as widely as those of the American states. Appenzell (I. Rh.), which does not tax personal property, naturally enough refuses to allow the deduction of mortgages; but all the others now permit deduction to a greater or less degree. Two of them authorize it in all cases. Some allow de-

duction only in case the landowner is a resident of the canton; others permit such resident landowner to deduct only in case the creditor lives in the canton and is taxed on the mortgage. Several allow nonresidents as well as residents the deduction, provided the creditor lives in the canton and is taxed there. Others extend the privilege of deduction to nonresidents upon conditions which cannot be enumerated here. Geneva limits the amount deducted to 50,000 francs. A further complication arises from the fact that in some cantons where deduction of mortgages is permitted in connection with the cantonal tax it is not allowed in local taxation. And finally, the canton of Vaud, which permits deduction even for local taxation, authorizes the communes to levy, in addition to the regular tax, a special realty tax for which no deduction is permitted. The result is that in Switzerland resident landowners can usually deduct their mortgaged debts, and that proprietors not resident in a canton are sometimes granted the deduction; but that for local taxation the laws are somewhat less liberal. The general situation is in striking contrast with that of most American states, which tax real estate without deduction and then endeavor to tax mortgage notes as personal property.

Most of the cantons require taxpayers to make a return of their taxable property, but a few cling to the method of official assessment, and ask for no declarations. About half confine the declaration to personal property, and tax real estate according to official estimate. Declarations are required annually in some cantons; in others, at periods of from two to six years. Usually they must be in writing, but two cantons still accept oral statements. In two cases declarations are demanded only when a person settles in the canton, and thereafter assessments are revised annually by the officials. When real estate is assessed by official estimate, general revaluation takes place at such periods as from five to twenty years; but in a few cases no definite time is set, and as a result land is sometimes taxed on the basis of cadastral valuations made half a century ago. The forms of declaration prescribed in the various cantons differ widely. Sometimes the taxpayer is required to submit a very detailed statement resembling those which most Americans conscientiously abstain from making; in other cases, including cantons where personal property is most successfully taxed, nothing is required

but a bare declaration that the net taxable property amounts to a certain sum, and that thereof a certain part represents the value of real estate. In Geneva, where personal estates are taxed with conspicuous success, the taxpayer makes no declaration of his property, but states merely the amount of the tax due from him. So far as I can learn, no canton requires the declaration to be under oath, but in some cases oaths are required if a person wishes to appeal from an assessment made by the officials. The statements of taxpayers are subject to official revision, and persons who make no declaration are assessed by the officials and frequently lose their right of appeal.

For recalcitrant or dishonest contributors the laws provide the usual terrors, together with some that are not usual. Persons who make no declaration, besides being assessed by the officials and losing the right of appeal, are sometimes fined. For continued recalcitrancy at least one canton prescribes cumulative doomage. False returns are punished by fines of larger or smaller amount, and one canton even authorizes imprisonment. Where evasion is detected, nearly all the cantons promptly proceed to recover back taxes for periods varying from two to twenty years, and add thereto fines varying from 100 to 2000 per cent of the amounts withheld. Back taxes for five years and a penalty of five times the amount of the taxes represent, perhaps, the average rigor of the laws. For the detection of evasion there are two principal agencies. One is the returns of estates subject to the inheritance tax, which may be made in the first instance by heirs, but are naturally subject to official control. The other is the compulsory official inventory made at the taxpayer's death, and pending which his books and papers are placed under seal. Seven cantons now have the official inventory; the others content themselves with returns of property subject to the inheritance tax and such other information as the assessors are able to gather. In general, the Swiss laws are more severe than those of most American states, but no canton has yet hit upon the Ohio expedient of dragging bank officials into court and compelling them to testify concerning the affairs of their customers. On the contrary, Swiss banks can refuse to give information about their customers' affairs, and uniformly would refuse to do so if the request were made.

Tax rates are much more stable in Switzerland than in the

United States. Sometimes the rate of the cantonal tax is fixed by the constitution or by a general law not easily changed. Even when it is nominally variable, it does not fluctuate much from year to year, and in practice is likely to remain stationary over considerable periods. Variable rates are generally considered an evil, while proposals to increase existing rates must often be submitted to popular vote and are usually rejected; so that the cantonal authorities must ordinarily content themselves with a stationary tax rate for property and income, and adjust their budgets accordingly. For local taxation the rates are subject to more variation, but probably fluctuate less than local tax rates in the United States. A few cantons have established maximum rates which communes are under no circumstances permitted to exceed; some others fix a rate which the communes cannot exceed without permission of the cantonal authorities.

The rate is usually the same for real and personal property, but this is not always the case. Four cantons impose a lighter rate on real estate than on personalty. In a number of others the rate is nominally the same, but realty is in fact less heavily taxed than personalty by virtue of provisions that it shall be assessed for only 70 or 80 per cent of its value, or that buildings shall be assessed at two thirds of their value, or that agricultural land shall be assessed at 70 per cent of its value, or that buildings devoted to agricultural purposes shall be exempted in whole or in part. Upon the other hand, one canton, after taxing land and movables equally under the property tax, imposes on real estate a second tax based upon the income it yields. It should be said, however, in this connection, that many cantons tax transfers of real estate; and that such taxes sometimes, as in Vaud and Geneva, go far to offset the lower rate of taxation for real property. At least one canton, finally, gives to forests a separate classification, and assesses them either at one half their present exchange value or at twelve and one half times their average net yield for the last ten years.

Switzerland has been called the home of progressive taxation, and much has been written about the progressive rates of her property, income, and inheritance taxes. While sometimes practiced in the Middle Ages, progression was not extensively employed until the last half of the nineteenth century, during which it steadily grew in favor. In some form or other it is now found

in nearly all the cantons, but not necessarily for all taxes, and in the taxation of property is less used than in the taxation of incomes and inheritances. In eleven out of the twenty-five cantons the property tax is proportional, and in six of the others local taxes must be proportional, although the cantonal taxes are progressive. The methods of applying progression are various, and have been variously classified by different writers. All have their respective advantages and disadvantages, a discussion of which would carry me too far afield. The important thing for present purposes is that the scale of progression, while sometimes sharp, does not suggest a desire to confiscate large fortunes; and that, wherever the taxes on large estates seem excessive, this result is due not so much to the progressive scale as to the fact that the taxes are too heavy all along the line. I am of the opinion, however, that some of the cantons have carried progression quite as far as is safe or financially profitable. For this country Swiss experience can offer nothing of present profit, since, until we have a tolerably complete assessment of taxable property, progression would mean nothing but graduating a person's tax rate according to his ability or inclination to dodge his taxes.

The taxation of corporations offers such a favorable field for diversity of methods that Swiss lawmakers would have been more than human if they had failed to take advantage of it; and the decision of the federal court that the constitution of the Confederation does not prohibit double taxation of the property of a corporation and its capital stock, has left them entirely free to do their best—or worst. About one third of the cantons tax corporations domiciled within their borders, usually in the same manner as natural persons, and exempt the shares of these companies, shares of companies not domiciled within the canton remaining subject to taxation. Nearly a third more tax the shares like other personal property, and then tax the company on some part of its property, or on its income, or in some other way that results in the company's paying something less than the ordinary assessment on all its property. Vaud seeks to avoid double taxation by making the shares taxable to the holders for their par value, and then taxing the companies on their reserve and other surplus funds, including sinking funds. Double taxation of stockholders and the property of the corporation is practiced in a few cantons, but in at least one of these, Baselstadt, the tax levied

on the corporation is so moderate that it leads to no complaint, and may perhaps be defended as a franchise tax.

What has been said applies particularly to cantonal taxes; for local taxation some cantons suspend all rules of the game, and allow the communes to pluck as many feathers as they please from any portion of any goose that may chance within their reach. Not unnaturally, this results in more squawking than is consistent with sound principles of finance. Other cantons suspend only part of the rules, and thus extend partial protection. Vaud applies to communal taxation the same regulations that govern cantonal, and so prevents double taxation. If cantonal taxation is diverse, communal is chaotic; and in general it may be said that in this matter our American states, although sufficiently in need of instruction, have little to learn from the laws of most of the Swiss cantons.

In a majority of the cantons the taxes levied for local purposes exceed those for the use of the cantons, but in no such overwhelming proportion as in the United States, while in a number of cases cantonal taxes exceed communal. One canton confines communal taxation to a tax on incomes, and in the city of Geneva the municipal tax is a combined income and occupation tax. But elsewhere the property tax is used for local purposes, though usually in combination with income, poll, household, habitation, and even other taxes. In most, if not all, cases the tax on property is more important than any of the others, and the rates are sometimes very high, here and there approaching those prevailing in the United States. In French Switzerland, where communal administration in any locality is centralized in the hands of a single governing body, the political commune, the citizen pays but one tax in respect of his property. But in the German cantons, where local administration is parceled out among a number of different sorts of communes, we find separate school taxes, church taxes, poor taxes, and finally "police" taxes which are for the general expenses of civil government. In former times the communes, like the Massachusetts towns during the seventeenth century, were allowed great freedom in matters of taxation; and in a few cantons to-day they are subject to little regulation. But the chaotic conditions resulting from such "local option" have led most of the cantons to regulate local taxation by general law. Sometimes the rules prescribed for the local

taxation of property are the same as for cantonal; but frequently they differ at certain points, as we have had occasion to remark. The deduction of mortgage debts is not so generally permitted for local taxation as for cantonal, since it would leave some communes very little taxable property. In dealing with corporations the cantonal laws designed to prevent double taxation are often suspended—perhaps for a similar reason. And finally, progressive taxation is frequently prohibited, even in cantons that make their own taxes progressive, either because deduction of mortgage debts is not permitted, or because it is realized that the taxable property which a citizen owns in a single commune may be only a part of his fortune.

III

Such in outline are Swiss methods of taxing property. Now, how do they work?

It will be convenient to begin with the taxation of real estate. Land is supposed to be assessed either at its selling value or according to the capitalized average yield. In cities the former basis is naturally the one generally adopted, but in many rural districts, where transfers are infrequent, the latter is easier to apply. There are undoubtedly many cases where assessment according to the selling price gives a higher valuation than assessment according to the capitalized average yield. A generation ago, when expenditures were smaller and taxes lower, the assessment of land was considerably below the true value; but more recently the need for increased revenue has obliged assessors to raise the valuation. In the cities, generally, assessments are now tolerably close to the true values, but in rural districts they are probably on a relatively lower basis. There are, doubtless, exceptions to the rule; but in most of the cantons it appears that, in respect of real estate, the cantonal taxes fall with undue weight on the urban districts. Large tracts of forest and pasture land belonging to rural communes are assessed for state taxation at only a third or a half of their value. Local assessors sometimes deliberately aim at low valuations in order to reduce the commune's contribution to the cantonal tax. In a few cantons there has been no general revaluation for an absurdly long time, and some other conditions exist which resemble those known in the United States. I incline, however, to the opinion

that the inequalities in the valuation of land in Switzerland are seldom as great as in our own country, that the average conditions are considerably better there than among us, but that in some localities in the United States the assessment of real estate is quite as satisfactory as in any of the Swiss cantons.

Buildings are usually assessed at about the figure for which they are insured, though special conditions sometimes warrant a departure from this rule. Since in most of the cantons insurance is compulsory, this part of the assessors' task is a comparatively simple matter. The partial or total exemption of buildings used for agricultural purposes tends sometimes to reduce the share of the cantonal tax falling upon rural districts, and there is reason for thinking that in rural communes assessors sometimes deal more leniently with all buildings than city officials are wont to do.

Some cantons, as we have seen, impose a lower rate of taxation on realty than on personalty; and others, by exempting a part of the value of buildings, or land and buildings, accomplish substantially the same result. This is occasionally justified on the ground that inasmuch as some personal property evades taxation, it is only fair that realty should have a lower rate. The usual justification is that it is a necessary concession to the agricultural interests, which stand in special need of the fostering care of government. The actual reason, however, for the favored position accorded to real property is that in most of the cantons a majority of the voters are small proprietors and are able to help themselves to anything they may desire. With the growth of public expenditures and the need of additional revenue the subject is beginning to attract attention. In the cities, and sometimes elsewhere, taxation of the increment of land values is frequently proposed; and one small commune has recently voted to introduce such a tax. Whatever the outcome of the present discussions concerning land taxation, it seems clear that the favors accorded to real estate in some of the cantons are without justification, and invite correction at the earliest possible moment.

The deduction of mortgages is a topic of peculiar interest. In most, if not all, of the cantons the mortgage indebtedness resting upon the land is surprisingly large. Although it is sometimes as low as 25 per cent of the assessed valuation of real estate, the average for all Switzerland is probably as high as 40 per cent; while there are not a few cantons where it exceeds 50 per cent

of the realty valuations, and considerable districts where it rises to 60 or even 70 per cent. It is not strange, therefore, that, for local taxation, the deduction of mortgages is frequently prohibited, even when it is permitted for the cantonal taxes. Several causes have contributed to produce this large mortgage indebtedness, and it is not easy to say how important a factor tax laws may have been; but it is clear that the right to deduct mortgages, so generally granted in Switzerland, has been a material factor in the situation. In cantons where the tax on personal property is widely evaded (and we shall see presently that there are such) a person can mortgage his land and invest the proceeds in securities which will partly or wholly escape taxation. Then, too, when the local tax on real property is progressive, it is obviously to the advantage of a nonresident proprietor to mortgage his land, since he thereby reduces the net value of his property and gains the advantage of a lower tax rate. Even when the tax on personalty is not evaded, and the rate is proportional, it is evident that exemption from double taxation, while it offers no special inducement to borrowing, removes an obstacle to the conversion of a part of one's real estate into personal property promising a higher rate of interest than is paid upon the mortgage.

There has been in Switzerland some complaint of excessive taxation of forests, and in 1889 the Society of Swiss Foresters turned for relief to the federal government, which could take no action, since the matter was one in which the cantons are sovereign. At least one canton has provided a special method of taxing forests, but usually private forests are subject to the property tax. Yet conditions are widely different from those prevailing in the United States, and the general result is much better. In the first place, a very large proportion of the forest area is owned by the communes, and is therefore exempt from local taxation. Then the law prohibits indiscriminate cutting, so that the value of a forest depends upon its sustained yield rather than on the profit that can be made from stripping the land of every stick of timber. And finally, the method of assessing land according to the capitalized average yield results in a lower valuation and is more favorable to rational utilization than the usual provision of American laws that land shall be assessed at its selling value. Swiss methods of taxing private forests may not be all that could be desired—upon that subject I am prepared

to express no opinion; but it is clear that the Swiss property taxes are far less injurious than those of the American states in so far as the latter are enforced.

We turn to the taxation of personal property. The results achieved in different cantons vary all the way from bad to satisfactory, through a variety of intermediate grades which I will not undertake to characterize. At the worst, conditions are better than in most American states; at the best, they are about as good as under any system of personal property or income taxation, and I do not except the income taxes of Great Britain and Prussia. While I am not yet prepared to assign a definite status to every canton, I believe that, in respect of the taxation of personal property, the Swiss states may be divided into four groups.

The first includes the two city cantons, Geneva and Baselstadt, and perhaps canton Vaud, where the taxation of personal property is conspicuously successful. Declarations are actually made by practically all taxpayers, as required by law, and the proportion of incorrect returns is comparatively small. Such evasion as exists is confined largely to the smaller properties, while the large estates are in general returned with scrupulous fidelity. In official reports of Geneva one may find such statements as the following: "Half of the revenue from the tax on personalty, or about 600,000 francs, is turned in by about one hundred contributors, who, it should be recognized, have fulfilled their obligations with absolute correctness and loyalty. It is not among them, but rather elsewhere, that one must look for evasions that cause loss to the treasury." In Baselstadt, where there is a double property and income tax, less than 4 per cent of the taxpayers paid 74.4 per cent of the income tax for 1908; and statistics of the property tax, if they were available, would probably make an equally remarkable showing. In both Geneva and Basel a progressive rate of taxation contributes largely to the results just stated, but it is also clear that without a substantially complete return of the larger properties the progressive rates would not be as productive as they are. Equally significant is the fact that in Geneva, in 1909, the tax on personalty yielded 2,135,900 francs, and that on realty 1,301,900. After making allowance for the circumstance that the rate of taxation on personal property is higher than that on realty, it remains true none the less that the assessment of the former is larger than that of the latter. I do

not wish to overdraw the picture. I know very well that no taxation of income or personal property can be wholly free from evasion, and am sure that some evasion exists at Geneva and Basel. But it is probable that in those cities not less than 80 or 90 per cent of the taxable personalty is returned for taxation, and it is certain that public opinion condemns tax dodging and supports the strictest enforcement of the law. There is, then, no reason for thinking that the tax on personal property in Geneva or Basel is less successful than the income taxes of such countries as Great Britain or Prussia. Whether Vaud does equally well may perhaps be doubted. Geneva and Basel are practically city states, and a uniform enforcement of the law is comparatively easy. Vaud, however, presents a variety of local conditions, communal tax rates are sometimes high, and the canton has reached its present fairly satisfactory position only after a bitter struggle over progressive taxation, the marks of which are not yet wholly effaced. That she is tolerably successful in enforcing the taxation of personal property cannot be doubted; I hesitate, however, to accord her the same rank as Geneva and Basel.

The second group includes a number of cantons, like Aargau and Solothurn, where severe laws, accompanied by vigorous efforts to enforce them, result in a fairly complete assessment of personal property, but unfavorable conditions in many localities render impossible such results as are obtained in Geneva and Basel. The cantons of this group probably tax from 60 to 70 per cent of the personalty subject to assessment, but in some communes the local tax rates are so high as to make it impossible for a person to pay his taxes upon a full valuation of his property. The result is that the law is not strictly enforced in such communes, or else that wealthy taxpayers take up their residence in localities where the rates are lower. The conditions that exist resemble at many points those which in the United States attend attempts to enforce vigorously the taxation of personal property; but in general these cantons have done very much better than any American state of which I have knowledge, and in them the tax on personalty, if not a conspicuous success, is far from being an utter failure.

In the third group belong a number of cantons in which conditions somewhat resemble those which prevailed in Massachusetts, and perhaps other American states, before the Civil

War. Here the terrors of the official inventory are unknown, and in other respects the laws are less severe than those of Vaud, Aargau, or Solothurn. Methods of enforcement, also, while not deserving to be called lax, are usually less rigorous than in the cantons of the first and second groups. Yet the rates of taxation are low; and, despite milder laws and administration, a substantial amount of personal property is actually assessed, perhaps as much as 50 or 60 per cent of that liable to taxation, and occasionally somewhat more. In this class I should place Neuchâtel, Zug, Uri, Nidwald, Obwald, and perhaps three or four others. Forty years ago the majority of the cantons employing the property tax might have answered to this description, but in some of these the growth of expenditures and taxes has either forced a change of methods of administration or produced the conditions that prevail in cantons of the next class.

To this fourth group belong notoriously Zurich, St. Gall, Appenzell (A. Rh.), Tessin, and probably Thurgau. In these cantons conditions approximate, though perhaps they seldom equal, those common in the American states. Few people make declarations, as required by law, and even fewer make honest ones. Personal property either evades assessment or tends to concentrate in localities where tax rates are low. Officials hesitate to enforce the law, because under existing conditions it is practically unenforcible, and public opinion will not sanction strict enforcement. Small properties or incomes and the estates of widows or orphans are heavily taxed, being required to contribute one fourth or one third of the income, while wealthy persons, able to evade the law, escape with a relatively small assessment. To an American audience it is unnecessary to describe in greater detail conditions so very similar to those prevailing in the United States.

How are we to account for the widely divergent results obtained by the various cantons in the taxation of personal property? Clearly not on the ground of differences in the character of the people, for in point of general honesty and respect for law it does not appear that the people of Zurich or St. Gall are inferior to those of Basel or Geneva. Nor is it a mere matter of severity in the provisions of the laws or of rigor in their execution. The milder laws and administration of the third group of cantons yield better results than more drastic measures employed

by cantons of the fourth group. Zurich and St. Gall provide quite as heavy penalties as Basel and Geneva, yet do not get the same results. Appenzell (A. Rh.) has the dreaded official inventory, as has Thurgau for certain cases, yet personal property largely escapes them; while it is well taxed in cantons that, like Basel and Geneva, content themselves with the returns of estates subject to the inheritance tax and such casual information as may come to the officials. Even state supervision of local assessments, while good in itself and productive of excellent results, is powerless to secure the enforcement of the laws under the conditions that exist in the fourth group of cantons, as the experience of Zurich, St. Gall, Thurgau, and Appenzell (A. Rh.) sufficiently demonstrates. Upon all these points Swiss experience teaches the same lesson as American: Draconian laws and drastic administration are of no avail under conditions that make rigid enforcement of the law disastrous, and therefore intolerable.

No single cause has produced the diverse conditions prevailing in the different groups of cantons, but beyond question the most important factor in the problem is the rate of taxation. Wherever in Switzerland personal property is taxed with reasonable success, the rate is comparatively moderate; and wherever the rate exceeds the bounds of moderation, the severest laws fail to prevent general evasion. The cantons of the first group impose rates that vary from 40 cents per $100 to 70 cents per $100 for the largest estates, and for smaller properties, subject to the lowest rates of the progressive scale, are decidedly less. Those in the second group suffer from high rates of communal taxation in certain localities. When the combined state and local taxes range from 40 to 60 cents per $100, the property tax may be said to work well; and in communes where it rises to $1 or $1.20 per $100, the attempt to reach personal property utterly fails. The cantons of the third group, by reason of their economic and financial positions, get along with a low rate of taxation for property, and their combined state and local taxes range from 30 to 60 cents per $100, seldom exceeding the higher figure, and sometimes not reaching the lower. As a result, their less drastic laws and milder administration suffice to reach a substantial proportion of the taxable personal property, as was the case in Massachusetts and perhaps other American states during the first half of the nineteenth century. And finally, the cantons of the fourth group are

vainly endeavoring to enforce taxation of personal estates at rates which, for combined cantonal and local purposes, usually range from 80 cents to $1.20 per $100, and in many cases rise to $1.50 or $2 per $100. The only possible result is hopeless failure.

This point is so important that you will bear with me if I make my illustrations more specific. In Geneva the *mobilière*, or personal-property tax, is used only for cantonal purposes, although in the city of Geneva there is a light local tax on the income of personal as well as real property. The rate, moreover, is fixed, and for the largest estates is at present 38/10 cents per $100. In Baselstadt the rate of taxation on property and income is also fixed, and for estates of the largest size the combined property and income tax in 1909 amounted to 62 cents per $100. In Vaud the *mobilière* is used for local purposes, and in some communes the rate is fairly high. The combined state and local rates usually range from 60 to 70 cents per $100 for large estates; and precisely because they sometimes rise to 70 cents or even higher, the canton is probably not in as good a position as Geneva and Basel. At the other end of the scale, in the fourth group, the canton of Zurich levies a state tax at a rate exceeding 40 cents per $100 for the larger estates, to which are added communal taxes averaging more than 80 cents per $100. In some cases the communal rates rise to $1.40 per $100, so that a large property will be taxed at a rate of $1.80 per $100. In the second group local conditions are worse than in Vaud, and seldom so bad as in Zurich, which accounts for the intermediate position of these cantons. In the third group the cantonal taxes vary from 3 to 25 cents per $100, and the local range from zero to 40 or 50 cents per $100. Thus, in Neuchâtel, the cantonal tax is 20 cents per $100, while local rates usually range from 20 to 30 cents per $100, and by law are limited to a maximum of 40 cents, so that the total tax levied on property is usually from 40 to 50 cents per $100, and can never exceed 60 cents. In Obwald the cantonal rate is but 3 cents per $100, and the local rates range from 20 to 30 cents per $100; in Uri and Zug both cantonal and local taxes are usually higher than in Obwald, but the total seldom exceeds 50 cents per $100, and is often considerably less. In most parts of Switzerland the local taxes are higher than the cantonal, and the excessive rates sometimes prevailing are the chief cause for the unsatisfactory working of the property tax in some of the cantons.

Perhaps some of you may ask whether I have not put the cart before the horse; and whether the high rates of taxation in certain cantons are not the result of evasion of the tax on personal property rather than the cause of it. I reply that historically they have been both cause and effect; but that, once established and accepted by the taxpayer as inevitable, they become the cause of a chronic state of evasion which nothing but a radical change in the system is likely to cure. This point I can make clear by the example of my own state. Prior to 1850, when rates of taxation in Massachusetts were less than one third of their present average, which is in excess of $1.70 per $100, a substantial proportion of the property assessed consisted of personal estates; in Boston the proportion of personalty varied from 40 to 50 per cent of the total assessment. But when growing expenditures subjected the property tax to a pressure it was not able to stand, personal property began largely to escape taxation; and this increasing evasion then became a second factor contributing to the further rise of tax rates. By the early seventies, when the average rate in the commonwealth had advanced to $1.50 or $1.60 per $100, taxpayers had adjusted themselves to the changed conditions; and, therefore, when they made or abstained from making returns of their taxable property, acted upon the reasonable and inevitable assumption that the tax rate would be about $1.50 or $1.60. Thirty years of added experience have now hardened this assumption into an accepted fact, and it is therefore correct to say that the high rate of taxation makes a full assessment of personal estates impossible in Massachusetts.

It is by a generally similar process that the property tax in certain Swiss cantons has broken down. In Switzerland, as in the United States, the last fifty years have witnessed an unprecedented increase of public expenditures. According to Schanz and Cérenville, the total federal and cantonal taxes of Switzerland increased from 18,800,000 francs in 1856 to 51,200,000 francs in 1876 and 109,000,000 francs in 1896, more than doubling in each period of twenty years. At the present time they exceed 160,000,000 francs, and are still rising. If the total communal taxes could be ascertained, the showing would be even more striking, since almost everywhere they have increased by leaps and bounds. Thanks to abundant revenues from custom duties, the Confederation until recently has been little embarrassed by

the rising tide of expenditure; but the cantons and communes have had no similar resource at their command. Some of them, by voluntary or enforced economy, have restrained, but not altogether prevented, the increase of outlay. Some, by thrifty husbandry, contrive to draw larger revenues from property or industries. Some have made large use of transfer and transaction taxes, and most have laid heavier hands on inheritances and successions. Here and there local taxes on polls and households have risen to extraordinary figures. But most cantons and a majority of communes have been unable to avoid increased pressure on property and income. Income taxes have been introduced where formerly only property taxes existed, and in one case a property tax where there had been only a tax on incomes. Withal there has been a sharper assessment of taxable property or incomes, with a sharper graduation of rates designed to secure more revenue from the larger contributors. In proportion as expenditures have been held in restraint or other sources of revenue developed, pressure on the property tax has been reduced, and a breakdown averted. The cantons where personal property is successfully taxed to-day are those which have managed to keep the pressure within reasonable bounds, and those which fail to do so are the ones that have done what the American states did during the last half of the nineteenth century. Not a few cantons have improved their methods of administration and imparted increased rigor to their tax laws. These measures have had excellent results when other conditions were favorable, but they have utterly failed to bring about a satisfactory assessment of personal property for taxation at the rates of $1 or $1.50 per $100. The fundamental factor in every canton has been the tax rate. A property tax levied at the rate of 50 cents per $100 is one thing, a tax levied at the rate of $1 or $1.50 per $100 is quite another. The former, as Swiss experience shows, may be enforced with conspicuous success; the latter never has been, nor can be, enforced in respect of any kind of property capable of concealment or undervaluation.

The taxation of incomes is in most cantons so closely connected with the taxation of property that I am constrained to refer briefly to the results attained. Speaking broadly, there can be no question but that the Swiss cantons have found the supplementary income tax on personal, professional, or industrial in-

comes a useful adjunct of the tax on property. It is enforced with at least tolerable success, yields a substantial revenue, and places under contribution a class of incomes which, under a pure property tax, would pay nothing. At this point Swiss experience has been absolutely different from that of the handful of American states that have experimented with a tax on incomes, but with so little success that the average taxpayer hardly knows of its existence. Concerning the working of the double system of property taxation in Baselstadt, Baselland, Tessin, and Solothurn, I prefer within the necessary limits of this paper to say nothing. The picture, however, is not all light; it undoubtedly has shadows which sometimes are rather dark. In agricultural districts taxation of incomes partly or almost wholly breaks down. The farmer believes that the use of his house, the living which his family gets off the farm, and everything else except the savings he puts into the bank are not—or at least should not be—included under the head of taxable income; and accordingly he does not include them. Where agricultural earnings are taxed on the basis of taxpayers' declarations, entire districts of great fertility contribute little or nothing; and the burden of taxation falls, therefore, with undue weight on industrial or commercial centers where incomes can be better ascertained and assessed. Thus, a city that pays 16 per cent of the cantonal tax on property may pay 36 per cent of the tax on incomes, and one that pays 13 per cent of the former may pay 39 per cent of the latter. To meet this difficulty, one canton arbitrarily fixes the taxable income from agriculture at a certain percentage of the value of the land, and another fixes the tax on agricultural incomes at three eighths of 1 per cent of the value of the land. Nor is the difficulty of taxing agricultural incomes the only one encountered. Small merchants and manufacturers frequently do not know the size of their incomes, and, like the farmers, think they should be taxed only on what they save. In Baselstadt, where the larger incomes are supposed to be pretty fully returned, it is evident that smaller incomes evade assessment to a considerable extent. Naturally enough, persons receiving fixed salaries or wages are unable to escape, and in some cantons, particularly Bern, it is believed that this class of contributors is considerably overtaxed. Altogether Swiss experience, while not unfavorable to state taxation of incomes, shows that such taxes present difficulties much like those en-

countered in taxing personal property, and for their successful operation require the very best methods of administration.

A subject that I cannot wholly ignore is state supervision of the assessment of property and income. In Switzerland, as in our own country, the assessment of property is, in the first instance, intrusted to local officials; and there, as here, it has been found advantageous to bring the process of assessment under state supervision or control. Swiss communes, like American municipalities and counties, naturally desire to attract or keep wealthy residents and large employers of labor; and to do so are often willing to make concessions inconsistent with both spirit and letter of the law. Actual bargains between assessors and taxpayers have probably been rarer in the Swiss cantons than in the American states, yet they are not unknown. Still more common are cases where local officials are unable to withstand the threat of withdrawal of property to some other commune where tax rates are lower or the officials more given to hospitality. In cantons where local tax rates are usually high, there seem always to be cities of refuge where oppressed taxpayers are assured of a cordial welcome. On Lake Constance and on the Rhine there are said to be colonies of wealthy people, who in selecting their places of domicile have considered, among other things, the advantages of a low tax rate and perhaps a moderate assessment. Then there are cases where a small commune is dominated by a large corporation which employs a majority of the inhabitants. In one canton there is a commune in which all voters and officials are employees of a large company which, as a consequence, used to enjoy a kind and amount of "home rule" in taxation inconsistent with the interests of the cantonal treasury.

To meet such conditions, state supervision and control have been introduced. Most of the cantons now provide for revision of the local assessments by a special commission appointed by the cantonal authorities. I hesitate to compare these commissions with the boards of equalization known to most American states; but in some cantons at least it appears that the commissions of revision have failed to revise just as our boards of equalization have usually failed to equalize, and for the same reason—lack of authority, time, and knowledge necessary for the task. I believe, however, that there have been cases in which the Swiss commissions have been able to accomplish valuable results. Not

a few cantons go farther, and appoint members of the local assessment boards. One adds to each communal board a cantonal representative with merely consultative powers; three appoint a district chairman, very much like the county assessor of Indiana and some other states, who supervises the communal boards within his district; one appoints two members of each local board, and another appoints a majority of the members; one appoints the chairman of each board, intrusts the appointment of two members to the district, and allows the commune to appoint the other two; and one intrusts the whole work of assessment to district commissions appointed by the canton. The general results of cantonal supervision and control have been quite as good as those achieved by the tax commissions recently appointed by various American states, though perhaps not so striking, since the original conditions in Switzerland were generally better than in the United States, and the chance for improvement correspondingly less.

My last topic is popular lawmaking in its application to tax legislation. By the initiative and referendum the tax laws of most cantons are directly under popular control, and in financial matters the referendum has been very widely employed. I speak with hesitation of this subject, and am not yet ready to express an opinion as to whether, on the whole, popular lawmaking has worked badly or well. Some things, however, are too clear for dispute, and will be questioned by no one acquainted with the facts. The chief result has been everywhere to make a change of the tax laws exceedingly difficult, since most proposals are certain to be defeated. Laws imposing taxes on transportation companies, increasing the rates of the inheritance tax, or graduating more sharply the taxes on large fortunes or incomes are not infrequently accepted by the people, since the average voter knows that the result will be to increase some other fellow's taxes. But a general income tax affecting the mass of the voters, a reform needed to increase the effectiveness of the property tax, or a proposal to raise the rate of taxation in order to avoid recurring deficits has about four chances in five of being rejected, and will be accepted only in cases of dire financial need. The introduction of property and income taxes during the last half of the nineteenth century was a work of the greatest difficulty, and the people of some cantons absolutely refused to accept a

direct tax until their governments were on the road to bankruptcy. In Aargau the people bestowed upon themselves in 1870 the right of fixing the rate of the direct state tax, and then proceeded to fix it at zero. They were at length persuaded to divest themselves of this right, but they will not to-day consent to a slight increase in the rate of the state tax needed to meet a chronic deficit in the cantonal budget, and the canton has been obliged to borrow money in order to provide for accumulated deficits. Baselland had a somewhat similar experience, and secured the establishment of a state tax in 1892 only by reducing the rates of various indirect taxes and making certain concessions to the communes. The rates of taxation then authorized by the constitution have never been adequate, and the government to-day is at its wits' ends, since it knows well that it is useless to propose an increase. St. Gall's experience is equally interesting. Her antiquated tax laws had brought the canton to a pass where amendment was absolutely necessary, but in 1900 the people rejected a reform measure. Three years later, knowing that a new project would meet with a similar fate, the leaders of all parties agreed to enact a law and then endeavor to avoid a referendum. This was actually done, petitions for a referendum failing to receive the necessary number of signatures; but it is doubted by no one that if a referendum had been ordered, the new law, which has greatly improved the finances of the canton, would have been summarily rejected. Upon the other hand, it is clear that the difficulty of securing the adoption of new laws has made the cantonal governments extremely careful, and has tended to retard somewhat the increase of expenditures. In not a few cantons new laws have been accepted during the past ten or twelve years; and some persons, in an excellent position to judge, are of the opinion that, with a few conspicuous exceptions, the people have judged fairly well concerning the necessity of proposed legislation. Upon the basis of my present studies I am unwilling to accept or reject this opinion.

Concerning the taxation of property by the Swiss cantons, I submit, somewhat tentatively, the following conclusions. General conditions in Switzerland are more favorable than in the United States to the successful operation of direct taxation. There is less making of law, and very much more enforcement; consequently, respect for law is undoubtedly greater than in our own

country, and the enforcement of tax laws far less difficult. Then the business of cantons and communes alike is conducted with reasonable efficiency, great economy, and absolute honesty; so that taxpayers know that their money will be well expended, and therefore contribute more willingly. State and local taxation, besides being reduced in amount by revenues from other sources, is more diversified than in the United States; and the pressure of the property tax is relatively less severe. In many respects the tax laws of the cantons are open to serious criticism. Some of them are antiquated statutes which, under popular lawmaking, it seems impossible to change. In America such laws would break down from mere weight of years without the slightest assistance from taxpayers or courts. Yet in Switzerland, with lower tax rates, efficient administration, and more favorable general conditions, they frequently work better than the most up-to-date revenue code ever adopted by a newly organized American state. In taxing real property the average Swiss canton probably avoids such gross inequalities as frequently occur in the United States, but a few of our commonwealths and not a few cities manage quite as well as any of the Swiss cantons or communes. And finally, Swiss experience shows that, with good administration and a moderate rate of taxation, personal property can be taxed with reasonable success. It also demonstrates that the most Draconian laws and rigorous administration are powerless to reach the great mass of personalty when the tax rate exceeds the bounds of reason and moderation. In Switzerland this fact finds general recognition; if American states would take it to heart, they could speedily solve the most difficult problem in the whole realm of taxation.

CHAPTER XII

THE GENERAL INCOME TAX

48. The Prussian Income Tax. — This tax has had an interesting history, since it has developed out of graduated capitation or class taxes which date back to 1821. In that year, in order to meet a deficit, the Prussian government established a class tax. This law grouped the population in four classes, according to social position; and then imposed three different rates of taxation within each class in order to allow for differences of wealth between the members of the same social class. The result was a graduated capitation or class tax with twelve different rates. The new tax was believed to be "a happy compromise" between a uniform poll tax and an income tax which would have required "minute and vexatious inquiry into the financial condition of the taxpayer." It did not, however, apply to cities; since in such places there already existed a grist and slaughter tax[1] which was considered a satisfactory substitute. The class tax did not prove successful in reaching the larger incomes, and it was found that, in 1846, 45 per cent of its yield came from the lowest class and only $3\frac{1}{2}$ per cent from the highest. Accordingly in 1851 it was supplemented by an income tax which, as amended at various times — notably in 1891, is now one of the chief branches of Prussian revenue. Dr. Joseph A. Hill gives the following account of the development of the income tax in Prussia since the reform of the class tax in 1851:[2]

[1] The grist and slaughter tax had been tried in country districts, but had not proved satisfactory because it was difficult to enforce.

[2] Reprinted, with the consent of the author, from the *Quarterly Journal of Economics*, VI, 212–225.

The successful reform bill, which became law in 1851, was of a still milder character.[1] The grist and slaughter tax for the large cities was retained. The class tax, confined as before to the smaller cities and country districts, was curtailed by the abolition of the highest class. For the three remaining classes, which were to include all taxpayers having incomes of not more than 1000 thalers, thirteen rates were prescribed, of which the highest was 24 thalers annually, while the lowest was, as before, $\frac{1}{2}$ thaler. To replace the tax on the highest class, a classified income tax was adopted, to be assessed throughout the entire kingdom on all incomes of more than 1000 thalers, with a rebate of 20 thalers in those cities which were subject to the grist and slaughter tax. The payers of this income tax were divided into thirty classes. In the lowest the annual rate was 30 thalers, in the highest 7200 thalers. These rates were graded with the intention of collecting 3 per cent of the minimum income in each class. This made the minimum for the highest class 240,000 thalers; and the amount by which any income exceeded that limit was, therefore, not taxed. No declaration was required from the taxpayer, and the assessment was to be made without "inquisitorial procedure."

In the two previous attempts at reform the main end in view had been a more equitable distribution of the burden of taxation. There had been no expectation of any considerable increase of revenue. But, in framing the law of 1851, the need of more revenue had been the principal consideration. Any sort of income tax which would meet this need was regarded as better than none. It cannot be denied, therefore, that "the Prussian income tax was introduced, not solely from a recognition of its social necessity, but at the same time on account of pressing financial needs." It is not strange, then, that the law did not fulfill the requirements of an equitable income tax. Its most serious defect was the retention of a maximum limit to the rates. Besides this the classification was not fine enough; that is, the dividing limits between the classes were too far apart. The result was a rather wide variation in the rate per cent of the tax; for while, as we have seen, it was 3 per cent

[1] Milder, that is, than a measure proposed in 1847, which the author had previously described. — ED.

of the minimum income in each class, on the maximum income it was in most cases equivalent to only about $2\frac{1}{2}$ per cent. On the whole, it may be said that this reform, like the introduction of the class tax in 1820, aimed principally at an increase in the public revenue, and obtained it by taxing the poor not less and the rich considerably more.

The conditions under which the next reform was accomplished, in 1873, were more favorable, since at that time any increase of taxes was not necessary. On the contrary, the state of the public finances was such — thanks to the French milliards — that the people felt justified in demanding some relief from taxation, and it was partly in response to this demand that the reform was undertaken. The grist and slaughter tax was repealed, to be replaced in those cities where it had existed by the class tax. The latter was now recognized as being, in fact, an income tax which was to be assessed "on the basis of the estimated value of the annual income." This was only a recognition of what had long been the case in actual practice. Indeed, the instructions for the assessment of the tax issued by the finance minister in 1867 had designated numerically certain incomes which were to be treated as *Anhaltspuncte* in assessing the several rates, and stated furthermore that the "presumable income" of the taxpayer was to be regarded as "not indeed the sole determining factor in the assessment, but still the principal one." Other circumstances were also to be considered, whereas the income tax was assessed "*solely* on the basis of income." This distinction between the two taxes was, on the whole, still maintained in the law of 1873, except as regards the two lowest classes of the income tax.

The maximum income subject to the class tax remained, as before, 1000 thalers, or 3000 marks; but now for the first time the law also prescribed a minimum taxable income. The limit selected was 420 marks, all incomes below that being thus exempted from direct taxation. The intention apparently was to exempt all who had previously been assessed with the lowest tax ($\frac{1}{2}$ thaler), which now disappeared from the scale of rates.[1] This, we may say, was the final disappearance of the one half

[1] In 1873, out of 9,300,000 persons assessed under the class and income tax, 5,000,000 paid the one half thaler rate. The number actually exempted when the new

thaler poll tax of 1811. But, while the reform may have been prompted to some extent by the desire to relieve the poorer classes from the burden of taxation, apparently the difficulty and expense of collecting the tax from such classes, especially in the larger cities, where the class tax was now to be introduced, had the most to do with this new departure. But, in making the tax progressive, — or better, perhaps, degressive, — there was undeniably the intention of favoring the poor. There were twelve rates, ranging from 3 marks to 72 marks; and the equivalent rates per cent on the minimum income of each class increased gradually from $\frac{5}{7}$ per cent in the lowest class to $2\frac{2}{3}$ in the highest. The tax on the incomes at the lower end of the scale was reduced, while at the upper end it remained about as it was before.

In the income tax the rates were, as before, equivalent to 3 per cent of the minimum income of each class. But the number of classes was increased, and, more important still, the maximum limit to the tax was removed. Incomes up to 780,000 marks were rated in forty classes, and beyond that point the tax increased 1800 marks for every 60,000 marks' increase of income. The same line of reform was carried a step farther in the years 1880 to 1883. An increase of revenue, derived principally from the imperial tariff and tobacco tax, — the proceeds of which, in excess of 130,000,000 marks, are divided among the states in the form of the so-called *Ueberweisungen*, — made a reduction of direct taxation possible, which, it was felt, should accrue to the benefit of the poorer classes. With this end in view, the two lowest rates of the class tax were abolished, thus exempting all incomes up to 900 marks, and the other rates were reduced, as well as the two lowest rates of the income tax, so that the principle of degressive taxation now applied to all incomes under 4200 marks.

Such had been the development of the class and income tax down to the reforms of the present year. The law of June 24, 1891, like that of 1873, has been enacted under favorable financial conditions, which relieved the government from the necessity of asking for any increase of taxes; and, while the

law went into operation, in 1874, was 6,400,000. See Zeitschrift des preussischen statistischen Bureaus, Bd. 15 (1875), p. 112.

reform can hardly fail to make the tax more productive, a guarantee has been given that any such result shall not accrue to the benefit of the public treasury, but lead to a relief from some other form of taxation or else to a reduction in the rates of the income tax itself. This time it was the net earnings from the state railroads, which, as Cohn says, made it possible to indulge in the luxury of distinguishing between a reform of the public finance and an increase of public revenue, — an indulgence which he seems to regard as very improvident, if not enervating.

But, if fiscal motives be wholly wanting in the new law, — which, after all, there is some reason to doubt, — it only adds to the interest and significance of the reform, since, if the burden of taxation is to remain the same, but be more justly distributed, we may draw some inferences as to what ideals of just taxation find favor in Prussia at the present time, even if we must premise that, as is usual in tax reforms, considerations of practical expediency have had quite as much weight as notions of abstract justice.

The new law introduces important changes in the method of assessment, the classification, and the rates. The class tax is no longer retained, and the incomes on which it was formerly assessed are now properly included under the income tax; but there is still a distinction as regards the method of assessment, since these incomes are, as before, to be estimated without, as a rule, requiring any declaration from the taxpayer, while for incomes above 3000 marks a declaration is required. This important reform, which has repeatedly been rejected by the Landtag, now encountered but little opposition,[1] and is a significant departure from the principles on which the assessment has heretofore been conducted. The law of 1851 was very explicit in the assurance it gave the taxpayer that there should be no intrusion into his private business affairs. To be sure, the chairman of the board of assessors was to collect the fullest pos-

[1] The declaration had been a feature of the unsuccessful income and property tax of 1812. It was strongly advocated by Stein and other leading statesmen of that period, but was rejected when the class tax of 1820 was adopted. It was rejected again in 1847, 1851, and 1869. In 1873 the government, although recognizing it as a desirable method of assessment, did not venture to propose it, feeling certain that the Landtag would not adopt it. See Annalen des deutschen Reichs, 1874, p. 939.

sible information in regard to the financial condition of the taxpayers, but only in so far as it could be done without a too-searching inquiry, — *ohne tieferes Eindringen.* The other members of the board were to subject the chairman's results to a careful examination, in which they were to make use of all sources of information at their command. But here again all intrusive inquiry — *jedes lästige Eindringen* — was to be avoided. Even when an appeal was made against the assessment, the proper tribunal must endeavor to get at the truth by the less rigorous method above described, before it exercised the right to institute a more thorough investigation and require definite statements from the appellant, summon witnesses, and so on. These provisions were not repealed or altered in 1873. The results of this method of assessment have proved very unsatisfactory. Outside of fixed salaries very few incomes have been assessed at their full value; and, as might be expected, the wealthier taxpayers were generally the ones who profited most by this leniency. Of course, from the nature of the case, any estimate of the extent of this undervaluation must be inaccurate. Yet it seems to be the general opinion in Prussia that, on the average, incomes have been rated at less than one half or even less than one third their true value; and this means that in individual cases the undervaluation has been far greater.[1]

Hereafter the Prussian taxpayer must make out a written return of his income, if it exceeds 3000 marks, entering it under the following four heads: 1. Income from invested capital; *i.e.*, interest and dividends. 2. Income from real estate, — *aus Grundvermögen,* — whether derived from its use or its ownership or both. 3. Profits or the earnings from trades, industries, and mines. 4. Wages, salaries, professional earnings, or pensions, annuities, or other sources of periodical income not included under the first three heads. It is only necessary to give the lump sum under each head without any further specifications. No oath is required, but simply an affirmation of the truth of the statement. These returns are subjected to the supervision of a county (*Kreis*) board of assessors, the majority

[1] See Annalen des deutschen Reichs, 1874, pp. 929 and 339; also Cohn, Die preussische Steuerreform, in Jahrbücher für Nationalökonomie (1891), Bd. 56, p. 31; and Delbrück, as quoted below.

of whom are elected in the county or assessment district, while the minority, including the chairman, are appointed by the government. If the taxpayer refuses to declare his income, he loses, in the first instance, the legal right of complaint or appeal against the official assessment; and, in case of a second refusal, the assessment is increased 25 per cent. False declarations, willfully made, are punishable with heavy fines. In this way, it is expected to obtain approximately correct returns. Whether this expectation will be realized remains to be seen; but there are good reasons to believe it will not, especially as this change is accompanied, as we shall see, by an increase in the rates on large incomes. In this connection, I may quote the opinion of Professor Delbrück of Berlin, expressed in the way of comment on a notorious case, which came up in the courts recently, where it was proved that a group of wealthy taxpayers had been assessed altogether too low:

> The Bochum tax case is seasoning for the new income tax law. The rich men in that place have almost all been assessed too low by half and two thirds, and to such a scandal as that, it is said, the declaration ought to and will put an end hereafter. "Ought to." Yes, but "will" as well? In the first place, I dare make the assertion that in the entire monarchy the case is the same as in Bochum. Select at random any city or county, subject it to the same test, and you will reach the same results. Without doubt the declaration will secure better returns than the previous method of assessment. For once we will venture to prophesy, and say that (apart from the new tax on corporations and the higher rates) it will secure an increase of from 25 to 30 per cent. Had it not been for the Bochum case, we would have said 25 per cent; but the alarm which this affair has occasioned may well help us to 30 per cent. But by how much was the assessment too low in the Bochum case? By one half to two thirds, and even more. This amount will not come to light even under the new system. . . . So long as we have not reached an inheritance tax and a considerable reduction in the communal sur-taxes, the declaration will be of little benefit. The strictest control and a reasonable moderation in the rates, — without these two wheels it is impossible to set the wagon going. (*Preussische Jahrbücher*, July, 1891.)

The assessment of incomes, then, in Prussia, has not been so very much better than that of personal property in America; nor is it certain that the new law is going to solve the problem for the former country. Yet in Prussia there is an efficient and reliable civil service; and the private citizen, moreover, is accustomed to submit to a good deal of investigation of his affairs on

the part of the public authorities. All this renders the success of such a law more probable there than in America, where, indeed, the attempts already made in certain states to secure correct returns of personal property by means of declarations have proved wholly ineffectual.

In grading the incomes, the new law has made the divisions much finer than before. There are now 75 grades or classes for incomes from 3000 up to 120,000 marks, while under the law of 1873 there were only 27, and before that 19. Beyond this point the increment of increase in the new classification is 5000 marks, while in the old it was for a few grades 24,000 marks, and finally mounted to 60,000. As a result of this change, it is now necessary to ascertain the taxpayer's income with an approach to accuracy which was not required before, and would at any rate be impossible without the declarations. Under the former classification the assessors, even though they were required to avoid *jedes lästige Eindringen*, might perhaps decide with some confidence that a man's income was, for instance, somewhere between 60,000 and 72,000 marks. Any variation within these limits could be neglected, since it did not affect the rate. Under the new law, however, there are now seven classes within the same limits; and it is necessary to decide whether, in the given case, the income is between 60,000 and 62,000 marks, or between 62,000 and 64,000, and so on, thus implying a pretty exact knowledge of the financial situation of the taxpayer, such as could hardly be obtained without his coöperation. Moreover, when once the income is ascertained, the new classification will have the effect of increasing the tax in most cases, for the reason that, under a classified income tax, the amount by which any income exceeds the minimum limit of the class in which it is rated is practically untaxed. The narrower the classes, therefore, the smaller these portions of untaxed income must be.

Of especial importance are the changes which the law has made in the rates. Beginning with the lowest class, which includes incomes from 900 to 1050 marks, the tax is 6 marks, being equivalent to about .62 of 1 per cent of the mean income. This rate increases until it reaches 3 per cent on an income of 10,000 marks, which, it will be remembered, was the uniform

rate per cent of the former income tax. In the ministerial bill the progression ceased at this point; and thereafter the rate was uniformly 3 per cent of the mean income in each class. But the Lower House of the Landtag was not content with this. Unlike its predecessor of 1847–51, it was more radical than the government, and in the bill as finally passed the 3 per cent rate is retained only on incomes between 10,000 and 30,000 marks. Then the progression begins again, and continues until the rate reaches 4 per cent on an income of 100,000 marks. Thereafter this remains the uniform rate per cent estimated on the minimum income of each class; or, in other words, the tax increases 200 marks for every 5000 marks' increase of income.[1] Speaking generally, then, the effect of the new law is to lower the tax on incomes under 10,000 marks and increase it on higher incomes. And even for incomes between 10,000 and 30,000 marks, where the rate is nominally, as before, 3 per cent, there is really an increase of taxation resulting: first, from the increase in the number of classes; and, secondly, from the fact that the tax is now 3 per cent of the *mean* instead of the *minimum* income in each class. To illustrate: under the old law an income between 14,400 and 16,800 marks was rated in class 12 and assessed 432 marks; under the new law this income would be taxed as follows:

Class	Income	Tax (= 3 per cent of the mean income)
30	13,500–14,500	420
31	14,500–15,500	450
32	15,500–16,500	480
33	16,500–17,500	510

There is here, then, a slight reduction in the tax on incomes between 14,400 and 14,500 marks, but above that point the tax is more than it was under the old classification.

In the assessment of small incomes, the Prussian law has

[1] It must not be forgotten that these rates by no means give the full amount of the income tax. The communal sur-taxes must be added to the state tax, and often have the effect of more than doubling the rates given above.

always favored the taxpayer by granting a partial or complete abatement of his tax, if he had to support a large family, or contend with any special misfortunes or disadvantages such as serious cases of sickness, accident, fire, floods, or debt. This was a feature of the class tax of 1851. The law of 1873 retained this feature, and introduced it for the two lowest grades of the income tax as well, so that all taxpayers whose incomes did not exceed 4200 marks were entitled to this special consideration, although under the income tax the reduction could not be carried farther than to the next lower rate. The law of 1891 gives a still wider application of this principle, by permitting a reduction of the tax to an extent not exceeding three grades on account of "any special economic conditions which seriously impair the efficiency (*Leistungsfähigkeit*)" of the taxpayer whose taxable income does not exceed 9500 marks. The exact nature of the special economic conditions is not more definitely described, but presumably the intention is to include such cases as were expressly mentioned in previous laws. The case of children in the family, however, is especially provided for; and, while the reduction is confined to the incomes under 3000 marks, — a return in this case to the limit of 1851, — it is not as before simply permitted, but is required and definitely regulated by law, since for every dependent member of the family under fourteen years of age 50 marks must be deducted from the taxable income of the head of the family. This of itself would not in every case produce a reduction of the tax; but the law further provides that, if there are three or more such members in the family, the tax itself must, at all events, be reduced by at least one grade.

One other new feature in this law is the taxation of corporations and stock companies, which must now pay the income tax on all dividends and net earnings above $3\frac{1}{2}$ per cent of the capital paid in. The dividends are of course also included in the income of the stockholder, and, if he is a Prussian, are taxed as such. This results in the double taxation of the excess above $3\frac{1}{2}$ per cent; but in this way and to this extent the foreign stockholder is taxed once, which seems to have been regarded as a strong argument in support of this provision. The double taxation of the Prussian stockholder may, perhaps, be defended

on the principle of the higher taxation of funded incomes, which, as we have seen, was a feature of the unsuccessful tax bill of 1847; but the provision appears to be simply a compromise between the desire to tax the foreign stockholder and the opposition which might be made against taxing the Prussian stockholder twice on the full amount of his dividends.

Thus the development of personal taxation in Prussia has resulted in the adoption of a partially progressive income tax. The general tendency of each reform may be more clearly seen, perhaps, if we indicate briefly the steps by which this result has been reached.

1. A uniform poll tax, 1811.

2. A class tax, collecting somewhat more from the prosperous and not less from the poor, 1820–21.

3. To supplement the class tax, an income tax with comparatively few classes, a uniform rate, and a maximum limit, 1851.

4. Classification made finer, the maximum limit removed, and the class tax made practically an income tax, with a progressive rate, and the exemption of incomes up to 420 marks, 1873.

5. Exemption of incomes up to 900 marks, reduction of the remaining rates of the class tax and of the two lowest rates of the income tax, 1881–83.

6. The principle of progression extended to all incomes under 100,000 marks, incomes under 10,000 marks taxed less than before, and higher incomes more; a declaration of income by the taxpayer required, and a finer classification adopted, 1891.

In connection with this *résumé* it may be well to note that such progression as existed in the rates on small incomes previous to this latest reform was probably not a true recognition of the progressive principle of taxation, but simply a reduction of the regular rate made in view of the fact that the indirect taxes collect proportionally more from the smaller incomes than from the larger, so that, when we consider the tax system as a whole, the aim was not progressive, but simply proportional taxation. Such a reduction from the normal or uniform rate German writers designate as degressive taxation. In the new law, however, the progressive principle finds a distinct although partial application, since in collecting 4 per cent from incomes of

100,000 marks or more and only 3 per cent or less from incomes under 30,000 marks, it is manifestly the intention that the rich shall contribute, not simply more proportionally than the poor, but also more than men of moderate means. Strictly considered, then, this is not an extension of the progressive principle, but its introduction.[1]

49. The British Income Tax. — Dr. Hill describes the working of this tax as follows:[2]

I. General Description

The tax has had, in fact, a somewhat remarkable history. Originally adopted as a temporary resource, it has now been assessed for over fifty years without any interruption; and although still, in form, a temporary tax, requiring for its continuance an annual renewal by act of Parliament, it is, in all probability, as firmly established and as permanent as any part of the revenue system. The tax is, however, more than fifty years old if we date its age from its first appearance in the fiscal system of England. A tax on incomes was resorted to by William Pitt as far back as 1798, and the income tax in its present form was introduced in 1803. These were war taxes. At that period a direct tax on income could hardly have been levied by any government in a time of peace. But under the pressure of the heavy strain which the struggle with Napoleon was imposing upon the financial resources of England, it was accepted as a burdensome but justifiable demand upon the patriotism of the nation. When the Napoleonic wars terminated with the Battle of Waterloo and a permanent peace had been established under the Treaty of Vienna, the tax was at once discontinued. It was not resorted to again until 1842. In that year Sir Robert Peel revived it, partly to provide for a deficit in the budget and partly to enable him to make certain

[1] It may be noted that in the communal sur-taxes the progression has often been carried much farther and made much sharper than in the state tax. See Neumann, Einkommensteuer, pp. 112 *et seq.*

[2] Reprinted from The English Income Tax, by Dr. J. A. Hill, in Economic Studies of the American Economic Association, 1899. Reprinted with the consent of the author and the Association.

reductions and reforms in the complicated system of protective import duties. It was expected that this revival would be only temporary, but it proved to be permanent. The government has never since found itself quite ready to part with this source of revenue, and the country, as represented by Parliament, has never insisted on being relieved from the impost; and so the income tax has been continued to the present day. It was many years, however, before the intention of ultimately dispensing with it was virtually abandoned. In 1853 Mr. Gladstone came before Parliament with a comprehensive and far-reaching financial programme which he confidently believed would place the government in a position to part with the income tax at the expiration of seven years; and it is probable that this expectation would have been realized and that the tax could and perhaps would have been given up at the end of that period, had it not been for the Crimean War. That unexpected event involved large expenditures which Mr. Gladstone had not anticipated, and when the year 1860 arrived he had no alternative but to ask for a renewal of the tax. Again, in 1874, when Mr. Gladstone felt constrained to dissolve Parliament and appeal to the country, he offered, in event of his return to office, to abolish the income tax. Mr. Gladstone's party, however, was defeated. But the election did not turn upon financial questions and could hardly be regarded as a popular verdict in favor of the income tax. Still the Disraeli ministry, which now came into office, naturally felt free to continue the tax and found it desirable to do so; and since that time no prime minister has ever proposed to part with this convenient and productive source of revenue.

In the earlier period of its history the tax was several times granted for a term of years. But ever since 1860 it has been an annual impost, which would expire with the close of the fiscal year if it should not be renewed by Parliament. This annual renewal affords an opportunity to adjust the rate of the tax to the condition of the finances. If, for instance, the revenues are insufficient, the necessities of the government may be provided for by adding another penny to the rate. If there is an excess of revenue, the country can be relieved from unnecessary taxation and the accumulation of idle funds in the treasury forestalled by taking off a penny. In this way the tax has re-

peatedly proved to be a highly convenient resource, of which the chancellor of the exchequer has availed himself both when he was confronted with the prospect of a deficit and when he was in the more fortunate position of having a surplus at his disposal. Hence in the English budget the income tax has served as a sort of regulator or adjustable element by means of which a close correspondence between revenue and expenditure can readily be maintained. This explains why the rate has undergone such frequent changes. For a number of years after 1842 the tax was kept at *7d.* in the pound, or a little less than 3 per cent. During the Crimean War it was increased to *16d.*; and since that period changes have been made every year or two. The lowest point was reached in 1875, the rate then being only *2d.* in the pound. Since 1880 it has varied from *5d.* to *8d.*[1]

From time to time changes have likewise been made in the exemptions and abatements which are granted to the possessors of small incomes. In recent years the range of these abatements has been very much extended, and in effect the tax has thereby been made progressive as regards incomes between £160 and £700. Incomes under £160 are wholly exempt, and incomes above £700 bear the full rate of the tax without any relief or abatement.[2]

In other respects the tax has undergone hardly any changes of importance since it was first introduced. In its main features it is the same to-day that it was ninety years ago; and even in details the changes have been comparatively few. The assessment is still for the most part regulated by the Act of 1842, and that Act is in turn a close reproduction, in form as well as substance, of the Act of 1807.

That the English income tax should have been in this way retained and perpetuated until it has become apparently a

[1] In order to meet the demands of the war in South Africa, the rate of the income tax was advanced to *1s.* in 1900, and then to *1s. 2d.* in 1901, and *1s. 3d.* in 1902. Under a rate of *8d.* the yield of the tax was £18,800,000 in 1899–1900. With the increased rates, its yield advanced to £29,700,000 in 1900–01; to £35,400,000 in 1901–02; and to £38,700,000 in 1902–03. — ED.

[2] As Dr. Hill explains in a later chapter, which we cannot reproduce, the law now exempts all incomes of £160 or less. Then it grants abatements on incomes between £160 and £700, the amount of the abatement decreasing as the size of the

permanent institution seems to establish a certain presumption in its favor. To be sure, in politics and finance, however it may be in the realm of nature, mere survival can hardly be said to constitute any very conclusive proof of fitness. Conservatism or other and perhaps worse influences may, as we know too well, perpetuate old institutions after they have become ill-adapted to changed conditions or even laden with abuses and injustice. The system of state and local taxation in the United States might be cited as a case in point. But there are no indications that the English income tax is thus becoming antiquated or that it contains such inequalities or defects as would justify a demand for its abolition or radical reform. Like most taxes, it has first and last given rise to complaint on the part of the taxpayers and to adverse criticism by statesmen, politicians, and writers on finance. Such criticism can by no means be dismissed as altogether unjustifiable. The tax has its defects, which would have to be taken into consideration were we to attempt to pass judgment on its general character and test its merits either by the standard of an ideal system or by comparison with other existing taxes, which, in turn, will be found to have other or

income rises. The result is a certain progression in the rate of the tax up to incomes of £700, after which the rate becomes uniform. Dr. Hill gives the following table:

Income	Abatement	Income Taxed	Tax at 8*d.* in the Pound	Rate per cent of the Tax
£160 (exempt)				
200	£160	£40	£1.33	0.66
250	160	90	3.00	1.20
300	160	140	4.66	1.55
350	160	190	6.33	1.80
400	160	240	8.00	2.00
450	150	300	10.00	2.22
500	150	350	11.66	2.33
550	120	430	14.33	2.60
600	120	480	16.00	2.66
650	70	580	19.33	2.98
700	70	630	21.00	3.00
750	——	750	25.00	3.33⅓
800	——	800	26.66	3.33⅓

similar defects. But however faulty or imperfect the tax may be, it has successfully withstood all criticism and opposition. Movements for its abolition or its reconstruction on different principles have, indeed, been set on foot, but they have not met with much support. Twice in the course of its history it has been made the subject of investigation by Parliamentary committees, — once in 1851 and again in 1861; but neither committee reported in favor of making any changes, and for the last twenty-five years or more there has been little to encourage any expectation that the tax will be abolished or will undergo any fundamental revision. Apparently the income tax has come to stay and is generally accepted as a justifiable and, on the whole, fairly satisfactory impost.

This result is no doubt due to a variety of causes. The tax is, as we have seen, a highly convenient fiscal resource for the government. It is regularly productive of a large amount of revenue, and can be made to respond quickly to the needs of special emergencies. Taken in connection with the other portions of the English system of taxation, it conduces to a just distribution of the public burdens and carries out the generally accepted principle that taxes on articles of general consumption should be supplemented by direct taxes on property or income. Politically it occupies a strong position since, in its incidence, it is confined mainly to the wealthy or well-to-do classes, which constitute but a small proportion of the total population; and consequently there will be little disposition on the part of the great majority of voters to join in any movement for its abolition. But after all due allowances have been made for these factors, it will be found, I think, that the success of the tax in surviving the test of experience is in no small degree due to the method by which it is assessed and the manner in which the assessment is carried out through the agency of competent officials. Probably this as much as anything else explains why, notwithstanding the great changes which have taken place in economic and industrial conditions, and the effects which these changes have produced on the forms in which property is held and the way in which the income of society is produced and distributed, the income tax has continued to be assessed, producing apparently better results and giving rise, on the whole,

to less complaint at the present time than it did in the earlier period of its history.

II. The Five Schedules

For the purposes of the assessment the different kinds of taxable income are classified under five different divisions or schedules:

Schedule A covers the income arising from the ownership of land or houses. It includes the rental value of premises occupied by the owner as well as the rents received by the landlord from the tenant.

Schedule B applies to the income from the use or occupation of land, *i.e.*, the income received by the cultivator of the land, whether he is the owner or the tenant.

* * * * * * *

Schedule C comprises the interest, annuities, or dividends payable in the United Kingdom on government securities, British, colonial, or foreign.

Schedule D includes the income from trades, professions, and business, from colonial or foreign possessions, from the stock or bonds of colonial or foreign corporations, and from any other sources which are not specifically included in any other schedule.

Schedule E consists of the salaries, annuities, or pensions received by the officers and employees of the state and of incorporated companies.

This classification is not employed for the purpose of making any distinctions in the rates at which the different kinds of income are taxed. So far as the rate is concerned all income is treated alike. The distinctions relate to the manner in which the income is assessed. It would seem that those who framed this measure of taxation came to the conclusion that that process of assessment which was calculated to produce the best results when applied to one form of income could not, without more or less modification, be as advantageously applied to another. At any rate we find that the assessment is regulated by distinct rules for the different schedules, and that there is consequently considerable diversity in the process and the machinery by which

the income is ascertained and taxed. So this classification may be regarded as having been devised with a view to adjusting the process of assessment to the kind of income to be assessed. The result is a complicated system. Simplicity has been sacrificed in order to secure this adaptation of the means to the end.

In all this diversity, however, one underlying principle has been introduced and applied so far as practicable. It is the principle of assessing the sources of income. This constitutes the distinguishing feature of the English income tax. So far as practicable the income is assessed where it arises and the tax is collected by stoppage at the source. Thus the tax on the landlord's income is assessed to and collected from the tenant, who then deducts it from the rent. In like manner the creditor's income is reached by an assessment upon the gross income or profits of the debtor, who deducts the tax from his interest payments. The right to deduct the tax from rent or interest is conferred by statute, and any contract intended to abrogate it is void. The stockholder's income is reached by assessing the tax upon profits of the corporation, and thus producing a corresponding diminution in the dividends which he receives. The five schedules constitute a classification which has been prepared with a view to reaching the sources of income so far as possible. The diversity in the nature of the sources necessitates considerable diversity in the process and machinery by which this principle of assessment is applied.

* * * * * * *

There are two important advantages which the English method of assessing income at the source possesses over an assessment upon individual incomes. In the first place the taxpayer is, as a rule, relieved from the necessity of disclosing for the purpose of taxation the exact amount of his income. He is required, to be sure, to disclose the gross amount which passes into his hands from certain specified sources; but he need not distinguish what proportion of this is *his* income, to be expended as he pleases, and what proportion he is required to pay over to other people; nor need he reveal how much income he receives from other sources. It is only when he wishes to claim the exemption or abatements which the law allows on individual incomes which come within certain specified limits that he is obliged to

give a complete and exact statement of his income. Leaving such cases out of account, it will be found that under this system of taxation a resident of England will be called upon to declare the rental value of the house which he occupies or the farm which he cultivates; he will likewise be required to declare the amount of income yielded by any business, trade, or occupation in which he may be engaged, and the amount received without deduction of the tax from any foreign investments; but he need not state how much of the sum so declared is absorbed by payments of interest on personal debts or borrowed capital or by payments of rent; and he need not reveal how much income he derives from the stock or bonds of domestic corporations, or from securities of the British government, or from lands or houses owned by him and leased to tenants. Consequently his aggregate net income may be a good deal more or it may be a good deal less than the sum which he is required to declare.

The other advantage which the system possesses is found in the ease and certainty with which it reaches the income subject to taxation. It is obvious that the opportunities for evasion will be greatly diminished, or entirely removed, if the income can be taxed before it comes into the hands of the person who is entitled to enjoy it; or, if there is still sufficient opportunity for evasion, the inducement to take advantage of it may be lacking so far as the person who is held responsible for the tax and required to make a return of the income is concerned. Under this system of assessment there is, in fact, a large amount of income in regard to which evasion is impossible. This is the case with the income paid out of the revenues of the state which imposes the tax. In the English system the tax on public annuities and on dividends or interest on the public debt is simply deducted from these payments as they are made. In the same way the tax is withheld from the salaries and pensions paid in the public service. Hardly less certain is an assessment on the profits of corporations in reaching the incomes of the stockholders and bondholders.[1]

[1] As Dr. Hill explains in a later chapter not reprodnced here, corporations are required to deduct the tax from the dividends and interest paid to holders of their securities. Thus of the total yield of Schedule D abont one half, representing the taxes paid by corporations, is collected by methods that make evasion impossible. — Ed.

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It is not possible, however, to apply this principle of assessment at the source of all kinds of income. In the first place the source may be inaccessible to the government imposing the tax. This is the case with the income from investments or possessions in foreign countries or in other states. But while this income cannot be reached at its source, the attempt is made, under the English system, to reach some part of it on its way from source to destination by requiring any banker or agent in Great Britain who may be intrusted with the payment of interest or dividends on foreign securities to account for and pay the tax on the sums passing through his hands in this way. Again there is considerable income which may be said to remain where it arises, the source not being distinguishable from the destination. The "first possessor" of it is also "the ultimate proprietor." This is generally true of the incomes obtained by the exercise of a trade, the practice of a profession, and the private, as distinguished from the corporate, management of business in general. It is also true of the income derived from the capital employed by the owner in his own profession or business; and of the income represented by the rental value of land or houses in those cases in which the owner is also the occupier.

As regards these descriptions of income, then, it is not possible to distinguish for the purpose of taxation between source and destination. The assessment will have to be made upon the person who receives and enjoys the income and who will consequently profit by any evasion of the tax. But while in these cases the person on whom the tax is assessed is not without the inducement to evade it, he may, nevertheless, lack the opportunity. Whether evasion is possible and easy or not will depend upon circumstances and particularly upon the character of the income. The assessment of houses and lands in the locality where they are situated, or of the income which they represent, is always a comparatively simple matter, affording little chance for evasion whether the tax be levied upon the owner or the tenant; and under the English system the assessment of the farmer's income is equally simple, because for the purpose of taxation the income is assumed to be equivalent to a

certain proportion (one third as the law now stands) of the annual or rental value of the farm, so that ordinarily it is not necessary to undertake to ascertain the profits which the farmer actually obtains.[1] Then, too, many of the moderate or smaller incomes earned in a trade, profession, or business can be estimated with so close an approach to accuracy that there is practically little chance for concealment.

On the other hand, there are many cases in which an accurate or adequate assessment is hardly possible without the assistance of information furnished by the person who possesses the income on which the tax is to be levied. Here both the inducement and the opportunity to evade some part of the tax are present and are, as it were, coincident, — the person who has the opportunity being the person who profits by the evasion. There is, in fact, considerable income which will hardly be discovered and taxed unless the recipient of it is honest enough to reveal it. This applies to the returns from foreign investments, where the tax has not been deducted by any agent, and must, therefore, be collected, if it is collected at all, from the investors themselves. In other cases the existence of the income may be obvious enough, but its amount cannot be accurately or perhaps even approximately estimated unless the assessors can avail themselves of the taxpayer's knowledge of his own affairs. This is, to a considerable extent, true of the larger professional and business incomes.

The opportunity for evasion, then, which is, perhaps, the strongest objection that can be urged against the direct taxation of income, has not been entirely eliminated under the English system, but its scope has been very much restricted. Probably more than four fifths of the tax collected is assessed in such a way or under such conditions that evasion is, broadly speaking, out of the question. This estimate includes all the tax assessed in Schedules A, B, C, and E, and more than half of that in Schedule D. But as for the remainder, it is assessed under conditions which do not wholly preclude the possibility and likelihood of more or less evasion, the income being of such a

[1] Since 1887 the farmer has had the option, however, of being assessed upon the profits actually received from his farm; but he does not generally avail himself of this alternative, perhaps because it is not often for his advantage to do so.

nature that the assessors are, to some extent, dependent upon the declarations which are required of interested taxpayers. Consequently, as regards this portion of the tax, the problems and difficulties which are involved in securing reliable declarations and making an adequate assessment are very much the same as those which arise in connection with the other and more usual form of income tax, which is assessed upon the aggregate net incomes of the individual taxpayers; and it will be found, in fact, that the process and machinery of assessment employed in Schedule D would be equally applicable to a tax which was wholly assessed upon the individual owners of the taxable property or income.

50. The Income Tax in the American Commonwealths. — Various American states have experimented with general or partial income taxes, and their experience has been summarized by Dr. D. O. Kinsman as follows :[1]

We shall now give a brief *résumé* before presenting our conclusion. We cannot charge the commonwealths with slighting the income tax. Of the forty-five states, sixteen have made legislative provision for it, either in a general or special form; of about one hundred constitutions passed by the states, thirteen, representing eight states, have made special provision for its use; and of some forty state tax commissions, which have been appointed by the different states, seven have treated it in their reports.

The use of the income tax proper[2] began about 1840 and has continued to the present time. Its history has been marked by three periods of special activity: one from about 1840 to

[1] The Income Tax in the Commonwealths of the United States, 110 *et seq.* In Publications of the American Economic Association, Third Series, Vol. IV (1903). Reprinted with consent of the author and the Economic Association.

[2] In the seventeenth and eighteenth centuries most of the colonies levied, for longer or shorter times, a partial income tax on "faculty," trades, professions, or occupations. This was designed to supplement the tax on property, but was of little financial significance. In some cases, as in Massachusetts and South Carolina, it survived until the nineteenth century, and developed into an income tax. For the early history of colonial and state income taxes, see Kinsman, Income Tax, 1–16; Seligman, The Income Tax in American Colonies and States, in *Political Science Quarterly*, June, 1895. — ED.

1850, during which decade six states introduced the tax; another from 1860 to 1870, during which decade seven introduced it; and a third from about 1895 to the present, which has been marked by a revival of the movement. Of the sixteen states that have employed it, six are still using it — Massachusetts, Virginia, North Carolina, South Carolina, Louisiana, and Tennessee.

Massachusetts has had the longest experience with the tax, extending from 1643 to the present time. South Carolina's experience began in 1701 and, with the exception of about thirty years, has extended to the present. Pennsylvania levied the tax from 1841 to 1871; Maryland, from 1842 to 1850; Virginia, from 1843 to the present; Alabama, from 1843 to about 1886; Florida, from 1845 to 1855; North Carolina, from 1849 to the present time. With but one exception the states introducing the tax between 1860 and 1870 employed it for only very short periods. Missouri employed the tax from 1861 to 1866; Texas, from 1863 to 1868; Georgia, from 1863 to 1866; West Virginia, during 1863; Louisiana, the one exception, from 1865 to the present time; Kentucky, from 1867 to 1872; Delaware, from 1869 to 1872. Tennessee tried the tax in 1883, but then, like Kentucky, only to a very limited extent.

Two causes have led to the introduction of the income tax: the demand for greater justice in the distribution of the burdens of taxation, and the need of increased revenue. A third cause, a desire to regulate the business from which the income is derived, has operated in a few instances. The need of revenue was the dominant force leading to the introduction of the tax in the period between 1840 and 1850, and also in that between 1860 and 1870. In the first period this need was due to the enormous state debts resulting from extensive internal improvements; in the second period, to the heavy expenses incurred by the Civil War. It must be recognized, however, that the democratic influences which were felt in almost every department of political life about 1840 had not a little influence on the movement during the earlier period. During the present period the demand for justice appears to be the dominant force, although in South Carolina, as we have seen, the financial need is having weight.

The states employing the tax have spared neither time nor ingenuity in attempting so to frame the laws as to make the tax effective. Every possible method has been tried. The tax has been levied as a general income tax upon all forms of income, and as a special income tax upon one or more forms of income; without regard to the source of the income and modified according to the source; as an apportioned tax, and as a percentage tax. The rate has been made proportional, progressive, and partly proportional and partly progressive. The exemption has been a fixed sum applied to all income and a sum varying with the form of income and with particular classes of individuals. The administration of the law has been under the direct supervision of the central government, and it has been left to the option of the local units. The tax has been employed strictly as a war measure, as a peace measure, and as both.

Of all the states using the tax, six have levied it as a general income tax, affecting all forms of income — rent, interest, wages, and profits. These states are Massachusetts, South Carolina, Virginia, Alabama, North Carolina, and Texas. The scope of the tax in Massachusetts, however, has varied with the different local interpretations placed upon the law.[1] The remaining ten states have each taxed some one or more of the four forms of income. All of them except Georgia, Tennessee, and Kentucky have taxed incomes from personal services, salaries being especially mentioned; seven of them, all except Florida, Tennessee, and Kentucky, have taxed profits. Five, Delaware, West Virginia, Kentucky, Tennessee, and Missouri, have taxed interest. The rate of the tax has usually been proportional, although six of the states have made use of the progressive rate.

An exemption has been very generally allowed, varying both in the different states and at different times in the same state. When a fixed sum has been allowed, it has been usually from $300 to $2500, $500 and $1000 being the most common amounts.

[1] Since 1873 the Massachusetts law has provided that "Income from an annuity, from ships and vessels engaged in the foreign carrying trade, and so much of the income from a profession, trade, or employment as exceeds the sum of two thousand dollars a year" shall be included in the assessment of personal property under the general property tax. Income derived from property already subject to taxation is not to be taxed. *Cf.* pp. 17–28 of Dr. Kinsman's monograph; also Report of the Massachusetts Tax Commission of 1897, pp. 10–11. — ED.

The exemption at present allowed in South Carolina is $2500. Many of the states have provided for special exemptions, such as the expenses of the business from which the income is derived and the incomes of particular classes of individuals, such as ministers of the gospel, state judges, and certain classes of laborers.

The administration of the tax has been much the same in all the states. It has been assessed, as a rule, by the local assessors and collected by the local tax collectors. The laws have required that the tax should be levied by self-assessment, almost invariably under severe penalties for failure to comply.

The revenue derived from the income tax has been insignificantly small. For instance, Alabama in 1882, during the period of her most successful experience, received an income tax of only $22,116 out of a state tax of over $600,000. In 1899 North Carolina's income tax amounted to only $4399 out of a total tax of $723,307. Virginia in 1899 received only $54,565 from this source, while her state tax amounted to $2,132,368. South Carolina in 1898, while levying a state tax of about $1,000,000, received only $5190 from her tax upon incomes.[1]

The attitude of the state courts toward the income tax has been one of sympathy. In the few cases upon the subject brought before them they have upheld the tax. Had all forces been as active in support of the system as the state courts, the tax would undoubtedly have been a success.

Of the thirteen state constitutions providing for the taxation of incomes, Texas has adopted three; one in 1845, a second in 1869, and a third, still in force, in 1876. Louisiana has also adopted three constitutions making special provision for the tax; one in 1845, another in 1852, and a third in 1868. The constitutions of 1879 and of 1898 failed to make such a provision. Virginia has provided for the tax since 1851, the constitution of that year and also that of 1870, still in force, expressly allowing the tax. The next state to provide for the

[1] In the cities of Massachusetts it was ascertained in 1896 that $1,891,742,000 of property was assessed for taxation. Of this sum, only $422,048,000 was personal property; and of this amount of personalty, only $3,880,000 was income. Of the 32 cities, 11 reported no incomes assessed, Boston, Worcester, Cambridge, and other large cities being of this number. — ED.

tax in her constitution was North Carolina in 1868. Tennessee, in her constitution of 1870, still in force, incorporated a similar provision. California did likewise in her constitution of 1879, now in operation. Kentucky followed in 1891, and South Carolina, the last of the states to make such provision, in 1895.

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A careful study of the history of the tax leads one to the conclusion that the failure has been due to the administration of the laws. This conclusion is borne out by both the admissions of the advocates and the assertions of the opponents of the tax, and is corroborated by the reports of tax commissions. The causes operating to produce this failure in administration appear to have been four: the laws themselves have been defective in the provisions for their own administration; the officials have been lax in the enforcement of the laws; the taxpayers have been persistent in evading them; and the nature of some incomes has made them especially difficult to reach. The income tax laws thus far, failing to recognize the weakness of the average taxpayer, have allowed him to return his own income. Some argue that to employ any other method would be undemocratic and that public sentiment would never submit to it. However, although the public has always opposed any inquisitorial system, the opposition has been often due rather to the fear that it may attain the end sought than that it is counter to the spirit of democracy. Often the taxpayer has something he wishes to conceal and calls on the "spirit of democracy" to help him out. We have yet to learn of a plausible argument in support of the assertion that the income tax is more inquisitorial than other forms of direct taxation. The income tax has succeeded in nations quite as democratic as the United States. Other methods than self-assessment have been employed successfully, both by foreign nations and to a limited extent by some of our own states. The use of the method of self-assessment has been due, not to public demands, but largely to the indifference of legislators. However, it is not to be condemned except that it furnishes the means by which the taxpayer, if he wishes to do so, may escape the tax.

The laxness of the officials in the enforcement of the laws doubtless also has had much to do with the failure of the income

tax. Although the laws have usually required the assessors to demand from each taxpayer a full statement of his income and to enforce their demand by a severe penalty, they have not only failed to do this, but in listing the individual's property have also entirely neglected his income or assessed it so low as to make the tax derived therefrom unimportant. Before we can hope for a successful taxation of incomes, officials must be faithful in the performance of their duty.

The taxpayer also has contributed much to the failure of the income tax. Not only has he taken advantage of every opportunity to escape it, but he has also exercised his ingenuity to contrive means of evading it. The taxpayer with an elastic conscience and a good opportunity has usually succeeded in escaping the tax upon such property as could be concealed.

The nature of income is such as to make concealment comparatively easy. Much income is received in such form as to make it quite impossible for any one except the recipient to know its amount, or at least to make more than a mere estimate, and even the recipient, in many instances, would find it quite impossible to be accurate. . . .

As a result of our study we conclude that the state income tax has been a failure, due to the failure of administration, which, in turn, may be attributed to four causes: the method of self-assessment, the indifference of state officials, the persistent effort of the taxpayers to evade the tax, and the nature of the income. The tax cannot be successful so long as taxpayers desirous of evading taxation are given the right of self-assessment. Since all attempts to change the method of self-assessment have failed and the nature of industry in the states is at present such as to make impossible the assessment of a general income tax at the source, we are forced to the conclusion that, even though no constitutional question should arise, failure will continue to accompany the tax until our industrial system takes on such form as to make possible the use of some method other than self-assessment.

51. The Wisconsin Income Tax: by Thomas S. Adams.[1]— The success of Wisconsin with her income-tax law of 1911 is described in the following selection:

[1] Reprinted from *Political Science Quarterly*, Vol. XXVIII, pp. 569–585.

For many years expert opinion in the United States has strongly condemned the state income tax. Despite the voice of authority, however, the legislature of Wisconsin passed an income-tax law in 1911, which has since stood the test of two assessments.

The Wisconsin income tax originated in an effort to find an equitable and efficient method of personal taxation. The operation of the general property tax has been steadily transforming it into a real tax—a tax on things rather than on persons. This tendency was believed in Wisconsin to be not altogether salutary. The property of many persons of wealth is situated in jurisdictions other than those in which they reside. These people, it was thought, owe some fiscal allegiance to the jurisdiction in which their persons are protected and their children are educated. The tax on property did not meet the requirements of the situation and, after the necessary constitutional amendment had been secured, a graduated income tax was adopted as the most available supplement to the system previously in force. The law was approved in July, 1911, and went into effect the following year. The first assessment, therefore, was made in 1912, based upon incomes of 1911.

The Wisconsin law is applicable to persons living in Wisconsin, to business transacted there and to income derived from property within the state. Where the business is taxed in Wisconsin any partner or shareholder residing in Wisconsin is exempt in his personal return from income taxed directly to the partnership or corporation. The rates are progressive, rising in the case of individuals and partnerships from 1 per cent on the first $1000 of taxable income to 6 per cent on taxable income over $12,000. For corporations the rate rises from 2 per cent on the first $1000 of taxable income to 6 per cent on income over $6000. The incomes of wife, husband, and children under eighteen years of age are grouped together and the following deductions are allowed: $800 for an individual, $1200 for man and wife and $200 additional for each child entirely dependent upon the taxpayer for support. No deductions are provided for partnerships and corporations. Educational and benevolent institutions not conducted for pecuniary profit are exempt from the tax, as are insurance companies and all those public utilities which pay taxes directly to the state government. The yield of the tax is, of course, greatly affected by this withdrawal of insurance companies, steam railways, street railways and all gas and power

companies associated with street railways. Since the first assessment, banks and trust companies have likewise been exempted from the income tax. This exemption is due to the fact that the income of most of these corporations is given proper weight in fixing assessments under the *ad valorem* tax imposed by the state government. Moreover, in the case of practically all of these corporations, the personal-property tax would be sufficient to cancel the income tax. For it is provided by the statute that any personal-property tax may be used as an offset or credit against the income tax. Thus a man with an income tax of $100 and a personal-property tax of $70 pays his personal-property tax and only $30 as income tax. It was found impracticable to make the income tax a complete substitute for the tax on personal property. On the passage of the income-tax law, however, all moneys and credits, household goods and farm machinery were exempted from taxation, thus leaving subject to the property tax only a few kinds of personal property, the most important of which are farm animals and the stock of merchants and manufacturers.

The administration of the tax is highly centralized, the assessment of corporations being made by the tax commission, and the assessment of partnerships and individuals by assessors of incomes appointed by the tax commission in accordance with civil-service requirements. But the income tax is still predominantly a local tax. The administration only is centralized. The state government gets only 10 per cent of the revenues collected and pays all expenses. Twenty per cent goes to the county government and 70 per cent to the town, city or village in which the tax is collected.

The first assessment was completed in the autumn of 1912. It naturally aroused no little irritation, and the income-tax law was made the principal point of attack in the gubernatorial campaign which followed. But the attack failed. Governor McGovern, who made it his chief issue, was reëlected, and in the legislature of 1913 practically no effort was made to touch the income tax except to strengthen and improve it. The fiscal results of the first assessment may be briefly and rather baldly described as follows: (*a*) The total income assessed amounted in round figures to $100,000,000 and the income tax to $3,472,880, of which tax 68 per cent was assessed to corporations and 32 per cent to firms and individuals. The average tax rate upon corporations was 5.4

per cent and upon individuals 1.96 per cent. (*b*) The tax was much more productive in urban than in rural districts, 42 per cent of the entire tax being assigned to Milwaukee alone. Comparatively few farmers and laboring men were found to be subject to the tax, the exemption—which for man, wife and three children amounts to $1800—relieving these classes almost entirely of income taxation. The tax is borne for the most part by the more prosperous business and professional elements of the city communities. (*c*) Of the $3,472,880 assessed in 1912, $1,628,318 had been paid into the public treasury at the end of the collection season, $411,863 remained due and collectible on delinquent rolls, and $1,432,700 had been offset or canceled by payments of the personal-property tax. The uncollected tax represents for the most part amounts which have been deliberately withheld by responsible companies pending judicial decision of a number of disputed points. (*d*) The cost of administering the tax in the first and probably most expensive year of its operation was $94,832. From this, however, should be subtracted at least $54,000, representing the equivalent of salaries previously paid to certain officers whose work has been taken over and better performed by the assessors of incomes. The net or real cost of the income tax was, therefore, in round figures, $40,000, making the tax one of the least expensive direct taxes anywhere collected.

I

The greatest discovery of the Wisconsin income tax is the non-political assessor of incomes. The law requires assessors of income to be selected in accordance with civil-service requirements and without regard to political affiliation. Among the forty-one assessors of incomes there are Republicans, Democrats, Socialists and single-taxers. The highest salary paid is $3600 a year; the lowest $800; the average almost exactly $1200. The assessors are appointed and subject to dismissal by the tax commission. They serve for a term of three years. They have been strongly supported by the commission in their work and earnestly urged to a thorough enforcement of the law. They have responded intelligently and not only have impressed the people of the state with their tact and firmness but have convinced them that the law is to be enforced just as written. It is very largely their

work that has made the income tax a success. With the property tax they have wrought something in the nature of a revolution.

Wisconsin had, from 1903 to 1911, county officers known as supervisors of assessment, appointed by the various county boards and exercising a general supervision over local assessment work, which now as then is performed by locally elected assessors. The county supervisors, appointed by the county boards and dependent upon such boards for their retention, did not accomplish much. They were timid and for the most part ineffective. Placed upon a civil-service basis by the income-tax law and urged by the tax commission to a tactful but firm and vigorous enforcement of the law, they have in the last two years effected a remarkable improvement in the assessment of real and personal property. At considerable trouble the Wisconsin Tax Commission secures very trustworthy estimates of the ratio of assessed value to the true value of property. In 1910 property was assessed generally throughout the state at 61 per cent of its full value. The assessors of incomes had only a few months to work in 1911, but they raised this ratio to 65 per cent in that year and to 73 per cent in 1912. In 1913, although the complete figures are not available, it is practically certain that the ratio will be not less than 83 per cent. In many taxing districts throughout the state there is now for the first time on any wide scale a full-value assessment. Those who know how effectually a full-value assessment tends to equalize the individual assessments, and how difficult it is to get such assessments, will realize the importance of the step which has been taken.

In a degree heretofore unknown the local assessors have called for assistance upon the expert agents employed by the state tax and railroad commissions. The appraisal of mines, of the terminal properties of railroads and of minor public utilities subject to local assessment, as well as of the larger and more difficult forms of manufacturing business, is coming to be in increasing degree the joint work of local assessors and state experts. The county equalizations, *i. e.*, the division of the county tax among the political subdivisions of the county, which calls for an assessment of all county property on the same basis, are now, in effect, being made by the assessors of incomes; whereas a few years ago they were largely influenced by political considerations, sectional jealousies and guesswork. In this way the expert agencies of the

state government are economically and efficiently brought to the aid of the local assessors. The state coöperates with the local assessor; it does not supplant him. It is a system which, as it is perfected, may combine uniformity with elasticity; which may start with the locally elected assessor and yet give proper scope to centralization and expert aid through the coöperation of the state commission. It avoids the defects both of excessive centralization and excessive decentralization. For this result both the state commission and the income-tax law are to be credited. Theoretically it might have been secured in the absence of the income tax by making the supervisors of assessment state officials. Practically, however, the stimulating rigors of the income tax were required to make the people see and feel that the greatest need of the tax system was a set of officers not dependent for the retention of their offices upon the favor of the people whom they assess. The appointment of a body of protected tax officials marks a new epoch in the fiscal history of the state of Wisconsin, possibly in that of the United States.

II

Closely connected with the results stated above are a number of important conclusions, very difficult to prove, yet which are hardening gradually into tenacious convictions in the minds of those who have had to do with the administration of the income tax:

(*a*) First of all is the feeling that the "protected assessor" is the most vital part of the whole tax system; that with him all things—even general property taxes perhaps—are possible; and that without him all is chaos.

(*b*) The income tax is as easy to administer as is a tax on real estate. This may sound revolutionary; none the less it is believed to be true. In the majority of cases a man's income is more easily determined and measured than is the value of his property, particularly if you secure his coöperation in the work of appraisal. Income is less tangible than property, but if we except farming properties and one or two allied classes of occupations the range of uncertainty in the measurement is usually less. Income is measured after the transaction is consummated. The amount received, with the proper exemptions and deductions pro-

vided by law, is the proper measure of the taxpayer's liability. What his real estate is worth, however, is a mere estimate—an estimate of estimates—really determined by estimating what other men will estimate to be its worth. Business property, moreover, must be valued as part of a going concern. The point under discussion is too large to be settled here. What is asserted with some confidence is that the intrinsic difficulty of computing or appraising income, as compared with the difficulty of appraising capital value, has been grossly exaggerated, particularly when the coöperation of the taxpayer can be secured.

(*c*) And in the great majority of instances his coöperation can be secured. The American taxpayer is the most maligned creature in all the annals of fiction. He has been compared, confused and used synonymously with the liar. As a matter of fact, when confronted with an equitable tax and a fearless assessor, he is amazingly honest. Corporations are included in this characterization. The great majority, both of individuals and of business concerns, tell the truth. In the opinion of those who administer the Wisconsin income tax, about 10 per cent will equivocate, twist the truth or flatly lie, according to their legal learning, their skill and daring. The rest, with a reasonable amount of prompting and supervision, will make fair returns and can be counted upon to lend their own knowledge and assistance towards the determination of a fair assessment. It is the locally elected property assessor, bent on conciliating voters and on keeping his own underpaid job, who has demoralized the American property tax and made it in the past a byword for chicanery, inefficiency and inequality.

(*d*) Equally misleading, if Wisconsin experience can be trusted, are the catch-phrases "self-assessment is poor assessment" and "don't tax anybody for anything that can move because it will move." It is true, of course, that a tax which is left completely to the taxpayer for assessment will be "left" there. There is, however, no truth in the contention that the taxpayer cannot be made and ought not to be made to coöperate in the fixing of his own assessment. It is equally untrue that taxes should be levied only on those tangible things which the assessor can see and appraise without the help of the owner or taxpayer. The taxpayer usually knows better than does any one else the amount of his income and the value of his property. Nearly always he has

in his possession data by which these questions can be determined. In the past far too little use has been made of the taxpayer and the facts which he can contribute. This is true of Wisconsin at least. The income tax has opened the eyes of the Wisconsin authorities not only to the honesty of the average taxpayer, but to the extent to which he can be depended upon, if properly approached and supervised, to assist in appraising his own property or income. The declaration of the taxpayer is the most natural, effective and helpful starting point in the administration of any direct tax. It could be used with great advantage in the assessment of real estate, if taxpayers were convinced in advance that there was going to be a full assessment of all property on the same basis.

The single-tax catchword with regard to the "moving" effect of taxes seems, in the light of Wisconsin's experience, particularly untrue. Discriminatory taxes may drive business away and excessive taxes may have the same result; but reasonable taxes, imposed and administered in a spirit of equity, move almost no property or business and few people, beyond a small number of curmudgeons for whose absence any community would breathe more freely. In the heated political campaign which followed the first assessment of the income tax, the statement was freely made that business enterprises were leaving the state on account of the income tax. Diligent effort was made to ascertain the facts, but not a single instance was found in which an industry had left the state on account of the income tax, or had failed to locate in Wisconsin because of the tax. It was discovered that in several instances the income tax had been considered by prospective investors and in one case that the income tax, along with other factors, had deterred a group of investors from making one use of a water power in the state which was, however, later employed for another purpose. In short, the income tax exercised practically no appreciable effect upon the location of industry. Taxes are ordinarily a minor element in the decision of this question. Whether in the long run industry will be appreciably affected by the imposition of income taxes in the state can, of course, be determined only by a longer experience; but the people of Wisconsin will probably be little influenced in selecting their system of taxation by apprehensions which in the past have been so skillfully played upon by certain classes of interested taxpayers.

The natural wealth of the state cannot run away, and the industry which cannot or will not stand fair taxes is in the long run a source of weakness, not of strength. The political atmosphere will be more wholesome and the general level of welfare and of real wealth will be higher for the absence of industries which are unwilling to contribute when their earnings are high.

III

It has been said by an able critic of state income taxation that no income tax can succeed among English-speaking people which does not make extensive use of collection at source, and that collection at source is not possible with a state income tax. If by "collection at source" is meant collection direct from corporations, joint-stock companies and copartnerships, then the Wisconsin income tax makes considerable use of it, inasmuch as 68 per cent of the entire tax was assessed to corporations alone, and to corporations and copartnerships more than 75 per cent. Moreover, the Wisconsin tax provides for the extensive collection of information at source. What is outgo to taxpayer A is income to taxpayer B. With respect to wages, salaries, rents and interest paid out, all taxpayers are required to list the names and addresses of the payees, and the income-tax returns of the latter are checked to ascertain whether the corresponding income has been properly reported. This device has proved exceedingly helpful and has gone far to negative the criticism that in state income taxes proper use could not be made of collection at source.

The Wisconsin authorities have, of course, no way of measuring the exact amount of interest and dividends from foreign corporations or other extra-state sources which is received and not reported by Wisconsin residents. But all indications point to the conclusion that this kind of evasion is not at all serious. Information about the receipt of such income is constantly being received from various quarters, and upon checking the returns of the recipients in question they have almost without exception been found to be correct. In short, most of the income of the people of Wisconsin is received from sources within the state, and the remainder is adequately known through the common honesty of the average citizen. Collection at source is a convenience and an added element of strength. It is not a necessity,

and critics who have built destructive arguments upon the alleged impossibility of incorporating the device in state income taxation should have learned as much from experience on the continent of Europe.

IV

A real difficulty has been encountered in the proper assessment of business concerns transacting business within and without the state. The amended law on this subject provides:

> In determining taxable income, rentals, royalties, and gains or profits from the operation of any mine, farm or quarry, shall follow the situs of the property from which derived, and income from personal service and from land contracts, mortgages, stocks, bonds and securities shall follow the residence of the recipient. . . . With respect to other income persons engaged in business within and without the state shall be taxed only upon such income as is derived from business transacted and property located within the state.

The definite allocation of certain sorts of income to the jurisdiction in which the property is situated or in which the company has its place of business considerably narrows the problem in question. Furthermore, in a large number of the remaining industries, a separate accounting for the Wisconsin business may be accurately and naturally made. In the latter case the problem is simple. But there remains a considerable number of important industries in which Wisconsin's share of the net income must be computed by a process of general apportionment which is at times both intricate and perplexing. Fortunately the task has been lightened by the fairness and coöperative spirit displayed by the great majority of the business concerns involved, most of which are corporations.[1] And as each case is taken up and thoroughly threshed out, the problem shrinks, because when a definite status is once reached, it will usually serve for many years. The task of dividing or apportioning the income of companies engaged in business within and without the state is therefore one of the real difficulties of a state income tax; but the problem presented by

[1] Either the great majority of corporations have been greatly maligned in the past or the corporate spirit and point of view have been wholly transformed in the last few years. Intimate contact with many large corporations makes one an optimist on the question of present-day business morality.

this difficulty is not a major one, and with proper administrative effort tends to become less irritating and formidable with each successive assessment.

Closely related to the foregoing is the problem created by the distributing or trading subsidiaries of the great industrial corporations. Almost every important American corporation to-day controls a subsidiary which takes out the licenses in states other than that in which the parent company is incorporated. The subsidiary is almost always capitalized at a very low figure in order that the licenses or foreign corporation fees, whose amounts are usually based upon capital stock, may be as low as possible. These subsidiaries usually act as the selling or distributing branches of the parent corporation; and the relation between parent and child is often of the most artificial kind. In most cases, though with some important exceptions, products are turned over to the subsidiary at prices high enough to assign all the real profit to the parent concern.

This practice creates a real and trying problem which the state income tax must solve. It has not, however, proved a serious impediment in Wisconsin. The cases are not numerous. The relations between manufacturing and distributing departments of corporations are in some instances so natural and fair that the reported net income of the subsidiary represents exactly what the state seeks to tax. Again, in most of the cases in which the relationship is wholly artificial, the corporations have acknowledged this fact without dispute and have acquiesced in the fusion of the two concerns for purposes of income taxation. Finally, Wisconsin has its fair share of such parent corporations, and in these cases the shoe pinches the other foot. Such instances simply accelerate the willingness of the corporations concerned to discard legal fictions in favor of the underlying economic facts. The evil possibilities of the "trading subsidiary" are great, but they are as yet—from the standpoint of state income taxation—mostly possibilities, and will probably never prove to be beyond the control of state taxing authorities.

A related legal problem should be considered at this point, not because it has up to the present time created any real difficulty in Wisconsin, but because of its sinister possibilities. The problem includes the ascertainment of what income may properly be said to be derived from interstate commerce, and the question

whether the state may tax such income or may impose a tax in accordance with or in respect to it.

Owing to the exemption of railroads and other public utilities from the income tax, the most obvious applications of this problem do not arise in Wisconsin; and it has up to the present time given very little trouble. But let us suppose the case of a Wisconsin factory whose products are all sold in other states. Many lawyers regard such sales as interstate commerce and hold that the state may neither tax the income derived from them nor impose a tax with respect to or measured by such income. Similar cases are now before the courts, but, tempting as would be the discussion of the interesting doctrines involved, it would be unprofitable to discuss the point now. But if the states are deprived by the federal law of the power to impose taxes on residents measured by income derived from sales to residents of other states, it will seriously cripple and perhaps wholly emasculate the state income tax.

V

More important than the difficulties discussed in the preceding paragraphs, because more numerous and more general, are the questions concerning depreciation, amortization, depletion and losses which occur perhaps in the majority of income-tax returns. These questions, all of which are necessarily involved in the proper definition or determination of net income, constitute the very stuff of which the real problem of income taxation is made. To discuss them adequately here would be impossible. But a general verdict concerning them can be announced with some confidence. They present serious problems, irritating to taxpayers and involving an endless amount of supervision on the part of assessors. The items are essentially intangible. Their determination is wholly dependent upon human judgment. No solution can be "absolutely right" or "absolutely exact."

Serious as are these difficulties, they are far from sufficient in the aggregate to destroy the usefulness of the income tax or even seriously to embarrass its operation, provided of course the tax is administered by conscientious and industrious men. They are inherent as well in direct *ad valorem* taxation. They are not fatal to the success of the income tax; first, because the margin of

possible difference in varying estimates, while important, is restricted in range. Secondly, the difficulties diminish with each successive assessment. Questions of depreciation and losses are always greater the first year an income tax operates than they are thereafter. Old accounts may have accumulated or insufficient depreciation have been written off in the past, and the income tax affords an inducement to inaugurate a more stringent policy and to write off claims or properties that should have been taken care of years before. Fortunately in one sense, the difficulties as frequently relate to *when* the depreciation or loss may properly be claimed as to the amount of such depreciation or loss. If the claim is disallowed by the taxing authorities one year, it may properly be brought up again when the evidence is stronger. If allowed in one year, the claim is finally disposed of and usually does not arise again. The element of continuity or compensation in income taxation—the possibility of readjustment and correction in subsequent years—is one which places the income tax in a position of decided superiority over the property tax. Thirdly, there are natural checks on these deductions, particularly in the case of depreciation. A corporation has to make reports to its stockholders, to the banks, to the insurance companies, which must harmonize with its reports to the assessor. This operates to keep such claims within proper limits. Finally, the element of compensation referred to makes it possible and equitable to dispose of many of these questions by general rules. The depreciation on a certain type of machine, for instance, may be fixed by a general rule at 12½ per cent a year, suggesting on the straight-line basis a life of eight years. Suppose the machine actually has to be replaced in seven years. The balance of the cost not written off may be taken care of properly at the end of the period. *Per contra*, the life of a mine may be underestimated and the depletion allowance be completed before the mine is really exhausted. If so, the depletion allowance simply stops and the state assesses the whole net profit at the end of the period—a consummation not so exact or satisfactory as it should be, but still reasonably satisfactory.

The difficulty of computing net income is at its worst, perhaps, with farmers, most of whom have some income in kind or produce which is theoretically taxable, and most of whom take a large part of their earnings or compensation in a very real but

exceedingly intangible appreciation in the value of their farms. This is a real but in many respects a minor obstacle to the satisfactory operation of the income tax; first, because with the exemptions provided in the Wisconsin act—and they are not excessive—few farmers would be subject to any tax, even though their accounts were kept with absolute accuracy; and second, because almost all the income tax goes back to the political subdivision in which it is collected. If a rural town, therefore, has no taxable income within its borders it gets little benefit from the income tax. Seventy per cent of the proceeds of the tax go to the local district, and the 20 per cent which goes to the county comes back to the local subdivisions, to a large degree, in the form of reduced county taxes. The rural district benefits slightly by the 20 per cent which goes to the county. It contributes less to this quota than it receives in the reduced county tax on property; but the difference is slight and is probably not unjust, because, after all, the greater share of tax-paying ability is found in the cities. This is particularly true of that form of personal ability which the income tax is specifically designed to reach. Moreover, under the personal-property tax the ratio of assessed to true value is higher in the country than the city districts; and real estate, which is relatively well taxed everywhere, constitutes a much larger share of the total wealth of the farmer than of the city man. While it is true, therefore, that the income tax works better in the city than in the country, it is also true that the defect is a small one and is counterbalanced by defects of the property tax working in the other direction. The two taxes are mutually corrective.

VI

The insignificant yield of the income tax in rural districts raises sharply the question whether or not the income tax has proved a successful substitute for the personal-property tax. No categorical answer to this question can be given. The income tax produced in the first year several times as much as the revenue formerly collected from the important classes of personalty exempted when the income tax took effect. In the larger cities, moreover, the income tax produced enough to warrant the immediate exemption of all personal property from taxation. On the other hand, in the smaller cities, villages and rural townships

the yield of the income tax is, except where there are important mines or factories, almost negligible.

In farming districts at the present time personal property represents only about 10 per cent of the total assessment, and the yield of the income tax is small. In the villages and smaller cities personal property constitutes about 30 per cent of the entire assessment, and the revenue from the income tax is again insignificant. In the larger cities, however, while personal property constitutes from 25 to 30 per cent of the total assessment, the yield of the income tax is large. From this statement it is apparent that the personal-property tax might be abandoned without any substitute in the farming districts, and that the income tax would fill the place of the exempted personal-property tax in the larger cities; but in many of the towns, villages and smaller cities, probably in most of them, the abolition of the personal-property tax would cause a decided increase in the tax rate on real estate. Unfortunately, also, the very places in which the personal-property tax is most important and the income tax least important are those places in which land values are least affected by the influences which give rise to the so-called "unearned increment." In these jurisdictions real estate is least able to bear the entire burden of taxation.

The Wisconsin Tax Commission has twice recommended to the legislature the abolition of the personal-property tax; and the legislature in retaining the tax on merchants' and manufacturers' stock, farm animals and other forms of tangible personal property was influenced not by any desire to preserve the personal-property tax but by prudent resolution to test out the income tax before relinquishing present sources of revenue. In the writer's opinion this action of the legislature was wise; and it will probably be many years before the personal-property tax can be entirely abolished in Wisconsin. Under the circumstances it seemed to be the wisest alternative to make provision for such elasticity in the tax system as would permit some localities to do away with the personal-property tax, allowing other jurisdictions, which find its abolition impracticable, to retain it. Accordingly, there was introduced in 1913 and passed in both houses of the legislature an amendment to the constitution of Wisconsin sanctioning a scheme of limited local option.

The proposed amendment, which must pass another session of

the legislature and then be ratified by popular vote before it can become effective, is quoted below. It will be noted that it does not give the local governments power to exempt property from county and state taxation, but leaves each jurisdiction in limited control of its own taxes—the state to say what forms of property shall be subject to the state tax, the county to determine what forms of property shall be subject to the county tax, and the town or city to decide what forms of property shall be subject to local taxation. This is really home rule. The trouble with many home-rule amendments introduced in the past is that they have proposed to permit the smaller unit to dictate the policy of the larger unit by authorizing local subdivisions to exempt property from all kinds of taxes—state, county and local. The proposed amendment is as follows:

The legislature shall have power to authorize counties, towns, cities and villages, by a vote of the electors therein, to exempt from taxation, in whole or in part, designated classes of property; but the value of such property exempted by any county shall be included in the assessment and equalization for state taxes, and the value of such property exempted by any town, city or village, shall be included in the assessment and equalization for state and county taxes.

If this amendment passes, Wisconsin will have reached the principal goal toward which the income tax constitutes the first and most important step. It is not believed that the introduction of the federal income tax will seriously interfere with state income taxation. Why should it? The federal income tax replaces regressive customs taxes, and the state income tax replaces defective property taxes. No new burden is created. The old burden is simply redistributed from the shoulders of those less able to pay over to the shoulders of those more able to pay. The individual who has no income above the minimum of subsistence and the business concern which makes no profit are not called upon to pay the income tax. Within reasonable limits it would seem that we could hardly move too fast in this direction of relieving from taxation consumption, property and business, as such, and placing an equivalent burden upon the successful people and business concerns of the community. And there is every reason to believe that the two taxes will be mutually helpful from an administrative standpoint. In Wisconsin the income-

tax rolls are public records—and incidentally it may be said that they attract little attention and produce none of the awful consequences so often predicted. The federal officials will find the state income-tax rolls of material assistance in their work. As a return courtesy the corporation assessments of the federal government will be thrown open to the properly accredited officers of any state government imposing a general income tax.[1] This is the beginning of a fruitful coöperation between state and federal governments which when consummated will vastly improve our system of commonwealth taxation.

52. Federal Taxation of Incomes (1861–1872).—Our federal government prior to 1913 had made two attempts to tax incomes: the first during the Civil War, the second in 1894. The income tax of the Civil War was established in 1861 and was discontinued in 1872. Its history is outlined by Dr. F. C. Howe, as follows:[2]

By the provisions of the measure, a tax of 3 per cent was imposed on all incomes in excess of $800, from whatever source derived, save that upon any income derived from United States securities 1½ per cent should be levied. Upon the incomes, dividends, or rents accruing upon any property or securities in the United States, but held by citizens resident abroad, there was to be charged a discriminating tax of 5 per cent, save upon so much of the income as was derived from federal securities. The tax was assessable on the first of January; and in computing income, all national, state, and local taxes were to be first deducted. The duty was self-assessed upon schedules prepared for the purpose, and was based upon receipts for the preceding year, irrespective of their source. In case of failure on the part of the taxable to make such return, the assessor was empowered to estimate the income, and to add thereto 10 per cent as a penalty for the default.

[1] The new income-tax act contains, in paragraph D of section g, the following provision: "Provided further, that the proper officers of any state imposing a general income tax may, upon the request of the governor thereof, have access to said returns or to an abstract thereof, showing the name and income of any such corporation, joint stock company, association or insurance company, at such times and in such manner as the Secretary of the Treasury may prescribe."

[2] F. C. Howe, Taxation in the United States under the Internal Revenue System, 90–102 (New York, T. Y. Crowell and Company, 1896). Reprinted with consent of the author and by special arrangement with the publishers.

The tax was assessed but once under this measure, when Congress, reassembling again in regular session, passed modifications which substantially repealed its provisions. By these alterations the exemption was reduced from $800 to $600; the rates were rendered slightly progressive, incomes above $600 and below $10,000 paying 3 per cent on the excess above the former sum, those above the latter sum paying 5 per cent. The rates upon incomes from special sources remained unchanged. In order that the tax might be relieved of the objectionable feature by which publicity was given to incomes, collectors were instructed by the commissioner that returns of incomes should not be open to inspection by the public, a ruling which laid the tax open to all sorts of evasions, and subsequently induced its reversal by the commissioner.

These rates remained in force for two years, when, in response to the recommendations of the commissioner, and the absorbing demand for revenues, the comprehensive measure of June 30, 1864, was passed, by which the duties were considerably increased, and the rates rendered more strongly progressive. By this act incomes between $600 and $5000 were taxed at the rate of 5 per cent, those from $5000 to $10,000 at 7½ per cent, while all incomes in excess of the latter sum were rendered dutiable at the uniform rate of 10 per cent. The act further provided that any revenues derived from United States securities should be included in estimating incomes under the section, and that any net profits realized from sales of land were to be returned as income, while any losses incurred in the same way were to be deducted. In a like manner the householder was permitted to deduct the annual rental value of his homestead, whether occupied as tenant from another, or held in his own right. The measure specified with great precision the methods for the computation of annual gains, and required the assessor to secure from each taxable an itemized account of his revenue for the preceding year. In the case of the farmer the requirement was extremely burdensome; for it demanded a minute return of all "incomes and gains derived from the increased value of live stock, whether sold or on hand, and the amount of sugar, wool, butter, cheese, pork, beef, mutton, or other meats, hay, grain, or other productions of the estate of such person sold." Such demands were somewhat onerous upon the citizen inclined to make an honest return; while,

to those aiming to evade payment, the privilege of deducting house rent, wages, interest upon incumbrances, and expenditures for repairs, opened an avenue for evasion and fraudulent return; and it occasions no surprise that, as a result, the tax was unpopular, the returns incomplete, and the burdens unequally distributed. This measure had scarcely received the signature of the President, when Congress, by joint resolution, imposed a special income tax of 5 per cent upon all incomes in excess of $600, which was collected in addition to the regular income duty of that year. It was assessed but once, in October, 1864, the war closing early in the year following, and produced $29,381,862, a striking commentary on the improvement in the method of assessment, as well as an indication of the loyalty and patriotism of the people.

The classifications of the law of 1864 remained in force for but one assessment, when they were again reduced to two, and all incomes in excess of $5000 were rendered dutiable at 10 per cent, all below that sum and in excess of $600 being taxable at the old rate of 5 per cent.

The war closed almost immediately after this latter modification had been made, and the imperative necessities of the treasury were in part relieved. Naturally, agitation for the immediate repeal of the tax at once commenced; but Congress wisely preferred first to relieve those subjects most oppressed by the excise. Industry was shackled, and the laws of trade unsettled, by the duplication of taxes induced by the general excise. The income tax, on the other hand, fell mainly upon accumulated wealth, and, in the mind of the Revenue Commission,[1] would "probably be sustained with less detriment to the country than any other form of taxation, the excise upon spirituous and fermented liquors, and tobacco, possibly excepted." It is this impotency of the income tax to affect prices and industry, as well as its non-interference with the free employment of capital, which renders it such a fit emergency tax. It is, in addition, elastic, and capable of immediate and indefinite expansion in time of temporary necessity.

Unfortunately, the report of the Revenue Commission, so replete and satisfactory in other respects, offers but little informa-

[1] In 1865 Congress appointed a Revenue Commission, of which David A. Wells was one of the members, to consider the best methods of reducing the burdensome taxes imposed during the war. — ED.

tion in regard to the operations of this tax. Its temporary retention was, however, advocated ; but the element of progressivity was deemed to be an unjust discrimination, and a "tax on the results of successful industry and business enterprise." The commission therefore recommended the repeal of this discrimination, and the imposition of a uniform rate of 5 per cent on all incomes in excess of $1000, which sum was held to be no more than the equivalent of $600 at the time when the tax was first imposed, inasmuch as the advance in the prices of all commodities had greatly enhanced the cost of living. The report further advised that deductions for house rent be no longer allowed, or, if permitted, that they be limited to $300; for such excessive rentals had been permitted by the assessors in the past that in New York alone the estimated losses to the revenue by reason of this permission exceeded $2,000,000 a year.

Congress acceded to the report in so far as it related to the raising of the exemption to $1000, with a uniform rate of 5 per cent upon all incomes in excess of that sum, while the proviso was added thereto that the tax should expire in 1870. This latter provision was not observed, however; for Congress, fearing a deficiency, later extended its operations for two years more, but with the exemption increased to $2000. It is of interest to note that under these later provisions the tax became even more unpopular than it had been before, as it assumed in the eyes of the payer the form of a compulsory tribute imposed upon large wealth. In addition to the exemption of $2000, as well as all taxes paid, deductions were also permitted, as in earlier measures, for all losses "actually sustained from fires, floods, shipwrecks, or that occurred in trade; the amount of interest paid during the year, the amount paid for rent or labor to cultivate land," as well as any expenditure incurred in repairs other than those for improvement.

The effect of these provisions was greatly to impair the productivity of the tax. Thus, in 1871, the number of taxables returned was but 74,775, while in the following year (the last of its operation) they fell off still further to 72,949; while the receipts for the same years were $14,434,949 and $8,146,686 respectively.

The income tax has always been unpopular with certain classes. It is indicted as invading the sanctity of the most private affairs, as being inseparable from inquisitorial scrutiny into business

relations, and an insufferable intrusion into those affairs of the individual which are in a sense sacred, and which in the past had been exempted from the visits of the taxgatherer. It is further alleged that a tax which offers such opportunities for evasion is a charge upon honesty and patriotism, and a premium upon perjury.

Unquestionably the tax was exposed to widespread evasion, especially in the large cities. Such complete confidence was reposed in the individual that evasion was an easy matter; and the instructions of the commissioner, early in 1863, that the returns should be open for inspection only to officers of the revenues, simply facilitated it. By a later ruling, however, all returns were thrown open to the public, "in order," as the commissioner said, "that the amplest opportunity may be given for the detection of any fraudulent returns that may have been made." That this ruling had its expected result may be questioned; for it induced other evils, which probably offset any stimulus to honest returns.

In order to facilitate the collection of the tax, extensive use was made of the principle of stoppage at the source. Corporations of a certain kind announcing dividends were directed to deduct the tax, and pay the same to the collector before the distribution of earnings to the stockholders. By this means a large portion of the tax was collected before the income reached the hands of the individual, while fraudulent returns were checked, and the necessity of supervision reduced to a minimum. It was estimated that the cost of returning this portion of the tax did not exceed one fifth of one per cent, a fact which led the commissioner to recommend that the system of stoppage be extended to all corporations for profit declaring dividends, as later provided in the measure of 1894. How efficient this method was will appear from the fact that in 1865, when the total receipts from incomes were $32,050,017, nearly 40 per cent, or $11,346,018, was turned into the treasury from the earnings of banks, canal, railroad, insurance, and turnpike companies, and federal employees.

But despite the fact that the income tax was unpopular, and the returns depleted by fraud and evasion, it proved one of the most satisfactory, from a purely fiscal point of view, of the many expedients hit upon by Congress.

In 1865 it produced as much as liquors, both malt and distilled,

and tobacco; while in the year following it returned nearly 40 per cent more than these combined sources. In the former year over 15 per cent of the entire internal revenue receipts was derived from this source. In 1866 over 23 per cent, and in 1867 over 24½ per cent.

* * * * * * *

Following the Act of March 2, 1867, which increased the exemption allowed to $1000, the number of taxables returned manifested a considerable falling off, while the receipts were diminished by about one half. During the four years of the operation of the revised rate, the average number of taxables returned was 267,210, of which number nearly 60 per cent paid taxes in excess of $20.

As a crowning enactment of this long period of experimentation, the limit of exemption was increased in 1870 to $2000, with the avowed intention of relieving all save comparatively large incomes from its operation. At the same time the rate was reduced to 2½ per cent, at which point it remained until 1872, when the tax expired by limitation.

From the experience of these years it is not possible to draw any absolute conclusions as to the availability of the income tax for federal purposes, inasmuch as the measure of a tax lies largely in its fitness to conditions and the times; and the defects of the duty during this period were largely administrative in character, traceable to the inefficiency of its administration. The entire service was experimental, the men untrained, and the machinery imperfect; and, had the tax been ever so well suited to our political and social conditions, its productivity would have suffered greatly from this cause.

53. The Income Tax of 1894.—On account of a deficiency in the revenues and in order to facilitate revision of the tariff, another federal income tax was established in 1894. Dr. Howe[1] gives the following account of this tax, which was speedily declared to be unconstitutional:

The provisions of the measure relating to incomes were modeled upon the later war legislation. They provided that the

[1] Taxation in the United States, pp. 233–236. Reprinted with consent of author and publishers.

tax should be first assessed on or before the first Monday in March, 1895, computed on the incomes received during the year 1894. The duration of the measure was limited to five years. All persons having an income in excess of $3500 were required to make a verified return to the collector, as were all persons acting in a fiduciary capacity; and in estimating the income of any person for this purpose there was to be included: (1) all interest received upon stocks, bonds, and other securities, save such bonds of the United States as were exempt from federal taxation; (2) all profits realized within the year from sales of real estate purchased within two years previous to the close of the year from which income is estimated; (3) interest received or accrued upon evidences of indebtedness, whether paid or not, if good and collectible; (4) the amount of all premiums on bonds, stocks, etc.; (5) the amount of sales of live stock, sugar, cotton, wool, butter, cheese, pork, beef, mutton, or other meats, hay and grain, or other vegetable, or other productions, being the produce of the estate, less the amount expended in the raising or purchase of such produce, as well as any part consumed directly by the family; (6) money, and the value of all personal property acquired by gift or inheritance; (7) all other gains, profits, and income from any source whatsoever, except so much as has been already taxed through the disbursing officer of the government or of a private corporation. In computing such returns, however, the following deductions were also permitted in addition to the minimum exemption of $4000: (1) the necessary expenses actually incurred in carrying on any business, occupation, or profession; (2) all interest due or paid within the year on existing indebtedness; (3) all national, state, county, school, and municipal taxes; (4) losses actually sustained during the year incurred in trade, or arising from fires, storms, or shipwreck, and not compensated for by insurance or otherwise; (5) debts ascertained to be worthless. No deductions were permitted for expenditures for improvements. In case the taxable neglected or refused to make such return, the collector was authorized to make up a list from the best information available, and to add thereto 50 per cent as a penalty, and in case of fraudulent return, 100 per cent. Appeal therefrom was permitted to the collector of the district, and from him to the Commissioner of Internal Revenue.

The principle of stoppage at the source was more widely extended in this measure than ever before; and all banks, trust companies, saving institutions; fire, marine, life, and other insurance companies; railroads; canal, turnpike, telephone, telegraph, express, electric lighting, gas, water, street railway companies; as well as all other corporations or associations doing business for profit in the United States, no matter how created or organized (but not including partnerships), were directed to deduct the tax of 2 per cent upon all profits and net incomes before the payment of the same to stockholders or additions made to surplus. And net profits for the purpose of estimating the tax were to include any amounts paid to stockholders, or carried to the account of any fund, or used for improvements or other investments.[1] The same principle was applied to federal salaries in excess of $4000, as well as any salaries paid by corporations to their employees in excess of that sum.

The act departed from earlier legislation in yet another and very important particular; for it forbade under heavy penalties the divulgement by the officers of the revenue of the incomes, losses, or returns of any taxable, whether a private corporation or an individual.

All returns were to be listed upon blanks provided for the purpose on or before the first Monday in March, and were to be paid before the first day of July of each year.

The law doubtless contained many imperfections, and in many places was so worded as to cause irritation to the payer, and to open wide the door for evasion, fraud, and false swearing. It reposed great powers, moreover, in a politically appointed service. These imperfections were particularly noticeable in the deductions allowed. For instance, as to what are "necessary expenses incurred in carrying on business," "losses actually sustained during the year," "debts ascertained to be worthless," there lay a possibility of wide divergence of opinion. The provision that corporations should deduct the tax from the salaries of their employees was absolute, notwithstanding the fact that they might have been entitled to deductions which

[1] The act specifically exempted all organizations of a religious, charitable, or educational character, fraternal or beneficial orders, building and loan associations, and savings banks and insurance companies of a strictly mutual character. Nor did it apply to states, counties, or municipalities.

would bring their incomes below $4000. Corporations were likewise compelled to pay the tax upon their net earnings, irrespective of whether the recipient of the dividends had an income of $4 or $40,000. Moreover, the collector was granted the widest latitude and most unusual powers. He was empowered to pass upon interest due and payable; to increase the return of the individual, subject, however, to appeal; and to make up a taxable's income from the best information available. These but indicate some of the difficulties which would have beset the administration of the measure, as well as the individual honestly desirous of making a fair return. Had we a trained service, these objections would lose much of their seriousness; but, with collectors appointed for partisan service rather than merit, there is reason to believe that this power would have become a means of unjust discrimination. It certainly offered great opportunities for corrupt collusion with taxpayers.

54. The Federal Income Tax of 1913.—Following the adoption of the Sixteenth Amendment to the Constitution, which empowered Congress to levy an income tax without apportionment upon the basis of population, a new federal income tax was introduced. Concerning it the editor[1] has written as follows:

The new income tax is probably a permanent addition to the fiscal machinery of the United States. It was written into the statutes after twenty years of discussion following the abortive law of 1894, and only after amendment of the federal constitution. The need of revenue was but one of the reasons for its enactment, and a compelling motive undoubtedly was the desire to change the distribution of national taxation, hitherto confined to custom and excise duties. Beyond doubt the present law expresses the settled purpose of the country to raise some part of the charges of the federal government by a tax that shall be apportioned according to the income of the citizen rather than according to his expenditure. As one who has long favored such a readjustment, I propose to consider how far the law of 1913 has actually succeeded in taxing the people of the United States

[1] Paper reprinted from *Proceedings of the National Tax Association*, Vol. VIII, pp. 264–279.

in proportion to their incomes. I shall also consider the relation of the income tax to state and local taxation.

There are three methods of levying a tax upon incomes: assessment by official estimation, assessment by taxpayers' declarations or returns, and collection at the source. The first is the method used by Prussia prior to the reform of 1891. It has never secured anything more than a rough approximation to a correct result, and in Prussia appears to have resulted in the escape of fully one-half of the income legally subject to taxation. It is, however, a method upon which all income taxes are compelled to rely in cases where contributors fail to make satisfactory returns, and is certainly an indispensable adjunct of any tax upon incomes. The second method is used to a greater or less extent by all countries levying an income tax, and is that upon which the various German states rely, having been adopted by Prussia in 1891. It is undoubtedly superior to the first, and, under proper conditions, results in a substantially complete assessment, as in the Canton of Basle and the state of Wisconsin. The third method is largely employed by the British income tax, and is more or less in vogue elsewhere, outside of Germany; but it cannot be applied to all kinds of incomes, and therefore is always supplemented by the second and even the first.

It is not strange that the framers of our federal income tax decided in favor of collection at source wherever that was possible. The success attending this method in Great Britain had led many other countries to follow her example, and the failure of our states to reach the great mass of personal property by means of taxpayers' declarations naturally created the impression that an income tax could be collected only at the source. Moreover, the success of our states in collecting taxes directly from corporations rather than from shareholders reinforced this conclusion, and most American students of finance had long been advocates of the method. The case seemed clearly made out, and therefore the new law provides that the normal tax of 1 per cent shall be collected so far as possible at the source.

But further consideration reveals various disadvantages of this method of collection, which are so serious as to justify reopening of the question. The first and most important is that, to a very considerable extent, collection at source changes the incidence of the tax and places the burden upon the wrong

shoulders. This is particularly true in the taxation of corporations and interest upon corporation bonds.

In 1910 Congress levied a tax of 1 per cent upon the net income of corporations, which was legally and practically an excise duty. There may have been a few cases in which this tax operated as one of a number of causes leading to a reduction of dividends, or prevented an increase that otherwise would have taken place. But in general stockholders were not affected by it; the tax was merely absorbed with other charges against gross income and served as an incentive to increased prices. With public-service corporations under state or federal control the tax became an element determining what should constitute reasonable returns for the service rendered, and therefore figured in subsequent arguments for higher rates. The general effect of the law of 1910 was to impose an indirect tax upon consumers, and this charge has merely been continued by the law of 1913. To-day a citizen who receives $20,000 from dividends upon corporation stock is exempt from the normal tax, while one who receives a salary of $5000 is subject to taxation upon the excess of his income above $3000, or $4000 if he is married.

Interest upon corporation bonds or other evidences of indebtedness is also taxed at the source, with the result that the tax in most cases falls upon the corporations and the bondholder goes scot-free. The greater part of the corporation bonds now outstanding have been issued under contracts by which the corporations have agreed to pay the stipulated interest free from any tax they may be required to withhold or deduct, and the law of 1913 is so drawn as to bring the present income tax clearly within the scope of these so-called tax covenants. The result is that the corporations are now paying most of the normal tax upon bond interest, and the bondholders are exempted; so that a citizen having an income of $20,000 from corporation bonds pays nothing, while his neighbor who has a salary of $5000 is taxed. The tax, therefore, is in effect an excise duty upon corporations, and in many cases will be shifted to consumers either in higher price or in poorer service.

There was, unfortunately, in Congress and perhaps elsewhere, a complete misunderstanding of the nature of these tax covenants, and it seems to have been thought that to impose the tax directly upon bondholders as a personal obligation would violate the

spirit and perhaps letter of contracts corporations had made with their creditors. There are, indeed, some issues of bonds that contain a covenant by which the corporations agree to pay any taxes the United States may levy upon the interest, and if Congress had interfered in such cases it would have impaired the obligation of contracts. But the great majority of tax covenants merely require the corporations to assume taxes that they are required to withhold or deduct from the interest, and have no reference, express or implied, to a personal tax levied upon the bondholder and payable by him. There was, therefore, no question of violation of contracts, and Congress should not have treated the matter as an issue between corporations and their creditors. The only question was one of public policy,—Is it better to levy a direct personal-income tax on bondholders or to levy an indirect tax upon bond interest, payable by corporations and ultimately shifted to consumers in most cases? There seems to be but one answer. The income tax should be so levied as to fall upon citizens in proportion to their incomes, and bondholders should not be exempted. This is the very purpose of an income tax, and to convert it into an indirect tax which will be largely shifted to consumers is to pervert its nature, impose the burden upon the wrong persons, and defeat the object of the Sixteenth Amendment. To-day a citizen receiving $20,000 from dividends and bond interest is wholly exempted from the income tax, and one receiving $20,000,000 is exempted from the normal tax, though, of course, subject to the additional tax. Congress had no scruple about making the additional tax a personal obligation payable by the bondholders; how ridiculous, then, is the contention that to levy the ordinary tax in the same way would impair the obligation of contracts!

To what extent collection at source tends to lead to a shifting of the tax on other classes of income is difficult to say. For the most part it has been taken for granted that an income tax cannot be shifted and must fall upon income receivers. But economic laws and forces do not operate *in vacuo*; that is, under conditions where they do not encounter the resistance of opposing forces. They must work out their result through countless business transactions, in which the unequal strength, knowledge, and bargaining skill of the contracting parties materially influence the outcome. Therefore it is always better to place the

tax on the right shoulders in the first instance, wherever that is practicable; and it is unwise to impose it on the tenant or debtor in the expectation that, in accordance with general economic laws, it will finally fall upon the landlord or creditor. Our present law, it is true, invalidates future contracts to assume the income tax; but it does not and cannot control the amount of contract rent or interest. It introduces into contracts for the payment of "fixed and determinable" income an element that in many cases affects the terms upon which agreements are closed, and produces conditions under which all the forces of economic friction and inertia oppose the transfer of the tax to the person it is intended to reach.

The second objection to collection of an income tax at source is that it places the government in an inconsistent position and injures what I may call the morale of the tax. The government first undertakes to collect at the source as much of the tax as possible, on the theory that if it proceeds otherwise there will be wholesale evasion; and it then calls upon citizens to make returns of the rest of their incomes. It has advertised in advance its expectation that incomes will not be honestly returned by personal declarations of taxpayers, and it then requires citizens to do that which it does not expect them to do honestly. A better method of destroying the morale of taxpayers could hardly be devised, or one more certainly calculated to make the income tax a tax on honesty.

This view of the case has been called sentimental and theoretical, and the objections have been considered of little weight beside the practical advantages of collection at source. Sentimental it undoubtedly is; honesty is partly, and in public matters very largely, a matter of sentiment. Theoretical it certainly is, also; but the theory has found practical recognition in the income taxes of various states, which are on the whole as successful as any others. Some years ago I asked the head of the finance department of the Canton of Basle why his state had never undertaken to collect any part of its income tax at the source. We have not done so, he said in substance, because we require the people of Basle to pay the income tax upon their entire income, and do not expect them to evade any part of it; if we were to collect part of the tax by the British method, our people would naturally think they were not expected to pay the rest loyally.

This is, when you carefully consider it, the ultimate logic of collection-at-source when applied to a general income tax. Some forms of income cannot be reached at the source and must be taxed by personal return or official estimate. A government that does not expect to succeed in taxing such incomes should never levy a general income tax, because at this point it would tax not income but honesty. By adopting collection-at-source it admits failure at the outset, and can hardly blame the citizens if they act upon the same logic as their government. This objection, of course, would not apply to a partial income tax levied only on such income as can be taxed at the source. But it is valid for any general tax upon income, and it is vital. No government should levy what it knows to be a tax upon honesty; and if it believes itself able to collect a general income tax, it should adopt no method for the collection of any part of the tax that implies disbelief in its ability to collect others. The morale of the taxpayers cannot fail to be impaired by such inconsistency in the tax law.

The third objection to collection-at-source is that it is inconvenient and expensive. If the tax applied to all incomes, whatever their amount or nature and without exemption or abatement, no difficulty would arise except in cases where incomes pass through several hands on their way from the source to the final recipient. But when exemptions and abatements are granted,—and this is the usual practice,—the difficulties multiply and soon become serious, because in the natural course of things many incomes will be taxed at the source although the recipients are exempt or entitled to allowances. The practice in Great Britain seems to be to collect the tax at the source and then permit the taxpayers to apply for refunds; and in 1909 it was stated that the Inland Revenue Department had to deal with 450,000 repayments and nearly 700,000 abatements.[1] Even then it seems that many persons entitled to refunds did not receive them either because they were ignorant of their rights or because the amount involved was not large enough to justify the trouble and expense of making application.

The British method has at least the merit of placing upon the government the trouble and expense of dealing with exemptions and abatements; our own income tax for the most part places

[1] Means, The Methods of Taxation, pp. 156–159.

the burden upon those persons who handle incomes either at the source or on their way to the recipient. The right of the government to collect taxes at the source, if it prefers to adopt that method, is doubtless unassailable; but if such collection involves much trouble and expense, common fairness requires that proper compensation be made for the service. The situation is aggravated by the fact that a large part of the work is not in collecting the tax but in dealing with incomes entitled to exemptions and abatements. In effect the United States has granted to certain persons exemption from an income tax collected at the source, and has thrown upon certain other persons, without compensation, the greater part of the work resulting from claims to exemption. Whether this amounts to taking private property for public use without compensation is a question I am content to leave to the lawyers, but it certainly is unjust and vexatious.

The difficulty is greatest in the case of interest upon corporation bonds and other obligations, since a very large proportion of these securities consists of coupon bonds and the tax must be deducted from all payments, whatever their amount. In some sections of the country the larger city banks have made arrangements by which country banks have been relieved of trouble and expense in connection with the tax, but this concentrates the burden rather than diminishes it. I am informed that one banking institution has been put to an additional expense of $15,000 per annum, and another to an expense of $20,000. These figures are exclusive of the heavy initial cost the system entailed, and represent what is likely to be the normal annual outlay for these institutions. If data could be secured for the entire country the total burden would surely be impressive.

Even worse than the absolute amount of the expenditure is its relation to the amount of tax actually paid the government. The institution that is spending $15,000 will have collected at the end of the first year $53,000 of income tax upon corporation bonds, the cost of collection amounting to nearly 30 per cent. A traction company collected $8200 of tax between November 1, 1913, and February 1, 1914, and spent $3299 in performing this service. Here the cost of collection rises to 40 per cent. Another public-service corporation collected $9821 of tax up to August 1, and expended $7011 in so doing, the cost of collection amounting to over 70 per cent; but these figures may include initial outlays

that will not recur. I can find no reason for thinking these cases exceptional, and they merely confirm the general opinion prevalent among those conversant with the facts, that the cost of collecting the tax on bond interest at the source is absurdly, preposterously high. The cost of collecting the customs revenue of the United States is about 3½ per cent, and the internal revenue in 1911 cost but 1½ per cent. The Wisconsin income tax showed a net cost of collection of 1.28 per cent in its first year. In general, any tax that costs more than 5 or 6 per cent to collect is uneconomic, and most taxes cost much less than this figure. But in respect of bond interest the government of the United States is now collecting an income tax at an expense of from 30 to 40 per cent—to other people.

My contention is, then, that collecting the income tax at source has largely changed its incidence, lowered its morale, and in some cases resulted in a preposterously high cost of collection which the government throws upon private citizens and corporations without compensation. But the question occurs to you, doubtless: After all, was not collection at source necessary to prevent evasion of the tax?

Before answering the question it is necessary to remind you that for all practical purposes tax evasion is purely a question of degree. There are few taxes, if any, that cannot be evaded to some extent. Even a tax on real estate, under the most favorable conditions, will fail to reach 100 per cent of the actual value of every parcel of realty, while under poor administration a very large percentage of taxable value will escape assessment. As a matter of fact we know that a 100-per-cent assessment upon every parcel of realty is an unattainable ideal, and that for practical purposes an average assessment of from 90 to 95 per cent must pass for full assessment. Yet in discussing the taxation of incomes it is usually assumed, tacitly of course, that there are taxes that can be collected without any possibility of evasion; and the income tax is then judged by this assumed absolute standard. Such procedure leads nowhere. We must, rather, recognize clearly that evasion is a matter of degree, and must judge the income tax accordingly. The question we have to consider, therefore, is this: Can a general income tax be collected *with reasonable certainty and completeness* without resorting to collection at source?

It must further be observed that one who answers the question in the negative cannot possibly advocate a *general* income tax without becoming an advocate of political immorality. For some incomes cannot possibly be taxed at the source, and one who believes that no other method can give a reasonably complete assessment must admit that in its application to these incomes a general income tax becomes one of the worst of fiscal expedients —a tax upon honesty. Such a person may very properly approve of *special* taxes upon incomes that can be reached at the source, but as an advocate of a *general* income tax he stands in no enviable light.

The answer to our question is, I believe, as follows: the operation of an income tax depends wholly upon the conditions under which it is levied. With poor administration, excessive rates, and a hostile public opinion, an income tax becomes a mere tax upon honesty, except in so far as it can be collected at the source; while under the opposite conditions it can be enforced with substantial certainty and justice, and as successfully as most other laws. Some evasion there will be, necessarily; but it is possible for an income tax to be so drawn and administered as to command general favor and reduce the amount of evasion to a reasonable minimum. As examples of such income taxes I can refer to the income tax of the Canton of Basle, the Prussian income tax in those communities that do not raise its rate to an excessive figure, and the tax now in successful operation in Wisconsin.

To develop fully this statement would carry me far beyond the necessary limits of this paper. It needs no demonstration that inefficient boards of local assessors will make bad work of an income tax. It cannot be doubted that excessive rates, such as prevail in Italy and some Prussian communities, lead to widespread evasion; and it is certain that when public opinion is decidedly hostile, as it has long been in France, the enforcement of an income tax must be extremely difficult. But in the United States the conditions were not, and need not have been made, unfavorable. The Bureau of Internal Revenue was well organized, and was undoubtedly efficient; there was no need of imposing a high rate of taxation; and public opinion strongly supported the tax. Congress had as fair an opportunity as could be desired to enact a well-considered law, and was mistaken in believing that it was necessary to collect the tax at the source.

Probably the decisive consideration in favor of the method adopted was the admitted failure of our states to tax personal property or incomes effectively by means of taxpayers' declaration or official estimation; but here, Congress misread the lesson of experience. All that the failure of the states taught was this: That it is impossible to collect from personal property a tax that would absorb half the taxpayers' income; and that a state income tax cannot be successfully enforced by local assessors, and as part of a system of taxation generally unenforcible. Wisconsin had already shown that with proper methods of administration, a reasonable income tax can be collected with substantial certainty and completeness; and against Wisconsin's evidence, the experience of other states under the very opposite conditions should have counted for little or nothing. Our country undoubtedly wanted an income tax; with all the criticism of details of the law of 1913, opposition to the principle of the tax has been so infrequent as to be negligible; and even the confused, cumbersome, and vexatious measure finally enacted has not made the income tax, as such, unpopular. Under these conditions, Congress could and should have levied a personal income tax assessed by taxpayers' declaration.

Of course it was frequently said that all men are liars, and that you cannot make them honest by law. But the first part of this statement, while it may be competent evidence of the character of the person making it, does not convict anyone else of mendacity, and the second part is wholly irrelevant to the question at issue. All men are not liars; most men will deal honestly with a government that treats them fairly; and the experience of Wisconsin shows that even the abused American taxpayer will pay loyally an income tax reasonable in amount and levied impartially upon everyone subject to it. Not taxation itself, but unfair, excessive, and discriminating taxation is what has made the average American a tax-dodger. If Congress had had the wisdom to levy the income tax as a gentleman's tax, there is no doubt that the taxpayers of the United States would have made loyal response.

But although the tax should have been collected in all cases from taxpayers, and not at the source, it would not have been necessary to rely exclusively upon personal declarations of income. In order to deal effectively with the small minority who

might make false returns, Congress might have instituted a system of reports at source, by which the people who under the present law are required to withhold and deduct the tax would have been required to report to the government the amount of the income and name of the recipient. This is an expedient which many governments employ to-day in taxing wages and salaries, and is capable of application to any form of fixed and determinable income. It was urged upon the committees having the income tax in charge, but not until after the measure had passed the House of Representatives and was beyond its formative stage. This plan would have prevented evasion quite as effectively as the present arrangement; its practical details would have been far easier to grasp;[1] it would have diminished enormously the labor and expense imposed upon those affected; and it would not have changed the incidence of the tax or impaired its morale.[2] It would, furthermore, have provided a check upon the returns of incomes subject to the additional tax; and at that point, where the rates are highest and the temptation to evade is strongest, would have been far more effective than the existing law.

While collection at source is undoubtedly the chief cause of the inequalities that must arise under the present income tax, it is by no means the only cause of inequality. In its very definition of income the law of 1913 is defective. I have time to call attention to only two points. No provision is made for including in a person's taxable income the fair rental value of a dwelling house occupied by the owner or the value of agricultural produce consumed on a farm. The result is that a person who invests $20,000 in securities is taxed upon the income he derives therefrom, if his total income exceeds $3000, while another who invests $20,000 in his dwelling is exempt from taxation upon the amount of income, in the form of use and enjoyment, that he derives from this investment. This is wrong in theory, and is contrary to the practice of well-considered income taxes. The

[1] Even interest coupons could have been reported by a method that experienced bankers pronounced simple and effective. Another method of dealing with the coupon problem would have been the imposition of a stamp tax payable by the bondholder. (See briefs and statements filed with the Committee on Finance; Income Tax and Custom Administration, p. 2096.)

[2] In behalf of clients, I presented this plan to the Senate Committee on Finance, in May, 1913. Briefs and Statements, pp. 2071–2075.

exemption of produce consumed on a farm introduces another fruitful source of inequality, since it exempts an important part of the income of one class of persons, while others are taxed on incomes of the same amount expended for household supplies and provisions.

Together with the high exemption of $3000 or $4000 of income from the operation of the normal tax, these defects in the definition of income work practically the total exemption of agricultural industry and in effect exempt the agricultural states. A farmer and his wife are not subject to taxation unless, in addition to house rent and a good part of their living expenses, they receive a net cash income in excess of $4000. Nothing in the condition of American agriculture justifies this discrimination. For more than fifteen years our farmers have enjoyed uninterrupted prosperity, and their products have been precisely the ones most affected by the general rise of prices. These features of the law of 1913 are another cause of great inequality, and are absolutely without justification. They are contrary to the practice of best income taxes, and are indefensible class and sectional legislation.

We must conclude, therefore, that the income tax of 1913 has not given the country what it had the right to expect—a tax levied upon citizens in proportion to their income, that is, according to their ability to pay. Instead of that we now have a law that largely exempts holders of corporation securities from the ordinary tax and substantially exempts agricultural industry, while it taxes incomes derived from unincorporated manufacturing or commercial enterprise and those received in the form of salaries and professional earnings. So far as most corporate capital is concerned, the ordinary income tax has been converted into an excise, and will be paid for the most part by the ultimate consumers in the form of higher prices or poorer service. To a very large extent, to a degree practically commensurate with the field of corporate industry, Congress has exempted funded incomes from the ordinary tax, and has confined that tax to incomes from labor and unincorporated enterprise. This outcome is a distinct disappointment, and when appreciated by the country should lead to a complete recasting of the law.

A final word concerning the relation of the federal income tax to state and local taxation. Obviously the national government

has now entered the field of direct taxation hitherto reserved in ordinary times for the exclusive use of the states. This is not in itself objectionable, but it raises important questions concerning the proper division in the field and the coördination of the two systems of taxation.

In regard to the first point it is very clear that the federal government in ordinary times should make very moderate use of direct taxation. There is, as we all know, a limit to the revenue that can be raised by direct levies upon property or income; and if the federal government makes excessive demands, the resources of the states will be seriously limited. The nation has at its command the whole field of indirect taxation, from which the states are almost entirely excluded, and it has no need of imposing heavy direct taxes in ordinary times. If it ever does so, it will seriously embarrass the state and local governments, which have to meet outlays that far exceed, in the aggregate, the expenditures of the national government.

If this view is correct, it follows that the maximum rates of the additional tax imposed by the law of 1913 are clearly excessive. They rise to 6 per cent upon the excess of incomes above $500,000, and with the ordinary tax make a total charge of 7 per cent. Now the limit of safety for income taxes is probably 10 per cent; and it certainly does not exceed 12, as the experience of all countries shows. The United States, therefore, has appropriated for its use about 70 per cent of the total possible proceeds of direct taxation upon large incomes, and its action will seriously embarrass the states in the efforts they are now making to tax personal property effectively or replace the personal-property tax with a state tax upon incomes.

Congress has acted with total disregard of the interests of the states, and apparently on the assumption that only the claims of the federal treasury require consideration.

What readjustments in state and local taxation the federal income tax makes desirable or necessary is a question of peculiar interest to this Conference. One proposal is that the states shall abandon the attempt to tax personal property or income, in favor of the national government. This is likely to meet with little favor. The states are now devising new and better methods of taxing these objects, and since they sorely need the revenue, are not likely to give the federal income tax exclusive right of way.

Another proposed solution is that the states abandon the taxation of personal property and income and that the national government levy an income tax the proceeds of which shall be divided with the states. Such a solution, however, would be attended with great difficulty in securing a basis of distribution satisfactory to the states. It would also have the grave defect of making the states dependent upon the national government for a substantial part of their revenues. There are undoubtedly those who would welcome such a condition, those who in their desire either for national centralization or municipal home rule wish to see our state governments shorn of their important functions and deprived of real vitality. But others should realize that in the long run the hand that controls the purse is likely to control all, and should reject any proposal that deprives the states of effective control of their revenues.

A third view is that a federal income tax may, under right conditions, facilitate greatly the introduction of state income taxes in place of the existing taxes upon personal property. If the citizen must now pay to the federal government a direct tax upon his income, it will obviously be easier and more convenient for him to make a similar return of income for state and local taxation than to make a totally different return of his personal property. No question of double taxation can arise, because the two income taxes would be for different orders of government each of which has the right to levy direct taxes for its support. It is also clear that from the administrative standpoint there would be a considerable advantage in replacing personal-property taxes with income taxes assimilated as nearly as possible to a federal income tax.

But before such an adjustment is possible the federal tax must offer a suitable model, and this the law of 1913 cannot do. What is requisite is that the national government shall levy a personal income tax collected upon the basis of personal returns by taxpayers of their entire incomes. This is absolutely inconsistent with collection of the tax at source, but will permit the requirement of reports at source as a check upon the small minority of persons who might otherwise be tempted to make false returns. It would give us complete returns from all citizens in the districts where they are domiciled, and this would furnish the basis for coöperation between national and local govern-

ments in assessing income taxes. The former would profit by the more detailed and intimate knowledge of local conditions possessed by local assessing boards; the latter would gain by reason of the wider reach and stronger arm of the federal authority. Such conditions, in fact, would furnish the most favorable opportunity for the much-needed and long-deferred reform of prevailing methods of taxing personal property.

CHAPTER XIII

PROBLEMS IN STATE AND LOCAL TAXATION IN THE UNITED STATES

55. The Separation of State and Local Revenues: by Charles J. Bullock.[1]—The following selection presents criticisms of the well-known project of separating the sources of state and local revenues:

Among plans for the reform of American taxation the proposal to separate the sources of state and local revenues holds a conspicuous place. Eminent authorities declare it the "necessary starting point of reform," and "the indispensable initial step" to any substantial progress. In one commonwealth complete separation has already been effected, and in a number of others the process is thought to be well advanced. Yet there has always been dissent, and of late the plan has encountered increasing criticism from persons sincerely interested in the cause of tax reform.

As the name implies, the proposal is that state and local revenues shall be drawn from separate sources. When first advanced, the plan was that the states should derive their income wholly from taxes on inheritances, corporations, and some other independent sources, and that local revenues should be raised by taxes on property. More recently, and as an alternative, it has been proposed that only part—though perhaps the greater part—of the state revenues shall be raised by independent taxes, and that the remainder shall be obtained by a direct tax apportioned among the local bodies in proportion to their respective local revenues or expenditures. In both the original and the alternative forms, plans for separation usually, though I believe not necessarily, contemplate that the local governments shall be left comparatively free to determine what property shall be taxed and what exempted from local taxation. And in both, the essential feature is declared to be that there shall be no direct state tax apportioned among local units according to their assessed valuation.

[1] An address delivered before the League of Virginia Municipalities, Oct. 7, 1909.

The advantages claimed for the plan of separation are numerous, but the more important are four in number. The first is that existing inequalities in state taxation would be removed, and substantial justice reached in the distribution of the burden. Boards of equalization have signally failed to secure a just apportionment of direct state taxes distributed according to valuation, and must always fail, since they have imperfect knowledge of local conditions, are subject to pressure of local interests or the vicissitudes of politics, and in any case would be impotent to overcome the mutual mistrust and antagonism of local taxing authorities. But if the states, following natural lines of demarcation between central and local functions, create independent revenues from inheritances, corporations, and other sources, it it said that a just distribution will be automatically secured—the states retaining what properly belongs to them and leaving to the localities the general mass of property naturally subject to local jurisdiction. And if more money is needed than the states can conveniently obtain from independent taxes, it is believed that the plan of apportioning a direct tax according to local expenditures or revenues offers a just method of distribution requiring for its administration nothing but the collection of accurate statistics.

The second advantage is said to be that the abolition of the state tax apportioned according to local valuations will remove the inducements to undervalue property subject to local taxation, and lead automatically to full and fair valuations. In any event, boards of equalization will no longer be necessary, since it will be immaterial to the taxpayers of one county whether property in other counties is assessed at 50, 60, or 100 per cent of its true value. And it is sometimes added that for purely local taxation it makes no difference to any one whether there is a low valuation of property with a high tax rate or a high valuation with a low tax rate.

The third benefit expected to result from separation is that such an adjustment of state and local revenues would remove that diversity of local interests which in our legislatures blocks most attempts to modify tax laws, and would open the way for other desirable changes. The direct state tax, apportioned according to valuations, binds each locality to every other in a single system which is hard to alter, since any change may affect

adversely the interests of particular localities, or, what is the same thing so far as legislation is concerned, may be feared to affect those interests adversely. With this tax either removed or apportioned according to local expenditures, it is believed that local suspicions and antagonisms would largely disappear, and that progressive legislation would become possible. It is chiefly for this reason, I take it, that separation of state and local revenues has been considered "the necessary starting point of reform."

And the fourth advantage usually, though not always, claimed for the plan is that, under it, the various local governments might be granted either partial or complete freedom in selecting methods of taxation. This I believe to be no necessary part of the scheme, since it is conceivable that a state, after establishing independent revenues for its own use, might consider it safer to prescribe the methods by which local revenues should be raised. But it is usually set forth as one of the chief advantages of separation, and, under the caption "local option," "home rule in taxation," or some other attractive name of supposedly popular character, figures prominently in plans of tax reform. The chief reason advanced in its favor is that, since local conditions differ, each community should be free to adjust its fiscal system to its own needs and should be free to work out its own salvation in matters of taxation. Uniformity in tax laws is considered undesirable, and the need of the time is declared to be freedom of experimentation.

This is the case in favor of separation. Its strength at some points must be frankly conceded, and it is supported by weighty authority. I must add that formerly, and largely through respect for authority, I fully accepted the proposal. Further study, however, has brought change of view, and compels me to join the dissenters.

In the first place I can see no guarantee, or even probability, that separation would ensure a just distribution of the burden of state taxation. It is proposed to create independent sources of revenue in conformity with the natural division of state and local functions, and it is thought that in this manner a just distribution will be reached automatically. But there is no necessary and automatic connection between the division of govern-

mental functions and the apportionment of sources of revenue. The former should be determined primarily with reference to convenience and efficiency of administration; the latter should depend chiefly upon comparative fiscal needs and resources. The national government charters and regulates national banks, but concedes to the states, under proper restrictions, the power to tax the capital stock and real estate of these institutions; and if it ever grants charters of incorporation to companies engaged in interstate commerce, we cannot doubt that the states will retain power to tax the property of such corporations. In these cases the governmental function is of a national character, but the property remains subject to state and local taxation because fiscal, and doubtless political, conditions require that it shall so remain. And similarly with the relations between the states and the local governing bodies. The state of New York administers the liquor-license tax and shares the revenue with the local bodies; in Massachusetts the towns and cities administer this tax and share the revenue with the commonwealth. What natural and automatic connection is there in these cases between the division of functions and the apportionment of revenue? So far as any rational principle controlled the latter, it was probably the consideration of fiscal needs; but it is probable also that politics was the chief factor controlling the division. I do not say that there is never a coincidence between the allotment of functions and the allotment of revenues,—indeed, the customs revenue of the national government furnishes an example of such coincidence; but I do maintain that the controlling factor in the distribution of functions is administrative convenience, that the controlling factor in the assignment of revenues should be comparative fiscal need, and that between the two there is no necessary and automatic connection.

This conclusion is readily confirmed by study of the particular sources of revenue which it is proposed to allot the states. The inheritance tax is always on the list, and in the United States the propriety of such allocation cannot be questioned at the present day. But this is because the tax takes from the local bodies nothing that they formerly possessed, and because, further, the yield is not large as compared with the needs of the states. If fiscal conditions were different, it might be convenient to divide the proceeds between the central and local governments,

as is done in Great Britain with the proceeds of the death duties. Fiscal convenience, evidently, is the controlling factor, and not an automatic connection between governmental functions and sources of revenue.

Taxes on corporations, particularly though not exclusively public-service corporations, are considered also to belong peculiarly to the states. If the taxes in question are confined to small annual payments for the franchise, as in New Jersey, I have no quarrel with the convenience of the arrangement. But if, under whatever guise or name, they are collected practically from property thereby withdrawn from local taxation, I deny that the arrangement is necessarily convenient or just. I do not question in the least the desirability and even necessity of the assessment of many kinds of corporations by state boards, or even the collection of corporation taxes by the states. But when a state appropriates to its own use the revenue from such sources, it is distributing the burden of state expenditures among the local units in proportion to the number and extent of the incorporated enterprises in each district, and this process results in a hit-or-miss distribution that accords with no conceivable principle of justice. True, the taxable values of some corporations, as railroads, are hard to localize; but this does not justify the state in assessing no tax upon districts not reached by railroads, a light tax upon localities where the roads occupy land of little value, and a tax of crushing weight upon a terminal city. It may well be that the tax should not be allotted wholly to the localities traversed by the roads—I cannot undertake in this paper a solution of the problem; but I maintain that the state has no natural and necessary right to the entire tax, and that the proper solution must be distribution in accordance with fiscal needs, and not distribution in conformity to governmental functions.

Many other examples might be given; I have time to cite but a few. If I deposit money in a national bank in Cambridge, I am required to pay the regular local tax on such deposits; but if I cross the street and place the money in a savings bank, the tax will be paid by the bank and appropriated for the use of the state. If Smith, Jones, and Brown form a partnership to conduct some form of mercantile business in Boston, they will pay a local tax on their merchandise and other stock in trade; but if

they incorporate under the laws of the commonwealth, the tax, according to the advocates of separation, naturally belongs to the state and not to the city in which the business is carried on. Search as you will, you will find no necessary and natural connection between the action of the state in chartering or regulating corporations and the just allocation of taxes assessed on the property or business of incorporated companies.

And the same is true of the other proposed sources of independent revenue for the use of the states. The controlling consideration always should be of a fiscal character, though in practice it is quite as likely to be political. The withdrawal of property from local taxation, either partly or wholly, merely distributes the state taxes in proportion to the respective interests of the different localities in such property, and can give no assurance of a just distribution.

There remains the alternative plan that a substantial part of the state revenue be raised by a direct tax apportioned according to local expenditures or revenues. In support of this it is said that the amount of money expended for local government is a fair index of a community's wealth and of its ability to contribute to the support of the state government. With individuals it would probably be admitted that expenditure is not a satisfactory index of ability, but with communities the case is thought to be otherwise; and the further suggestion is made that a state tax apportioned according to expenditures would be a salutary restraint upon local extravagance.

I must admit that when this proposal was first advanced it impressed me as attractive in many ways; but I now believe that there is a better remedy for existing inequalities in the apportionment of state taxes, and that this method of distribution is unjust and in other ways undesirable. It is unjust because communities, like individuals, differ in need and in disposition to adopt a liberal scale of expenditure. Their needs differ on account of differences in situation and in the character of their population; and to tax in proportion to expenditures absolutely necessary for public works, public schools, and protection to life or property, is to tax the more necessitous communities for the benefit of the more fortunate. Again, communities differ in their disposition to provide improved forms of public service which

modern conditions make highly desirable. Better schools, improved highways, increased care for public health and sanitation, more intelligent and humane treatment of dependent, defective, and delinquent classes—these things are imperatively required by the conditions of our age; and to impose a larger share of state taxation on the communities that exhibit the most progressive spirit would be extremely shortsighted and objectionable. By so doing we might, indeed, curtail local expenditures, but we should certainly repress many desirable improvements in public service. Extravagance, no doubt, exists, and is always to be deplored; but I am not anxious to see it checked in any way except by improvement in the spirit and methods of government, and least of all by a method that taxes progressive communities for the benefit of unprogressive. For these reasons I hold that apportionment by expenditure would overtax the least fortunate, place a penalty on progress, and divert attention from the true method of dealing with local extravagance.

To meet such criticism it has been said that, after all, the state taxes are comparatively light, so that the objection has little force. This is true in some states, as in Massachusetts, but is absolutely untrue in others where the outlay of the commonwealth is a very large part of the total expenditure. It can be true in very few states that levy a state tax for the support of public schools; and wherever such a levy is made, apportionment by expenditure would be likely to defeat the very purpose of the school tax, which is to equalize educational opportunities. Since another remedy can be found for existing evils, I believe that the proposed method of apportioning the state tax must be rejected without reservation or qualification.

My second general criticism of the plan of separation is that it will not remove all inducements to undervaluation of property subject to local taxation, or lead automatically and surely to full and fair valuations. Abolition of the state tax or apportionment by expenditures would undoubtedly remove one inducement to undervaluation, but unfortunately there are others. First, there are the county taxes, which in the United States in the year 1902 exceeded by 75 per cent the direct taxes levied for the use of the states and territories. There may be states in which conflicts of local interests do not arise within the separate counties, but in many, if not most, county assessments are now vitiated by

the same forces that affect so unfortunately the apportionment of the state levy. In all such cases separation would hardly reach the roots of our present difficulties. A second reason for the continuance of local undervaluation is the fear of taxpayers that, if property is assessed at its true value, the ultimate result will be not a lower tax rate but larger expenditures and an increase in the actual burden of taxation; and the experience of some communities that have raised valuations with a view to reducing tax rates lends some force to this apprehension. And a final reason is that the full and fair assessment of all property, even real estate, is not a simple task, as sometimes assumed, but a work requiring skill, experience, and freedom from political or personal influence. In the state of Wisconsin the opinion of the best judges is that the practical separation of revenues there accomplished has not affected appreciably the work of local assessors. The truth is that the evils of which complaint is made are more deep-seated than the advocates of separation have ever realized, and would not be removed by the plans they propose.

But it is said that undervaluation, even if it were to continue, would not be a thing of much importance after the state tax had been abolished, since it would work no injustice between different counties. And, for local purposes, there is said to be no difference between a low valuation with a high tax rate and a high valuation with a low tax rate. This I believe to be a great mistake. In the first place, if the law now prescribes assessment at the true value, it should be either obeyed or amended; and boards of assessors who willfully disregard the statutes at one point are almost certain to violate them at others. Can the habitual disregard of laws relating to taxation be admitted to be a matter of little moment? And, in the second place, it seems clear that the true rule is assessment at the full value, if we wish to secure equality of individual assessments within the same community. Investigations have shown that when assessors, with the best intentions, undertake to undervalue all property at some uniform percentage, say 70 per cent, they will value some parcels of real estate as low as 20 per cent of the true value and others as high as 120 per cent. For this there is a simple explanation. If the practice is to assess realty at its true value, the assessor has a definite mark at which to aim, and the taxpayer a definite standard by which to compare his own

assessment with his neighbor's; but when undervaluation prevails, the work is beset with uncertainty, the detection of errors is difficult, and glaring inequalities escape notice.

Not only should local officials aim at a full valuation of taxable property, but it is becoming increasingly clear that in this work they should have the advice, support, and, when necessary, compulsion of the state. Experience shows, both in this and other countries, that local assessments of property, income, or business need constant supervision and control by some central authority. I do not refer to mere "equalization" by boards of the old-fashioned type, but to genuine supervision, by commissions clothed with necessary authority over the methods and, when necessary, the details of local assessments. This raises a question too large to be considered adequately here; and I can only refer you to the work accomplished by such commissions in Indiana, Wisconsin, Minnesota, Washington, and a few other states, which has been described in various papers contained in the *Proceedings of the International Tax Association.* I am aware that centralization has its disadvantages as well as advantages; I could even wish that in this case it were not necessary; but I am convinced that local boards of assessors need to be supervised by a central body of experts, specialists in their appropriate field, and free from personal, local, or political influences. Instead of abandoning the effort to secure full and fair valuation, the duty of the state, after enacting a rational system of tax laws, is to insist upon the strict enforcement of those laws in letter and in spirit. This may be a difficult task; it certainly will not be accomplished in a day. But this is no reason for discouragement, and certainly no excuse for taking what can plainly be seen to be a step in the wrong direction.

The third criticism of the program of the separationists is that it would not put an end to diversity of local interests in tax legislation. At some points, I concede, it might do so; but at others the old antagonisms would remain, and would lead to most unfortunate consequences. For the independent revenues of the states must come from somewhere, and most of the special taxes which it is proposed to assign the commonwealths can be seen clearly to burden some localities more than others. All of the plans with which I am familiar would have for their net result the shifting of a considerable share of state taxation from

rural districts to urban, and particularly to the larger urban centers. Indeed this is frankly avowed by leading advocates of separation, and considered to be one of the merits of the plan. Whether, in view of the problems confronting the modern city, such a result is desirable, I cannot now consider; but the transfer of burdens must arouse the same local antagonisms that attend the apportionment of our present state taxes, and in the process city interests would be arrayed against country as they so often are in our legislatures and boards of equalization.

In Massachusetts the problem of distributing the proceeds of the general corporation tax has for years arrayed the residential towns and cities against the manufacturing and commercial centers, principally the city of Boston. In Connecticut, during the past winter, it is reported that the problem of raising additional revenue for the state brought on a contest between city and country interests. In the state where complete separation has been accomplished, the division of the liquor-license tax and the enactment of a tax on stock transfers seem to have arrayed the virtuous and unselfish "up-state" counties against the wicked city of New York. If you will read the reports of tax commissions that have recommended plans for separating state and local revenues, you will find that although appeal is made to abstract justice or scientific principles of taxation, care is usually taken to construct statistical tables showing that a majority of counties, or towns and cities, will pay less under the new arrangement than under the old. And as for the average legislator, you may rest assured that, while he will cheerfully agree with you that what we want is fair play and a square deal all around, his first, and usually last, question will be, How does your scheme affect my district? Until you can devise taxes that come from nowhere and are paid by no one, you may depend upon it that the quest of new sources of state revenue ordinarily means a search for taxes that some other fellow or other district will have to pay, and that imposts of most objectionable character may be established if thereby a combination of towns or counties can unload state charges on one or more large cities as convenient beasts of burden. If the time has come or ever does come when taxes resting upon country districts must be transferred to large cities, I submit that the transfer should be effected according to some rational principle, and not by the hit-or-miss methods

contemplated by the advocates of separation; and venture the further suggestion that we cannot expect to effect the change without arousing local jealousies and antagonisms.

A fourth criticism concerns the proposal usually made by separationists to confer upon local governments freedom to devise their own systems of taxation. This is advocated by those who believe that taxes on personal property ought to be abolished, and think that if local option were permitted, some communities, perhaps many, would grant such exemption. It is favored also by our friend the single taxer, who hopes that some communities would elect to place all their taxes upon land values. Neither the merits of the single tax nor the desirability of exempting personal property can be considered in this paper; I can only state my opinion that the remedy for the shocking evils that now exist is to be found in a proper classification of property for taxation, coupled with state supervision of the work of assessment. From my own point of view, therefore, local option, or home rule in taxation, has no attractions; and it must be still less attractive to those who believe that all property should be taxed at a uniform rate.

The reason usually assigned for the proposal is that local conditions differ very widely, and that each community is the best, indeed the only, judge of its own needs. But I believe that there are few advocates of local option who, after prolonged consideration of such diversities, would not in any concrete case recommend either total exemption of all personalty or the single tax. And I have often heard the opinion expressed that if any locality should hold out to investors the prospect of total exemption of personal property,—to say nothing of exemption of improvements on land,—capital and industries would migrate to that district in such volume that other places would be forced to grant similar exemptions if they desired to retain any part of their movable wealth. I cannot, then, believe that the real purpose of most advocates of the plan is anything but the ultimate establishment of a uniform system of exemption of certain classes of property, and the concentration of local taxes on real estate or on land values alone. Such a program is difficult to carry through state legislatures where the farmers have a voice, but it might readily be accepted in large cities where only a small fraction of the voters are owners of real estate. Until we are prepared to

accept state-wide uniformity in the concentration of local taxes upon real estate or land values, we are bound to oppose local option as a remedy for real or alleged diversities of local conditions and needs.

If, however, I am wrong in believing that the purpose and possible result of local option is what I have represented it, and if the outcome of the experiment would be the establishment of diverse local methods of taxing many or most kinds of property and business, it is easy to show that such diversity, unless narrowly restricted by state law, would give rise to undesirable, even intolerable conditions. Suppose that one county should decide to tax mortgages as an interest in real estate where the land lies, that another continues to tax mortgages as personal property, and that the state, in its quest of independent revenues, establishes a recording mortgage tax. Then the interest the mortgagee has in the land would be taxed in the first county, the mortgage note might be taxed in the second, and the state would impose a third tax at the time the mortgage was recorded. In the assessment of taxes on business enterprises owning property and conducting operations in two or more places, similar opportunities would exist for double or multiple taxation; and other cases would probably arise in which similar injustice would be perpetrated. So far as I know, no country permits any such degree of local option, and the only result in the United States would be local chaos, assuming still that most forms of property and business would remain on the list of taxables. This is not to say that no latitude whatever should be allowed local governments. Such a tax as the habitation tax, which does not affect the distribution of capital or offer opportunity for unjust double taxation, might be introduced, if any community desired it, in connection with other taxes; and there may be one or two other taxes the use of which could safely be made permissive. But with such possible exceptions, the forms and methods of local taxation should be prescribed by state law, and few things could be more undesirable than the wide discretion it is proposed to grant local governing bodies.

A fifth and final criticism lies against that form of separation which contemplates drawing all the revenue of the states from independent sources, without a direct tax of any sort or description. To this the objection is that it leaves the states without an

elastic tax which can readily be increased when more revenue is needed, and reduced when a surplus is foreseen. Taxes on inheritances ought to be levied at unchanging rates in order to secure equality in the distribution of their burden; nothing can be more unequal than to tax at a high rate an estate probated in a year of a deficit, and to tax at a low rate one that is transferred in a year that shows a surplus. Taxes on corporations are either levied at fixed rates, or at rates depending on the aggregate of local taxation. They might be made to vary with the needs of the commonwealth, but such a proposal would probably encounter so much opposition as to postpone to the Greek Kalends a plan of separation contingent upon its acceptance. And so with the other sources of independent income; they should not, or probably could not, be made variable taxes.

There may be states in which inelasticity of revenue would cause no embarrassment,—in which expenditures would not outstrip the natural increase of the income from established taxes, and in good years a surplus would be set aside to provide for the lean ones. This has been said to be true of New Jersey and Pennsylvania. But I apprehend that in most states the abolition of the direct tax would remove a necessary check on public expenditures. Experience shows that legislative bodies will usually spend all the revenue drawn from indirect taxes or from taxes on inheritances and corporations, since these are not felt sensibly by the average taxpayer; and in good years will regard a surplus merely as a reason for increased appropriations. This is not mere speculation. It has been, notoriously, the experience of our national government, and is confirmed by the experience of not a few states.

For it should not be forgotten that during the first half of the nineteenth century separation of revenues was attempted in a number of states. The experiment has never been fully studied, and the results were complicated by the fact that at the same time extensive public works were undertaken with borrowed money. But I think it can be shown that in most cases, even when allowance is made for unwise use of public credit, the usual result of abolishing direct state taxation was an unprecedented increase in ordinary expenditures. My own state (Massachusetts) affords a particularly good field for study, since the experiment was hardly affected by the use of loans ; and it is too clear

to admit of doubt that from 1825 to 1853 the attempt to dispense with direct taxation resulted in loss of control over state outlay.

Concerning the present working of complete or partial separation in the states where it now prevails, I speak with diffidence, for I have been unable to study the situation at first hand. But it is a fact that in New York expenditures increased from $12,934,000 to $34,589,000 during the fifteen years ending in 1908, and that, although opinions differ, there are well-informed persons who believe that abolition of direct taxation is responsible for a considerable part of the increase. In New Jersey the condition of the state's finances was the subject of a special message from the Governor last January, and although that document denies that expenditures have been extravagant, it states that the condition of the treasury is such that the legislature ought either to appropriate to the use of the state certain revenues formerly distributed to the counties or levy a direct tax. In Connecticut I find that during the decade ending in 1908 expenditures rose from $2,530,000 to $4,741,000, that the official best qualified to judge declares "the abolition of a direct state tax has led to extravagance in expenditure," and that the present year the legislature was obliged to levy a direct tax, the first since 1890. And finally it is a significant fact that whereas the original proposals of the separationists contemplated the abolition of direct taxation for the support of the state, the plans now current usually provide for a direct tax apportioned according to local expenditures.

Thus far, and not without regret, I have offered you little but destructive criticism. I trust, however, you have not formed the impression that I am satisfied with existing methods of taxation, either state or local, or that I think there is no remedy for the evils admitted to exist. Will you permit me to state in the fewest possible words what I believe to be a wise and practicable solution of the problem?

There are, undoubtedly, certain taxes which should be reserved for the use of the states. One of these is the inheritance tax, which takes from the localities nothing in the way of revenue which they formerly possessed and is collected with approximate equality from property in all parts of a commonwealth. A second may well be a light tax on the franchises of all corporations, which is a reasonable payment for something which the state

confers and is not in derogation of the taxing power of counties or municipalities. Third in order are the usual taxes on insurance companies, which reach taxable values distributed with some approach to equality and never, so far as I recall, subject to local taxation. Further than this the question is less clear, though perhaps the states may reasonably claim a portion of the taxes collected from railroads and from telegraph, telephone, express, and parlor-car companies, since these fall in part upon intangible values hard to localize and belonging naturally to no one district rather than another. And finally, in view of their increasing outlay for dependents, defectives, and delinquents, the commonwealths may fairly claim part of the liquor-license taxes, since the business taxed contributes in some degree to the production of pauperism, disease, and crime.

After this allocation of revenues to the states, the remainder of their income should be drawn from direct taxation. If, in any case, the revenue from the specified independent sources equals or exceeds the needs of the treasury, a larger part of the taxes on transportation companies should be assigned to counties or municipalities, in order that the legislature may not be freed from the restraints imposed by an annual or biennial accounting with the people. The apportionment of the state tax may not be an easy task, but an intelligent revision of our laws relating to the taxation of property will remove all serious difficulties.

As the source of local taxation we must assign property and business generally, undiminished by the hit-or-miss reservation of important classes for the exclusive service of the state. But I speak not of a general property tax, levied as at present at a uniform rate; for that has proved the abomination of abominations, and cannot be amended until we learn to classify property in a rational manner and adjust the rates and methods of taxation to the economic nature and needs of each class of taxable objects. The method of classification, I need hardly add, should be prescribed by the state; and the process of assessment should be under strict and direct state supervision, though performed by local officials. The result, I believe, will be a reasonably full and fair assessment of taxable property; not instantly, perhaps, since new methods are not learned perfectly in a day, but ultimately and at no distant time. It is obvious, too, that such a consummation will solve the problem of the just distribution of the direct state tax.

56. A Classified Property Tax.[1]—The classification of property for taxation is discussed in the following selection:

The general property tax, which is in this country the mainstay of state and local finances, has been the object of incessant criticism for more than forty years. Discontent with its workings undoubtedly existed in the early part of the nineteenth century, but it was not until the period following the Civil War that state and local taxation acquired the status of a "problem." Between 1867 and 1876 six states appointed tax commissions to investigate the subject, and their example has been followed by many others, until the student of taxation is now confronted by the reports of scores of such commissions, which constitute in the aggregate a literature of financial discontent without parallel in any other country. Everywhere the story is the same: existing laws are either unenforced, or, if enforced, prove destructive to industry and highly unjust in their operation upon individual taxpayers. The outcome usually is that personal property evades assessment to an increasing extent, so that the burden of taxation falls more and more heavily upon real estate. The system as a whole is inadequate, and was long ago discarded by most other countries; so that in the United States we have the proud distinction of possessing about the worst methods of local taxation to be found in any part of the civilized world.

Ever since discussion of the subject began, critics of the general property tax have maintained that our troubles arise from attempting to tax all, or substantially all, forms of property. Proposed reforms have generally contemplated the total exemption of certain kinds of property, such as intangible wealth or even all forms of personalty, and the retention of taxes on real estate supplemented by corporation, inheritance, income, or business taxes. That a practicable system might be worked out in some such fashion, I will not question; but it must be apparent that the proposal to exempt important classes, not to say all classes, of personal property has thus far failed to gain the popular approval necessary for its adoption, and is not likely soon to command such approval. In view of this fact, I ventured a year ago to call the attention of this Association to the merits

[1] By Charles J. Bullock. Reprinted from *Proceedings of the National Tax Association*, Vol. III, pp. 95–105.

of a moderate uniform tax upon intangible property, such as now prevails in two of our commonwealths; and I desire this year to carry the discussion a stage farther, and outline a general plan for a classified property tax.

The root of our difficulty, I believe, is not that we have attempted to tax all classes of property, but that we have tried to tax them all at a uniform rate high enough to meet public expenditures at the present day. During the first half of the nineteenth century, when expenditures were smaller and tax rates but a fraction of their present figures, the general property tax, while occasioning more or less friction, did not lead to the intolerable conditions that have existed since the Civil War. In my own state the average rate of taxation could not have exceeded 40 or 50 cents per $100 in the year 1820; in Boston it was 36 cents per $100 in 1822. As late as 1860 the general level was from 60 cents to $1 throughout the state, and in 1861 the average was approximately 83 cents. It is to be further observed that the rate of interest on good investments was considerably higher at that time than at the present day, so that a tax of 60 cents per $100 represented less, rather than more, than 10 per cent of the taxpayer's income; and the evidence shows that under such conditions the tax could be levied upon all property with reasonable success.

In the city of Boston in 1794, when the rate of taxation was 30 cents per $100, personal property constituted more than half of the total assessment; and as late as 1850, when the tax rate was 65 cents per $100, it formed 41 per cent of the total valuation; but after 1850 conditions changed, public expenditures greatly increased, and the rate of taxation rapidly advanced. Whereas in Boston the *per capita* tax levied in 1850 was about $8, by 1874 it had risen to $35.70. In the state of Massachusetts between 1860 and 1870 the *per capita* taxes upon property increased from $6.04 to $17.10. The tax rate in Boston, which in 1850 had been 65 cents per $100, advanced to $1.56 in the year 1874; and in Massachusetts the average tax rate, which was 83 cents in 1861, stood at $1.57 a decade later. The result of this great increase in rates was widespread evasion of taxes upon personal property, which brought it about that personalty thereafter formed but a small proportion of the total assessment, leaving the burden to fall chiefly upon real estate. It was under such conditions

that Massachusetts appointed its first commission to investigate the working of its laws relative to taxation.

While the situation may not have been the same in every other state, it appears that in the country at large the same thing happened that occurred in Massachusetts. The census shows that the average tax rate in 1860 in all the states was 78 cents, whereas in 1870 it was $1.98 and in 1902 was $2.05. It further discloses that in 1850 personal property throughout the United States was assessed at $2,125,000,000, and realty at $3,899,000,000; while in 1902 personalty was assessed at $8,923,000,000, and realty at $26,415,000,000. The evidence points to the conclusion, therefore, that it was mainly the progressive increase of tax rates after 1860 which caused the disintegration of the general property tax and produced the intolerable conditions with which we are all familiar.

Nor should this conclusion surprise us. While some forms of taxation may be more convenient and flexible than others, the most important thing about any tax is the proportion it bears to the income of the taxpayer. If this proportion is small, the burden is more cheerfully borne and the collection of a tax correspondingly easy; while as it increases, the temptation to evade becomes stronger and the process of collection more difficult. I would by no means minimize the other considerations which have contributed to the unsatisfactory working of the general property tax in the United States, but I believe the thing of greatest moment is the unparalleled increase of tax rates which occurred during the last half of the nineteenth century. For forty or fifty years we have been endeavoring to collect from all classes of property a tax amounting to some such figure as 2 per cent of the selling value. Such a tax can and will be paid by no property that can manage to evade it, and its only effect must be to drive personalty into hiding and impose a constantly increasing burden upon real estate. In the eighteenth century and early part of the nineteenth, when the tax rate was but 50 or 60 cents per $100, it may have been possible to tax all property at a uniform rate; at the present time, when the average tax rate is $2 per $100, it is absolutely impossible to do so; and no reform of the property tax is possible until we learn that the rate of taxation upon any class of property should be adjusted to what that class can bear. If we are to continue to tax property, as

apparently we must for a long time to come, it is under modern conditions imperative that we should classify property in a scientific manner and pass from a general to a classified property tax.

A scientific method of classification must be based upon facts, and the first fact which it must recognize is that the heavy taxes needed at the present day to defray the increased cost of local government must fall chiefly upon real estate. This is actually the result of our present system, although it is reached through the devious channel of evasion of taxation by personal property, and not by the process of classification. In 1902 the total state and local taxes amounted to $860,600,000. Of this sum, $153,900,000 came from miscellaneous taxes on polls, business, inheritances and corporations; while $706,700,000 came from taxes assessed on property. Of the taxes on property, as nearly as can be estimated, 75 per cent fell upon real estate, so that the total contribution of real property to the state and local revenues amounted to $529,000,000, out of a total of $860,600,000 raised by taxation. In reality, however, the contribution of real estate was somewhat larger, since a portion of the inheritance and corporation taxes represented realty values. In recognizing, therefore, that the basis of a classified property tax must be a tax upon realty, I am not proposing so much a change in actual conditions as a different and better method of bringing such conditions about. Indeed, there is room for thinking that, by scientifically classifying personal property, the contribution it makes toward public charges may be somewhat increased so that a natural result of the change would be to diminish somewhat the actual burdens on real estate.

Not only is it a fact that real estate is and must be the chief source of local revenues, but it is further true that under modern conditions this ought to be the case. Nearly nine-tenths of the taxes levied upon property in the United States are for the use of local governments, and little more than one-tenth are for the support of states and territories. The local taxes are expended in large measure for objects that tend to enhance or maintain the value of real property. Allow streets, sidewalks, and sewers to fall into decay, and you reduce real-estate values in any locality. Withdraw police and fire protection, extinguish street lights, and otherwise diminish municipal services, and you undo the

owner of real property. Personal property can usually be removed or sold, so that its value will not be greatly affected; and it is not, like land, the permanent beneficiary of municipal growth and development. It is but just, therefore, that real property should be taxed for local purposes at a higher rate than personalty; and this principle is frequently recognized in special assessments levied by various American cities to defray the cost of certain kinds of improvements.

The heavier burden which falls upon real estate is greatly alleviated by the fact that, whenever real property changes hands, existing taxes are capitalized, so that the purchaser buys upon what is practically a tax-exempt basis. Every buyer of real estate, at the time of his purchase, takes into account the taxes falling upon the property, and adjusts accordingly the price he offers. The result is that, at any time, the value of real estate is diminished by the existing taxes capitalized at the current rate of interest, so that these taxes are no real burden for the subsequent purchaser. If the taxes increase during the time he holds the property, the additional burden of course falls upon him, since it diminishes by so much the price obtainable at the next transfer. In this manner from generation to generation the burden of real-estate taxation is diffused among successive owners, each of whom bears only such increases in the tax rate as occur during his period of tenure.

While real estate must be the basis of the system, a classified property tax can draw substantial revenues from personal property if it rightly classifies the objects to which it applies. Personal property has sometimes been considered to form a single class, and it has been proposed either to exempt it from all taxation or to tax it at a uniform rate, though not at the rate levied upon real estate. But this ignores the well-defined distinction between tangible and intangible personalty, a distinction which must be recognized by any reasonable scheme of classification.

Intangible property is easiest of all to conceal or remove from one jurisdiction to another. It can be taxed successfully only by making the rate moderate and uniform throughout the widest possible area. For this reason it is desirable not only that the rate should be the same throughout an entire state, but that the various commonwealths should, so far as practicable, bring their rates to a common standard. In the next place, intangible prop-

erty consists of investments from which the owners on an average derive but simple interest; perhaps 5 per cent is a fair average in most parts of the United States. In a reasonable system of classification, then, it would seem that the rate for intangibles should not exceed such a figure as a government can collect with reasonable certainty from property that is easily concealed and yields only an income of 5 per cent. Experience shows that from 5 to 6 per cent of the income is a reasonable figure for any tax upon intangible wealth; and that taxes exceeding this rate, by causing evasion, are less productive than those which do not exceed it. Pennsylvania and Maryland have learned this lesson and have demonstrated that a tax of 30 or 40 cents per $100 is the safe limit in the taxation of intangibles.

Tangible personalty, on the other hand, consists either of personal effects or of capital employed in agriculture, manufactures, and commerce. A tax upon personal effects bears no determinate relation to the taxpayer's income, and is of the nature of a tax on consumption. Capital actively employed in trade may be presumed, on an average, to yield the ordinary trade profit, which is twice the rate of simple interest. It, therefore, can and should pay a higher tax than intangible property, and its tangible character makes the collection of such a tax possible. If 30 or 40 cents per $100 is the correct figure for the taxation of intangible wealth, it would seem that the tax on tangible personalty should be placed at some such figure as 60 or 80 cents per $100.

How such a limitation of the tax rate on tangible personalty would affect the revenue from this source cannot yet be ascertained from actual experience, as can be done in the case of the moderate uniform rate on intangible property. But it appears that throughout the country merchandise and manufacturing capital are greatly undervalued. Investigations have shown that the assessed value may not exceed one-half or one-third of the true value, and in the state of Ohio the assessment of "merchants' and manufacturers' stock" declined from $70,442,000 in 1870 to $52,446,000 in 1906. It would seem, therefore, that at the reduced rate of taxation the assessed value of this class of property might double or treble, and that the taxes collected might well equal the present revenue from such sources. And if it should be said that such a result would leave merchants and manufacturers about

where they are to-day, the sufficient answer is that they would then be paying all the law requires, and would no longer be dodging their taxes.

Since the classification of personal property is undoubtedly the crux of the problem, it may be well to emphasize the fact that the method I have proposed would give the same average result as a general tax on incomes. If we assume that the average rate of interest in any community is 5 per cent, and that the income tax is levied at the rate of 6 per cent, then $100 invested in intangible wealth will yield, on an average, an income of $5 per annum and pay a tax of 30 cents; while $100 invested in manufactures or trade will yield an average trade profit of $10 and pay a tax of 60 cents. If the rate of the income tax is 8 per cent, intangibles will, on an average, pay a tax of 40 cents, and capital invested in manufactures or trade, a tax of 80 cents. Clearly, if average results alone are considered, the result is the same whether the tax is levied on income or levied on property under a correct system of classification. In individual cases, it must be admitted, the results would differ, since all property of any given class is not equally productive. But for such differences in individual incomes from investments of the same class no property tax can make provision; indeed, it is a commonplace with students of finance that such inequality is inherent in any method of property taxation. This may be, and in my opinion is, a sufficient reason for substituting income for property taxes whenever practicable; but whenever such a change is impracticable, the most that can be expected is to adjust taxation to average conditions, and that can be done only by some system of classification such as I have proposed.

Forest property would also need to be dealt with in a scientific scheme of classification. In papers read at earlier meetings of this Association it has been made sufficiently clear that forests are unlike ordinary real estate and cannot be taxed in the same manner. The Forest Service of the United States is now investigating this problem, and will be in a position eventually to recommend a scientific method of taxing forests. Since the problem is primarily one for the forest expert, I may be excused from making any definite suggestion concerning the taxation of forests, and refer to the subject merely for the purpose of emphasizing the need of a proper classification of property for taxation.

I am compelled to leave untouched many other questions that naturally suggest themselves, and must content myself with this brief discussion of the chief problems involved in a reasonable classification of property. I may refer, however, to the fear sometimes expressed that, if the rule of uniformity is abandoned, we shall fall into a chaos of diverse and bewildering classifications. Such fear I believe to be groundless. Property falls into certain natural classes of which the economic characteristics are tolerably plain, and our legislatures would be decidedly averse to making classifications except for sufficient cause. Ordinary real estate, forests, tangible personalty, intangible property,—these classes are well established and recognized by all. Some others may need recognition—I do not profess to offer a final classification; but experience shows that our legislatures are slow to diversify methods and rates of taxation, and that there is more danger that they will not go far enough than that they may go too far.

We have been so long accustomed to a tax upon all property that the proposal to classify and adjust rates to the economic nature of each class gains acceptance but slowly, even though it is surely finding increased favor. It may help to overcome dissent if I suggest that nothing is here proposed that is inconsistent with accepted principles of legislation and business procedure.

All successful legislation is based upon a reasonable discrimination between the classes of things with which it deals, and laws that ignore necessary distinctions between classes prove ineffectual or pernicious in their results. Uniform regulations for the transfer of all classes of property, a uniform penalty for all crimes, and absolute uniformity in the treatment of persons, without discrimination of age, sex, or condition, would be no more unreasonable than a uniform rate of taxation for all property, irrespective of its nature or class.

Diversification of rates of taxation agrees with the ordinary business principle of adjusting charges and prices to "what the traffic will bear." No railroad charges as much for carrying logs as for carrying furniture; but the discrimination in favor of logs, by enabling that traffic to move, contributes to the revenue of the road and decreases the charges upon furniture and other traffic of higher grade. When the average rate of taxation was 40 cents per $100, it was possible to tax all property at a

uniform rate because the tax was not higher than any important class of property could bear; but under modern conditions the rate of taxation is so high that it is necessary to classify property and adjust methods and rates of taxation to the needs of each important class.

Reasonable discrimination between the objects of taxation is the principle upon which our customs tariff and internal taxes upon commodities are now adjusted. We tax beer at one rate, spirits at another, and tobacco at another; and no sensible man would propose to tax all three commodities at a uniform rate. Our tariff taxes cut diamonds at the rate of 10 per cent, and levies upon sugar a duty equivalent to 60 per cent *ad valorem*. This discrimination is both just and expedient, since a duty of 60 per cent upon diamonds would lead to so much smuggling as to produce little revenue; while the duty of 10 per cent yielded, in 1905, $2,500,000. This illustration not only makes clear the necessity of adjusting taxation to "what the traffic will bear," but points to the reason therefor. The duty of 10 per cent can be collected from any dealer in diamonds, because the government succeeds in collecting it from practically all dealers. If the duty were raised to 60 per cent, and a few dishonest dealers were tempted to evade payment of it, the honest dealers, who would have no objection to paying duties uniformly collected upon all persons engaged in their trade, would have no choice but to resort to smuggling or go out of business. Evasion of taxation, when it becomes general, is not due to dishonesty on the part of the average taxpayer, but to the sheer inability of the honest man to pay his taxes when other persons succeed in evading theirs.

Not only in the indirect taxes levied by the national government, but also in the taxes levied in certain states upon deposits in savings banks can we find a noteworthy illustration of the advantage of adjusting taxation to what property will bear. In 1862 Massachusetts made deposits in savings banks subject to an excise duty which for many years has been nominally one-half of 1 per cent, and actually one-fourth of 1 per cent of the total deposits. This duty has been collected from banks, and there has been no possibility of evasion, yet the deposits in those institutions have increased very much more rapidly than any other class of taxable property in the state, with corresponding benefit to the revenue derived therefrom. Far from injuring

owners of other classes of property, the moderate tax upon savings deposits in Massachusetts and some other states has greatly benefited them, and their taxes would to-day be higher than they are if we had undertaken to collect a tax of 2 per cent.

Then, finally, we have the experience of Maryland and Pennsylvania, with their present taxes on intangible wealth. Their experience has shown that a rate that can be collected is far more productive than a higher rate that cannot be enforced, and they have pointed out a way to remove some of the worst abuses in our system of local taxation. We have had, then, even in this country, some practical object lessons of the benefit of classification, so that the proposal I make finds a basis in experience as well as in reason.

The platform of this Association commits us to the policy of removing obsolete constitutional restraints upon the classification of property for taxation, and has further recognized the impossibility of taxing forests under the general property tax. Our action gives rise to the natural question, Whither are we moving, and where are we likely to come out? May I suggest that we are tending toward a classified property tax, under which both rates and methods of taxation will be adjusted to the needs of each class of property. In such a system no rate upon any class will be higher than can be collected with reasonable certainty; none will be so high as to drive out of a community persons or capital or industry; and it will be recognized that any rate exceeding what the property will bear must result in loss of revenue, injury to industries, and such general demoralization as accompanies widespread evasion of law. If we move in this direction, may we not devise a system of taxation suited to the conditions of modern life, just in its operation upon individuals, and beneficent in its effect upon the industry and commerce of our common country?

57. The State Income Tax and the Classified Property Tax.[1]— The following selection deals with later developments in the taxation of property and income:

During the past decade two plans for the reform of state and local taxation have gradually forced themselves to the front: the classification of property and the substitution of income for

[1] By Charles J. Bullock. Reprinted from *Proceedings of the National Tax Association*, Vol. X, pp. 362–384.

property taxes. Both have now passed beyond the stage of mere discussion, and have been subjected to the acid test of experience. Both have a record of successful achievement, but neither can claim to have solved all taxation problems. Both have advocates and both have critics. It would seem, therefore, that the time has come when a comparative study of the classified property and state income taxes can be profitably undertaken.

The classified property tax was first in the field. When it was seen to be impossible to enforce the uniform taxation of all classes of property at the high rates prevailing in the United States, it was natural that some of the commonwealths should diversify their practice by classifying some kinds of property for taxation by special methods and at lower rates. Prior to the present decade this was undoubtedly the line of least resistance for the average state. Our people had always been accustomed to the taxation of property, and were inclined to regard the income tax as inquisitorial. Then, too, taxation of incomes had been tried by a few states, and had always proved a signal failure; so that it had come to be generally agreed that the states could not, and should not, impose taxes upon incomes. Prior to the discussions attending the ratification of the sixteenth amendment of the Federal Constitution, the income tax would have been the line of greatest resistance in the average state. But the coming of a federal income tax and the successful inauguration of a state tax on incomes by Wisconsin have wholly changed the situation. Oklahoma and Massachusetts have recently enacted income taxes, New York has had such a measure under consideration, Connecticut has imposed an income tax on certain classes of corporations, and much interest has been aroused in several other states. To-day the income tax appears to enjoy at least a large measure of popularity, and may prove in many states to be the most practicable method of remedying the evils of the general property tax.

Comparative study of the two plans of taxation requires first of all some consideration of the results so far achieved, and I begin with the classified property tax.

Intangible property is now classified for taxation at flat rates, ranging from two to five mills in the dollar, in six states: namely, Pennsylvania, Maryland, Minnesota, Iowa, Rhode Island, and

North Dakota.[1] In the last state the law is of such recent date that no statement about the results is possible; but in all the others except Iowa the flat tax has been a financial success. In Iowa the experiment was made under the worst possible administrative conditions, and the immediate result was a loss of revenue, though not so large as has been represented by opponents of the flat tax; but subsequently the assessment of intangibles materially increased, and the present prospect is that, even under unfavorable conditions, the new law will give a better financial result than the old.

To form a just estimate of the working of the flat tax it is very necessary to observe the exact scope of the tax in each state before making comparisons with others. This the few critics invariably fail to do. Not all kinds of intangible property are subject to the flat tax in any of the six states. Stocks of domestic corporations are everywhere exempt from it, savings deposits are often if not always exempt, mortgages on domestic real estate are exempt in Minnesota and Maryland, stocks of foreign corporations are exempt in Minnesota, intangibles yielding no income are exempt in Maryland, and there has been some question as to whether bank deposits are taxable under the Pennsylvania law. Under these circumstances comparisons are difficult, and I cannot undertake them in this paper. It should suffice that those conversant with the facts in Pennsylvania, Maryland, Rhode Island, and Minnesota testify that the financial results are good, and that the revenue from this source tends steadily to increase.[2]

[1] In 1915 Virginia imposed a state tax of 65 cents per $100 upon intangible property and limited local levies to 30 cents, with the result that the maximum rate on intangibles is now 95 cents per $100, or nine and one-half mills. I am not sufficiently informed about the results of this legislation to justify an expression of opinion on the subject. In 1916 a 4-mill tax on intangibles was established in the District of Columbia, where such property had been exempt from all taxation since 1903.

[2] Criticisms of the flat tax can be found in Professor Seligman's address in the *Proceedings of the Ninth Annual Conference of the National Tax Association*, pp. 126–145; report of the Committee on Taxation of the City of New York, 1916; and report of the Joint Legislative Committee on Taxation of the State of New York, 1916. Professor Seligman's criticisms were answered by various delegates to the Ninth Conference. See *Proceedings*, pp. 226–237; also article by Professor Brindley in *Quarterly Journal of Economics*, May, 1916. *Cf.* the current reports of the Rhode Island, Maryland, and Minnesota Tax Commissions for full informa-

Another consideration which the critics have always missed is that the introduction of the flat tax on intangibles tends to improve greatly the assessment of tangible personal property. This has been notably the result in Maryland and Rhode Island, and seems to be true in Minnesota. We can therefore say that the flat tax not only increases the revenue from intangibles, but indirectly contributes to produce an increased assessment of tangible personalty, and consequently a larger revenue from that class of property.

But while the tax has been, upon the whole, a distinct success, there is room for improvement both in details of the law and methods of administration. The rate of 5 mills now imposed by Iowa is probably higher than the average state can at present expect to collect with reasonable certainty, and upon the other hand the 2-mill rate imposed by North Dakota is lower than it should be. For the average state 3 mills is probably the best rate, and 4 mills is certainly the maximum.

Improvement is possible also in the provisions made for deductions on account of indebtedness. In some of the states, as Rhode Island and Iowa, debts of any description can be offset against taxable credits, with the result that we find unlimited debt deduction from a limited class of property. Minnesota goes to the other extreme and permits no offset of debts. In the first case the revenue from the flat tax suffers, and in the second considerable hardship to the taxpayer may occur. Both difficulties might be obviated by adopting the principle of proportional deduction of debts, which has been followed in the Massachusetts income tax. Taxpayers might safely be permitted to deduct from the value of their taxable intangible property such a proportion of all their debts as the amount of their taxable intangibles bears to their total property. This would, indeed, require persons seeking deductions to make a return of all their property, but only as a condition of receiving a privilege. It would avoid the absurdity and abuses incident to permitting unlimited debt deduction against a limited class of property, and at the same time obviate the cases of hardship arising from refusal to grant any deductions whatever.

tion concerning those states; also the reports of the Joint Committees of the Senate and House of Representatives of Pennsylvania to consider the Revenue Laws of the Commonwealth, appointed under resolutions of 1909 and 1911.

Better administration also is needed in most of these states. Minnesota from the start gave the state tax commission adequate supervisory power in the premises, and has achieved gratifying success; but the work of educating local assessors has proved a difficult task, and is far from completed. In Iowa, on the other hand, the taxation of intangibles was left wholly to local boards of assessors, with such results as might have been expected. Maryland and Rhode Island are accomplishing much through their tax commissions, but in many localities the assessors seem still to be a law unto themselves. Pennsylvania exercises, through the auditor general, some slight control over the local authorities, but has not yet established methods of administration that promise to become generally effective. Intangible property cannot be successfully taxed by unskilled and underpaid boards of local assessors, and the successful working of the flat tax requires strict central control over the entire process of assessment.[1]

Instead of resorting to a flat tax on intangibles, some states have preferred to employ registration taxes. Connecticut led the way in 1889 by permitting owners of bonds or other choses in action to register them with the state treasurer and secure exemption for five years by paying a tax which is now fixed at 2 per cent, or, disregarding interest, 4 mills per annum. Since registration was purely voluntary and local assessors have made little effort to tax intangibles under the general property tax, comparatively few people have had any motive to register their securities; yet the tax has yielded a substantial revenue to the state. In 1915 legislation was enacted providing for the better enforcement of the tax, with what result time will disclose. In 1903 Alabama imposed a recording tax upon mortgages in lieu of taxation under the property tax, and subsequently her example was followed by New York and several other states. In 1911 New York, later followed by Michigan, imposed a registration tax, somewhat after the Connecticut plan, upon secured debts.

These registration taxes, provided their rates are adjusted to the period of exemption, are obviously another method of reach-

[1] Since it has been supposed that I have maintained that mere reduction of the rate of taxation will secure a full assessment of intangibles, I wish to call attention to the fact that in my first discussion of the subject I recognized fully the need of proper administrative methods. See *Proceedings of the Second Annual Conference of the National Tax Association*, p. 132.

ing the same result as the flat tax on intangibles. The 2-per-cent tax levied by Connecticut upon bonds which are exempted from taxation for five years amounts to practically the same thing as the 4-mill tax levied annually by Rhode Island upon intangible property. In states where there is deep-seated opposition to what is called "the listing system," the Connecticut plan may be for the present the line of least resistance or even the only way out. But when, on the other hand, the registration tax is payable once for all, at a rate that is the same for obligations having one or one hundred years to run, it becomes unequal in its incidence, and for long-term bonds amounts to an exemption rather than a taxation measure. A registration tax of $5 for a $1000 bond having fifty or one hundred years to run can be understood if it is regarded as the nearest practicable approach to total exemption, but as a tax it is too absurd to admit of discussion. In fact the chief advocates of such so-called taxes are persons who hold that intangible property ought not to be taxed at all. Even when the rate is graduated according to the life of the obligation, it seems clear that an optional registration tax, though accompanied by penalties upon unregistered securities disclosed in the probate courts, cannot reach intangible property as fully and certainly as an annual tax of reasonable amount under proper conditions of administration.

Tangible personal property continues in all the states, except Minnesota, to be taxed like real estate. Yet it would seem that in a proper scheme of classification this kind of property should be segregated and taxed at a special rate. It consists, for the most part, of merchandise, machinery, and live stock, property which may be assumed to be employed in trade and to yield an ordinary trade profit which may be taken to be about 10 per cent. From property of this description, which is mobile and subject to severe interstate and even international competition, it is doubtful if any of our states ever has collected, or can expect to collect, taxes that absorb more than 10 per cent of the income. Since $100 of such property may be assumed to yield an average income of about $10, the proper tax rate would be 80 cents or $1 per $100; but the rates prevailing in our states are usually double these figures. The result is general undervaluation, by which tangible personalty as a class is assessed at from 30 to 60 per cent of its true value, while in individual cases assessments

range from nothing up to 100 per cent, producing the grossest inequalities between taxpayers. The introduction of better methods of taxing intangible property has indeed simplified and improved somewhat the taxation of tangible personalty, and the efforts of efficient state tax commissions have changed things for the better; but the problem has not been solved.

For manufacturing and commercial states the question is one of the greatest importance. In these commonwealths public expenditures are usually heavy and tax rates are high. Strict enforcement of a tax amounting to $1.50 to $2.50 per $100 would not be long tolerated by public opinion, since it would drive so much business to other states. The rational, expedient, and straightforward thing to do is to reduce the tax to a figure that can be collected, and then enforce the law in all cases without fear or favor. When expenditures are small and the general tax rate does not equal or exceed $1 per $100, the matter may not be of great importance; but elsewhere the proper classification of tangible personal property is becoming increasingly desirable and necessary.[1]

Time does not permit me to develop this topic as I should like to do, but I may point out that a precedent for such limitation of the tax rate on tangibles can be found in the taxes levied by New York, California, and Connecticut upon banks at the flat rate of 1 per cent. While these are legally taxes upon bank stock, they are economically and practically taxes upon a form of commercial capital analogous to the capital of manufacturers and merchants. Just what the financial result of such rate limitation would be cannot be stated with any degree of certainty, but it is probable that tangible personalty, as a class, is so far undervalued that a full assessment at the lower rate would produce about as much revenue as is secured to-day.

Real estate also is sometimes classified for taxation.[2] No less than six states[3] have adopted new methods of taxing forest lands, which recognize more or less fully the need of replacing

[1] This point was considered in my paper entitled "A Classified Property Tax," in the *Proceedings of the Third Annual Conference*, pp. 100–102.

[2] I omit here classification of suburban land such as has long existed in some localities.

[3] Vermont, Massachusetts, Connecticut, New York, Pennsylvania, and Michigan.

the tax upon growing timber by a tax upon the product. The exemption of buildings, or taxation at a reduced rate, has been advocated by single-taxers and some others in a number of states, but so far Pennsylvania is the only commonwealth that authorizes this, and its law applies only to the cities of Pittsburgh and Scranton.

Another interesting and important tendency is the remarkable extent to which special assessments have been developed in some localities. When not only the original construction of streets, but also the cost of successive resurfacings or repavings which virtually relieve cities of ordinary maintenance expenses, are financed by special assessments, such contributions become recurring charges which must be regarded as special land or real-estate taxes. Even in older states, like Massachusetts, assessments are now levied to cover such recurring expenses as street-watering and the destruction of insect pests. It is not impossible that in these, and perhaps other, ways special assessments may develop into a new form of special land or real-estate taxes, even in states having constitutions that require taxation to be uniform or proportional upon all classes of property.

Only one state, Minnesota, has undertaken as yet to establish a general scheme of classification of property for taxation. In that commonwealth a law enacted in 1913 provides that property shall be divided into four classes. Iron ore, which constitutes a class by itself, is assessed at 50 per cent of its actual value; urban real estate, which constitutes another class, is assessed at 40 per cent; rural real estate and such tangible personalty as live stock, merchandise, and machinery form another class, and are assessed at 33⅓ per cent; while, finally, household goods, wearing apparel, and similar personal belongings are assessed at 25 per cent. Since intangibles were already provided for, this class of property was omitted from the law.

This scheme of classification was very largely based upon the antecedent conditions existing in the state, and amounted virtually to a legalization of those conditions. It made possible a far better assessment of property in 1914 than had ever before been secured, and has therefore greatly improved conditions in Minnesota. Concerning it the Tax Commission of the state has said: "From a theoretic standpoint it is open to very serious criticism and leaves much to be desired; but as a measure designed to ac-

complish a practical and much-needed reform, it has proven a most pronounced success."[1] With this opinion I heartily concur. Other states can learn from Minnesota's experiment the great advantage that accrues from having property assessed in conformity with the law rather than according to standards established by local authorities in defiance of the law. But the plan of assessment at fractional valuation is in some respects unfortunate, and the classification of the different items of property is at some points open to criticism.

Classification by fractional valuation has, indeed, the advantage of giving the taxpayer a direct interest in the rate of taxation, which is lost when classification is brought about by imposing a flat rate. But upon the other hand it is less likely to result in equal valuations than the alternative plan of taxing property upon its full value at a reduced rate. I understand that the Minnesota Commission requires assessors to record the true value in all cases, and that the fractional valuation is then computed for the purpose of determining the tax. But, even so, the public knows that the law provides for undervaluation; and when cases of unequal assessment occur, is less likely to take notice of them. If the law requires assessment at true value, and a parcel of real estate assessed at $6000 is sold for $10,000, the discrepancy is glaring enough to excite comment and perhaps action. But if the law provides for assessment at 40 per cent, and a parcel assessed at $2400 is sold for $10,000, the discrepancy is less glaring and less likely to lead to correction of the valuation. Under any other plan than that of full valuation, inequalities are not so apparent to the public and not so keenly appreciated, and everything depends upon the vigilance and skill of the assessor. Perhaps this ought not so to be, but it is a psychological fact with which tax legislation ought to reckon.

The classification accorded to some kinds of property by the Minnesota law is at some points questionable and at others clearly wrong. Unplotted real estate is assessed at 33⅓ per cent, other real estate at 40 per cent, and iron ore at 50 per cent. This arrangement brings it about that urban realty is taxed about 20 per cent more than rural for direct state and county taxes, and that iron-ore lands are taxed 50 per cent more than rural and 20 per cent more than urban real estate. How such discrimination

[1] Report for 1914, p. 23.

can be justified is not apparent, and it is hard to explain except upon the ground that farmers are numerous in Minnesota and that the ore lands belong to corporations the stockholders of which are chiefly residents of other states. In practice the higher valuation of ore properties has contributed to produce extravagant expenditures in the iron districts, and in theory it must be condemned.

By providing that live stock, machinery, and merchandise shall be assessed at 33⅓ per cent the Minnesota act moved in the right direction, but did not go far enough. This means that the true rate of taxation upon machinery and merchandise is 80 per cent of that imposed upon urban real estate, and in the long run is likely to mean a tax so heavy as to be incapable of strict enforcement. With an average nominal tax rate of about $3 per $100, tangible personal property to-day is actually paying at the rate of $1 per $100, which, though high, is probably not excessive under proper conditions of administration. But if the future increase of public expenditure raises tax rates above the present figures, the Minnesota classification plan will encounter increasing difficulties in the taxation of tangible personal property. This danger can be readily met, however, by reducing the percentage at which such property is assessed, or, better still, by limiting the rate of taxation.

I have dwelt at such length upon the recent Minnesota law because it is the first which undertakes to establish a general scheme of classification and is therefore of peculiar interest and importance. If the discrimination against certain kinds of real estate were removed, and the assessment of tangible personalty reduced to the right proportion, Minnesota would have the distinction of working out a correct scheme of classification, and would blaze a path for the other states.

The recent history of state income taxes may be more briefly told. Prior to 1912 some sixteen states had attempted at various times to tax incomes; but the results were invariably farcical, and it had come to be the general opinion that no state could or should levy an income tax. This opinion, however, was based upon a superficial view of the case. State income taxes had, indeed, failed everywhere; but they had always been part of an unworkable system of taxation, and had been tried without suitable machinery for administering them. The experience of the

states taught conclusively that, under such conditions, income taxes could not be enforced; but that is all it demonstrated. Under totally different conditions it was at least conceivable that there might be a different result.

So, evidently, Wisconsin thought when in 1911 she obligingly came forward with an object lesson. By a well-considered law, enacted in that year, this state levied, at reasonable, progressive rates, a tax upon incomes of individuals and corporations; and then exempted from local taxation intangible property, farm machinery, and household goods. I cannot consider in detail the structure of this tax or the manner in which it is adjusted to certain state taxes upon corporations; for present purposes its important features are, first, that it imposes a tax of reasonable amount; second, that it is in lieu of other taxation of intangible property; and, third, that it is administered by special assessors of incomes who are appointed and controlled by the state tax commission. Had it been a tax of 30 or 40 per cent of the taxpayers' incomes, had it been superimposed upon the old method of taxing intangible property, and had its administration been left wholly to the local assessors, the Wisconsin tax would have gone the way of previous state income taxes. But Wisconsin did none of these things, and instead established new conditions under which the tax has operated with most gratifying success.

The Connecticut act of 1915 applied to ordinary business corporations, and imposed a tax of 2 per cent upon the net incomes in respect of which such corporations are required to pay a tax to the United States. Administration of the law was placed in the hands of the state tax commissioner, and the companies were required to file with him copies of the income returns made to the federal government. In 1916 the yield of this tax exceeded expectation, and it is not impossible that presently the scope of the law will be broadened.

Concerning the recent Oklahoma law I am not fully informed; but it appears that the act superimposed an income tax upon the general property tax and did not exempt intangibles from other taxation. Administration of the tax was placed in the hands of the state auditor, who was not furnished with a force of special assessors of incomes such as had been provided in Wisconsin. The result, therefore, has been far from satisfactory, as might have been expected under the conditions.

The law enacted in Massachusetts last spring is narrower in scope than either the Wisconsin or Oklahoma acts. It continues in force the old tax upon incomes from professions, employments, trade, and business, which in one form or another has existed for two hundred and seventy years; and then imposes a tax upon income from intangible property which is exempted from other taxation. It also imposes a tax upon speculative profits derived from dealings in intangible property. Finally, its administration is placed in the hands of the state tax commissioner, who is provided with all the machinery—including district assessors of income—needed for the enforcement of the law. It will, therefore, be tried under comparatively favorable conditions, and ought to prove a solution of the problem of taxing intangible property. I should state, however, that, under the old system, Massachusetts has probably taxed some $500,000,000 or $550,000,000 of intangibles, a much larger amount than any other state seems to have reached under the general property tax. It is hardly to be expected, therefore, that the immediate results of the new law will be as spectacular as those achieved in Baltimore, or in Minnesota and Rhode Island, upon the introduction of the flat tax on intangibles, or in Wisconsin under the income tax. The law goes into effect in 1917.

Meanwhile Virginia, North Carolina, and South Carolina retain the income taxes which have long stood on their statute books, and from time to time seek to give increased vigor to them. But neither state has made the radical changes necessary for the successful operation of an income tax, and so neither has succeeded in reaching more than a fraction of the taxable incomes. In New York the need of additional revenue is likely before long to result in important changes in the tax laws, and a state income tax has been recommended by a legislative commission. Elsewhere the movement toward state taxation of incomes has not advanced beyond the stage of preliminary discussion, and does not claim our attention.

I now come to the important question of the merits of the classified property and the state income taxes, which can be best treated by making a somewhat detailed comparison of the two imposts.

The normal source of taxation is and always must be income.

A property tax, whether general or classified, is merely one method of determining what part of his income the individual citizen should contribute, and it takes as the measure of the citizen's contribution the amount of property that he owns. The income tax is merely another method of doing the same thing, so that we can say that fundamentally the two taxes differ merely in the measure, or if you please the yardstick, which they use in determining the amount of the citizen's contribution. So far as the owner of productive property is concerned, it is really immaterial to him what name is given to a tax of stated amount. To the owner of intangibles yielding 5 per cent a 3-mill tax in Minnesota is exactly the same thing as the 6-per-cent income tax imposed upon large incomes in Wisconsin. If we are to escape bondage to mere words, names, and labels, we must not regard a property tax as fundamentally bad and an income tax as fundamentally good; or *vice-versa*. Basically the two taxes are merely different methods of doing the same thing, that is, levying upon the income of the citizen; and what we need to know is which tax gives the better results.

The second point to be noted is that the manner in which either a property or income tax works depends very largely upon the rate of taxation. A property tax levied at a rate that absorbs 30 or 40 per cent of the taxpayer's income is, in ordinary times, incapable of strict enforcement in respect of any kind of property that can be hidden or moved to another jurisdiction, as we in the United States know full well. The same thing precisely is true of an income tax, in ordinary times; and it is a commonplace that, as a tax upon incomes rises above the rate of 10 per cent, it becomes increasingly difficult to collect. Upon the other hand, a property tax levied at the rate of 30 or 40 cents per $100 is just as enforcible as an income tax levied at the rate of 6 or 8 per cent, as the experience of some of the Swiss states and the history of our own flat tax on intangibles fully demonstrate. Just as a chain is no stronger than its weakest link, so property and income taxes are no stronger than they prove to be in respect of things not visible or tangible and capable of ready removal. A general income tax levied as the general property tax is levied in American states would produce exactly the same results. Under it real-estate incomes would pay the bulk of the taxes, and other incomes in the long run would largely or wholly escape. The

appropriate remedy, in such a case, would be classification of incomes, in order to adjust the rate imposed upon any class to the situation and needs of that class.

In the third place it is evident that conditions of administration are about as important as the rate of taxation in determining the success or failure of property and income taxes. Under a purely local system of administration there never was and never will be a generally satisfactory assessment of either income or property, for reasons perfectly familiar to us all. Central control of the process of assessment is necessary for the successful operation of either a property or an income tax, and hardly more so for the one than for the other.

A fourth point of comparison is that of the fairness or equality with which the two taxes operate. It is often said that a property tax is unequal because property is not equally productive. One investment of $1000 may yield 10 per cent, another 4, and another may for the time being yield nothing; yet the property tax exacts the same contribution in all three cases, if the market value of the property is the same, as it may happen to be. The income tax, upon the other hand, proportions the contribution to the income that each investment yields, and is therefore much more equal. This argument is plausible, but it overlooks one important feature of the case. An investment that yields 8 per cent upon the market value involves more risk than one which yields 4, and therefore a part of the higher interest is not net income but a premium for risk. The purchaser of 6-per-cent securities must, if he wishes to keep his principal intact, allow for a larger percentage of losses than one who buys 4-per-cent bonds. Now the income tax makes no adequate allowance for this fact. Even if it permits taxpayers to deduct losses as they occur, the amount of such deduction is limited to the amount of the taxable income of the year, or even more narrowly, whereas losses of principal may greatly exceed taxable income. Manifestly the case is not so simple as the advocate of the income tax assumes, and when the element of risk is taken into account it seems that the income tax cannot be said to be unquestionably fairer than the property tax.

The previous argument, moreover, takes for granted the ability theory of taxation; and we must not forget that, no matter what place may be assigned to this theory, no system of taxation ever was or ever can be based wholly upon the principle of ability. We

do not exempt urban real estate because the owner has been unfortunate in business and has no income this year. Business taxes do not exempt the merchant when his books show a balance on the wrong side. Taxation of real estate, and sometimes of business, is based very largely upon the principle that taxpayers have received certain benefits and must pay for them whether they make large or small profits in any year. To the extent that benefit is and must be regarded in the distribution of taxes, it is obviously incorrect to say that the income tax is inherently fairer than a tax on property. All things considered, it seems impossible to prove that either tax is necessarily more equal than the other.

A fifth comparison of the two taxes turns on the matter of debt deduction. It is claimed that the state income tax is superior to the classified property tax because the latter does not, like the former, make allowance for debts. Undoubtedly income taxes do, almost invariably, permit deduction of debts; while property taxes, as we find them in the United States, usually permit only the offset of debts against credits, and sometimes narrowly restrict that. But this is not universally or necessarily true. In Switzerland the property tax is very generally imposed upon net fortunes.[1] Under a general property tax deduction of all debts can be granted just as fully as under a general income tax, and under a special or classified property tax deduction of a proportionate amount of indebtedness can be permitted quite as readily as under a special income tax. With both taxes, abuse of the privilege is possible, and indeed inevitable under certain conditions; while under other circumstances the privilege will not lead to serious abuse. Bad administration, excessive rates of taxation, unlimited rights of deduction against a limited class of property or income, make the operation of either tax farcical in the extreme; but such conditions can be avoided under a classified property tax quite as readily as under a state tax upon incomes.

A sixth consideration is that of enforcibility. We are sometimes told that personal property is, from its very nature, impossible to assess with any certainty, and that therefore any attempt to tax it must fail; whereas income can be taxed, especially if good administration is provided. Upon this point the opinions of writers seem to be determined largely by geography. In England, where there has long been a successful income tax and the

[1] See pp. 359–360.

general property tax is unknown, Bastable and other writers naturally incline to the view that assessment of income is easier than assessment of property. In the Canton of Vaud, where there is a successful property tax, Cerenville holds that property is easier to tax than income. In Germany where both income and property taxes are now in successful operation, writers do not think they differ greatly in this respect. In the United States, where the general property tax has been a general failure, it is not strange that we should think almost any other tax easier to enforce.

The fact seems to be that neither tax operates well unless administrative and other conditions are favorable, as I have already shown; and that between the two there is very little to choose. The income of many securities is a simpler and more definite thing to assess than is their capital value. The income of a business is usually about as difficult to ascertain as is the value of the property invested therein. When transfers are frequent, the value of real estate is probably easier to ascertain than is the net income. The value of farms or live stock is much easier to determine than the income of farmers; indeed before the latter problem income taxes usually break down, and have to be administered by arbitrary rules of thumb. Altogether, it is difficult to say whether, upon the whole, either tax has any net advantage over the other.

Which tax is more inquisitorial and inconvenient to taxpayers is a seventh matter that is sometimes the subject of argument, and here again we come to something that seems to depend upon what a person has been accustomed to. Many an advocate of a protective tariff under which a lady's trunk may be ransacked upon a dock, or a traveler invited to a private room where he is stripped and searched, has objected to an income tax upon the ground that it is inquisitorial. In American states where there is a formidable "listing system," an income tax was, at least very recently, usually regarded as an invasion of one's private affairs. And, upon the other hand, in New York, where taxpayers have never been required to return their property for taxation, we find advocates of an income tax who criticise the classified property tax on the ground that it requires a "listing system" and is inquisitorial. The fact is that both taxes have to be inquisitorial, and that under good administration taxpayers

readily become reconciled to inquisition and presently accept it as the most natural thing in the world. You cannot excite, or even interest, an Englishman by telling him that the English income tax is inquisitorial; and if you should make the same comment upon the property tax of Switzerland, the average Swiss would say, "Why not?" Between making returns of your income or returns of your property, there is little room for choice —at least upon rational grounds.

An eighth line of comparison turns upon the antiquity or modernity of the two taxes. It is often said that the general property tax is a fiscal device of the palæolithic age, when property was homogeneous and existed mostly in simple petrified forms which were visible and tangible and therefore could be taxed with reasonable success by prehistoric assessors equipped with prehensile toes. It is not surprising, then, that critics of the classified property tax have advanced the deadly palæontological objection that property taxation is antiquated and the whole modern tendency is to impose taxes upon income.

Now it is true that the property tax existed in antiquity, and that the income tax is mostly the product of the last century, but the assertion that property taxation is becoming obsolete is a complete perversion of historical fact. About the year 1800 it would have been comparatively easy for a palæontologist to write the obituary of the general property tax. It had gone out of vogue almost everywhere, and could hardly be found except in two Swiss cantons and the original American states. From 1800 to 1850 European opinion was mostly adverse, but nevertheless the general property tax was reintroduced into most of the Swiss cantons, and was adopted by newly organized American states. In Switzerland and the United States the general property tax is for the most part the product of the nineteenth century, and only in a few cantons or states is it a survival from earlier times. The last half of the nineteenth century brought a change of European opinion, and since 1893 a general property tax has been introduced, as a supplementary tax, in a number of European countries. As a sole reliance, it is indeed obsolete; but so are all other taxes. It exists in full vigor in Switzerland as a principal tax, and elsewhere in Europe as a supplementary tax. No European economist would to-day treat the property tax as obsolete; and it is time for us to abandon palæontological fables.

There is no modern tendency everywhere to abandon property as the basis of taxation. The taxation of income has been greatly extended since the opening of the nineteenth century, but that has not prevented the reintroduction of property taxes in Europe. Nor has it prevented the substitution of property for income as the basis of taxation in certain cases. It had long been customary in Europe to tax real estate upon an income basis; but the rapid growth of cities in the nineteenth century made this method unduly favorable to undeveloped urban land, and therefore German cities have been adopting capital value as the basis of taxation, and England has adopted a tax upon increments of capital value. In Australasia, also, there has been a marked tendency to substitute capital for income value in the taxation of real estate. What has really happened is that modern countries are using both income and property as bases of taxation, according to the circumstances of the case; that they have found income taxes useful for some purposes and property taxes for others; and that the two imposts have been shown to be complementary and not mutually exclusive forms of taxation. Americans, therefore, can experiment with the classified property tax without justly incurring the reproach that they are troglodytic petrothetes. I venture the further suggestion that not a few states will find, as Wisconsin has done, that a judicious combination of income and property taxation is best suited to their needs.

So far we have found that property and income taxes are very much alike in many important respects. But they have, of course, certain points of difference, two of which are important. A property tax does not, like an income tax, reach directly incomes derived wholly from labor. To meet this situation most of the Swiss cantons supplement the property tax with a tax upon incomes not derived from property, such as business profits in excess of the current rate of interest, wages, salaries, and professional earnings; and a very few American states, such as Massachusetts, have done the same thing. Such a combination of income and property taxes fills the gap which a single property tax would leave, and reaches all forms of incomes. If any critic objects that the classified property tax is defective, because it does not reach incomes that are not derived from property, the obvious answer is that there is a simple remedy which is already in common use.

The other important difference is that a pure income tax exempts from contribution property that yields no income, whereas a property tax reaches it if it has any value. The property in question may be divided into two classes: first, unproductive investments, and, second, durable consumer's goods such as household belongings, personal effects, and objects of art. The second class need not detain us long. Swiss advocates of the property tax consider the income tax seriously defective in that it exempts the rich man from taxation upon luxurious consumption evidenced by the possession of costly furniture, valuable paintings, lavishly appointed stables, and the like. Upon the other hand, those American reformers who would cure most of the defects of the property tax by the short and simple remedy of exemption would naturally consider it a merit of the income tax that it avoids all trouble at this point. I will merely suggest that if any state or country considers this defect of the income tax to be a serious matter, it can nevertheless adopt that tax and then fill the gap by imposing direct consumption taxes upon objects of luxury.

The exemption of unproductive investments, which takes place under the operation of a pure income tax, is a decidedly important matter. If the investments are securities, the speculator can be reached adequately by including his profits in your definition of taxable incomes. If they are capital invested in merchandise and machinery, exemption favors the concern that is struggling to exist; but it may permit large properties that require expensive governmental services to go scot-free, or practically so, whenever they occupy land of little value. This problem is not a simple one, and I must content myself with the single suggestion that a combination of property and income taxes will give some relief to the concern that is having a bad year, but will require it, nevertheless, to pay something for the expensive service it receives.

Unproductive land raises the most important question. Fifty years ago the tendency was almost universal to temper the wind to the shorn lamb, and the man who was "land poor" was considered to be one of the "deserving poor." But the rapid growth of cities in Europe and the United States changed all this, and to-day the cry is to tax the cursed "speculator." Europe, by taxing land upon an income basis, unduly favored the individual

in question, and of late has shown some inclination to substitute property for income as the basis of real-estate taxation. In the United States, where taxation upon capital value was the long-established practice, we have avoided for the most part such conditions as have existed in European cities; and no one would seriously propose to tax land, exclusively or even principally, upon an income basis. In the case of real estate, property is so far superior to income as the basis of taxation as to leave little room for argument. This fact makes it certain that our states will not wholly abandon the taxation of property, and that the introduction of the income tax will not mean the abandonment of our present tax on real estate.

The foregoing discussion leads to the conclusions, that neither the income tax nor the classified property tax is always and at every point to be preferred to the other; that these taxes are, to a large extent, merely different methods of doing the same thing; and that they ought to be regarded as imposts, not mutually exclusive, but capable of being combined in a logical and practicable scheme of taxation. In choosing between them at any point we need to weigh all the circumstances of the case and then determine on which side the balance of advantage lies. No general pronunciamento in favor of either tax will solve any practical problem of taxation.

In any state one's choice should be guided largely by public opinion. If the Rhode Island Commission of 1911 had recommended a state income tax, instead of a flat tax on intangibles, its report would have fallen upon deaf ears. If recently a flat tax had been proposed in Massachusetts, instead of a state income tax, nothing would have come of it. Since the only thing that matters is to get a proper classification of the objects of taxation, names are of no account and we ought to follow the line of least resistance.

This conclusion, however, needs one qualification. The two taxes are not equally well adapted to the needs of every state. The income tax works much better in manufacturing and commercial communities than in rural, on account of the difficulty of computing farmers' incomes and because the high exemptions usually inseparable from an income tax permit the average farmer to slip through the net and diminish greatly the revenue secured.

It also involves a greater departure from established ideas and practices, and probably requires, at least when first introduced, more skillful administration. A state that is almost wholly devoted to agriculture would, therefore, do well to adopt the classified property tax; and one that is not prepared to centralize the machinery of assessment, as Wisconsin and Massachusetts have done, certainly will achieve no great success with the income tax. The last statement, however, is almost as true of the classified property tax, as Iowa's experience shows; so that we need always to insist that a considerable degree of centralization is a fundamental requisite in any plan of tax reform.

The practical problem is everywhere one of adjustment. The present real-estate tax, flat taxes on tangible personalty at some practicable rate, the flat tax on intangibles, existing taxes on corporations, and the state income tax,—these are the elements out of which we must build our system of taxation. There are a number of practicable combinations. A classified property tax, plus a tax on incomes derived from other sources than property, would be one solution. A tax on incomes not derived from property and upon incomes from intangible property, plus a classified property tax upon real estate and tangible personalty, is another possible adjustment. A tax upon all incomes not derived from real estate plus a property tax upon real estate is a third arrangement. A tax upon income of all descriptions, plus a property tax upon real estate, is a fourth possibility. And finally it is possible to impose a tax upon all incomes, and then tax all tangible property under a proper classification. The advantages and disadvantages of these five plans I cannot consider in this paper, but hope to discuss at some future time. Nearly all of them have precedents in the income taxes of the world; the first three bring about nearly the same distribution of the weight of taxation; but the fourth and fifth produce somewhat different results. Where there exist special corporation taxes which it is desired to maintain, all of these plans would need to undergo certain modifications, as was the case in both Wisconsin and Massachusetts; but all admit of the necessary adjustments.

As a final, but not necessarily as the immediate, solution, I strongly prefer the fifth plan. If every citizen were taxable at his domicile upon his entire income without exemption or de-

duction, except such as may be proper in the case of small incomes, and if then all tangible property were taxed, under a proper classification, at its situs, we should have the simplest, most logical, and most satisfactory of all solutions. Everybody would pay an income tax in the locality where he lives and enjoys the benefits of government, and all property would contribute to the support of the jurisdiction where it receives the benefit of governmental services. The former tax would necessarily be of a personal character; the latter would be levied purely objectively upon things without regard to ownership.

This arrangement would offer the following important advantages. It would greatly simplify administration, since there would be no need of apportioning incomes among different states, no questions would arise concerning the ownership of tangible property, and it would be unnecessary to ask what income or property is taxable and what is exempt. Secondly, it would secure a certain compensatory action of the two taxes, since inequalities in the actual operation of one might be offset by inequalities in the other, and it would seldom happen that the two sets of inequalities would be cumulative. Thirdly, it would solve all questions of double taxation by universalizing the practice, and would secure a simple and just distribution of taxable values between the state where a taxpayer is domiciled and that in which his tangible property is located. For such double taxation of property and income there are not a few precedents, and it is the only practicable method by which under federal governments unjust double taxation can be wholly avoided.

But I am not greatly interested to-day in ultimate solutions. For good or ill various states seem inclined to experiment with taxes on incomes, and it is important to understand the nature and the good or bad points of the income tax. It should not be regarded as a panacea, it is not going to replace all taxation of property, it must be carefully adjusted to existing taxes on tangible property and corporations, and it will certainly work badly if the rate is excessive or the administration decentralized. Finally, the state income tax should not be regarded as the rival, but rather as the complement or helpmate, of the classified property tax.

58. Preliminary Report of the Committee Appointed by the National Tax Association to Prepare a Plan of a Model System of State and Local Taxation. —The following report was submitted to the Twelfth Annual Conference held under the auspices of the National Tax Association at Chicago, in June, 1919.

I. Introduction

Section 1. At the conference held at Atlanta in November, 1917, under the auspices of the National Tax Association, the committee appointed by the Association to prepare a plan for a model system of state and local taxation submitted its first report. The committee was able to announce that it had reached a general agreement concerning the principles upon which a uniform system of state and local taxation should be based, and expressed the opinion that, if further conferences of its members could be arranged, it would be possible to reach an agreement concerning the details of the proposed system. Following this report, the executive committee of the Tax Association authorized the holding of such a meeting, and accordingly the committee upon a model tax system met at Pass Christian, Mississippi, during the week extending from January 21 to January 27, 1918.

There were present at the meeting Messrs. Bullock, Galloway, Howe, Link, Lord, Page, and Tarbet, and also, by special invitation of the committee, Mr. A. E. Holcomb, the Treasurer of the National Tax Association. Three members of the committee,

Messrs. Adams, Mills, and Rearick, were unable to attend the meeting; Messrs. Adams and Rearick because they were prevented by the pressure of other duties, and Captain Mills because he had gone to France. Messrs. Adams and Rearick, however, were fully informed about the progress of the committee's deliberations, and have lent their valuable criticism and counsel, so that the report now submitted has received the careful consideration of all the members of the committee except Captain Mills.

Following the meeting at Pass Christian, the chairman of the committee prepared a tentative draft of a report based upon the votes taken by the committee, and this draft was submitted in July to all of the members of the committee except Captain Mills. After securing such criticisms and suggestions as the other members had to offer concerning the tentative draft, the chairman was able to prepare a report which is now submitted, with the approval of all the members of the committee except Captain Mills, for the consideration of the Twelfth Annual Conference of the National Tax Association.

SECTION 2. This report has been printed in advance of the holding of the Conference, for the information of members of the Tax Association and delegates to the Conference. It is submitted as a preliminary rather than a final report, and is offered with a view to furnishing the Conference a basis for discussion.

The committee realizes that a general agreement upon any plan for a model system of taxation can be reached, if at all, only after mature consideration by all interested in the work of the National Tax Association, and believes that no attempt should be made to reach a decision this year. We are, therefore, submitting this report for the considerate judgment of the Conference in the hope and expectation of deriving great assistance from such discussion and criticism as it will there receive. If the conclusions we have reached command sufficient approval, it will then be possible for this committee, or some other appointed for the purpose, to prepare in the following year what may be considered a final report. This is a matter in which haste is both unnecessary and undesirable, and one in which success can result only from a general consensus of opinion reached after the fullest and maturest deliberation.

SECTION 3. In further explanation, we desire to point out that the present report deals only with the general principles upon which a model system of taxation may be constructed and with the general framework of such a system. Even if all necessary details had been fully worked out, it would have been undesirable to present them now, since they would inevitably have tended, to some extent, to divert attention from the fundamentals of the plan. But all the details have not been worked out, and could not be within the time the committee has had at its disposal. We have found that, even if the plan in its general outlines is approved, there will remain numerous matters that will require further consideration, some of them by committees having technical qualifications which the members of the present committee do not possess. We have, therefore, not attempted to deal with such subjects, and have recommended to the executive committee of the National Tax Association the appointment of several special committees to report upon these questions. A model system of state and local taxation cannot be devised in a single year, and we are, therefore, attempting in the present report to provide only a foundation upon which future work can be based. We believe, however, that, if such a foundation can be laid, the work that remains will be greatly facilitated and the completion of the structure need not be long deferred.

II. THE PRINCIPLES UPON WHICH A MODEL SYSTEM OF STATE AND LOCAL TAXATION SHOULD BE BASED

SECTION 4. Whatever other purposes taxation may properly have, its fundamental purpose is to provide revenue which, it will be agreed, ought to be raised as equally, certainly, conveniently, and economically as possible. Until this fundamental purpose is achieved, and the American states are to-day very far from accomplishing it, we shall hardly find it worth while to consider what other purposes taxation may properly have. Therefore, the committee has confined itself to the one problem of immediate practical importance, which is that of devising methods by which the large revenues now required by American state and local governments may be raised with the greatest practicable degree of equality, certainty, convenience, and economy.

SECTION 5. Any proposed system of state and local taxation must, at the very outset, recognize certain existing conditions and conform to certain practical requirements before it can be seriously considered as a basis for legislation. These conditions and requirements the committee has had constantly in mind. They may be stated briefly as follows:

A. The proposed system must yield the large revenues which our state and local governments require at the present time.

B. It must be practicable from an administrative standpoint; that is, it must be capable of being administered by such means and agencies as the states have at their command and can reasonably be expected to provide.

C. It must be adapted to a country with a federal form of government, and to this end must reconcile the diverse claims of our several states, which now conflict at many points, thereby producing unjust multiple taxation and disregard of interstate comity.

D. It must respect existing constitutional limitations, federal and state, or else point to practicable methods of constitutional amendment.

E. It must represent as nearly as possible a general consensus of opinion, and to this end must give careful consideration to the most influential body of opinion developed and formulated by the National Tax Association.

F. It must not propose measures wholly foreign to American experience and contrary to the ideas of the American people.

SECTION 6. Study of the tax laws of the American states reveals the fact that there are three fundamental principles which have been more or less clearly recognized by our lawmakers, and have very largely determined the provisions of the enactments now standing on the statute books.

The first is the principle that every person having taxable ability should pay some sort of a direct personal tax to the government under which he is domiciled and from which he receives the personal benefits that government confers. This is most clearly exemplified by the laws providing for the taxation of securities and credits which represent in large part interests in tangible property and business located in other jurisdictions. In spite of the fact that such laws may lead to unjust double taxation, most of the states have insisted upon taxing

evidences of ownership, upon the theory that the owners are within their jurisdiction and receive from them certain personal benefits which justify the imposition of a tax. State income-tax laws usually proceed upon a similar principle; and the same may be said of the poll tax, which is still found in many of the commonwealths.

The second principle is that tangible property, by whomsoever owned, should be taxed by the jurisdiction in which it is located, because it there receives protection and other governmental benefits and services. That the owner is frequently a non-resident is not considered a material fact, because the property must be protected where it is located, and, if employed in trade, comes in competition with similar property of residents. This principle, furthermore, has received the sanction of the Supreme Court of the United States in cases which have developed the rule that tangible property is taxable in the jurisdiction within which it is located, and not elsewhere.[1]

The third principle, somewhat less clearly and generally exemplified by our tax laws but discernible none the less, is that business carried on for profit in any locality should be taxed for the benefits it receives. If the owners of the business are residents of the state, this principle need not be appealed to, since the ordinary methods of taxation may be considered to provide for such a case. If a considerable amount of real estate and other tangible property is employed in a business conducted for the account of non-residents, again no appeal may be made to this principle, since here too the ordinary methods of taxation may be considered adequate. But if the owners are non-residents, and the business, though very profitable, employs little or no property subject to taxation in the locality, the states, to an increasing degree, demand that some method shall be devised for reaching such business enterprises. This tendency is exemplified in the taxation of corporate franchises in California and some other states, in the taxes imposed on incomes in Wisconsin and some other commonwealths, and in such laws as that enacted by Louisiana taxing non-residents upon credits arising from business done within that state. It finds, further, an even more general expression in the numerous business taxes, usually in the form of licenses, which are found in many states, particularly in the South.

[1] See, for instance, *Union Refrigerator Transit Co.* v. *Kentucky*, 199 U. S. 194.

Whatever one may think of any or all of these principles, the fact remains that they undoubtedly represent hard facts which any new system of taxation must take into account. That they are not in many cases logically and consistently applied, admits of no doubt; that they sometimes lead to confusion and involve unjust double taxation and disregard of interstate comity, cannot be questioned. But the committee believes that there is merit in each of these principles, even though they have been frequently misapplied; and is satisfied that the laws in which the principles are embodied will not be changed except to give place to statutes that provide fairer and more logical methods of carrying the principles into effect.

The problems we here encounter have not arisen by chance, or as a result of mere ignorance and inexperience. They result from claims which the states assert in pursuance of what they consider their legitimate interests in the vitally important matter of taxation. At this point, indeed, we get to the very heart of the most difficult problem encountered in devising a logical plan of taxation in a country having a federal form of government; that is, the adjustment of the conflicting claims of independent taxing authorities. The committee, therefore, has determined to make this problem its chief point of attack upon the entire subject referred to its consideration.

SECTION 7. Mature reflection has brought the committee to the conclusion that the conflicts of jurisdiction and other evils resulting from tax laws based upon the foregoing principles have not been due to inherent defects of the principles themselves, but have arisen from the illogical and inconsistent methods by which the principles have frequently been applied. That every person should pay a direct tax to the government under which he lives, appears to us perfectly reasonable and just; that tangible property should be taxed where located, is both reasonable and in every way expedient; and that business may properly be taxed in any jurisdiction where it is carried on, seems to admit of no serious doubt. Moreover, we find in the tax laws of other countries many examples of explicit recognition of all of these principles; so that we must conclude that both reason and experience confirm the underlying theories upon which the American states have based these provisions of their tax laws.

The trouble has been that the states have not applied logically and consistently the principles upon which they have undertaken to act. Under the system of the general property tax it was practically impossible for them to do so. They naturally and properly taxed tangible property within their jurisdictions on the theory that such property ought to be taxed at its situs, and then they sought to tax intangible property representing interests in tangible property already taxed elsewhere, on the theory that such intangible property ought to be taxed at the domicile of the owner. By so doing, they imposed but one tax on property owned by persons residing in the state where the property was situated, and imposed two taxes upon a great deal of property the interests in which were represented by securities owned by persons whose domiciles were not in the state where the tangible property had its situs.[1] In each case the underlying theory was sound, but the method of application resulted in unjust double taxation of interstate investments. The only solution under the general property tax would be an agreement between states by which one tax would be levied, presumably at the situs of the property, and the proceeds thereof would be divided in equitable proportions between the state where the property had its situs and that in which the owner was domiciled. But such an agreement, besides presenting administrative difficulties, would have been practically impossible to secure; and therefore unjust double taxation has been tolerated because the only practicable alternative seemed to be the surrender of a claim which was in itself just.

In the attempts of the states to make property or income taxes apply to all kinds of business carried on within their jurisdiction, similar conditions obtain. Assuming that all such business ought to be taxed, it is nevertheless true that it ought not to be taxed by a method which imposes two taxes upon some enterprises and only one tax upon others. The states of domicile naturally decline to forego all their claims with respect to the property or income concerned, because they hold that the owners or recipients

[1] Double taxation sometimes occurs, of course, when the persons having an interest in the property live in the state where it is situated, as in the case of mortgages and corporation bonds. No attempt is made at this point to consider all possible cases of unjust double taxation, although the plan we propose provides a remedy for them.

have an obligation to the governments under which they live; the states where the business is carried on with equal propriety assert their right to tax; and the result is unjust double taxation. The underlying theories of taxation are correct in both cases, but the method of application is seriously defective.

SECTION 8. It is the opinion of the committee that the only method of reconciling these conflicting claims of the states is the adoption of a diversified system of taxation which recognizes fully the three principles above mentioned and provides a method by which, without formal agreement among the states, these principles may be logically and consistently applied. We propose, therefore, a personal tax which shall be levied consistently upon the principle of taxing every one at his place of domicile for the support of the government under which he lives; a property tax upon tangible property, levied objectively where such property has its situs and without regard to ownership or personal conditions; and finally, for such states as desire to tax business, a business tax which shall be levied upon all business carried on within the jurisdiction of the authority levying such tax. By this method we believe it is possible to satisfy every legitimate claim of every state without imposing unequal and unjust double taxation upon any class of income, property, or business. We propose, in other words, nothing more than to ask the states to apply logically and consistently the principles that to-day underlie the greater part of their tax laws. By so doing we are recommending action along the line of least resistance, and for our proposals we find many precedents in the legislation of this and of other countries.

SECTION 9. Such a diversified system of taxation as we recommend will not only reconcile the conflicting claims of the states; it will also facilitate greatly a proper classification of the objects upon which taxation falls. One of the greatest evils of the general property tax has been that it has been levied upon different classes of property without regard to differences in the nature and taxable ability of such classes, or to the different degrees in which they benefit from public expenditure. This is a commonplace to all students of the subject, and is sufficiently set forth in the publications of the National Tax Association. The Association has long been committed to the proper classification of the subjects of taxation, and the conferences held under its auspices

have repeatedly endorsed the principle of classification. So far, indeed, as the principle is concerned, we believe that a general agreement upon this point may be taken for granted, and that the only profitable topic for discussion is, and for some time has been, that of the proper method of classification. We find it unnecessary, therefore, to dwell further upon the need of classifying the subjects of taxation.

It is important, however, to point out that the plan we recommend goes far toward securing a proper classification of the subjects of taxation. The personal income tax will reach every kind of taxable income, and will make it unnecessary to attempt to levy any tax upon intangible property, thus eliminating the most serious difficulty connected with property taxation. The property tax will be applicable to every form of tangible property that any state wishes to tax; and admits of being levied upon such property uniformly, or of being levied under a proper classification such as we shall hereafter suggest. And finally, the business tax, since it will be levied purely as a business tax and not as a part of a personal income tax or a property tax, can be readily adjusted in such a manner as the needs of business and the situation of every state may require.

SECTION 10. The plan which the committee recommends is, therefore, fundamentally a plan intended to reconcile the conflicting interests of the states, and to facilitate the proper classification of the subjects of taxation. It involves nothing new in principle, and merely requires the logical application of principles already recognized by the tax laws of many states. It will bring about a full and adequate taxation of income, property, and business, and will produce as much revenue as the state and local governments can expect to derive from these sources. Finally, it encounters no insuperable constitutional difficulties, and certainly will require no more changes in state constitutions than any other plan that would be adequate to the needs of the case.

III. THE PROPOSED PERSONAL INCOME TAX

SECTION 11. The first decision reached by the committee was that in the proposed model system of state and local taxation there should be a personal tax levied with the exclusive view of carrying out the principle that every person having taxable

ability should pay a direct tax to the government under which he is domiciled. There appeared to be four forms of personal taxation which have been employed for this purpose.

The first of these is the poll tax. It is evident, however, from the nature of the case that this tax would be utterly inadequate to accomplish the object in view, even if levied at graduated rates, as has sometimes been done in other countries. It would be so unequal and so far inferior to the other forms of personal taxation that it cannot be deemed worthy of serious consideration. Whether, as a supplement to an adequate system of personal taxation, it might be desirable to retain the poll tax as a means of insuring some contribution from people owning no property and having small incomes, the committee preferred not to consider in this report. It has been our desire to confine ourselves to main issues, and not to undertake to solve every minor problem of taxation. We, therefore, say nothing about the poll tax, except that it is inadequate for the purpose that we have in view, and cannot be recommended as an important element in any system of state and local taxation.

The second method of imposing the personal tax would be to levy a tax upon every man's net fortune; that is, upon the total of his assets in excess of his liabilities, without exemption of any kind of asset or exclusion of any liability. This would mean a general property tax, but a *net* property tax such as is found in some countries in Europe. It would be a tax levied not upon property as such, but upon net fortune as a measure of the citizen's personal liability to contribute to the government under which he is domiciled. It would be entirely distinct from any tax that might be levied objectively upon property, as property, at the place of its situs, and would have to be levied exclusively upon the property owner at his place of domicile. It would necessarily be levied at a moderate rate, perhaps $3 per $1000, which would correspond approximately to a 6 per-cent income tax upon investments yielding 5 per cent. Although precedents may be found in other countries for such a personal tax levied upon net fortunes, the committee has concluded that it is not to be recommended for adoption in the United States. Such a tax would raise the difficult constitutional question of the right of a state to levy a tax even upon the *net* fortune of a citizen if that fortune included tangible property located in another common-

wealth. It is, furthermore, foreign to American experience, and would certainly not lead us along the line of least resistance. Since the coming of the federal income tax, it is obvious that it is easier for the states, and more convenient for the taxpayers, to adopt income rather than net fortune as the measure of the obligation of the citizen to contribute to the government under which he lives.

The third method of personal taxation is what may be called a presumptive income tax; that is, a tax levied upon persons according to certain external indicia which are taken to be satisfactory measures of taxable ability. House rent is the index commonly used in such presumptive income taxes, and a tax on rentals has been proposed in times past by special commissions in Massachusetts and New York. Such a tax would be comparatively easy to administer, and would raise no difficult constitutional questions. It would undoubtedly be better than an income tax or a tax on net fortunes if those taxes were badly administered. But the amount that a citizen pays for house rent is after all such a very imperfect and inadequate indication of his income or fortune that the committee is unwilling to recommend it to any state in which there is any reasonable expectation that conditions are, or may presently become, favorable for the introduction of a better form of personal tax. It appears that in France, where the tax on rentals has been in continuous operation since the Revolution, there is so little correspondence between house rents and taxable ability that in the greater part of the communes the taxing officials disregard to a greater or less extent the letter of the law, and assess people according to what they appear able to pay. The committee finds, therefore, that the tax on rentals is not to be recommended except, perhaps, as a last resort in states where administrative and other conditions are unfavorable to the introduction of any better form of personal taxation.

There remains a fourth form of personal taxation, the personal income tax. By this is meant a tax levied upon persons with respect to their incomes, which are taxed not objectively as incomes but as elements determining the taxable ability of the persons who receive them. This tax is better fitted than any other to carry out the principle that every person having taxable ability shall make a reasonable contribution to the support of the

government under which he lives. It is as fair in principle as any tax can be; under proper conditions, it can be well administered by an American state, as Wisconsin and Massachusetts have proved; it is a form of taxation which meets with popular favor at the present time, and therefore seems to offer the line of least resistance. The committee, therefore, is of the opinion that a personal income tax is the best method of enforcing the personal obligation of the citizen for the support of the government under which he lives, and recommends it as a constituent part of a model system of state and local taxation.

SECTION 12. While it is impossible in this report to describe the proposed taxes in every detail, it is essential that the committee should explain at least in broad outlines the manner in which these taxes should be levied. In so doing it will be necessary to refer constantly to the general principles previously stated, and to adjust the details of each tax in such a manner as to enable it to carry into effect logically and consistently the principle upon which it is based.

Since the purpose of the personal income tax is to enforce the obligation of every citizen to the government under which he is domiciled, it is obvious that this tax must be levied only upon persons and in the states where they are domiciled. It is contrary to the theory of the tax that it should apply to the income from any business as such, or apply to the income of any property as such. The tax should be levied upon persons in respect of their entire net incomes, and should be collected only from persons and at places where they are domiciled. It should not be collected from business concerns, either incorporated or unincorporated, since such action would defeat the very purpose of the tax.

At first thought this proposal will doubtless seem objectionable to many, who will ask why a state should not tax all incomes derived from business or property located within its jurisdiction, irrespective of whether the recipients are residents or nonresidents. And if the personal income tax were the only one proposed, the objection would be well grounded. The committee, however, is under the necessity of reconciling the conflicting claims of the states, and of doing so in a manner that will avoid unjust double and triple taxation of interstate business and investments. We, therefore, propose as the only practicable remedy

a system which comprises three taxes, each of which is designed to satisfy fully and fairly the legitimate claims of our several states. We are elsewhere providing methods by which property will be taxed where located and business will be taxed where it is carried on. At this point we are dealing exclusively with a personal tax designed to enforce the right of our states to tax all persons domiciled within their jurisdictions; and we are merely insisting that, in enforcing this claim, the states shall act consistently, and shall confine personal taxation to persons and attempt to levy it only at the place of domicile. If the personal income tax is levied in any other way, it will simply reproduce and perpetuate the old evil of unjust double taxation of interstate property and interstate business.

The second detailed recommendation we have to make is that the personal income tax shall be levied in respect of the citizen's entire income from all sources. Under existing constitutional limitations, of course, interest upon the bonds of the United States and the salaries of federal officials cannot be taxed by the states, but we recommend that all other sources of income be subject to the income tax without exception or qualification. We are aware that, under the unreasonable and unworkable requirements of the general property tax, it has appeared desirable in times past to exempt state and local bonds from taxation, to exempt real-estate mortgages, and to grant various other exemptions. All such exemptions are inconsistent with the theory of the tax we here propose, and should be discontinued as rapidly as the circumstances of each case permit. Against the policy which led to these exemptions under the general property tax we here offer no criticism. But we are now dealing with a tax which is designed to be a part of a new system of taxation, and it is evident that none of the considerations which led to the exemptions created under the general property tax are applicable to a personal income tax levied upon the principle we here advocate. The personal obligation of the citizen to contribute to the support of the government under which he lives should not be affected by the form his investments take, and to exempt any form of investment can only bring about an unequal, and therefore an unjust, distribution of this tax. Our reasoning applies, of course, to the exemption which agencies of the federal government now enjoy. But that is a matter which is beyond the control of the

states, and for the purposes of this report it will be considered a fixed datum which must be accepted.[1]

Our third specific recommendation is that the personal income tax should be levied upon net income defined substantially as a good accountant would determine it. We submit no formal definition at this time, and content ourselves with referring to the provisions of the Wisconsin and the Massachusetts income taxes. Our recommendation means that operating expenses and interest on indebtedness must be deducted, but we wish to call attention to the fact that the issue by the federal government of large amounts of bonds which are exempt from local taxation will make it necessary for the states to limit the interest deduction to an amount proportional to the income which the taxpayer derives from taxable sources. This would mean that if a person derives half of his income from taxable sources and one-half from tax-exempt federal bonds, he should be permitted to deduct but one-half of the interest that he pays upon his indebtedness. Any other procedure will tend to make the personal income tax a farce in many cases and will give occasion for legitimate complaint.

The fourth recommendation relates to the exemption of small incomes. The committee believes that the amount of income exempted from the personal income tax should not exceed $600 for a single person and $1200 for a husband and wife, with a further exemption of $200 for each dependent up to a number not to exceed three. This would give us a maximum exemption of $1800 for a family consisting of husband, wife, and three children or other dependents. We recognize, however, that conditions may well differ in various states, and have decided to make no specific recommendations about the amount of the exemptions granted to persons having small incomes. We limit ourselves to the above statement of the maximum exemptions that should be granted and the further observation that, under a democratic form of government, it is desirable to exempt as few people as

[1] We here follow the view that has long prevailed concerning existing restrictions on the taxing power of the states. In two recent cases (*Peck* v. *Lowe* and *U. S. Glue Co.* v. *Oak Creek*, 247 U. S.) the court has developed a doctrine which may justify the belief that a net income tax, levied upon state officials along with all other persons, with respect to their entire net incomes, might not be held to be a tax upon agencies of the federal government, and therefore forbidden by federal decisions.

possible from the necessity of making a direct personal contribution toward the support of the state.[1]

Our fifth recommendation is that the rate of the income tax shall be the same for all kinds of income; that is, that it shall not be differentiated according to the sources from which income is derived. If the tax stood by itself, a strong argument could be made for imposing a higher rate upon funded than upon unfunded incomes. But the tax is, in fact, designed to be part of a system of taxation in which there will be a tax upon tangible property. Under this system there will be heavier taxation of the sources from which funded incomes are derived; and there will, therefore, be little if any ground for attempting to differentiate the rates of the personal income tax. Such differentiation, furthermore, would greatly complicate the administration of the tax, and would lead to numerous difficulties. Upon all accounts, therefore, we recommend that there shall be no differentiation of the rate.

In the sixth place, we recommend that the rates of taxation shall be progressive, the progression depending upon the amount of the taxpayer's net income. Concerning the precise schedule of rates, we offer certain general recommendations. The lowest rate should not be less than 1 per cent, and under present conditions we regard it as inexpedient for any state to impose a rate higher than 6 per cent. The classes of taxable income to which the various rates apply need not be smaller than $1000, and probably should not be larger. It results from what has been said that if the exemption to a single person be placed at $600, we would recommend a tax of 1 per cent upon any amount of income between $600 and $1600; a tax of 2 per cent upon any amount of income between $1600 and $2600; a tax of 3 per cent upon any amount of income between $2600 and $3600; a tax of 4 per cent upon any amount of income between $3600 and $4600; a tax of 5 per cent upon any amount of income between $4600 and $5600; and a tax of 6 per cent upon all income in excess of $5600. We present these figures merely for the purpose of illustrating our preferences, and make no definite recommendation except that the rates of the personal income tax should be moderate, and should be, as nearly as practicable, uniform throughout the United States.

[1] For administrative convenience we recommend that, in order to minimize the number of very small tax bills, no person liable to pay an income tax shall be assessed for less than $1.

Our seventh suggestion concerns the administration of the proposed tax. No argument can be needed by the National Tax Association to support our recommendation that the administration of the personal income tax should be placed in the hands of state officials. This we regard as an indispensable condition for the successful operation of any state income tax, and we should be disinclined to recommend the adoption of an income tax by any commonwealth that is unwilling to turn over its administration to a well-organized and properly equipped state department. Local administration of an income tax has never worked well and, in our opinion, never can operate satisfactorily. It is obvious, finally, that a state tax commission, or commissioner, is the proper agent to administer the proposed tax; and we desire to record our belief that satisfactory results are hardly to be expected if the administration is turned over to any other state officials. Upon this whole question of administration, which is of the most vital importance, we are fortunate in being able to rely upon the authority of the opinions repeatedly expressed by the conferences of the National Tax Association. We are glad also to point to the experience of Wisconsin and Massachusetts.

Our eighth recommendation is that the personal income tax be collected from taxpayers, upon the basis of strictly enforced and controlled returns, and without any attempt to collect it at the source. Upon this point there might have been doubt several years ago. But the experience of Wisconsin and Massachusetts shows conclusively that, with good administration, a reasonable tax upon incomes can be collected in the manner we have recommended, with the general coöperation of the taxpayers and with the minimum amount of evasion. Collection at source presents serious administrative difficulties, imposes unwarranted burdens upon third parties in respect of transactions which strictly concern only the taxpayers and the government, and not infrequently tends to shift the burden of the tax to the wrong shoulders. What we seek is a personal tax which shall not be shifted and shall bring home to the taxpayer, in the most direct possible form, his personal obligation for the support of the government under which he lives. Collection at the source is plainly inconsistent with the purpose of such a tax. We recommend, however, that in certain cases information at the source be required as is now done under the Massachusetts and Wisconsin income taxes.

Such information is helpful to the administrative officials, and does not alter the incidence or otherwise affect injuriously the operation of a personal income tax.

SECTION 13. The only remaining point is that of the proper disposition of the proceeds of this tax. So far as our general plan of taxation is concerned, it is immaterial whether the revenue from the personal income tax is retained in the state treasury, distributed to the local political units, or divided between the state and local governments. It is probable, furthermore, that the same solution may not be advisable in every state. If the state should keep the entire revenue, then every section of the state would benefit to the extent that such revenue might reduce the direct state tax. Upon the other hand, if the revenue from the income tax is distributed wholly to the local units, as is now the case in Massachusetts, the lightening of local burdens tends to reduce the pressure of the direct state tax. It seems probable that in most cases a division of the revenue would be considered preferable; and in such cases we suggest that the state governments might well retain a proportion corresponding to the proportion which state expenditures bear to the total of the state and local expenditures, and that the same principles should apply in determining the share received by each of the subordinate political units. Thus in case state expenditures amount to one-fifth of the total, county expenditures to two-fifths, and municipal expenditures to two-fifths, the state should receive one-fifth of the revenue from the income tax, the counties two-fifths, and the municipalities two-fifths. Whether distribution to the local units should be made upon the basis of the amount of tax collected in each unit, or whether the tax should be distributed upon some other basis, is also immaterial to our general plan of taxation. In states where domiciliary changes occurring under the general property tax have not produced an unnatural concentration of wealth in certain localities, it will probably be best to distribute the revenue according to the domicile of the taxpayers. But where, as in Massachusetts, under the operation of the general property tax, wealth has been greatly concentrated in a few localities, such a method of distribution is obviously impossible and some other method must be found. In such a case the income-tax revenue might be utilized for a state school fund, or might be distributed among the localities according to

the proportions in which they are required to contribute to the direct state tax. Since this entire question of distribution must be so largely affected by local conditions, the committee prefers to do no more than to offer these general suggestions.

IV. The Proposed Property Tax

Section 14. The second part of the tax system proposed by the committee is a tax upon tangible property, levied exclusively at the place where such property is located. By this means the several states will be able to satisfy adequately and fairly their just claims in respect of property enjoying protection and other benefits under their laws.

Concerning this tax, it will be observed, we recommend that it be confined to tangible property, and that intangible property of all descriptions be exempt from taxation as property. All attempts to reach such property under the general property tax have in the past proved failures, and in our opinion, with the rates of taxation now prevailing in the several states, will always fail to accomplish the desired end. Moreover, they necessarily involve a large amount of unjust multiple taxation which we can see no way of avoiding under the property tax.[1] We believe that the personal income tax which we have already recommended will reach income from intangible property fully and fairly at the only place where it can be taxed without running the risk of unjust double taxation; that is, at the domicile of the recipient. With this provision made for deriving a fair revenue from intangible property, it is obviously undesirable that the states should continue to tax it as property, and we therefore recommend that, under the proposed system, property taxation be confined exclusively to tangible property.

Section 15. Whether tangible property should be taxed at a uniform rate or should be classified for taxation is a question that requires careful consideration and one concerning which there may be difference of opinion. It is the judgment of the

[1] As an illustration of this we may refer to the vast amount of litigation, uncertainty, and injustice resulting from the attempt to fix the *situs* of intangible property and from the recognition of a so-called "business situs" for intangible property, which inevitably bring about unjust double taxation. This subject will be further alluded to in our discussion of the business tax which we think would remove the cause of this difficulty.

committee, however, that a distinction should be drawn at least between real estate and tangible personal property, and that the latter should receive a separate classification. The reasons for this conclusion are, in the first place, the difficulty of enforcing strictly a tax upon many kinds of tangible personal property at the high rates of taxation which under present conditions our states commonly impose and must continue to levy upon real estate. Tangible personalty can be moved from one jurisdiction to another, and it frequently is removed if taxation is considered excessive. Moreover, it does not occasion so much government expenditure as real estate, and does not benefit from many kinds of local expenditure to the same degree as the latter. Our opinion is confirmed by the fact that in a state like Wisconsin an efficient state tax commission, clothed with all necessary authority, has become so impressed with the difficulty of taxing tangible personalty at the same rate as real estate that it has recommended the total exemption of this class of property. Where the general rate of taxation is low, the difficulties attending the taxation of tangible personal property may be less serious; but, at the commonly prevailing rates of $1.50 or $2 per $100, we believe that strict enforcement of a tax upon tangible personalty will continue to be found most difficult and even impossible.

In our opinion, the rate of taxation upon tangible personal property should not exceed $1 per $100. At that rate it is probable that, with suitable provision for enforcement, the tax will yield not less than is now collected at the higher rates usually applied to property in general, and may even yield something more. Experience may show that even a lower rate, perhaps $0.80 per $100, may be preferable; only experience can determine this point. For the present, we content ourselves with recommending a separate classification for tangible personalty with a maximum rate of $1 per $100.[1]

It is sometimes suggested that the remedy for excessive rates of taxation upon tangible personalty is not a separate classification for such property but effective provision for a full valuation of all property. With such full valuation, it is thought, the rate of taxation upon all property, real and personal, will be reduced

[1] In the opinion of the committee, it is desirable to exempt from taxation a certain minimum amount of tangible personal property, perhaps some such figures as $200 for an individual and $400 for a family.

to some such figure as is here recommended for tangible personalty. In a few states, like West Virginia and Kansas, this result was actually secured some years ago by thoroughgoing revaluations; but, with the present high level of public expenditure, it cannot be attained in the average American state, and to-day is hardly to be expected anywhere. We therefore see no practicable course except to recommend a separate classification for tangible personalty, and this we do in order to make our tax laws enforcible and to create conditions under which all taxable property shall be valued strictly in accordance with law.

SECTION 16. At this point it should be remarked that the imposition of a *classified* tax on tangible personal property is not a vital feature of the general plan which we recommend. Under our proposed system any state desiring to do so could continue to tax tangible personalty at the same rate as real estate without violating any rule of interstate comity or defeating the general purpose of our plan. We are here dealing with a subject of taxation which lies wholly within the jurisdiction of the state levying the tax, and no unjust or inconsistent results will develop if certain states continue to tax tangible personalty in the same manner as real estate. It should also be pointed out that our general plan would not be affected at any vital point if some state, like Wisconsin and New York, should prefer to exempt tangible personalty from all taxation. Here, again, it would be wholly a question of what a state might prefer to do with subjects of taxation lying within its exclusive jurisdiction. It is true that uniformity in methods of dealing with tangible personal property is desirable, and diversity will produce certain inconveniences and difficulties; but these, although undesirable, will not be so vital as to jeopardize the success of our plan, and will not involve any questions of interstate comity.

SECTION 17. The next recommendation we make is that uniformity in the methods of taxing tangible personal property is extremely desirable, and that every possible effort should be made to this end. A uniform tax date throughout each state, and even throughout the United States, is obviously to be desired. Uniform methods of valuation can in many cases be worked out. Our committee has not the information needed to enable us to make definite recommendations along these lines, but believes that practical results can be readily secured by committees of tax officials appointed by the National Tax Association.

SECTION 18. Our next observation concerning the taxation of tangible property is that effective administration is indispensable. Under purely local administration there never has been, and probably never will be, a satisfactory assessment except here and there in a few progressive localities. The primary work of assessment will, of course, continue to be done by local authorities; but it is essential that such work should be supervised, and where necessary controlled, by a competent state tax commission or tax commissioner. To this subject we shall hereafter recur.

SECTION 19. In the taxation of property under the plan proposed, certain special problems will be encountered. Public-service corporations, for example, are now frequently taxed by methods different from those applied to other classes of property, and must doubtless continue to be so taxed. Our plan, strictly applied, would require that only the tangible property of such corporations should be subject to taxation, and that the taxation of gross receipts and the *ad valorem* taxation of corporations as going concerns should be abandoned. But such radical changes are not necessary, provided that existing methods are adapted to the general plan of taxation here outlined and certain adjustments are made in connection with the business tax which we herewith recommend. Uniformity of method, as we all know, is not necessary in order to secure substantial equality in taxation, and all that can be required of any proposed system is that it shall produce substantial equality in its net results.

We, therefore, do not recommend that either the taxation of gross receipts or the *ad valorem* taxation of public-service corporations as going concerns shall be discontinued wherever these methods are in successful operation. But we are obliged to point out that in many, and perhaps most, cases the amount of such taxation should be reduced or else that relief should be given to public-service corporations in connection with the business tax. When public-service corporations are assessed as going concerns, it is evident that they are more heavily taxed than other business enterprises which are subject to taxation merely upon their property, considered as property, and without reference to their value as going concerns. When a corporate-excess tax is applied to all corporations, equality may then be secured between public-service corporations and other incorporated com-

panies; but it is evident that unincorporated concerns escape with a lighter tax than successful corporations are required to pay.

It seems clear to the committee that when public-service corporations are assessed under an *ad valorem* system as going concerns, while other kinds of business are not, they are to-day discriminated against, and will be under our proposed system unless relief is given at some other point. The system we propose enables us to recommend such relief. We propose that, in addition to the personal income tax and to the tax upon tangible property, there shall be a business tax as hereafter outlined. Wherever public-service or other corporations may continue to be taxed as going concerns by a method which involves the taxation of what is commonly called the corporate excess, or the good will, of such companies, we recommend either that they be wholly relieved of the business tax, or that the rate of such tax be reduced to a figure that will fairly offset the extra burden of taxation imposed upon them by the property tax.

In the taxation of gross receipts a similar adjustment is necessary wherever such taxation is in lieu of, and is substantially equivalent to, the taxation that would otherwise be imposed under an *ad valorem* tax upon corporations as going concerns. Concerning the comparative merits of the tax on gross receipts and *ad valorem* taxation, it is unnecessary for us to express any opinion. We should probably be disinclined to recommend a change in the taxes on gross receipts now levied by such states as Minnesota, California, or Connecticut; and we should be equally disinclined to recommend a change in the *ad valorem* system now in successful operation in a state like Wisconsin. Diversity of method is not inconsistent with real equality in taxation, and at this point we content ourselves with a mere expression of our approval of the conclusions reached some years ago by the committee appointed by the National Tax Association to consider the Taxation of Public-Service Corporations.[1]

The recommendations which we make concerning public-service corporations are equally applicable to other classes of incorporated companies. Our proposed system uniformly applied would require that stockholders and bondholders pay a personal income tax upon their interest and dividends, that the corporation be taxed upon its tangible property, and that finally the

[1] *Proceedings of the National Tax Association*, Vol. VII, pp. 372–383.

corporation pay a business tax in any locality where its operations are carried on. But it will not be inconsistent with the general plan if particular states prefer to continue other methods of taxing the property of corporations, provided that they make the adjustment we have recommended in connection with the business tax. It would merely serve to divert attention from the general plan we recommend if we undertook at this time a detailed examination of the merits and demerits of the various methods now employed in the taxation of business corporations.

SECTION 20. In the taxation of national banks a special complication arises on account of the limitations imposed by the federal statute which now controls the taxation of shares of the capital stock of these institutions. The result, as we all know, is that at present the states are confined to the taxation of all banks, state and national, by a single method. It is also a fact that, when bank shares are taxed upon their full value at the prevailing local rates of taxation, they are taxed more heavily than most other classes of property under the property tax. The solution of the difficulty is not easy to find, and the committee has not attempted to provide one. For the purpose of this report, we prefer to call attention to the situation, and to recommend that the National Tax Association appoint a special committee to work out a plan of taxing banking institutions in a manner consistent with the general scheme of taxation here outlined.

SECTION 21. Mines and other mineral properties also present peculiar difficulties arising from the nature of the mining business. In the time at its disposal the committee has been unable to consider, except in a general way, the subject of the taxation of mines, and only a few of its members are qualified to deal with the subject. We are agreed that mines should pay, under whatever method may be adopted, a tax commensurate with that paid by other real estate in the same taxing district. But further than this we are unable to go at this time. In view of the peculiar nature of the industry, we are of the opinion that the subject of mining taxation should be considered by a special committee appointed by the National Tax Association, and we so recommend.[1]

[1] Acting on this recommendation of the committee, the executive committee of the National Tax Association has authorized the appointment of a special committee to investigate the subject of the taxation of mines and other mineral properties.

SECTION 22. Forests as well as mines present peculiar problems which seem to us to need consideration by a committee possessing special qualifications for the task. We are of the opinion that no special favors should be extended to owners of forest lands; but we are impressed by the fact that many students of the subject are of the opinion that an annual property tax discriminates against forest properties, and discourages the adoption of rational forestry practice. We are unwilling to express any opinion upon this subject; and we therefore recommend that the National Tax Association appoint a special committee to investigate the subject of the taxation of forests.

These are the principal problems to which the committee desires to call attention. Doubtless there are others, connected with the taxation of ships, of machinery, and perhaps of merchandise, which may well require further study by special committees; but concerning them we make no recommendations at this time.

V. THE PROPOSED BUSINESS TAX

SECTION 23. If it had been possible to reconcile in a satisfactory manner the legitimate claims of the several states of the American Union without recommending, in addition to the income and property taxes, a separate tax upon business, the committee would have preferred to do so. But we find that many states are now levying what are in name or in fact business taxes, upon the theory that they have a right to levy taxes upon business done within their jurisdiction. This claim appears to us to be reasonable, and we find no other method of satisfying it that is consistent with interstate comity, except that of levying a properly constituted business tax as a part of the proposed system. Perhaps the decisive consideration in the minds of the committee is that the income taxes which are now being introduced in a number of the states generally combine the idea of personal with that of business taxation in a manner which, if it continues and is extended, will necessarily result in a large amount of unjust double taxation. These income taxes are imposed upon residents, on the theory that a citizen owes a personal obligation to the government under which he lives; and they are also imposed upon incomes earned within the states by nonresident individuals and corporations, upon the theory that since

the business is carried on there the income from the business is properly subject to taxation. The result is in many instances a new form of unjust double taxation of interstate industries and investments, which is likely to increase unless a suitable remedy is found.[1]

The committee is also influenced by the fact that the many taxes now imposed upon business, in the form of licenses or otherwise, by various states are an important factor in the whole problem of state and local taxation, which has usually been neglected, or even ignored, in discussions of the subject. These taxes are frequently illogical in their structure, and unequal and vexatious in their practical operation. No plan of state and local taxation can possibly ignore their existence, since there is no likelihood that the states will surrender the right to tax business carried on within their jurisdictions. Viewing the matter from this angle, therefore, we are convinced that a properly constituted business tax must be included in our proposed system of taxation. To those who may be inclined to question the wisdom of adding a business tax to the proposed combination of income and property taxes, we suggest that the committee is not recommending anything novel to American experience, but is merely proposing to reorganize upon a rational and equal basis a form of taxation that is now prevalent in many of our states and is not likely to be abandoned except for some better form of business taxation.

It may be well to add also that for such a combination of income, property, and business taxes there are precedents in the legislation of other countries. The original French system of direct taxation established by the Constituent Assembly pro-

[1] The difficulty is only partly remedied by provisions for taxing in any state where business is carried on only a proportionate part of such business. If a resident of one state receives dividends from shares of a corporation which owns a plant in a second state and carries on business in a third where it is subject to taxation upon an amount of income corresponding to the business transacted in that state, the stockholder's dividends will be taxable in the first state under the theory of personal taxation, the property and part of the corporation's income will be taxed in the second state under the general property tax, and a part of the income will be taxable in the third state; whereas, if the stockholder had lived in the state where the plant was located and the corporation had done all its business in that state, only one tax would have been levied in respect of the corporation's income.

vided for a personal tax, which was regarded as a substitute for an income tax, a tax upon land and buildings, and a tax upon business. Other taxes were subsequently added to the original system, but the three taxes just mentioned have continued down to the present day. In the principal German states an income tax has been combined with taxes levied upon land, buildings, and business, in a manner similar in principle, though not in its application, to the system of direct taxation established in France in 1791. There is, therefore, no lack of precedents for the recommendation which the committee has made.

SECTION 24. In the taxation of business various methods may be employed. The tax may be levied in the form of a license or as an ordinary tax. Its amount, if not a fixed sum, may be determined with reference to the net income of a business enterprise, the gross receipts, the rental value of the premises occupied, the size of the town or city in which the establishment is located, the number of employees or the number of machines in use, or, finally, the amount of raw materials used by a manufacturing enterprise or the amount of goods purchased by a mercantile concern. In some cases, as that of the French business tax, a number of these elements are taken into account in determining the amount of a taxpayer's contribution. Generally considered, the various methods resolve themselves into three: first, the imposition of a tax of fixed amount; second, the levy of a tax upon net income; and third, the adoption of various external indicia, such as gross receipts, rentals, and the like, which are considered to be approximately fair indications of the profits of a business.

It is evident that a tax of fixed amount, such as is often imposed by license taxes, even though the amount may vary for different trades and occupations, cannot, on account of its inequality, be recommended as an adequate method of taxing business. In connection with licenses imposed upon certain occupations chiefly for the purpose of police regulation, a charge of fixed amount may be entirely wise and unobjectionable. But the case is very different with a tax levied with a view to obtaining revenue.

External indicia of business profits may be adopted as the basis of a system of business taxation with very tolerable results. They produce a certain amount of inequality, since none of the

indicia can lead to anything but a very rough approximation of business profits. A combination of several indicia, such as gross receipts, rental values of premises occupied, and the number of employees, might, together with a proper classification of occupations and a carefully adjusted schedule of rates, result in a form of business taxation that would operate as well as, let us say, the French business tax. But administrative difficulties multiply as the basis of taxation is made more complicated, so that ultimately a point is reached where such a system becomes less convenient and in some ways more troublesome than a system which at the start adopts net income as its basis.

SECTION 25. The committee has come to the conclusion, therefore, that the proposed business tax should, except in certain cases, be levied upon the net income derived from business carried on within the state levying the tax. Prior to the coming of the federal income tax, it would probably have been unwise and impracticable to adopt net income as the basis of business taxation. But to-day every business concern of any considerable size is obliged to make a return of its net income to the federal government; and it is, therefore, both practicable and convenient to impose a business tax upon net income. This will involve, of course, in the case of interstate concerns, the determination of the proportion of the income derived from business carried on in each state. But there are practicable methods of making such a determination, so that no serious difficulty need arise at this point. With proper administration, we believe that a tax thus levied upon net income will be so far superior to any tax levied according to external indicia of business profits that there can be no doubt concerning the advisability of adopting it.

There may, however, be certain cases in which an exception should be made to the general rule. Concerns so small as to be exempt from the federal income tax might be taxed upon their gross receipts, their gross purchases, or the rental value of the premises occupied, with the provision that the tax in no case should be less than a certain minimum amount, perhaps $2. In any case where the apportionment of net income from an interstate business is peculiarly difficult, it may be that an adequate tax upon gross receipts within the state should be substituted for a tax upon the net income. The desire to secure equality should not lead us to adopt a Procrustean method, which per-

mits of no adjustment to meet special cases. But we believe that only genuinely exceptional cases require any departure from the general rule, and suggest that the burden of proof rests very decidedly upon anyone who asks for exceptional treatment.

SECTION 26. Obviously the rate of the business tax should be proportional and not progressive. Neither the absolute amount of the net income nor the relation it bears to the invested capital has any bearing upon the question of how much a business concern should pay for the benefits it derives from the government under which it carries on its business. A concern which invests a large capital, and therefore earns a large income, cannot be assumed to benefit more than in direct proportion to the size of its investment or the amount of its income; while the relation of the income to the invested capital is an indication of the success with which the business has been managed rather than the amount of public service which it has received. Moreover, in practice, graduation of rates will produce difficulties which are bound to react unfavorably upon the general administration of the law, since it will produce in many cases absurd results which cannot be remedied except by the arbitrary discretionary action of the tax officials.

The actual rate of the tax should be moderate. Where the business requires the employment of a substantial amount of tangible property, the business tax will be in addition to a tax paid upon that property; and in cases where the business employs little or no property in a particular locality, it is evident that the concern is making but comparatively small demands upon the services of the government. One per cent of the net income derived from business done in the locality would be a very light tax; and we believe that, in general, a tax of 2 per cent of such income would be adequate. Exceptional conditions in particular states may justify higher rates, but we believe that the rates in no case should exceed 5 per cent, and that very exceptional conditions would be required to justify such a high rate for a business tax levied as a part of such a system as we propose.

SECTION 27. It seems clear to us that the administration of a business tax must be placed in the hands of the state tax commission or tax commissioner. All the considerations which make it desirable that the personal income tax should be administered by state rather than by local officials apply with

equal force to a business tax levied upon net income; while there is the further fact that, if the state administers the personal income tax, it can administer the business income tax more conveniently, economically, and efficiently than any county or municipal authorities. The same is true of any tax that may be levied in exceptional cases upon gross receipts in lieu of net income. Upon the other hand, taxes levied in exceptional cases upon the basis of rental values, or levied in fixed amount upon particular occupations requiring special police regulation, may be left to local administration.

SECTION 28. The proceeds of the proposed business tax may well be divided between the state and local authorities in due proportions. Our recommendation is that the states retain a proportion corresponding to that which state revenues or expenditures bear to the total state and local expenditures or revenues, and that the remainder should be turned over to the taxing district in which business is carried on. The details of the plan of distribution may well vary from state to state, but this general rule seems to us a satisfactory general guide.[1]

SECTION 29. It goes without saying that the business tax we recommend is proposed as a substitute for all existing business taxes. The diversity, multiplicity, and inequality of the existing taxes levied upon business by both state and local authorities in many commonwealths have long constituted serious evils, and the time has certainly come when better methods should be adopted. Unless the business tax is imposed by a single assessment, the revenue being distributed as we propose, it is obvious that the desired end will not be accomplished. There is great need of a simple system, admitting as few exceptions as possible, and uniform so far as practicable in all the states which desire to levy business taxes. There is need also of better administration, which can be secured only through state authorities, as we have recommended. We are proposing, *in fine*, the adoption of a comparatively simple and uniform system of business taxation in place of the multifarious, vexatious, and frequently unequal methods now employed in many of our states.

In concluding this subject, we may point out that under our proposed system there is no necessity that any state which prefers to dispense entirely with business taxation, except minor

[1] See, however, page 531.

license taxes such as are everywhere imposed for police purposes, should adopt a business tax if it prefers not to do so. It may well be that some states will consider that a personal income tax and a tax levied upon tangible property meet fully the needs of their situation, and may, therefore, be reluctant to adopt the third proposed tax. To such we say that there is no necessity of doing so if a state is willing to renounce completely the claim to impose a tax upon business, as business, simply because it is carried on within its jurisdiction. A state will do nothing opposed to interstate comity, will impose no unjust double taxation, and will not interfere with any other state which desires to impose taxes upon business, if it decides not to assert the principle upon which the taxation of business is founded. This will mean necessarily that non-resident individuals and corporations employing little or no tangible property within its jurisdiction, but carrying on business and earning substantial profits there, will not be required to contribute to the support of its government. We have nowhere asserted that it is every state's duty to make such persons or business concerns contribute, but have merely recognized that it is reasonable for any state to do so if it desires. Our argument has merely been that, if interstate comity is to be respected and unjust multiple taxation avoided, any state that taxes business must levy a tax upon *all* business done within its limits, whether conducted by individuals, partnerships, or corporations, and must not levy its personal income tax or its taxes upon property or corporate franchises in such a manner as to impose unequal, and therefore unjust, multiple taxation upon interstate business and investments. We have, in a word, undertaken to provide a reasonable, fair, and practicable method of business taxation which any state can employ consistently with the rules of interstate comity; but we have not argued that every state ought to adopt this form of taxation, irrespective of its particular situation and fiscal needs.

VI. Summary of the Proposed System of Taxation

Section 30. At this point it is desirable to consider as a whole the proposed system of taxation. In the first place, it is evident that this system will satisfy every legitimate claim of any American state. It provides that all persons shall be taxed fairly and

fully at their place of domicile for the personal benefits they derive from the government. It provides that all tangible property which any state may desire to tax shall be taxed fully at its situs for the governmental services it there receives. It eliminates the taxation of intangible property, as property, because such taxation cannot be carried out without a large amount of unjust double taxation. And, finally, it provides a method by which any state which desires to tax business may do so in a fair and effective manner. No single tax levied either on income or property could possibly satisfy all of these claims, unless all the states, by formal agreement, should adopt a plan by which one tax would be levied upon interstate business and investments, the proceeds of which would be distributed in some agreed proportions between the states of domicile, the states where property is located, and the states in which business is carried on. Such an agreement we believe it is impossible to secure; and we have, therefore, recommended three separate taxes, each of which can be levied in such a manner as to enforce fully, fairly, and consistently the taxation of the subjects it is intended to reach.

SECTION 30(a). In the second place, it is evident that the combination of taxes we have recommended will give better results than any one tax, however levied, which is made to yield the same amount of revenue. With the best-drawn law and the very best of administration, there will always be a certain amount of inequality in the operation of any tax. If, therefore, all the revenue needed is derived from but one tax, such inequality as inevitably arises will be concentrated at a few points where it cannot be mitigated. But under a system by which the same amount of revenue is collected from separate taxes levied upon income, property, and business, it is clear that such inevitable inequalities as arise in the working of any one tax may be, and to a considerable extent must be, offset or mitigated by inequalities arising under the others. By the mere law of probability, it must happen that the inequalities arising under the three separate taxes will not all be concentrated at the same points, and that some of them will to a certain extent compensate for others. This is one of the reasons why a double system of income and property taxation has worked well in certain European countries and has met with increasing favor from students of taxation and

practical administrators. We regard this compensatory action of the three taxes we have recommended as an important argument in favor of our proposals.

SECTION 31. A third point to be emphasized is that the system here recommended will bring about heavier taxation of funded incomes than unfunded, without requiring the states to undertake the very difficult task of differentiating the rates of their income taxes. That funded incomes should be more heavily taxed than unfunded, nearly all will agree. At the same time, it is certain that the attempt to levy an income tax at different rates on different kinds of income greatly complicates the administration of the tax, and raises difficult problems which any one familiar with the practical side of tax administration would desire to avoid. But it is evident that, by combining a tax upon property with a tax upon income, we shall in effect impose heavier taxation upon funded incomes; and therefore the net result of our tax system will be to secure differentiation without undertaking the very difficult task of differentiating the rates of the income tax.

SECTION 32. Finally, the committee desires to point out that, although the proposed system prescribes certain lines of action which must be followed if interstate comity is to be observed, it admits of considerable elasticity at other points. The personal income tax does, indeed, require definite rules which cannot be violated without undesirable results. It must be levied upon persons at their place of domicile, and must not be levied upon the income from property at its situs or the income from business at the place where business operations are carried on. The property tax, however, permits of such adjustments in the taxation of corporations, mines, forests, and certain other things as may be necessary to fit existing taxes into the proposed system or to improve existing methods which may be deemed to be unsatisfactory. The business tax also permits such adjustments as may suit the conditions of different states. The committee is obliged to insist that, if such a tax is levied, it should be levied equally upon all business carried on within the state, under whatever form of organization it is conducted, since this is the only manner by which unfair burdens on interstate business can be avoided. But we see no reason why every state ought, from the nature of the case, to impose business taxes; and while we recommend a tax upon net income as the best form of business tax,

we have pointed out that in special cases taxation upon the basis of external indicia may be preferable and entirely consistent with our general plan of taxation.

SECTION 33. A word should be said concerning the relation of our plan to the classified property tax which for some years has played no unimportant part in discussions of state and local taxation. It is evident that the flat tax upon intangibles, which is a part of every classified property tax, is unnecessary under the scheme we propose. The purpose of the tax on intangible property is chiefly to enforce the principle that every citizen, no matter where his investments are located, should pay a direct tax to the government under which he is domiciled. It is evident that this purpose is fully carried out by the personal income tax which we have recommended, and, therefore, we have not recommended any tax on intangible property as a part of our proposed plan. With intangibles eliminated from the operation of the property tax, we have left only the question of how tangible property shall be treated; and we have recommended that tangible personal property be separated from real estate and made subject to a lower rate of taxation. It will be seen, therefore, that, so far as tangible property is concerned, our plan is based upon the idea underlying the classified property tax, and that our plan differs from the latter chiefly by reason of the fact that it eliminates wholly the taxation of intangible property.

The relation of existing state income taxes to the proposed plan should also be considered briefly. The Wisconsin income tax is in part a personal income tax like that which we propose, and in part a tax upon business income. A part of it, therefore, would find its place naturally in our proposed personal income tax, and the other part could readily find a place in our proposed business tax. The Massachusetts income tax is throughout its entire structure a personal tax, since it is in no case levied upon non-resident persons or interests. It is, therefore, a proper nucleus for a personal income tax, but fulfills in no respect the functions of our proposed business tax. The corporation income taxes of Connecticut, New York, West Virginia, and Montana may be classified as business taxes, and with certain modifications can readily meet the requirements of our system. Some of the other state income taxes, which have been modeled after the federal income tax, are more difficult to classify and

violate some of the principles we have advocated; but they at least serve to establish the principle of state taxation of income, and can be remodeled in a manner conforming to the requirements of the plan we propose.

VII. Tax Administration

Section 34. Since the best tax laws will not work satisfactorily if they are badly administered, the committee desires to submit some observations and recommendations concerning administration. It is well known that many of our states, by creating tax commissions or appointing tax commissioners, have greatly improved the administration of their laws in recent years; but it is also known to all that, taking the country as a whole, there is still need of great improvement in tax administration. We have already made several recommendations concerning the administration of the particular taxes which we have proposed, but we are unwilling to submit our new system without considering more broadly and generally the subject of administration.

Section 35. In the United States the assessment of property has always been entrusted to local officials, and doubtless will continue to be performed by local agencies. The local assessor, therefore, is a vitally important part of our system of administration; and if his work is not well performed, no mere process of correction will ever bring about a good assessment of property. We are in complete agreement with the conclusions reached by the committee appointed by the National Tax Association a few years ago to consider the subject of the administration of tax laws.[1] Besides endorsing the findings of that committee, we desire in this report to make the following specific recommendations:

A. Assessment districts should be large enough to justify the employment of at least one permanent official in each such district, who should receive a salary sufficient to make it possible for him to give all his time to the work. Such permanent assessors should be provided with well-equipped offices, a suitable number of permanent clerks, and such part-time assistants as

[1] For the report of this committee, see *Proceedings of the National Tax Association*, Vol. IX, pp. 197–207.

may be needed for a short period in each year. Even if assessments are not made annually, there is always enough work of investigation and of keeping track of new developments to justify the employment of a permanent force. At present many assessment districts are too small to make proper compensation possible; and the result is that the work is done by persons who cannot give to it the time it ought to receive and seldom acquire the necessary expert and technical knowledge. Manifestly, the county is a better assessment district than the township; and, generally speaking, we may suggest that it is undesirable to erect assessment districts smaller than a county, unless such districts have a sufficient population to enable them to employ at least one permanent assessor and a suitable staff.

B. Whether assessors should be appointed or elected is a question about which there may be room for difference of opinion. The committee, however, favors strongly the method of appointment, since it does not believe that, other things being equal, elective officials can or will perform their work as efficiently as appointive. Recognizing, however, that there may be serious difference of opinion at this point, we make no specific recommendation; and content ourselves with recommending that, whether assessors are elected or appointed, they should serve for a term of at least four years in order that there may be reasonable continuity in their work and that there may be time for their policies to justify themselves by their results.

C. We recommend that all assessors, whether elected or appointed, be subject to removal for willful negligence or malfeasance in office. This power of removal should be placed in the hands of the state tax commission, which should be authorized, either upon complaint or upon its own motion, and after hearing all parties in interest, to remove a local assessor from office. This power is now given to the tax commission in certain states, and has led to excellent results. Even though seldom exercised, the very existence of such a power tends to prevent many abuses and to secure a more efficient administration of tax laws.

SECTION 36. That a permanent state tax commission, or tax commissioner, should be established in every state, is a recommendation which to-day requires no argument to support it. We will merely say that neither the system of taxation which

we recommend nor any other can be expected to give satisfactory results in states that refuse to place in the hands of some permanent central authority the administration of taxes upon incomes and inheritances, the original assessment of certain classes of property, and general supervisory powers over the assessment of all property subject to local taxation.

How this central authority should be constituted is naturally the next subject for consideration. We believe that experience has abundantly proved that a state board constituted of *ex-officio* members is totally inadequate for the work in hand. The members of such a board have other duties and responsibilities which have first claim upon their interest and time, so that they never become experts in taxation and seldom give adequate attention to their work as members of a tax commission. In states which are content to vest in *ex-officio* boards central control over the administration of their tax laws, we cannot expect satisfactory results from our proposed system of taxation, or, indeed, from any other.

Whether a tax commission is to be preferred to a single commissioner is a point upon which there is certainly room for difference of opinion. In many, if not most, of the states that have tax commissions it would have been impossible to secure enactment of laws vesting in the hands of a single commissioner the authority given to the commissions. Upon the other hand, some states have developed strong and efficient tax departments under the authority of a single commissioner, and evince no desire to change this arrangement. It is also true that the internal taxes of the United States are collected by a department which has at its head a single commissioner. The committee believes, therefore, that there is no reason to suppose that a commission is always to be preferred to a single commissioner, or that a tax department with a single head is always to be preferred to a tax commission; and concludes that the important thing is the adequacy of the resources and extent of the authority conferred upon the state tax department.

Where the commission exists, the members should be appointed, in classes, for terms of at least six years. Provision should be made that all the members of the commission should not belong to the same political party, and every effort should be made to remove their appointment from politics. The salaries

paid should be adequate to secure men of first-class ability, and removal from office should be authorized only for cause and after due hearing of all parties in interest.

The powers of the tax commission should include: (*a*) original assessment of all property or business that has a state-wide rather than a local character, all financial institutions, and public utility companies of every description;[1] (*b*) the assessment of the personal income tax and the tax on business incomes which we have here recommended, also the administration of inheritance taxes and any other state transfer taxes; (*c*) the equalization of property assessments for the purposes of state taxation and the equalization of county assessments whenever there are different assessment districts within a county;[2] (*d*) directive and supervisory power over the assessment of property, including the power to order reassessments and, if necessary, to appoint appraisers to reassess any property that local officials have not assessed in accordance with the law; (*e*) power of removal, after a hearing, of local assessors for inefficiency or misconduct; (*f*) authority to act as board of appeal in such cases as may be necessary; and (*g*) authority to investigate the entire subject of taxation, and to gather and publish comprehensive statistics concerning all matters of taxation and public finance.

SECTION 37. The committee has recommended that the proposed personal income and business income taxes should be administered by state rather than local authorities, and in the previous section we have pointed out that the state tax commission or tax commissioner should be entrusted with this work. For this purpose it is very desirable, and even necessary if the best results are to be secured, that a state should be divided into income-tax assessment districts of convenient size, each of which should

[1] Certain other classes of property, such as mines, may well be included in this list, but we will not undertake further specification.

[2] This recommendation means, of course, that there should be no separate state board of equalization. We are aware that in certain states where there are no tax commissions there are state boards of equalization which now possess some of the functions of a tax commission, and may at any time be clothed with other such functions. Such boards should be, as fast as possible, developed into competent tax commissions of the type that we recommend. Whether they would better retain their present names or be known as tax commissions is probably not a matter of great importance; but we venture to express our preference for the latter name.

be placed in charge of a district assessor of incomes, appointed by the state tax commission, or tax commissioner, and directly responsible to the same authority. The success of the Wisconsin and the Massachusetts income-tax laws is due in large part to the fact that the administration was placed wholly in the hands of the state tax departments. But it was due also, in no small degree, to the work of the district assessors who served the useful purpose of bringing the administration of the law home to the people of the several districts and helpfully decentralizing the work of administration. In the more populous states we believe that such a district organization is necessary for the successful operation of income taxes; and we, therefore, strongly recommend it. In the less populous states, it may be necessary for the state tax department to deal directly with all persons subject to the income tax. In all states the establishment of an income-tax bureau within the state tax department is absolutely essential.

It is obvious that district assessors of income may be advantageously utilized in the general supervisory work of the state tax commission or commissioner. Wisconsin now employs district assessors of income as supervisors of local assessors within their districts, and thus has established a useful connecting link between the state tax department and the local assessing boards. On other grounds, such an intermediary between the state and the local taxing authorities is very desirable; and we, therefore, point out that the establishment of district assessors of incomes will facilitate greatly the carrying out of the supervisory powers with which every state tax department ought to be clothed.

VIII. The Inheritance Tax

Section 38. In this report the committee has preferred to make no specific recommendation concerning the taxation of inheritances. Such taxes are now in operation in almost every state, and it is certain that they are a permanent part of our system of taxation. The committee strongly favors the use of the inheritance tax by the American states, and is in general accord with the various recommendations which have been made from time to time by committees appointed by the National Tax Association. We have felt obliged, however, to devote our attention principally to other subjects concerning which there is

greater diversity of opinion and greater need for thoroughgoing reforms. It is clear that none of our recommendations, if carried out, will interfere in any way with the levy of inheritance taxes by the states; and we have, therefore, concluded that further study of this subject could properly be left to some other committee, or undertaken by our committee in some subsequent year. Our decision is due solely to limitations of time, and does not imply lack of appreciation of the importance of the inheritance tax in any rational system of state taxation.

IX. Taxes upon Consumption

Section 39. In the course of its deliberations, the committee has had occasion to consider whether, in view of the great increase of state and local expenditures in recent times and the entrance of the federal government into the field of direct taxation which had hitherto been utilized exclusively by the states, it might be possible for the states to derive more revenue than in the past from taxes levied upon consumption. The taxes now levied by the states upon automobiles represent the sort of taxes which the committee has in mind. Taxes upon amusements, on non-alcoholic as well as alcoholic beverages, on hunting licenses, and a few other things, have been brought to our attention; but we have decided to make no recommendation upon the subject at this time. It is perfectly evident that, with the exception of automobiles, none of the taxes which have been suggested will ever be likely to constitute an important source of revenue; and we have preferred to concentrate attention this year upon the problems of chief practical importance. It may well be, however, that at some future time the National Tax Association will do well to appoint a committee to canvass carefully the possibility of supplementing existing sources of state and local revenue by taxes levied upon what may be fairly classified as luxurious consumption.

X. The Separation of the Sources of State and Local Revenues

Section 40. The proposal to separate the sources of state and local taxation has played a sufficiently important part in previous discussions of tax reform to justify a brief consideration

of that subject. We may first observe that the plan we propose does not require any separation whatever of the sources of state and local revenue, but that it is not inconsistent with the adoption of a thoroughgoing scheme of separation. Under our plan, it would be possible for many states to raise from the personal income tax a sufficient sum to defray the entire expense of the state government, so that the taxation of property could be turned over wholly to the local authorities; while the revenue from the business tax, although collected by the state, could either be retained by the state or distributed to the local governing units. We refer to this fact merely to emphasize our remark that the plan we have proposed will neither prevent the states from adopting the plan of separation, if they so desire, nor compel them to do so, if they prefer not to experiment with that plan.

The committee is of the opinion that a partial separation of the sources of state and local revenue is desirable, but that complete separation, by cutting the connecting cord between the state and local governments, tends to destroy the states' sense of responsibility in the matter of local taxation. There is no experience to justify the belief that, if the states turn over to the local governments independent sources of revenue, and adopt the theory that local taxation is an affair of purely local interest, we shall ever have a satisfactory administration of the tax laws by local officials. Experience abundantly shows that such officials need constantly the expert advice, intelligent guidance, and, when necessary, the effective control of a state tax commission composed of experts and keenly alive to the need of just and efficient administration of tax laws by local officials. Total separation of the sources of state and local revenue, at least in the forms in which it is usually presented, seems to the committee to be distinctly a backward step, especially at this moment when the need is for greater emphasis upon state control over the taxation of property for local purposes. A further difficulty of complete separation is that the abolition of the direct state tax upon property tends to remove a desirable check upon state expenditures.

The committee believes, however, that a partial separation of the sources of state and local revenue is desirable. The inheritance tax is obviously a proper source of state revenue. Taxes upon insurance companies and upon automobiles may very prop-

erly be allocated to the state rather than the local governments. Under special conditions it may be better that railroad taxes should be retained in the treasury of the state than utilized as a source of local revenue. From the taxes thus enumerated, it is obvious that states can, and should, derive revenues that are independent of local taxation; but we believe that it is desirable that a state tax on property should be retained as the regulator of the state finances and a reminder to the state of its responsibility for the proper assessment of property in every locality within its jurisdiction.

We have recommended that a part of the personal income tax, corresponding to the proportion which state expenditures bear to the total of state and local expenditures, be allocated to the state treasury. Such an arrangement will tend to lighten the direct state tax, but will not make such a tax unnecessary. We have pointed out that the distribution of the proceeds of the proposed business tax may well vary from state to state. We here suggest that whether the state should be assigned a share may well depend upon the comparative revenue needs of the state and the local governments. If the state tax is light, the entire revenue from the business tax may well be assigned to the local political units; and if the state tax is heavy, it would follow that the state might well retain a share of the business tax. Here, as elsewhere, the system we propose permits of different adjustments to suit the varying conditions of our several states.

XI. Amendment of State Constitutions

Section 41. As has been repeatedly set forth in the publications of the National Tax Association, it is certain that no important departures from the system of the general property tax are possible in many states under constitutional restrictions which provide that taxation must be uniform, equal, and proportional. That such constitutional limitations have, in fact, tended to secure neither uniformity nor equality in taxation, is also fully set forth in the *Proceedings* of the annual conferences of the National Tax Association and in various reports of special committees. Upon this subject the committee needs only to say that in states which are now limited by constitutional restrictions prescribing a uniform rule or method of taxation, no satisfactory

adjustment of tax problems can be reached until such limitations are removed, or at least modified. There may be room for difference of opinion concerning the form which constitutional amendments should take. Some states have preferred to adopt amendments authorizing specific departures from the uniform rule, while others have eliminated wholly the requirement of uniformity. The committee has concluded that it is unnecessary at this time to say more than that the plan of taxation which it recommends will require no more, and probably no less, amendment of state constitutions than any other plan adequate to the needs of the case.

CHAPTER XIV

PROBLEMS OF TAX ADMINISTRATION

59. Central Control of the Valuation of Taxable Subjects: by Samuel T. Howe.[1]—The chairman of the Kansas Commission discusses in the following selection some of the results of the work of state tax commissions.

The formation of the revenue systems of many of the states has not seemed to follow intelligent design. The systems have been built largely piecemeal; have been guided in growth sometimes by legislative thoughts of expediency, at other times by popular demands for changes in revenue measures inspired by the wiles of the demagogue who too often speculates upon the credulity of the uninformed, and at still other times by those able to influence legislation for their own selfish purposes.

Until comparatively recently, administration of many branches of public business in the states has proceeded quite independently of expert or scientific knowledge, but within the past two or three decades many states have realized the benefits which have come to other governments through the employment of experts in the various lines of service and are taking over approved methods in order to have like benefits within their own jurisdictions.

There is need of an educative movement so that the people may come to realize that there is in the land a great body of intelligent, able and high-minded students who by careful inquiry into past experiences of the race have become qualified to propose measures to law-making bodies which if placed on the statute books will greatly promote social welfare; and it should also become commonly known that large numbers of public servants in the various branches of service are earnestly seeking ways to improve the law and its administration so that the benefits

[1] Reprinted, by permission, from "Readjustments in Taxation," *Annals of the American Academy of Political and Social Science*, Vol. LVIII, March, 1915.

of government shall be enjoyed by citizens and its burdens borne by them in a relatively equal manner.

In keeping with the modern centralization of productive energies, there has been a centralization, though in much less degree, of governmental activities, much the larger part of the movement having occurred within the past one or two decades.

Real equality in laying taxes upon property requires relatively equal assessments of all property in a given assessment district, for within the district the rate of tax for district purposes must be uniform.

Some districts are a complex whole constituted by smaller districts as units, and may themselves be units in the formation of a still larger district. Ordinarily, a school district is the smallest area in which a particular tax rate is applicable; but school districts are seldom assessment districts; in combination with other like districts having different rates of levy for school purposes they form the township assessment district.

The township-district tax rate varies among the township districts, and all such districts unite with city districts to form the county assessment district. The rates of tax vary among the county districts but are uniform over their respective areas, and the county districts are units in the formation of the state assessment district, where the state tax rate applies to all property uniformly.

Thus the unit assessment district least in area may be the township or the county. Under the township plan, values for county purposes are fixed according to the varying opinions of numerous assessors who are seldom chosen because qualified for the work. Under the county plan, one judgment fixes all values, and it hardly needs saying that uniformity in assessment is here possible while it is impossible under the other plan.

Boards of equalization are functionaries common to the states, and as the name implies are designed to remove inequalities in the assessment. Experience shows that such boards are not able to furnish all the remedies provided by law. They lack a knowledge of the conditions which surround individual taxpayers, and do not have the time during the assessment period within which to acquire the information necessary to advise them as to the condition of all taxpayers in their respective jurisdictions, and this knowledge is a prerequisite to a removal of inequalities which

may occur in the local assessment. Individuals who complain in legal form may have relief, but those who lack the information of how to proceed to obtain relief and those who discover their grievances too late to apply for it must go without a remedy.

It follows that equality in the original assessment is the indispensable condition of a real equality in laying taxes, and that the larger the area covered by one assessing power the greater will be the uniformity of valuation among taxpayers.

Logically the centralization of the actual work of assessment should be with the authorities of the state district so long as the state tax levy is laid upon all property in the state; but the great burden of taxation arises from local tax rates, and a centralization of the assessment work in the county authorities with a directory and supervisory control by the state will afford a method both practical and expedient, and therefore suitable to achieve the desired end.

Ideal centralization involves the control of the machinery of assessment, and this means of course appointive instead of elective assessors. In no other way than by appointment is it possible to select assessors because of their qualifications and to continue them under civil-service rules so long as they prove to be efficient. Centralization is thus necessary for general tax purposes, and the prevalent emphatic movement toward centralization affirms its desirability and expediency.

However, the unsatisfactory results attending the assessment of certain forms of corporate property by a divided responsibility first led to centralization. It was quite early in the history of these corporations found to be utterly impracticable to assign to numerous persons the valuation of parts of a railroad, a telegraph or a telephone line situated in the different districts through which the railroad or the other lines were constructed, and soon it became the policy to create state boards to assess this class of property. The property of such corporations being usually public-service corporations and subject to local tax rates, justice required that it be assessed in a relatively equal manner with local property; but this proved to be a difficult proposition, because the railroad or other line was assessed by one authority at a uniform value in all the districts through which it passed, while local property as valued by the local authorities varied greatly in the different districts from the uniform

value of the railroad or other line. Because of the resulting wide variation from a single standard of valuation there arose inevitably the need of a central authority to place all property upon the same basis of actual value, and state boards of equalization, tax commissions or other central bodies were a natural growth.

In 1842 there came a degree of centralization in New Hampshire, and in after years more or less centralization occurred in other states: in Indiana, in 1851; Massachusetts, 1865; Dakota, 1868; Kansas, 1869; Missouri, 1871; Illinois and Iowa, 1872; Arkansas, 1878; California and Wyoming, 1879; New York, 1880; Vermont, 1882; New Jersey, 1884; North Dakota, South Dakota and Washington, 1890; Rhode Island, 1898; Wisconsin, 1901; Nevada, 1903; Oregon, 1909; Ohio, 1910.

The method was first developed largely in connection with the assessment of public-service corporations operated interstate or intercounty, but gradually the central bodies were reformed and given additional powers tending to the control of general assessments.

Important powers lodged with permanent tax commissions or with bodies having analogous duties to perform are the following:

The administration of oaths in all matters concerning proceedings in connection with the discharge of official duties.

The formulation and promulgation of a uniform method of keeping tax rolls and other records relating to taxation, for use in all counties of the state.

The formulation and promulgation for use in the several counties of all forms necessary in the listing, assessment and return of property and collection of taxes.

Power to exercise a general supervision over and to direct county assessors in the performance of their duties.

Authority to investigate generally the condition of the system of taxation throughout the state in order to report to the legislature needed changes in the system designed to promote a general equality of taxation.

The power to require local officers having to do with assessment and the collection of taxes or the disbursement of public funds to report in such form as the central body may require, information bearing upon any investigation being made; and in such investigation to call upon individuals and corporations for

information bearing upon the subject of taxation; to examine books and papers; summon witnesses to appear and testify and to produce books and papers before it at a time and place to be appointed by it.

Authority to prescribe all needful rules not inconsistent with law for the orderly, methodical and effective performance of its duties as a board of assessment or otherwise, and for conducting hearings and other proceedings before it.

Authority to exercise a general supervision over the administration of the assessment and tax laws of the state, over the township and city assessors, boards of county commissioners, county boards of equalization and all other boards of levy and assessment to the end that all assessments of property, real, personal and mixed, be made relatively just and uniform.

Power to confer with, advise and direct assessors, boards of commissioners, boards of equalization and others obligated under the law to make levies and assessments as to their duty under the statutes.

Power to direct proceedings, actions and prosecutions to be instituted to enforce laws relating to penalties, liabilities and the punishment of public officers, persons and officers or agents of corporations for failure or neglect to comply with the orders of the central authority or with the provisions of law governing the return, assessment and taxation of property; and to cause complaints to be made against assessors, county commissioners, county boards of equalization or other assessing or taxing officers in the courts of proper jurisdiction for the removal from office for official misconduct or neglect of duty.

Power to call upon the attorney general of the state or the county attorney of the respective counties to assist in the commencement and prosecution of actions and proceedings for penalties, forfeitures, removals and punishments for failure to observe the tax laws of the state.

Power to require township, city, county, state or other public officers to report generally upon matters of taxation, and particularly to make and prosecute research and investigation concerning the detailed properties of corporations, the business, income, reasonable expenditures and true values of the franchises and properties of all public-service corporations doing business in the state.

Power to summon witnesses from any part of the state to appear and give testimony and to compel such witnesses to produce records, books, papers and documents.

Authority to cause the depositions of witnesses residing within or without the state or absent therefrom to be taken in accordance with the customary practice in taking depositions.

Power to make appraisement and assessment of the property of all public-service corporations which are not confined to the limits of a single county.

Power to require any county board of equalization at any time after its adjournment to reconvene and to make such orders as shall be determined to be just and necessary, and to direct and order such county boards of equalization to raise or lower the valuation of the property, real or personal, in any township or city, and to raise or lower the valuation of the property of any company or corporation; and to order and direct any county board of equalization to raise or lower the valuation of any class or classes of property, and generally to do and perform any act or to make any order or direction to any county board of equalization or any local assessor which may seem just and necessary in order that all property shall be valued and assessed in the same manner and to the same extent as any and all other property, real or personal, which is required to be listed for taxation.

Power to prosecute any member of any board of county commissioners and any assessor for violation of any of the rules and regulations which may be prescribed by the central body, or the violation of any statute of the state relating to assessment of property and the collection of taxes.

Power to prescribe a list of questions to be answered by taxpayers or other persons.

Power to sit as a state board of equalization and to equalize the assessment of property throughout the state; to equalize the assessment of all property in the state among persons, firms, or corporations of the same assessment district, among cities and townships of the same county, and among the different counties of the state, and the property assessed by the said central body in the first instance; the equalized value so fixed to be adopted as the assessment roll for the extension of all tax rates, state and local.

Power to order a reassessment of all or any part of the property assessed by the local authorities in any given assessment district; such assessment to be made by assessors appointed by the central body and the assessment to be made at the expense of the district so reassessed.

Power to remove county assessors for dereliction in duty and to approve of the removal by the county assessor of deputy assessors.

All of the above powers—and others of less importance not mentioned—have been given to one or more permanently organized central bodies, and are illustrative of the modern tendency to organize the business of taxation upon lines of efficiency.

The responsibility thus placed with some of the central bodies is very great, and calls for a large knowledge and a wise discretion in the performance of duty. Power, and an inclination to its full use, usually go hand in hand. Careful deliberation before the exercise of authority is very important, and it will be found many times that power held latent but ready for use will be fully as effective for good as if it were exerted.

One form of centralization is yet to come, and this will be in relation to corporations operating transportation and transmission lines interstate. There is at least as much justification for a centralized assessment of the property of these corporations as there is for a central assessment of like property of lines crossing several districts within a given state. In fact, such centralization would seem to be more needed because under the irresponsible divided system now obtaining there is a tendency on the part of states to reach out and import values pertaining to property of public-service corporations operating interstate. Just how this centralization will come is a matter of speculation. The power of assessment may be lodged in a body raised by Congress, or the central body may be appointed jointly by the states interested, under some federal law of control, with proper provision for a division of the value of the property of particular lines of transportation or transmission among the states through which the lines are built.

The revenue systems of the states are so diversified, and the duties required of central boards are so many and varied, that classification of the boards is very difficult.

An interesting classification of central boards that are charged with the duty of corporate assessments in one form or another

may be found in Part V of the valuable report of the federal commissioner of corporations on the taxation of corporations, made to the department of commerce.

In the first class are included wholly *ex officio* boards or officers, and these exist in New York, Pennsylvania, Delaware, North Dakota, Iowa, Nebraska, Missouri, Montana, Idaho, Wyoming and New Mexico. (Since the report a permanent tax commission has been created in North Dakota.)

In the second class are the boards, one or more members of which are *ex officio* and the remaining members are specially chosen either by election or appointment. The boards of this class are found in Connecticut, Indiana, Illinois, Michigan, Oregon and California.

The central authorities not classed as above indicated have memberships wholly selective and are in the following states: Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, New York, New Jersey, Maryland, Ohio, Wisconsin, Minnesota, North Dakota, South Dakota, Kansas, Colorado, Utah, Nevada, Washington and Arizona.

Boards or officers having central authority are variously named as follows: comptroller, auditor general, state treasurer, state auditor, secretary of state, state board of equalization, state executive council, state board of equalization and assessment, tax commission, state board of tax commissioners, state board of assessors, state board of appraisers, commissioner of taxes, etc.

The classification mentioned above was prepared by the commissioner of corporations with relation only to the central assessment of corporate property. To harmonize with what is here said a different arrangement is needed. The nomenclature of the central authorities is so varied that one or another name must be selected to designate a class of which the members may be variously styled. A consideration of the functions of the central authorities naturally suggests a threefold classification, *i.e.*:

I. Authorities that are charged only with the assessment of corporate property or the determination of the amount of tax due from certain corporations.

II. Those that have not only the duties of the first class to discharge but in addition are required in some degree to equalize assessments in general.

III. Those that perform not only the same duties that are imposed upon members of classes I and II, but are required also to exercise a directory or supervisory control of the work of local assessors.

Class III is under consideration in the preparation of this paper, and its members may be generally designated as "permanent tax commissions."

Among the individuals of the class, centralization is more or less differentiated. The Indiana commission was the first body to be granted what may be called extraordinary powers, and as the other states have since created similar commissions in rapid succession, the policy has been to give added powers until in a few jurisdictions the commissions have practically all the authority that is needed.

As the benefits of centralization have been perceived there have resulted also increased powers to the earlier created bodies. The only thing which tends to check the movement towards centralization is the separation of the sources of state and local revenue. In states where this system has been provided, the tendency is naturally away from centralization except as to the assessment of property which provides the state with revenue.

States which have members of class III appear in the table on page 542 in chronological order of creation, as near as could be ascertained; and also there are given the dates when the commissions were organized, so far as such information is available.

In Wisconsin an income tax has largely replaced the personal property tax, and the tax commission appoints all assessors of incomes. In Ohio, deputy state tax commissioners are appointed by the governor, and are subject to removal by the tax commission with the consent of the governor. Deputy assessors are appointed by the deputy state tax commissioners, but all are under the absolute control of the tax commission. The Ohio commission is among the latest creations, and as the result of the benefits of centralization observed in other states has been assigned nearly all the powers that have been devised to give full centralized control of assessments.

In a few other states the commissions have power to appoint assessors, but this ideal power has not yet been extensively bestowed. Efficiency in this branch of the public service will

States	Date of Law	Date of Organization
Maine	March 26, 1891	1891
Massachusetts	1891	1891
Indiana	1891	1891
New York	1896	1896
Michigan	1899	1899
Wisconsin	April 19, 1899	June 7, 1899
Connecticut	1901	July 1, 1901
North Carolina	1901	1901
West Virginia	Aug. 11, 1904	Nov. 28, 1904
New Jersey	March 29, 1905	April 3, 1905
Texas	April 17, 1905	Aug. 13, 1905
Washington	1905	1905
Alabama	1907	1907
Kansas	March 7, 1907	July 1, 1907
Minnesota	April 25, 1907	April 27, 1907
Arkansas	May 12, 1909	May 18, 1909
Oregon	1909	1909
Wyoming	1909	1909
Ohio	May 10, 1910	July 1, 1910
New Hampshire	April 15, 1911	May 1, 1911
North Dakota	1911	July 1, 1912
Colorado	June 2, 1911	May 20, 1912
Rhode Island	Feb. 15, 1912	Feb. 20, 1912
Arizona	May 12, 1912	May 18, 1912
Georgia	1913	1913
Maryland	1913	1913
Nevada	1913	1913
Montana	Feb. 1913	April 1, 1913
South Dakota	Feb. 13, 1913	Feb. 26, 1913
Idaho	March 13, 1913	May 13, 1913
Florida	June 7, 1913	July 10, 1913
Vermont	no data	no data

certainly be sooner realized under an appointive assessor system than where such officers are elective. Under the first plan they can be chosen because of their qualifications and can be retained so long as they efficiently and honestly serve the public. Under the elective system the choice is a sort of "hit or miss" selection. Rarely will a qualified officer be chosen in this way. As a rule qualifications for special work receive little consideration at the polls.

In conclusion some of the results of the work of commissions are as follows :

Arizona: Organized 1912, but three weeks thereafter the assessment rolls were closed and but little could be done that year. The commission rewrote the entire revenue laws of the state and removed inequalities. The bills prepared became laws. An investigation showed that there was great inequality in the distribution of the tax burden, and resulting action increased the revenue from mines from 19 per cent of the total tax previous to the organization of the commission to $37\frac{2}{10}$ per cent of the total tax in the first full year of the commission's work, and the revenue from railroads from 12 per cent of the total to $22\frac{8}{10}$ per cent.

A careful system of checking in regard to stock shipments resulted in a large number of animals being placed upon the roll that had previously escaped taxation. Pursuant to a law written by the commission and enacted by the legislature, the state revenue will be increased in 1914 to the amount of $18,000 from a source never before taxed, *i.e.,* the property of private car companies. A careful equalization of all property in the state has already brought about a more equitable distribution of the tax burden. In 1911 the total taxable valuation of the state was $98,000,000, and through the work of the commission the total in 1914 will approximate $408,000,000.

Arkansas: The endeavor of the commission has been to have the property in the state assessed at approximately 50 per cent of its full value. An investigation caused the commission to conclude that the property of utilities, the assessment of which was to be made by the commission, had previously been assessed at about 30 per cent of its value; by the assessment of the commission it is now valued at from 45 per cent to 50 per cent of full value. In 1908 it was assessed at $51,000,000, and the latest assessment by the commission was a little over $90,000,000.

In like manner the commission raised the valuation of telephone and pipe line companies from 20 per cent of full value to 50 per cent of the same. The original assessment at a million dollars has been increased to three million. Other public-service corporations which were in 1908 assessed at two millions were in 1913 assessed at something in excess of six millions of dollars. All property now assessed by the commission was valued in 1908 at $55,000,000; the commission value in 1914 is a little in excess of $102,000,000. The result is more real equality in the distribution of the tax burden.

This commission lacks power of equalizing assessments between individual taxpayers, and as the variation from true value is all the way

from 5 per cent to 100 per cent great inequality exists which the commission cannot as yet remedy, though it is looking for a more elastic and equitable law at the hands of the legislature which will permit the removal of the inequalities now existing. The commission administers the corporation franchise tax. The commission drafted and submitted to the legislature in 1911 a law providing a franchise tax to be paid by corporations on that part of their capital stock employed in Arkansas. The tax is $\frac{1}{15}$ of one per cent. Under the old law the revenue from this tax was about $65,000; under the new law the amount received is $180,000.

Colorado: Through the work of this commission for the first time in the history of Colorado the law has been enforced which requires property to be assessed at full value. Correspondingly, the tax rate has been reduced from over 40 mills to $13\frac{87}{100}$ mills. In 1913 for the first time there was something like a fair equalization of value among the sixty-three counties. Under the supervision of the commission the county assessors have made a more full and complete listing and valuation of local property. As the result of the work of the commission, coöperating with county assessors and county boards of equalization, the tax burden is more equitably distributed among the different classes of property than ever before.

An instance of an equitable shifting of the tax burden is the following: agricultural lands and improvements have been increased nearly $50,000,000; metalliferous mining property has been increased $28,000,000, while town and city lots and improvements have been reduced $65,000,000. Local public utilities formerly assessed by county assessors at $16,000,000 in round figures were assessed by the commission in 1914 at $68,000,000. The larger public-service corporations, such as railroads, etc., under the old law were assessed at approximately $60,000,000, and for the year 1914 by the commission at $195,000,000.

Before the creation of the commission the tendency on the part of the county assessors was to so act in assessing as to shirk the state tax, there being a great rivalry among the county assessors in this particular, and as a result the state had become practically bankrupt. The constitutional limit of state tax is four mills, and as the result of the commission's efforts the rate is now only one and three-tenths mills. The effect is to put the state upon a sound financial basis.

The commission has drafted and secured the enactment of several effective revenue measures. There has been a general toning up in the administration of the assessment laws and in the collection of taxes.

Connecticut: In this state there is only one officer, the tax commissioner, who first took office July 1, 1901. In this state there is separation of the sources of state and local revenue. Under the administration

of the commissioner the assessment of buildings and land has been separated. Pursuant to his recommendation the terms of offices of the assessors have been lengthened to three and four years, thus giving the municipalities the benefit of experienced assessors. The educative work performed by the commissioner has produced meetings of assessors, boards of revenue and tax collectors, at which meetings the laws in relation to the duties of each of these classes of officers and methods of administration have been discussed, and the result is that now there are two associations of tax officials which hold annual meetings and have definite programs of speakers. The whole result is educational and is causing the public to take notice of tax matters.

Pursuant to the recommendations of the commissioner, there have been a number of changes in the tax laws of the state whereby the public interest has been promoted. The law in relation to the taxation of forest lands now provides a nominal tax on the value of the land during the period of growth, and a yield tax at the time the timber is cut. Pursuant to the recommendations of a special commission, of which the commissioner was a member, the legislature has changed the law in relation to the assessment of telephone and telegraph companies. The former system of taxing physical properties of the kind has been replaced by a gross earnings tax which yields a larger revenue to the state without unjustly burdening the companies. Another change in the law has abolished the taxation of inheritances of non-resident decedents so far as personal property is concerned.

This commissioner, in so far as his authority extends, has been intelligently active with the result that in many ways the public has been benefited.

Florida: This commission is new, the date of organization being July 10, 1913. As yet it has had little opportunity to produce results. The aim of the commission is to get all property in the state assessed upon a basis of full cash value as the law requires, but it has found that such result will be inexpedient for the present year, 1914, and is operating with the fifty county assessors of the state to get all property assessed upon a basis of 50 per cent of actual value. In succeeding years full value will be the aim. Upon the 50 per cent basis of value the aggregate assessment has been increased from $234,000,000 in the previous year to $295,000,000 in 1914; and correspondingly the state tax levy has been reduced from $7\frac{1}{2}$ mills to $5\frac{1}{2}$ mills. Some effort has been made to equalize values of property among counties and also in some instances the property of a particular kind in single counties. The educational effect of the commission's work is apparent in the fact that the public begins to realize the importance and necessity of a centralized assessment.

Idaho: This is also a new commission, its organization having been made on May 13, 1913. Consequently, it has had but little time within which to produce results. Among the achievements is an estimated amount of $150,000 in taxes saved through the enforcement of the law regarding the collection of unsecured personal property taxes at the time of assessment. The assessment of public utilities after a careful investigation has been increased several millions of dollars for the purpose of more equally distributing the burden of taxation among the different property owners. A vigorous enforcement of the inheritance-tax law has resulted in the collection of a considerable amount of delinquent inheritance or transfer taxes.

Kansas: The first assessment of all property in the state under the control of the commission was in 1908. Total assessment, $2,451,560,397. The total assessment of the previous year under the old plan, $425,281,214. Average rate of levy for all purposes in the state, 1907, .0469638; average rate of levy for all purposes in the state, 1908, .0086548. Average state levy, 1907, old plan, .006; average state levy, 1908, .0009. The sixth assessment under the control of the commission produced an aggregate of $2,809,801,434, and average rates for state, .0012; for all purposes, .01048995. The rates, it will be observed, have not been correspondingly reduced with the increase in valuation, but this is accounted for by the fact that public expenditures in 1913 exceeded those of 1907 by the sum of $8,985,780. In the assessment under the new plan, property has been brought practically to actual value, and the increase in various kinds of property ranges from 300 per cent to 1000 per cent. Thus property is brought upon an equal plane of assessment.

One important result under the new plan is that the practice of underassessing valuable properties relatively with less desirable and less valuable properties has been to a great extent eliminated. The educational work of the commission with the local officers has elevated the standard of work and has substituted for a desire under the old plan to underassess, an earnest effort to actually assess property at its full value.

Another result has been to get upon the tax roll personal property in excess of $300,000,000 never before taxed.

At the instance of the commission many important amendments have been made to the statutes tending to cause a more equal distribution of the tax burden.

The commission drafted a legacies and successions tax bill, and secured its enactment in 1909, the provisions of which administered by the commission brought to the general revenue of the state approximately $200,000 per annum. This law after four years of successful operation was in 1913, as the result of partisan politics, repealed absolutely.

A law written by the commission and enacted by the legislature doubled the revenue derived from express companies.

Another law proposed by the commission more than doubled the revenue received from private car companies.

All increases in revenue produced through the work of the commission tend only to equalize the distribution of the tax, and do not unjustly burden the sources of the revenue. The commission has large powers, but has refrained from exercising extreme power except in a few cases of emergency. Its power to remove assessors has only once been exercised and that indirectly by suggesting a resignation; it has several times approved the removal of deputy assessors by the county assessor. The power to reassess districts has been exercised several times, always with good results. In such cases the assessors are appointed by the commission.

Massachusetts: In this state there is only one officer possessing the central authority, the tax commissioner. The department was created in 1891, and since that time there have been but two incumbents of the office. The term of the first commissioner expired by reason of his death in 1899, and the present commissioner has since been in office.

Under this commissioner the taxation of corporations has been made uniform so far as the laws are uniform. The revenue of the commonwealth has been increased. Local assessments have been considerably equalized and the procedure of local boards has been made uniform. The administration of the inheritance-tax law has been made even and searching. The chief reason probably for the good which this commissioner has been able to accomplish has been his freedom from molestation on account of partisan politics.

Michigan: The chief benefit from the work of this commission has been in placing upon the assessment rolls a large amount of property which had formerly entirely escaped taxation, and, by the exercise of its powers of review of assessments, the correction of innumerable inequalities in individual assessments. During the past three years twenty counties have been completely reassessed by the commission and property placed upon the rolls at its true cash value as required by the constitution and the laws of the state. This procedure was made necessary by the manifest inequalities between individual assessments resulting from the inefficiency of local workers. The commission instituted probably the first searching investigation as to the proper basis for the assessment of the property of transportation companies.

Minnesota: The work of this commission has been very effective and has resulted in the following benefits to the public.

A classified assessment law by means of which in the year 1914 there

is the first full and fair assessment of property that has been made in the state in fifty years.

A complete system of assessing mines and mineral property which in operation has increased, through the work of the commission, the valuation of such property from $64,000,000 in round numbers to $260,000,000.

An increase in the gross earnings tax on railroads from 4 per cent to 5 per cent, the net increased revenue from such property being 25 per cent.

The enactment of a comprehensive and very satisfactory graduated and progressive inheritance-tax law, yielding large sums to the state.

Upon the recommendation of the commission the legislature enacted a three-mill "money and credits" tax law, as the result of which the revenue from such property has been very materially increased.

Also it has caused the enactment of 5 per cent gross earnings tax on sleeping-car companies, as the result of which the revenue from such companies has been doubled in two years.

Has recommended and procured the passage of a very satisfactory mortgage registry tax law.

It will be observed that this commission has accomplished a great deal. It is in the front rank of working commissions.

Montana: Organized April 1, 1913, so that there has been but little time for results. The powers of this commission are advisory only, but the commission has already done some effective work towards the removal of inequalities in assessments. Much property previously under-assessed has been brought nearer to equality with other property. Has procured the assessment, as property, of reserved mineral rights. Has studied the systems and laws of other states carefully and will recommend constitutional changes permitting classification and effective equalization.

New Hampshire: Organized May 1, 1911. Through the work of this commission many property units, corporations, etc., have been increased in valuation for tax purposes from 100 per cent to 300 per cent. Property valuations as a whole have been increased nearly 50 per cent; the tax rate has been lowered; the general equalization of assessments has brought all property in the state to the basis of actual value.

New Jersey: The board of equalization of taxes is the name of this board, and in 1905 it succeeded the state board of taxation, which had been in existence since 1891. The board is an appellate board and grants remedies to appellants from the action of the local authorities, and has done much of this kind of work. Equalization of all property in the state through coöperation with local authorities has been one of the principal results.

New York: This commission dates from 1896. Particular attention has been given to the enforcement of the special franchise tax law, and the assessment of property thereunder, and to the organization of local assessors, and extending aid to them in order to place upon the assessment rolls all taxable personal property; and also to obtain a more equitable and just assessment of real property and a just and equitable equalization of assessment among the towns and counties of the state. Numerous achievements have resulted, enumeration of which is prevented by lack of space.

North Dakota: This commission is new, dating only from July 1, 1912, but has been busily at work and the results are indicative of increased results as the work of the commission progresses. The getting upon the assessment rolls of much property which escaped before the organization of the commission has had attention, and two items of about sixteen millions each of such escaped property were added, and besides these two items eight or nine millions of similar items. The revenue derived from this heretofore omitted property is estimated at $500,000. The laws of this state do not permit the assessment of property at full value, and an attempt to get the law amended in that particular failed because of the veto of the governor. At the instance of the commission the legislature passed an inheritance-tax law which is being administered by the commission. This commission has been very busy with the multitude of duties which necessarily come up in administering tax laws, through hearings, investigations, etc. The duty of equalization is placed elsewhere, but the commission makes recommendations to the state board of equalization.

It is impossible to detail briefly all the accomplishments of an active commission, and this one shows activity, and when it has a little longer life will undoubtedly have accomplished much for the public benefit.

South Dakota: This is one of the newest commissions, having been organized in 1913. The results of its work are:

(1) An educational movement which is causing people to take active and intelligent interest in matters of taxation.

(2) Assessed valuations have been brought up from 25 per cent or less to approximately full value as required by the constitution.

(3) Better equalization from townships to state as a whole, due to equalization according to schedule of valuations for all classes of property.

(4) The commission has recommended the codification of revenue laws, including county assessor plan, and will also recommend submission of six constitutional amendments to be voted upon in 1916.

For a new commission it seems to have been busy.

Ohio: Since the organization of this commission in 1910 its accomplishments have been many, too numerous for detailed mention. The most salient thing is the increase in property valuations. Data for 1910 before, and for 1913 after, the commission commenced its work given below indicate the increase:

	1910	1913
Value of realty	$1,656,944,631	$4,418,953,299
Value of personalty	827,370,943	2,300,115,670

Rhode Island: The work of this commission dates from February 20, 1912. A valuable educational movement was started by the commission in the organization of a state tax officials' association which meets twice a year. The quite apparent results are a more thorough understanding of tax laws and better assessments and valuations. In many other ways the commission seeks to advise the public upon matters of taxation. Large amounts of intangible property which always escaped taxation, through the efforts of the commission are now bearing a share of the tax burden. Relatively, the tax burden is much more equal than under the old system. Tax lists have been standardized and also the call for financial town meetings and the votes by which the levy is made. Like all active commissions it is doing much good which cannot be stated in detail.

Texas: This commission has slight control over local assessing officers as its power is only advisory. Its accomplishment has been chiefly in getting upon the tax roll the intangible assets of corporations through its own direct valuations and through coöperation with local valuators of property.

Wisconsin: No commission has been more active or has accomplished more than the Wisconsin commission, which was the first commission to be given the extraordinary powers before mentioned; in fact, the law of Wisconsin and the work of its commission have been a guide in the reformation of tax systems in other states. It has been able to accomplish more than most other commissions because the legislature of Wisconsin has been liberal in its appropriations, and has given the commission facilities for the gathering of statistical data and expert study of all questions concerning taxation, which privilege has been denied to most other states. It is difficult to briefly summarize the work of the commission, but some of its work and recommendations are as follows:

A change from the gross receipts tax upon railroads to the assessment of railroad property on the *ad valorem* basis, with the application of the average rate of the general property of the state. An exhaustive investigation into the value of this class of property was made. Later the *ad valorem* system was extended to the property of street railway and telegraph companies.

Pursuant to the recommendation of the commission many beneficial changes in the tax laws have been made by the legislature, and among other enactments have been laws providing for tax on inheritances and an income tax, both of which laws are administered by the commission.

Wisconsin has pioneered the way in many reforms, but the most distinctive perhaps is the replacement of a large part of personal-property taxation by an income tax. This law is the first of its kind in the central western states, and is enforced by the commission in a manner never equaled before in the United States in the enforcement of income-tax laws, which laws exist in several of the eastern states.

The brevity required here does not permit even a mention of many other accomplishments by this commission.

West Virginia: In this state there is no board, only a single officer whose commission was first issued November 28, 1904. The things accomplished are:

(1) The assessment of property at a more uniform value.

(2) A reduction in the tax rate of more than 50 per cent.

(3) The installation of a uniform system of accounting of public funds, which has saved to the communities hundreds of thousands of dollars.

(4) Has secured a more vigorous enforcement of the laws relating to license taxes, with the consequence that they are paid more promptly, and practically everybody who is required under the law to pay such taxes now responds. Under the old system many persons escaped the payment of license taxes.

This commissioner enjoys the unique distinction of being also the commissioner of prohibition, and is charged with the enforcement of the prohibitory laws of the state.

The results above set forth indicate that the modern commissions which have power at all approaching their needs are busy and active bodies. Other states not included might be in the same class, but data for inclusion were not available. One noticeable trend in the work of the commissions is to increase the taxes of corporations and thereby to benefit other property. This inclination should not become effective except in cases where the burden of the tax has been relatively lighter upon the property of corporations than upon other property. The taxes of corporations should not be increased for political reasons, and always in adjusting taxes the probable incidence of the tax should have consideration. The consumers of a product, whether it be transportation, transmission, or otherwise, will probably

in the end bear a considerable part of the tax advanced by the corporation, and the question whether special classes of consumers should be taxed for the benefit of the public will bear argument.

It would seem that this article would be incomplete without at least a brief reference to the work of the National Tax Association. The national tax conferences held annually under the auspices of the association have brought together scholars, experts, legislators and practical administrators of tax laws upon a common platform for the interchange of views, and the result has been a wonderful progress toward tax reform throughout the whole country. Congressional legislation has in some instances been molded through the direct work of the association or of its members. Constitutions in states have been amended as the result of the educational work of the association so that hard-and-fast rules which have not permitted a relatively equal distribution of the tax burden have been removed.

Uniformity among the states as regards tax legislation is very desirable, and the association is pioneering the movement, and it is reasonable to expect that the laws of the states will ultimately be molded so as to eliminate to a large extent the unsatisfactory double taxation that is now prevalent because of conflicting state laws.

60. The Administration of Laws for the Taxation of Property: Report of a Committee of the National Tax Association.[1]— This committee was appointed pursuant to the following resolution adopted at the last conference :

"*Resolved:* That this conference recommend to the National Tax Association that the association appoint a committee to investigate the methods of administering laws relating to the taxation of property in the several states and provinces and prepare a report for the information of future conferences."

The text of this resolution excludes the subject of excise or privilege taxes such as those upon corporate franchises, inheritance taxes, and similar forms of revenue usually employed for state purposes and collected by a central authority. Nor do the

[1] Reprinted from the *Proceedings of the National Tax Association*, Vol. V, pp. 363–376.

methods of administering the laws for these special forms of taxes present a serious problem at this time. Whatever difficulties may arise under them seem to be easy of solution by the particular state imposing the tax. Moreover, such taxes form a small portion of the total revenues, and the method of collecting them affects directly a very small part of the population.

Existing Conditions

The general property tax supplies more than 80 per cent of local revenues in the United States and more than 75 per cent of the total of state and local revenues. The property assessed for this tax was valued, according to the last available census figures (1902), at more than thirty-five billion dollars. The total taxes collected from this assessment were then over seven hundred millions of dollars annually, and the annual sum has, without doubt, increased considerably since the last figures were compiled. The equitable valuation of this enormous amount of property, so that this great tax burden of hundreds of millions of dollars shall be fairly distributed among those liable to the tax, is a problem which increases in gravity with the increases of tax rates and in property values. It is this general property tax and the methods of its administration which your committee will consider.

The administration of the general-property-tax law in any state or under any statute is in three parts: the actual assessment made in the first instance by a local assessor; second, the review of the assessment and correction of errors by supervising or reviewing boards; and, finally, the announcement of the results for information of the taxpayers and for study and comparison.

All three stages of administration have provided fruitful sources of complaint and have been denounced with equal vehemence and perhaps with equal justification. But suggestions for reform in administration have concerned themselves chiefly with improvements in the review and correction of errors. The changes made in the states where most has been done to improve assessment methods, as in Kansas, Minnesota, and Wisconsin, have been in the main along the lines of either relieving individual and complaining taxpayers or of so-called equalization between entire districts or counties. Little change has been made

anywhere in the preliminary field work or in the method of primary assessment by the local assessor.

We have built from the top down in the effort to improve the system. It is time that the foundations should be considered and that the local assessment work should be improved.

1. *The Local Assessor*

The usual method throughout the United States (with a few exceptions) of administering the general property tax is to divide the state into tax districts, usually comprising a city, village, or township; in some cases a county. The people of the tax district choose, usually by election and for a short term, the assessor. He is not required or expected to give much time to his work, and, in most cases, he is paid a ridiculously small sum per day and limited to a few days' work in the year. Even when his district is large, as in the case of a county assessor, or where it has high values, as in a city, it is seldom that the assessor is chosen because of special knowledge or study of assessment work, or that he is paid a sufficient salary or given a sufficiently long tenure to justify him in making a special study of this work. It is the duty of this assessor to value the real estate within his district, and (according to the law of his state in regard to its *situs*) to value either such tangible personal property as he finds within his district, or, more usually, to assess each inhabitant thereof for all the personal property that he may own wherever located.

These property valuations are made in accordance with the judgment of the assessor as to the actual values of the property with which he deals. When he has completed these valuations, he places them upon an assessment roll and, unless corrected, the taxes required for the purposes of that district, and those required from it for county or state purposes, will be apportioned among the inhabitants or the owners of property therein in such proportion as the relation which the valuations made by the assessor bear to each other.

Thus, in the first instance, this local assessor has the responsibility, and performs the work, of distributing among the inhabitants or property owners of his district, in accordance with his judgment of values, a tax burden which represents over three

quarters of the contributions of the people for all public purposes, and which in the total aggregates over seven hundred million dollars.

This method of local assessment, as generally administered throughout the United States, is practically unchanged since colonial days. When property values were low and the total tax burden was light, and the residents of a tax district knew each other's circumstances and were known also to the assessor, this system no doubt resulted in a reasonably fair distribution of the tax burden.

But these conditions have changed in all respects. Property is increasing both in quantity and in value. Where formerly, over large areas, land was of equal value per acre, it now varies even in rural communities, through the increased demand for the better land and the growth and location of transportation facilities. Many districts formerly entirely rural now contain villages or border upon a city, while values in cities are measured by feet and inches and reach almost incredible amounts. Improvements on land are increasing in value and diversity. In the majority of tax districts the assessment of ordinary real estate presents many difficulties. The development of modern industry and the building of huge factory plants with complicated machinery, the development of railroads and other transportation lines and of local public-service corporations have resulted in the creation of a class of property whose value can only be estimated by those specially familiar with it. And yet the ordinary local assessor is expected to proceed unaided, without instruction and without experience, to properly apportion the burden of taxation.

In the matter of personal-property assessments the condition is far worse. In most states the law requires an assessment of each inhabitant of the tax district on the value of all of his personal property, except certain tangible property which may be permanently outside the state. This local assessment of personal property has broken down completely under modern conditions, and the causes of the failure have been set forth by the committee which reported to the last conference on this subject. In practice the local assessment of personal property is too often the result either of the mere estimate of the assessor as to how much each person will stand without too vigorous a

protest, or of a positive bargain with individual citizens regarding the amount they are willing to pay.

2. *Board of Review and Equalization*

Protection against unjust or arbitrary assessment by the local assessor has been attempted by the establishment of boards of review or of equalization.

The function of boards of equalization is generally to attempt to secure some fairer distribution of the taxes imposed by one district upon other districts than would be obtained if those taxes were placed entirely upon the valuations made by the local assessor. The oldest form of equalization is probably that made by a state board for the purpose of distributing the burden of a tax for state purposes among the local districts. This is done by arbitrarily changing the entire value placed upon the property in a county by its local assessors. Similarly county equalization exists in various forms whereby the total valuation of a tax district is arbitrarily changed so as to make a different distribution of the county tax between the districts comprising the county.

Neither of these methods touches the inequalities between individual taxpayers of any one district. To correct those inequalities boards of review have been established in some localities to hear appeals of individuals from the valuations made by the local assessor and to grant reductions if thought proper. These boards of review present as great a variety of organization and powers as do the local assessors themselves in the methods of appointment or election, jurisdiction, and powers as applied to the local assessors.

One idea, however, runs through them all, namely, that on the complaint of the aggrieved taxpayer or on the wider knowledge of the actual facts possessed by the members of the board of review, the actual assessments made by the local assessor shall be adjusted, either accurately or roughly in the mass, so as to provide a nearer approach to equality of burden among the taxpayers. Obviously such boards of review can deal only with a comparatively few cases or else they would really be making a new assessment. The vast majority of taxpayers must of necessity pay without alteration whatever share of the tax burden

may be placed upon them through the valuations made by the local assessor. It is only in extreme cases of individual injustice that appeals are profitable. Most people have not the time, or the means, or the inclination to do more than complain to the local assessor himself. And even if individual complaints to him, or appeals to boards of review, or to the courts give a specific relief to the individual, they will have little or no effect upon such maladjustment of the tax burden as may exist through unequal valuations of the property of those who do not appeal.

There are, as a rule, three boards of review (though not always called by this name): the local board organized in the territorial area covered by the local assessor; the county board, whose jurisdiction covers the county and which is intended to preserve equality between the units making up the county; and the state board, acting in a similar capacity for the whole state and dealing with the counties as units.

The usual method is to have the local board of review composed of the local assessors when there is more than one assessor. This, of course, has the obvious disadvantage of making them judges of their own work. When there is only one local assessor, it is customary to join with him in the local board of review some other local officials. This in its turn has the obvious disadvantages of placing men on the local board of review who have made no special study of values, and also of introducing into such board the men who are most likely to be influenced by considerations of the effect of their action on their own election or their own line of work. As a result, of all the boards of review established by law, the local board of review has generally proved to be the most unsatisfactory and has done the least to accomplish the object of its establishment.

The county board of review, in like manner, has usually been composed of men elected or appointed for other purposes and who have had imposed upon them this duty of equalization and review of assessment simply because such duty has to be imposed on somebody and the group selected seemed to be the least objectionable for that purpose. It is difficult to see how it was ever possible to assume that the important work of equalizing tax burdens could be satisfactorily performed by men unfamiliar with the work of assessment, and whose only reason

for approaching the work was simply compliance with the mandatory provisions of a statute which required them at stated periods to perform a stated act. The performance of this duty, from the very outset, degenerated into a perfunctory compliance with the letter, rather than the spirit, of the statute, or if that were not the case, into an attempt to twist compliance with the vague terms of the statute into partisan political advantage.

The State Board of Equalization, the final board of review, has not proved much more satisfactory, because it is usually made up in much the same manner as the county board. The only thing that has given it and its work any greater respect is the fact that the board being further removed from the actual assessments has been freer from the personal influences which tend to warp the judgment and the action of the local boards and the county boards.

3. *Publicity of Assessments*

As a general rule, there is almost no attempt to advise the taxpayer of the assessment that is about to be made against him or against his property. And in like manner there is practically no attempt made to provide him with any means of studying and comparing the results of the assessments that have been made.

Everywhere the law assumes that the individual taxpayer is familiar with assessment laws, that he has constantly before his mind the dates involved in assessment work, that he knows the local assessors, and that when the books are opened for inspection, he and all his neighbors will flock to examine, study, and compare the results. This, of course, in the present day and generation, whatever it may have been in past time, is a wild assumption and is everywhere at variance with actual facts. Hence we have the intense annoyance and feeling of rankling injustice on the part of the taxpayer; hence the abuse of the assessor and his work and the antagonism which he meets when he should have assistance. Hence also comes the feeling, which is so prevalent, that taxation is a hopeless muddle, that nothing can be done to improve it, and that it is one of the necessary evils of civilization which must be endured or evaded by any means, good, bad, or indifferent.

Suggestions for Improved Administration

This can be but a preliminary report. The subject is too vast to admit of more than a few tentative suggestions in such a report as this. Your committee, however, offers the following for consideration:

1. *As to the Local Assessor*

In the first place, the local assessor must be relieved from the assessment of those classes of property which require expert knowledge not possessed by most citizens. This has been done in some states where railroads and similar public-service-corporation property is assessed by a State Board, which can employ engineers or others familiar with that class of property, and is also better able to discover and assess those intangible or franchise values which do not attach to any part of the physical property, but add to the value of such property considered as a whole. Where it is not practicable to have such property assessed by a central board, provision should be made for supplying to local assessors data by which an estimate may be made of values of unusual classes of property, such as mineral lands or quarries.

Your committee will not enter into details in regard to methods of making local assessments. In the matter of real estate, another committee of this conference reported last year on the subject of uniform classification of real estate, and was continued for the purpose of preparing suggestions for local assessment work.

In the matter of methods of personal-property assessment, the local assessor should be relieved of the assessment of personal property or, at least, from the assessment of all except such as he can readily find and value. It is admitted by all investigators of the subject that local assessment of personal property cannot be made successfully. It is not within the province of this committee to express an opinion as to the proper method of taxing and assessing this class of property. Another committee is now investigating the questions of substitutes for the personal-property tax. But we must point out the impracticability of improving the methods of local administration so long as this property is assessed under the general property-tax system.

In the second place, the position of an assessor should be dignified by a sufficient tenure and salary to justify him in giving full and complete service. It is not to be expected that an assessor who is paid $1.50 or $2 a day and limited to perhaps sixty days as a maximum, which is the custom in some states, will give the subject of valuations and methods his entire time and attention. It is true that tax districts are frequently so small that they do not warrant a large increase in salary, nor would they require much more time for a proper assessment than the assessor now gives. In these cases such districts should be consolidated where practicable so that they will be sufficiently large in area and valuations to justify the employment of all the time of a competent assessor.

Where practicable, better results no doubt could be secured if local assessors were appointed with either a permanent tenure or a longer term than is usual under the elective system. This is done in a number of cities where a board or commissioner, either elected or appointed, is at the head of a tax department, but the actual work is performed by subordinates who give their entire time to work and whose tenure is secured by civil-service regulations.

Where it is not practicable to secure either the consolidation of districts or the appointment of assessors, the locally elected assessor should be paid an adequate salary for the work which he is expected to perform instead of the ridiculous sum so frequently given. And he should also have the fullest possible assistance from a central board or commission, either directly from the board or, in states which have township assessments, through the intermediary of a county supervisor of assessments.

In those states where the assessment district is a county, the area is usually sufficient to employ the assessor for all his time and, in a number of cases, requires that he shall have assistants. But this system exists in comparatively few states.

In some of our states assessments of property are made by the taxpayers themselves. Each individual fills out a return stating the amount and value of his property both real and personal, and from these returns the assessing official compiles a list upon which taxes are collected. This system, or rather lack of system, can hardly be termed administration. It has not the first essentials of an assessment. While the official entering the

valuations can make inquiries and change the total of property or of values from the estimates returned to him by the individual, it is obvious that this will be done in but few cases, since it involves a direct questioning of the veracity of the individual making the return. All such self-listing systems should be abolished.

We deem it best at this time to refrain from any discussion of the subject of discipline of a local assessor. The question of the removal of a local assessor opens up a wide field of discussion. So does the question of the power of a higher authority to order a reassessment.

The committee also passes for the present the question of the advisability of having all assessments for local taxes made by one assessor. In many states school taxes and other local taxes are assessed by assessors other than those who assess for the general local purposes. Much can be said in favor of consolidating the work of local assessment for all purposes into the hands of one assessor. We have, however, confined our attention in this report to a consideration of the quality of the work of the local assessor, and have not attempted a consideration of more efficient or more economical administrative machinery.

2. *Boards of Review and Equalization*

A. LOCAL BOARDS

Local boards of review, whose jurisdiction is coterminous with the local assessment district, and which are composed wholly of the local assessors, should be abolished. Your committee does not mean by this that local boards of review must necessarily be abolished, but that, if they are to be continued, their membership should be changed.

We are not prepared to formulate a general rule on this subject. All that we recommend is that in the composition of the local board there should be provision for one or more members who, if possible, should be men having some knowledge of values and who are in a position to resist the influences which tend to induce concessions to powerful owners. How to accomplish that is a serious problem. We offer as a suggestion the possibility of providing a place on such board to be filled

by some one appointed by a higher administrative authority, such, for example, as the county board or the state tax commission or the state board of equalization. In such states as have a county assessor, as well as local assessors, the county assessor might be a member of the local board of review.

The county board of review presents the same difficulty and we can only recommend that in a similar way provision should be made for a place upon such board for some one appointed by higher authority and thus free from local influence and prejudice.

The State Board should be composed of men giving their entire time and attention to the work.

B. STATE SUPERVISORY BOARDS

An increasing number of states are establishing state tax boards or commissioners with the duty of supervising local assessment work. Sometimes this supervision is merely advisory, and the powers of such commissioners are confined to giving good advice to such local assessors as are inclined to listen. This is a step in advance, but a small one. In other states the powers of the board extend to ordering a reassessment of all the property in a district and the making of a new assessment roll, upon evidence of gross inequalities. In one state at least the State Board has the authority, upon appeal or upon its own motion, to correct the individual assessments in any tax district. Necessarily, as in the case of appeals to local boards, this power can be exercised but rarely. If it were exercised frequently, such a board might as well be charged with the duty of making or directing the original assessments.

The existence of these powers is a stimulus to local assessors to be more careful and diligent in their work. But the greatest benefit from such centralized supervision is in preventing unequal assessments through proper instruction of local assessors and the installation of correct assessment methods, rather than in attempts to correct the errors after they are made.

In the states where assessments are now, and are likely to be for some time to come, made by an assessor elected for a small district like a township or village, whose pay is small and who will not and cannot be expected to give much time to his work,

much can be done if some central authority is empowered to give advice and actual help to these local assessors. This can be done either through traveling agents, or, preferably, through district or county supervisors, who, on the one hand, shall be responsible to the State Board for the general results in the district which they supervise, and, on the other hand, will be looked upon by the local assessors as part of a local administrative system rather than as agents of a central power.

An important function of such supervisory boards is the collection and publication of statistics relating to the assessment and collection of taxes in the various local subdivisions. Such compilations are essential to enable proper comparisons to be made of the efficiency of local administration.

3. *Publicity*

A further aid to the improvement of local assessment work is to secure the fullest possible publicity for the results. This can be accomplished in various ways, depending somewhat upon the character of the tax district. In any event, assessment rolls should be open to public inspection without hindrance for the longest possible period of time both before and after the confirmation of the assessment roll. In some manner notice of the impending assessment should be given personally to the taxpayer, and an invitation be extended him to come and inspect the rolls and make comparisons with his neighbor's assessments. Where changes in value are frequent, as in cities, and the individual resident is not personally familiar with the size and value of property holdings, the assessment lists may be printed at varying intervals and distributed in pamphlet form.

The greatest aid to publicity, however, will be found in the preparation and use of assessment maps, because the use of such maps will assist the assessors to better work, and will more than anything else enable a taxpayer to study and compare his assessment with his neighbors. It is the difficulty that now attends such comparison which creates most of the feeling of injustice and antagonism. The objection to paying taxes is greatly minimized when each taxpayer feels that his neighbors are subjected to the same burden, equitably distributed.

Conclusion

Your committee has merely suggested some of the remedies for the defects in the administration of the general property tax. We do not feel justified in making any positive selection out of these various methods. Some of the changes proposed could not be adopted by some states because of existing constitutional restrictions. Other changes would not be adopted because of local conditions, or would have to be modified so as to coördinate with the administration of other departmental functions. We sum up the result of our consideration of this subject as follows:

First, that the present administration of the general property tax, from which 75 per cent of state and local revenue is derived, is unsystematic, antiquated, and unequal.

Second, that substantial improvement can be secured only by improving the ordinary local assessment work.

Third, that this can best be done by such readjustment of local assessment systems as will insure to local assessors better pay for their work.

Fourth, that where practicable local assessment districts should be made sufficiently large to justify the employment of the whole time of a competent assessor.

Fifth, that a central supervisory board which will furnish advice and help to local assessors, either directly or through a district supervisor, can secure great improvement in the original assessment work and minimize inequalities.

Sixth, that full publicity of assessment matters, both of the details of local assessment rolls and by comparative statistics issued by the central supervisory body, will also help to improve local administration.

61. The Assessment of Real Estate: Report of a Committee of the National Tax Association.[1]—This committee, after presenting its first report a year ago, was continued for further investigation of the general subject assigned and was charged with the additional duty of preparing tables, rules, and general instructions for the assessment of real estate.

[1] Reprinted from the *Proceedings of the National Tax Association*, Vol. V, pp. 345–362.

It is difficult to proceed along the line assigned to us without some discussion of the powers and duties of local assessors and the various methods existing in the different states for the review of assessment; but as there is a committee on administration of tax laws, which is considering these topics, we shall refrain from any comment thereon as far as practicable. We shall endeavor to consider only the methods and schemes of work which are being applied or may be adopted by assessors in their actual assessment of property.

In our report last year we presented as one of the essentials in a proper classification of real estate the necessity for a separation of land and improvements in the field work of the assessor and the statement of such separate values on the tax roll. This we now repeat and emphasize. In the same manner we renew our recommendation for tax maps in each district as a foundation for assessment work, and for the preparation of land-value maps on which the unit values of land may be set down in such a way that the gradations of value from one point of high value to the next point of high value may be seen at a glance.

The committee desires that in reading this report there should be kept in mind the passages in its report of last year referring to the need of assessment *in rem* rather than *in personam*, and the need of full-value assessment, and also the discussion at the last conference on the question of the need of true consideration in deeds for the purpose of supplying the local assessor with the data for making equitable assessments.[1]

These, however, are all general propositions, and, even if they should all be enacted into law or embodied in the rules and regulations of tax departments or boards of assessors, will not supply the assessor with the necessary rules for the assessment of a particular lot or a particular building.

Your committee has not been able to undertake a complete canvass of all local assessment districts, nor of any large number of cities. Most of the committee, however, as members of state supervisory boards, have been sufficiently in contact with local assessment conditions to render such detailed investigation superfluous for present purposes.

[1] See also the address on "Uniform Listing of Real Estate," by L. G. Powers, Chief Statistician Census Bureau, at the Third Conference, 1909.

Little progress has been made, except in a few localities, towards developing systematic methods of real estate assessment. This is due, we believe, chiefly to the short terms of office of local assessors or tax boards. It is due also to the popular belief, now happily diminishing, that a proper and equitable assessment of real estate can easily be made by any person familiar with the locality who will merely make a diligent personal inspection of the various properties therein.

In some localities, chiefly in cities where assessors have had permanent tenure, much progress has been made in developing systematic methods of assessment. In many other localities good work is done because of the knowledge and experience of the assessors, but without such systematic development as to make this knowledge or experience readily available for their successors or for the information of inquirers from elsewhere. If we refer in this report chiefly to the methods of a few cities, this is because they have developed their methods sufficiently to enable assessing officials from other localities to profit by their experience, and many have availed themselves of the opportunity.

The task of the assessor is to measure the value of each lot and building, and to do this accurately and scientifically he must have some standard of measure. Of course the actual assessed value set down upon the tax roll will be in dollars. Back of that statement in dollars there should be the entry, somewhere in the tax records, that the land value is composed of a given number of units of area, either in acres or feet, and of a given value, and that the building, in like manner, contains a given number of units of dimension each of a given value. Our task, then, is to suggest a standard, or set of standards, for the assessor that shall have been tested by experience and shall be sufficiently simple to be readily employed and understood.

Real estate for purposes of assessment may be considered in three groups:

1. Ordinary real estate, such as (*a*) land and buildings in cities and (*b*) farm property in rural districts.

2. Real estate of public-service corporations, including easements in public highways.

3. Mines, forests, and similar lands requiring some special knowledge to determine their value.

1. Ordinary Real Estate

A. *Land and Buildings in Cities*

The highest values for given areas of land or of buildings are found in cities, and, in consequence of these high values, it is in cities that systematic methods for the assessment of real estate have been most highly developed. For this reason, and also because many of the ideas underlying a proper assessment of city real estate can be applied to other kinds, this class should be considered first.

Two things are essential to an accurate assessment of city real estate. First, maps which shall show the area, dimensions, and locations of the real property and the various subdivisions of ownership, and, second, a separate statement of the value of the land and the value of structures thereon.

TAX MAPS

Tax maps for the assessment of real estate have been used in some cities for many years. The city of Newark began the lot-and-block system forty years ago. The cadastral system, applying to both city and country real estate, has been in use in the Province of Quebec for a much longer time.

The lot-and-block system of assessment is the best plan for mapping. This consists of an official map, based on an actual survey, filed of record with some public officer, on which certain areas are designated as "blocks" and which are given a fixed, unchangeable number. On such a map a block should be bounded by street lines.

Within the block the map will be further subdivided according to the individual ownership of parcels. As lots are bought and sold, they may be united or subdivided, and when any change of this kind occurs, the map should be changed by some competent surveyor to conform to the new lines of ownership and the date of such change noted on the map.

Within each block, all the lots should be numbered consecutively, beginning with the number one for each block and continuing around the four sides of the block.

It will be found convenient to so number the lots as to leave vacant numbers for new lots if there is a prospect of subdivision among the existing lots at the time the first numbering is made.

When real estate is assessed by this lot-and-block system, the assessment roll may or may not carry the exact name of the owner. The assessment should be made against the particular lot as numbered on the city official map with such structures as appear thereon.

In Newark assessments are entered upon the tax books by streets for convenient reference. The assessor begins at the end of a street, and proceeds continuously to the other end of the street, or at least to the boundary of his district, and makes the assessment by the block-and-lot number of the official map.

In the city of New York, which has largely followed the Newark plan, the assessments are made entirely by blocks: first, of the frontage on one street, and then, continuing around the other three sides of the block. This method does not afford as easy comparison of different assessments along a given street as the Newark system. However, this objection is overcome by the use of land-value maps.

SEPARATE ASSESSMENT OF LAND AND IMPROVEMENTS

The general method of stating a real-estate assessment is to set down opposite the description of the property one valuation which includes the value of both the land and the buildings, if any, thereon. This method renders intelligent comparison of values impossible.

The separation of these two different elements of value is essential to an accurate assessment, and their separate statement on the assessment roll is necessary to enable proper comparisons to be made between the valuations of different parcels of property.

A few states require by statute the separate assessment of land and of the buildings thereon to be entered upon the assessment roll.

The method adopted in the city of New York in 1903, and this year extended by statute to all the cities in the state, requires merely a separate statement of the value of land, in addition to the statement of the total valuation of the real estate. The advantage of this method of separate assessment is, that it forces the assessor to recognize the economic fact that the

value of a building is simply the difference between the value of the parcel of land with the building and what the same parcel would be worth if the building were removed. The difference between the two methods is slight when the improvements are new or perfectly adapted to the location, but in the case of old structures or those which are no longer suitable to the sites, the New York method is superior.

One plan or the other, however, should be employed by the assessor in his work, and where practicable the values should be separately entered upon the assessment roll.

ESTABLISHING STANDARDS OF VALUE

When the actual work of assessment is undertaken, the first problem that confronts the assessor is to find a basis for valuation, that is to say, a standard of value by which to measure each parcel and in terms of which to express its relation to the standard.

It is apparent that the primary need of the assessor is to determine for his own locality the normal unit of land area. This may be the lot of average size, say, 25 × 100 feet, or 50 × 150 feet, or whatever is by common consent regarded as a normal lot in the particular city. It is impossible to lay down one unit for all cities. Lots in one city may be generally 100 feet deep, in another 150 feet, and in still another 200 feet. The normal width of such lot may be 20 feet in one place and 50 feet in another. But in each city or section thereof it is clearly possible to fix upon a lot of a given size as the normal. From this lot of normal size, the assessor may easily determine the value of one-foot frontage of the normal depth, and from this smaller unit he can determine the value of a lot of normal depth of any frontage by simple multiplication.

In Trenton, N. J., the Commissioners of Assessment keep a unit-value book, by streets, showing for each block on the street the front-foot value determined by the board for inside lots 100 feet deep. These values are revised by the board annually before the actual assessment is made, and the book is ruled so that the values for several years appear in parallel columns. In New York the unit value used is noted by the assessor on his field book.

RULES FOR VARYING DEPTH OF LOTS

The next problem is to formulate a rule for valuing lots which are shorter or longer than the normal. This has been met in such cities as Newark, New York, and Baltimore by the use of tables, based upon the experience of the Tax Departments, on which are shown, in percentages of the whole, the value for each foot of depth. The Newark rule and the New York rule are not quite identical. The Newark rule gives a little more value to the front part of the lot than the rule in use in New York. We do not undertake to say that one is nearer the absolute truth than the other. Local conditions in each city may require a special table for such locality. A table similar to the Newark and New York tables should be prepared for each city, and should be used by the assessors. This table should be given the utmost publicity, and should be revised as occasion demands, whenever the assessors are satisfied that the need exists. There is this, however, to be said, that as soon as any table is generally accepted by the assessors and by the real-estate men of any city, the need of revision would practically disappear, because whether the rule conforms absolutely to the actual fact or not does not matter, provided purchases and sales of real estate in that city are substantially based on the use of such a rule. This has proved to be the fact both in Newark and New York.

Fifty years ago in deciding a lawsuit Judge Hoffman of New York laid down the rule that an ordinary city lot 50 feet deep was worth two thirds as much as a lot adjoining which was 100 feet deep, the latter being the standard depth in the city of New York. This formula has been accepted generally by real-estate men and by the City Tax Department, and various rules and scales have been devised from it based upon the same principle. The Hoffman rule has been adopted in other cities also.

The Hoffman rule, however, has been found to give too little value to the front portion of a lot or to a short lot as compared with a deeper one on business streets, especially where frontage values are high. Various modifications of this rule are employed by individual assessors in different districts.

In the city of Newark, where front-foot values are second only to those in the city of New York, a slightly different rule is

used. For business properties the Newark rule gives 50 per cent of the value to the first 25 feet, taking, also, a 100-foot lot for a standard. This is about the ratio used by the assessors in New York business districts.

For lots deeper than 100 feet there is a decided variance in rules and opinions. Generally a 200-foot lot is estimated to be from 25 to 30 per cent more valuable than a 100-foot lot where the latter is the standard.

It should be noted also that experienced assessors do not all agree that 100 feet can be used as a unit when normal lots are 150 to 200 feet in depth.

In Baltimore the normal depth of lots in the business section is 150 feet. The table used in that city is calculated to show the percentage which a lot shorter than 150 feet bears to the standard size, and also the additional value of a deeper lot up to 200 feet. This rule practically makes the rear 100 feet of a 200-foot lot worth 20 per cent of the front 100 feet. But in the comparative value of the first 50 feet of a 100-foot lot it comes closer to the Hoffman than to the Newark rule.

Your committee expresses no opinion on these disputed points. We believe that the actual variation between the various rules is negligible compared with the enormous advantage of adopting some tested rule in place of an arbitrary judgment of each piece of property.

The rules above discussed have been considered only in their application to lots of usable size. The rules may be used on narrow lots and lots of irregular shape, but they should be applied with caution, and the results should be carefully checked by a study of actual conditions and values.

In actual assessment work the assessor will enter on his field map the unit value of a normal unit on each street, or, to be more accurate, on each side of each block. From this unit value he can then compute according to his table of percentages the land value of each lot of any size or shape upon that street, and enter the same on his assessment roll.

Thus all the lots along the given block will bear a just relation to each other, and the same will be true of all the lots upon the frontage of any block in the city.

It is to be observed, however, that while this method secures equality and precision among the lots along the side of a block

or on the opposite sides of a street, it does not necessarily secure the proper relation between the assessments of lots in one block or one street with the lots in adjoining or neighboring streets or blocks. If we may compare the blocks to townships and the city to the county, we may say that the method above described has secured a proper equalization among the lots within the township, but has not provided for equalization among the townships in the county.

In the city of New York provision has been made for equalization among the blocks by the use of land-value maps.

LAND-VALUE MAPS

An outline map of the city is used, subdivided into such areas as may be convenient. On each side of each street, for each block, the unit value of the normal unit is entered. Thus the relation of value on one street with values on another street is at once apparent. Points showing high value will grade off towards the points showing low values, and everywhere the values on one street will interlock with the values on the next street in a way that can be seen, understood, and explained. Accuracy and precision will be introduced into an assessment. The disturbing influences of abnormally high or abnormally low sales will be minimized, and the assessor will be doing what he ought to do; namely, exercising his judgment in assessing all lots within a given area in their relative values to one another.

The city of Milwaukee has for almost twenty years made a practice of using maps which have been termed "Equalization Maps," to assist in fixing unit or front-foot values. These maps are bird's-eye views of each ward drawn to scale, on which are shown each square or block of land bounded by streets or alleys. There is also shown on each map a tier of blocks of all the surrounding wards or adjoining property for the purpose of making comparisons. On these maps the assessed values of the land are shown on all sides of each block, so that comparisons can readily be made with all parts of such ward or adjoining wards.

CORNER VALUES

One of the hardest problems presented to the assessor is to determine corner values. On this point the committee is unable

to discover any common rule among assessors. There seems to be no agreement as to how far the corner influence extends down the side of the street, or how far back it extends from the street front.

Corner influence, of course, is a fact, and a corner lot has a much greater value than an inside lot. All that we can at present say on this point is that the consensus of opinion appears to be that corner influence varies according to the use to which the property is put, being greatest in retail business districts and smallest in suburban residence districts.

BUILDING VALUES

It is much more difficult to establish standards for assessing buildings than for assessing land. The assessor should have some formula, sufficiently flexible, by which to appraise the building. The cost of construction for a new building, of the type of the building under consideration, can be worked out. This is not a difficult problem; real-estate men and builders can readily supply the assessor with this information. From such information he can construct a table, made up of definite types of buildings, of definite size and construction. If this table is sufficiently worked out, it may be made to include all types of buildings coming within his jurisdiction. If such table is not worked out in this detail, it is possible for the assessor to reduce his table so as to show the cubage cost or the cost per square foot of floor space for each type. Then by ascertaining the cubage or the floor space of the given building and multiplying it by his unit cost he will have the approximate cost of construction of such a building.

This, however, does not allow for depreciation. Attempts have been made to work out tables of depreciation based upon age, but we have not been able to learn of any table of this kind that is really satisfactory or accurate.

Another thing that must constantly be borne in mind in assessing buildings is that the building must be suitable to the site. A residence standing in the midst of business buildings, far from the usual residence neighborhood, will have small selling value. It may be in the best of repair and admirably designed for residential purposes, but its value will be practically nil, because

it is unsuited to the site. Every city, doubtless, has many instances where the transition from residence to business uses has taken all value from some buildings. To assess such buildings on the basis of construction cost or on their actual conditions as dwellings would be a great injustice to the owners.

An assessor can be sure of his land values. But when he assesses buildings by the use of building factors, the result in each case should be tested by his judgment of the additional selling value which the building gives to the lot on which it stands. If the total of land value and building value as thus assessed exceeds the actual selling value, the assessor should go over his figures and reduce his building factor. Otherwise he will not make proper allowance for deterioration or inadequacy of the improvement to the site.

B. *Land and Buildings in the Country*

AREA

The first requisite is a determination, as accurate as possible, of the area of each separately assessed parcel. If there is a tax map, this should show the area. In most country tax districts at the present time there is no tax map, and absolutely no means exists for verifying the guess at the area of a farm which the assessor makes when he compiles his tax roll. The discrepancy which appears so frequently when one attempts to compare the total area of the assessed land in a township with the actual area of such township is startling, and the conclusion is inevitable that much land has not been assessed at all. In fact, it may be accepted as of common knowledge that the number of acres assessed to the owner of a farm is often well under the size of the farm. A tax map of some sort is a prerequisite to equitable and scientific assessment work in country districts, but, as said in our former report, such tax map may, in the beginning, be merely an outline sketch map, if nothing better is available.

SEPARATE ASSESSMENT OF LAND AND IMPROVEMENTS

We do not feel it necessary to repeat or enlarge on what was said on this subject in our former report, to which we beg to refer.

ESTABLISHING STANDARDS OF VALUE

The problem of fixing a standard of value is presented to the country assessor just as to the city assessor, but it is not the same problem. In cities frontage is the chief element of value in lots. But frontage is of small relative importance in the country. To assess two lots in a city, of equal frontage, but of different depths, by square-foot value would produce gross inequality. In the country to assess two farms of equal area and fertility, but with unequal frontage on the highway, by a front-foot rule, would in turn produce gross inequality. Superficial area or acreage must be the rule for assessment in the country.

The country assessor does not have to determine a normal unit of area as does the city assessor. The acre is the commonly accepted unit. But he has the same problem as the city assessor of establishing the value of his unit at different points in his district.

We recommend the same method as for city assessors; namely, land-value maps.

LAND-VALUE MAPS

On each road the value of an acre of each class of land, into which the land in his district is divided for purposes of assessment, should be determined. From such unit values the value of the acreage in each farm can be determined, making due allowance for rock, gully, hillside, etc.

In our last report we discussed at length the classification of land for assessment purposes, particularly rural land. The country assessor can enter on the maps at appropriate points the values which he has determined upon as the normal value per acre of land of these different classes. Then by looking over the maps as a whole he can readily see whether he has made sufficient allowance in these acreage values for differences of location, topography, transportation facilities, improved highways, and other advantages or disadvantages.

BUILDING VALUES

The assessment of buildings in the country does not present problems differing from assessment of buildings in the city, and the country assessor can use the same rules as the city assessor.

He will have fewer types to deal with, and the problem should be easier for that reason. We desire, however, especially to caution country assessors to make a proper allowance for depreciation in the value of buildings, for the methods of construction and the failure to keep up proper repairs in country buildings cause them to deteriorate much more rapidly than city buildings.

2. Public-Service Corporations

The property of public-service corporations should be assessed as a unit. This rule, if followed, will remove most of such property from the local assessors, as by far the largest amount of public-service-corporation property extends through more than one tax district. The manner of distributing taxes collected upon the value of public-service-corporation property when assessed as a unit, and whether such property should be assessed at one rate or at local rates through an apportionment of assessed values among the local tax districts, are questions outside the scope of this committee. Our suggestion is merely that the assessment of this property should be made as a unit by one assessing authority. This, however, is impracticable in some states because of constitutional provisions.

Where the local assessor must continue to be charged with the actual assessment of the property or franchises, or both, within his district, of a public-service corporation whose lines extend through several districts, he should, where practicable, be guided and controlled by positive regulations, prescribed by central state authority, so that there may be uniformity of assessment of this class of property.

So much of the value of public-service-corporation property, however, depends upon its employment as a unit and its actual or potential earning power, that a local assessment at physical valuation is rarely satisfactory to any one.

3. Forests, Mines, and Quarries

The local assessor is, as a rule, poorly equipped for making a valuation of unusual classes of real estate such as we have embraced in the general terms of forests, mines, and quarries. Such assessment work requires special knowledge and skill. A State Tax Commission can be of great assistance to local

assessors in furnishing data and rules for the assessment of such property.

In the state of Washington, for example, the State Tax Commission has conducted "timber cruises" for the purpose of mapping the timber lands of the state. The commission has prepared maps of a number of counties, subdivided into sections, and has noted upon each map the character of the timber in each of these subdivisions, together with other information of great assistance in valuation.

The Minnesota Tax Commission has conducted extended investigations of the iron-ore deposits, and has compiled tables showing the relative values per ton of the various grades of iron-ore deposits.

Wherever practicable, assessments, or at least a valuation, of such unusual real estate should be made by a State Board for the information of local assessors. Where this cannot be done, it would be advisable in many cases for the local governing officials to have a valuation made by a competent person, or persons, for the guidance of local assessors.

Conclusions

1. A tax map should be used in each tax district. Accurate, equitable, and scientific assessment cannot be made without an accurate map as a base.

2. Land and improvements should be separately assessed.

3. Standards of value should be established by each assessor, for land and for buildings, to assist him in the exercise of his judgment.

4. A table of values, by which to determine the relative value of lots of varying sizes, should be established and used in each city.

5. Land-value maps, on which the unit values of land throughout the city are shown, should be prepared and used in each city.

6. A table of building factors should be prepared and used by assessors, from which, when applied to cubage or square-foot floor area, the approximate value of a building may be determined.

7. Land-value maps would be of great assistance to assessors in rural districts.

CHAPTER XV

THE IMPÔT PERSONNEL-MOBILIER

62. General Description of this Tax. — The *impôt personnel-mobilier* occupies a peculiar position in finance; nothing precisely like it can be found in the tax systems of other countries. The following is a general description of the tax:[1]

The *personnel-mobilier*, as its name indicates, is composed of two taxes, the personal tax and the *mobilier*, which in certain respects are subject to different regulations.

This tax is due, in general, from every citizen of France and every foreigner, enjoying civil rights[2] and not indigent.

* * * * * * *

The personal tax is the same for all the inhabitants of any locality, and is equal to three days' wages. The general council of each department fixes each year . . . the average value of a day's labor for the department. It cannot, however, value it lower than fifty centimes or higher than one franc fifty centimes.[3]

* * * * * * *

The *mobilier*[4] is assessed according to the rental value of inhabited houses. This is the legal basis of the tax; and it is not

[1] Translated from the Dictionnaire des finances, II, 849 *et seq.* (Paris, 1889–94).

[2] The following classes of persons are not included here: married women living with their husbands; or children, whether they have reached their majority or not, who live with their parents or guardians and do not have an independent income from property or labor. — ED.

[3] In about half the communes the tax is fixed at 50 centimes per day, or 1.50 francs in all. In 1891 only 5 communes valued a day's labor at the maximum figure and placed the tax at 4.50 francs. — ED.

[4] The tax is called the *mobilier*, since it was designed originally to reach revenue derived from personal property, and employed the rental value of a person's habitation merely as a method of estimating this form of income. It was complementary to the land tax, which reached revenue from real property. — ED.

possible to find a satisfactory substitute, as is often attempted, in the assumed ability of the taxpayer, the income from his real estate, or the profits drawn from the soil.

63. The Working of the Impôt Personnel. — Leroy-Beaulieu gives the following account of this tax:[1]

The personal tax is joined to the *mobilier;* and the two taxes form together an apportioned tax.[2] In the apportionment the fixed rates established for the personal tax are maintained by the following process. In raising the quota of the *personnel-mobilier* due from each commune, the taxpayers are first assessed for the personal tax according to the rates fixed for the value of a day's labor. This assessment falls short of the entire amount of the commune's quota, and the balance then remaining is assessed upon the taxpayers according to the rental value of the dwellings they occupy.

The personal tax in France presents two peculiarities, one of which is met in several other countries. In communes that levy *octroi*[3] duties the quota due upon the *personnel-mobilier* may be paid in whole or in part out of the proceeds of the *octrois*. . . . If only part of the *personnel-mobilier* is raised in this way, the rest of the quota must be raised by means of the *mobilier*. It even happens, as a rule, in such cases that the persons paying the lowest rentals are exempted from the *mobilier* as well as the personal tax.

It is easy to understand the reasons which in France lead municipal councils to do away with a direct tax, even though it is a light one, upon persons who already pay the indirect *octroi* duties. I consider, nevertheless, the disappearance of the personal tax in the larger cities of France as something to be regretted. Believing in the maxim that every one should pay a direct tax, I should prefer that the personal tax, and even the *mobilier*, should continue in the large cities; and that some of

[1] Translated from his Traité des finances, Pt. I, Bk. II, ch. 5.

[2] An apportioned tax is one that is not assessed directly upon individuals at established rates; but is first apportioned among the smaller civil divisions, the quota due from each division being finally assessed upon individuals. — ED.

[3] Duties levied upon liquors, provisions, and sometimes other articles, upon their entry into towns. — ED.

the *octrois*, particularly those on indispensable articles of food, should be reduced or abolished.

The second peculiarity is that, by the law of 1832, the personal tax is not subject to sur-taxes[1] for any purpose, whether national, departmental, or communal. The personal tax, therefore, not being subject to sur-taxes, varies from the minimum rate of one franc fifty centimes to the maximum rate of four francs fifty centimes, according to the commune. If it were really intended to make it equal to the value of three days' labor, the rate should range at least from four and one half to nine francs; for there is no part of France where a day's wage is less than one franc fifty centimes, while in large cities and prosperous agricultural or industrial districts it never falls below three francs. Naturally enough the yield of the personal tax in France is very small, because the valuations of a day's labor are so low. But the number of persons subject to the tax has steadily increased. . . .

The number of persons paying the personal tax, including those whose contribution is defrayed out of *octroi* duties, was not less than 7,799,000 in 1866. To-day, despite the loss of Alsace and Lorraine, it has reached the figure of 8,000,000. If the valuations placed upon a day's labor were raised to the correct figures, — one and one half francs for the poorer districts and three francs for the cities and the richer districts, — the assessment would be 5.25 francs per contributor, even if the average day's wage were placed as low as 1.75 francs. This rate for 8,000,000 of contributors would bring in 42,000,000 francs, or about 26,000,000 francs more than the present yield. This simplification in our finances would permit us to abolish certain objectionable indirect taxes, like that on salt, the product of which is 30,000,000 francs. This would be a very desirable result. . . .

Far from rejecting all capitation taxes, I believe that a moderate tax like that just described would have an excellent effect. It would dispense with indirect taxes upon such a necessity as salt; would make the people feel that the payment of a tax is a

[1] In France departmental and local expenses are met largely out of sur-taxes (*centimes additionnels*) added to the rates collected for national purposes. Sometimes a sur-tax is levied for national purposes. — ED.

necessary accompaniment of the enjoyment of civil rights; and would teach them that the government can collect directly from the laboring classes at least a part of their share in the expenses of the state.

64. The Working of the Impôt Mobilier. — Although intended to be a proportional tax upon the rental value of dwellings, the *mobilier*, in its actual operations, is something different from what the law contemplates. Boucard and Jèze give the following account of the working of the tax:[1]

The *mobilier*, in law and in practice, is tending to become a progressive tax.

This tendency in practice is the result of changes prescribed by custom. In order to understand this custom, it is necessary first of all to notice that the *mobilier* is joined to the personal tax, and that the combined tax (*personnel-mobilier*) is apportioned.[2] In other words the amount to be raised for national purposes is fixed each year by the law regulating the finances (*la loi de finances*), and is divided among the departments by the same law.[3] The quota of each department will be divided among the *arrondissements* by the general councils; and the quota of each *arrondissement* will be divided among the communes by the council of the *arrondissement*. Then the quota of each commune will be assessed upon the taxpayers by officials

[1] M. Boucard and G. Jèze, Cours élémentaire de science des finances, 347 *et seq.* (third edition, 1903).

[2] The authors explain, as Leroy-Beaulieu does, the method of keeping the rate of the personal tax fixed while apportioning the *mobilier*. They then give this illustration:

"Suppose that the quota of a commune is 1000 francs. Suppose, too, that the total assessment of the personal tax (that is, the value of three days' labor for all taxpayers) is 300 francs. The difference, or 700 francs, will be assessed *pro rata* upon rentals by the provisions of the *mobilier*." — ED.

[3] Naturally enough, the result of apportioning the tax has been to produce shocking inequalities between departments, *arrondissements*, and communes. . . . The equalization of the apportionment constitutes a serious problem. (The authors go on to show that in some communes the quota to be raised is as low as 2 per cent of the rental value of all dwellings, and that in others it rises to such a figure as 10 per cent or more. In 1901 a law was passed to alleviate the situation, but it does not meet the needs of the case.)

appointed by the prefect from a list presented by the municipal council. In this work the officials do not follow the law, which prescribes *pro rata* assessment of rental values. In 1884 it was ascertained that in 2340 communes, representing 1,733,000 contributors and 24,305,000 francs of the principal of the tax, the *mobilier* was based upon rental values, in accordance with the law. In 1657 communes, representing 238,000 taxpayers and 732,000 francs of the tax, the assessment was based upon rental value, but without precise rules and without always following the rule of proportionality. In 18,664 communes, representing 2,684,000 taxpayers and 8,351,000 francs of the tax, the officials assessed the tax according to the rental value *and the supposed ability of the taxpayers*. Finally, in 13,446 communes, representing 1,981,000 taxpayers and a tax of 6,280,000 francs, the assessment was based upon the supposed ability of the taxpayers as estimated by various *indicia* such as the area of cultivated land, the amount of live stock owned, the number of teams of horses, or such other indications as accorded with the conditions of the regions and the habits of the people. Thus there were only 3997 communes out of 36,107 which conformed to the requirements of the law; and in over 32,000 communes the assessment was according to the discretion of the officials. In the same locality one could find some of the rentals taxed at double the rate imposed on others. The conditions have not changed since 1884. It is known that in most of the rural communes, where the dwellings are much the same whatever the wealth of the occupants may be, the assessors, struck by the fact that often two taxpayers of very unequal ability are housed in about the same manner, have made the tax progressive by increasing the assessed valuation.

The progressive character of the tax has also been sanctioned by the law, through exemption of a certain minimum rental. (Then follows an account of certain provisions of laws enacted in 1846, 1900, and 1903, which sanction in certain cases a departure from a proportional rate of taxation.[1])

[1] One other fact concerning the practical working of the tax is emphasized by Leroy-Beaulieu. When the quota of the *personnel-mobilier* due from a commune is apportioned among the taxpayers, it is clear that, the lower the value placed upon a day's labor, the smaller the amount raised by the personal tax, and the larger the

65. The Theory of the Impôt Mobilier. — Interesting to American readers, on account of various proposals which have been made in the United States, is Leroy-Beaulieu's discussion of the merits of the *impôt mobilier*. He says : [1]

When the legislator abandons the idea of taxing directly the entire income of the taxpayers because he does not wish to resort to arbitrary official assessments and apprehends the deceptions which result from calling for personal declarations of one's income, the best method of taxing citizens according to their abilities is to impose a tax upon the rental value of dwellings. The house rent that a man pays is the least deceptive index of the size of his property or income. Among people who love material comforts and luxuries the first use generally made of wealth is to enlarge and to embellish one's dwelling.

The opponents of this tax (the *mobilier*), who are usually advocates of a general tax on property or income, find many objections to it. Certain persons, they say, by their natural tastes, for reasons of family convenience, or by professional necessity, expend for house rent a larger portion of their income than is ordinarily devoted to that purpose ; while others, on account of simpler tastes, or for economy's sake, spend but a small part of their income for rent. The first class will be overtaxed, and the second undertaxed, by the *mobilier*. This objection is specious. It proves that the tax on rentals is not perfect ; and persons who are sanguine of attaining absolute perfection in fiscal affairs, can reject this tax as not realizing their ideals. But though specious, the objection is not well founded. In the first place, the law can permit a taxpayer to furnish proof that the income which his lodgings indicate that he has is larger than his real income. There would be nothing unjust in demanding that a person in an unusual situation should demonstrate the fact. As for the demands which a profession, like that of the doctor or lawyer, make upon one's income, it would be possible to take this element into account in assessing

amount to be raised by the *mobilier*, will have to be. Since the valuations of a day's labor range from 50 centimes to 1.50 francs, it is clear that the rate of the *mobilier* must vary considerably. — ED.

[1] Traité, Pt. I, Bk. II, ch. 7.

the tax. In this way the tax could be reduced for taxpayers whose profession obliges them to occupy dwellings that are more expensive than those occupied by most persons having the same income. Yet these deductions and allowances do not seem very necessary since the rate of the tax ought always to be moderate.

It is probable that after a time, and just because of the tax, every one will spend for rent just about the proportion of his income which the law assumes that he spends. Few people would care, through ostentation or negligence, to place themselves in a position where they would have to pay a disproportionate tax. As for misers who wish to cheat the government by occupying lodgings far less expensive than they could afford, it is evident that it is difficult to prevent them from doing so in any case. . . .

An objection of greater weight is that the tax on rentals burdens large families more heavily than small; whereas the former should rather be favored than burdened by the tax-gatherer. We may observe that this objection is equally valid against taxes upon consumption, although not against a general tax on property or income. . . . But the difficulty is easily avoided. It would be removed if, in the assessment of the tax, allowance was made for the size of families. A bachelor could be taxed at a higher rate than a man with a family; and, further, the tax could be reduced in rate according to the number of children in a family. Thus, supposing that the rate of the tax were 12 per cent of the rent paid by a bachelor, it could be reduced to 10 per cent for a married man; and might be lowered by one per cent for each child living with its parents; so that a family with four children would pay but 6 per cent of the amount of rental, while a bachelor would pay 12 per cent. (The author then argues that the *mobilier* taxes funded incomes more heavily than unfunded, since, income for income, persons who draw revenue from property will spend more for rent than persons with temporary incomes.)

To this tax on rentals could be added, as the Constituent Assembly did in 1791, certain simple sumptuary taxes, such as taxes on pleasure carriages and servants. We shall discuss such sumptuary taxes later. Here we may say that if they are added to the *mobilier*, the rate should increase according to the

number of carriages or servants. The tax, for example, should increase 10 per cent if the taxpayer keeps horses and carriages, and should increase 5 per cent for each male servant.

* * * * * * *

The preceding discussion has shown that the tax on rentals, which is called improperly the *mobilier*, is one of the best that exists. It certainly is not perfect;[1] but it can be made proportional to the income, or, rather, the ability, of the citizens as closely as is possible in fiscal affairs. It avoids arbitrary methods. And finally it can be made very productive. The rental value of all buildings in France may be estimated at not less than 2,000,000,000 francs. From this we must make some deductions in order to obtain the rental value of dwelling houses; shops, factories, and stores should, therefore, be left out of the estimate. The rental value of dwellings cannot be less than 1,800,000,000 francs. An average tax of 10 per cent, for state and local purposes, would yield 180,000,000 francs; whereas the present *mobilier*, with the personal tax included, yielded only 164,000,000 in 1896.

66. Proposals for a Tax on Rentals in the United States. — The New York Tax Commission, in 1871, proposed that the state should levy a tax on rentals, as a substitute for the existing tax on personal property; and similar recommendations have come occasionally from other sources. As lately as 1897 the Massachusetts Tax Commission, after recommending that the present taxes on intangible personalty be abandoned, proposed that a tax on direct inheritances and a tax on "the occupants of habitations" should be introduced as substitutes. In defense of the suggested tax on rentals, the commission said:[2]

We have said, when discussing the possibility of an income tax, that some contribution in proportion to income enjoyed

[1] Elsewhere the author says: "The great fault of the *mobilier* is that it is an apportioned tax. The quota demanded from each political division is based upon old assessments, and the product of the tax does not keep pace with the increase of wealth. . . . The only way to reform it is to change it into a rated tax." — ED.

[2] Report, pp. 104–109.

would be a desirable addition to the tax system of the commonwealth. In addition to the tax on inheritances and successions, something more in the way of immediate and direct contributions from present incomes seems to us desirable, both as a supplement to the inheritance tax and as an addition to the financial resources available for public expenditures.

For this end we recommend for adoption by the General Court a tax on presumed or estimated income, based on the expenditure of the taxpayer for dwelling-house purposes. We propose that a tax shall be levied on all persons occupying dwellings of an annual rental value of more than $400, at the rate of 10 per cent on the excess of rental value over that sum. We propose to levy no tax of this sort on persons whose incomes are so moderate that their expenditure for dwelling accommodation is not over $400 a year. Those whose income is such that they exceed this expenditure for their dwellings, are to pay, not in proportion to their total dwelling rental, but in proportion to the excess of rental over the exempted limit of $400. Thus, a person occupying a house whose rental value was $500 would pay a tax of $10 a year, this being 10 per cent on the excess of the rental value over $400. A person occupying a house whose rental value was $600 would pay a tax of $20; a house of $800 rental, $40; a house of $1200 rental, $80; and so on. The tax, it will be observed, is on the occupier of a dwelling, and of a dwelling only. Houses or parts of houses used for business purposes are in no way affected by it. The tax is to be levied on the occupier, whether he be owner or tenant. If owner, it is a tax on his general income, additional to the direct tax which he pays as owner of the house. If tenant, it is again a tax on his general income, separate from the direct tax which the landlord pays on the house. In either case, it is a tax on presumed or estimated income, proportioned (in the manner described) to the expenditure for dwelling accommodation.

In the bill which we submit for this tax, we have endeavored to make appropriate provision for the difficult cases which would need to be considered in its administration: for apartment houses, where the separate apartments or tenements may be above or below the exempted amount; for buildings occupied partly for trade and partly as dwellings; for boarding and

lodging houses; and so on. As to the specific legislation which seems to us best for these details, we refer to the several clauses of the bill. We wish here to bring to the attention of the General Court the advantages of such a tax, which seem to us to outweigh its disadvantages, undeniable though the disadvantages be.

It may be contended that such a tax is unequal in its operation. It bears more heavily on a man of large family than on one of small family, since the former will probably spend a larger proportion of his income on dwelling accommodation. It may not reach at all a bachelor, perhaps of good income, yet not called on to spend much of it for his lodgings. In general, expenditure for dwellings is only a rough and uncertain test of income. Two men of the same income may occupy very different sorts of houses; while, on the other hand, a rich man and a man of moderate means may occupy houses of the same general character. As a man grows richer, while he will probably spend more for his dwelling, it is very possible that he will not spend a sum larger in proportion to his increased means.

These disadvantages are real. As compared with an ideally arranged and ideally administered income tax, this form of tax is not to be commended. But no perfect income tax, indeed, no perfect tax of any sort, is within reach; and we must compare any proposed tax, not with the best that could be got under ideal conditions, but with the best that is practically available. Every system of taxation brings occasional hardship and inequality. The essential question is whether a given method of taxation secures on the whole substantial justice, can be administered smoothly, and will yield a large and regular revenue. A tax, moreover, must be considered not by itself alone, but in connection with the nature and effects of other taxes imposed side by side with it. The proposed tax, in combination with the other changes we recommend,[1] seems to us not only to be greatly better than what we now have, but to promise better results than any other available method.

[1] The other changes recommended were as follows :

"1. An inheritance tax, levied with respect to realty as well as to personalty, at the rate of 5 per cent, with an exemption for estates not exceeding $10,000 and an abatement of $5000 on estates between $10,000 and $25,000. The revenue from

The tax begins at a very moderate rate (being levied only on excess of rental over $400), and it becomes heavier as the scale of dwelling accommodation rises. It may be true that for the very rich the scale of tax does not rise in proportion to the total income. But, on the other hand, the inheritance tax, as proposed by us, bears with its full weight on the rich, while it is subject to exemption and abatement for those of small or moderate means. We have recommended, under the inheritance tax, exemptions of estates of $10,000 and less, and abatements on estates up to $25,000, while estates exceeding $25,000 pay tax on their full value. Each of these taxes, the inheritance tax and the house-rentals tax, tends to supplement the other.

The advantages of a tax on house rentals can be easily stated. It is clear, almost impossible of evasion, easy of administration, well fitted to yield a revenue for local uses, and certain to yield such a revenue. It is clear, because the rental value of a house is comparatively easy to ascertain. The tax is based on a part of a man's affairs which he publishes to all the world. It requires no inquisition and no inquiry into private matters; it uses simply the evidence of a man's means which he already offers. We have provided that a taxpayer may either declare the value of the dwelling he occupies or leave it to be estimated by assessors; the matter being one which, in the majority of cases, can be so nearly estimated without declaration by the taxpayer that it is not very material whether he hands in a statement or does not. It cannot be evaded except by change in the style of living, which few people, if any, would undertake because of a moderate tax. We have endeavored to provide, in the bill submitted, for the due assessment of persons dwelling in apartment houses and in hotels. We have provided also for the payment

this tax to be distributed from the state treasury among the several cities and towns, one half in proportion to population, one half in proportion to assessed valuation.

"2. A tax on occupiers in proportion to house rentals, only the excess over $400 of rental being taxable.

"3. Abolition of the present taxes on intangible personalty, such as stocks, bonds, loans on mortgage, income; the taxes recommended under 1 and 2 being relied on to yield at least as large a revenue as is now secured by the taxes to be abolished.

"4. Assumption by the state treasury of county expenses.

"5. Appropriation by the state of the revenue from taxes on corporate excess, now distributed among the several cities and towns." Report, p. 120. — ED.

of two taxes in respect of house rentals by those persons who are so well-to-do as to occupy for their own use two separate houses in the commonwealth; for the bill provides that (except in case of mere change of residence) occupancy of any dwelling for a period of three months or more shall be ground for the collection of the tax. Hence those who have winter and summer houses will pay this tax in both localities in which they reside.

It may be objected that the tax is on real estate, and is additional to the taxes already levied on real estate. As to the owner of a dwelling who occupies it for his own use, it is true that he will pay not only the present taxes on the real estate, but another tax based on the rental value of his house. But this additional tax is levied with respect to the income which he must have, if able to live in an expensive house. No one can own and occupy a house whose rental value is $600 or $800 or $1000 a year, unless he has some considerable income from other sources; and on that income he may be fairly called on to pay a tax, if it be not unduly heavy, and be proportioned in some approximate way to his income. So far as tenants of dwellings are concerned, the owners are called on to pay the direct tax on the real estate, and the tenants alone to pay the proposed tax on rental values. If, indeed, this second tax were so heavy as to cause tenants to avoid dwellings whose occupancy would subject them to it, and were to cause them to seek cheaper houses, it might indirectly affect the demand for houses, and so might affect their rentals. But the rate of tax, as proposed, is very low on houses of moderate rentals, and advances slowly on houses of higher price. We do not believe it would cause any appreciable shifting in the selection or tenancy of dwellings, for comfort or luxury in dwellings is highly valued by most men, and they will hardly modify their expenditure on it because of a moderate tax. We believe, therefore, that this tax would operate, as it is designed to operate, not as a tax on real estate, but as a tax on the incomes of those who are prosperous enough to dwell in comfort or in luxury. We may remark, also, that its financial yield would be an important addition to the revenue of the towns and cities in which it would be levied, and would operate, so far as this went, to make possible a reduction in the rate of direct taxation on real estate.

This brings us to the financial aspects of the proposed tax, in which we find additional strong reasons for its adoption. It is obvious that it would be collected chiefly in the cities, in certain of the larger and more prosperous towns, and in some of the smaller towns whose climate and site cause them to be resorted to by persons of means. The agricultural towns would be almost wholly outside its scope. The strictly manufacturing cities and towns would be little affected. In the other cities, and in the towns affected by it, the tax would be collected solely from those able to live in comfort and luxury, and would be of considerable weight only on the well-to-do. In these places, also, it would be of financial importance. These are precisely the parts of the state which would lose financially from the readjustments proposed by us in connection with the inheritance tax. As we have already pointed out, these places would gain less from the distribution of the proceeds of the inheritance tax than they would lose by giving up the revenue now derived from the taxation of intangible personal property. This difference would be more than made up, in most places, by the new revenue from the house-rentals tax.

The revenue from this tax must be almost entirely a matter of estimate. There is hardly any basis on which to make any specific statement in figures. But we have made a rough calculation as to one ward in Boston, that containing the Back Bay district, and we think it well within bounds to put the tax revenue in this single ward at about $300,000. For the whole city of Boston we think $500,000 a low estimate of the proceeds. The financial loss of Boston from the rearrangements we have proposed elsewhere would be fully made up by this sum. Newton and the town of Brookline would secure a large revenue; the same would be the case in cities like Cambridge, Worcester, Springfield. Similarly, the summer resort towns, whose present gains from the taxes on intangible personalty would cease on the adoption of our proposals, would find some compensation in the revenue from the new tax. The introduction of this tax, in fact, would prevent any financial shock from the other important changes which have been proposed, and would enable the commonwealth to enter at once, without any painful process of readjustment, on a new, and, as we believe, a better system of taxation.

In view of the imposition of this new tax based on presumable income, we recommend the abolition of the present tax on incomes "from profession, trade, or employment." We make this recommendation, not only because the retention of the existing tax side by side with that proposed must result in double taxation of the same object, but because the present tax has proved no less difficult of satisfactory administration than the other parts of the present method of taxing intangible personalty. As matters stand, the partial income tax which the statute imposes is assessed and collected in the most uncertain and unequal manner. Some persons in receipt of salaries that are well known are taxed unfailingly on such income, and this is especially the case with public officers, whose salaries (usually very moderate) are published in official documents. Many other persons, in receipt of larger salaries from corporations or from private employers, never hear of the income tax. Physicians and lawyers who earn incomes from their professions are taxed by guesswork, often not at all, very rarely with certainty and accuracy. The same is true of business men; except that here, in the cases where the income tax is assessed and collected, it is additional to the taxes on the real estate, machinery, and stock in trade of the business carried on, and so is open, in part if not in whole, to the charge of double taxation. In fact, the difficulties which we have referred to elsewhere, when discussing the proposal for a general income tax, have appeared in full evidence with the existing income tax. On every ground, therefore, and especially in view of the proposed tax on house rentals, we recommend its abolition.

CHAPTER XVI

TAXES ON BUSINESS

67. The French Business Tax. — Established in 1791 and receiving practically its present form in 1844, the French business tax (*impôt des patentes*) is one of the oldest taxes on business profits, and has served as a model for business taxes in many other countries. The following description of this tax is taken from a recent treatise:[1]

The tax is defined by the law of 1880, as follows: "Every person, Frenchman or foreigner, who carries on in France any trade, industry, or profession, not expressly exempted by the law, shall be subject to the business tax."

The tax, then, is general. The law aims to reach all profits from industry or profession without any exceptions other than those expressly granted. The omission of any occupation from the published tariff of charges is no reason for exemption; in this case, an administrative ruling is made in order to reach a taxpayer who would otherwise escape. . . .

The *impôt des patentes* is composed of a "fixed" and a "proportional" duty. The purpose of the law in providing a proportional as well as a fixed duty was, on the one hand, to make a proper distinction between various occupations, and, upon the other, to proportion the tax to the profits realized by persons engaged in the same occupations. The fixed duty, therefore, seems to be a tax on the occupation, independently of the conditions under which it is carried on; while the proportional duty is designed to take account of these conditions.

[1] J. Caillaux, Les impôts en France, I, 46 *et seq.* (Paris, 1904).

The Fixed Duty

The occupations subject to the fixed duty are described in three schedules, A, B, and C, which are appended to the law.

(1) Schedule A includes the general run of merchants and artisans. Merchants can be divided into three classes: those who sell principally to other merchants (*marchands en gros*), those who sell both to retailers and to consumers (*marchands en demi-gros*), and those who ordinarily sell only to consumers (*marchands en detail*).

In this schedule the fixed duty is based upon the nature of the occupation and the population of the locality. The occupations are divided into eight classes, for each of which nine rates of duty are prescribed according to population. For example, in order to ascertain the fixed duty to be paid by a grocer in the city of Toulouse, it is necessary first to determine in what class his occupation belongs. He will be in the first class if he is a wholesale grocer; in the second class, if he sells both to retailers and consumers; and in the fifth class, if he is a retail dealer. Then, in the second place, it will be necessary to examine the rates of duty applying to the class in which the grocer belongs, and to select the one which corresponds to the population of Toulouse.

(2) Schedule B applies to a certain number of occupations, such as bankers, proprietors of department stores, and water or omnibus companies. It was thought that the population of the locality was not the only element to be considered in graduating the rates for different persons in any one of these occupations; and also that the occupations themselves could not be classified, as are those in Schedule A. Therefore a special charge was established for each of these occupations; and an attempt was made to adjust the fixed duty according to profits, by breaking it into two parts in the majority of cases. The first part is a determinate charge (*taxe déterminée*) which varies for the same occupation according to the population of the locality and, in exceptional cases, according to other circumstances. The second part is a charge based upon the number of persons employed in excess of five, and applies to most of the occupations in the schedule. In some cases, however, such as water, omnibus, and

hack companies, there is no tax upon employees, but simply a special set of charges for these occupations. (The author then describes an amendment of 1893 relating to department stores. This amendment imposed rates which increase progressively according to the number of employees and the population of the city.)

(3) Schedule C applies to industrial pursuits. It takes no account of the population of the locality where an establishment is situated, since this generally has little to do with the importance of the enterprise. Here the fixed duty may be simply a determinate charge, a charge composed of variable elements, or a combination of the two.

The determinate charge is uniform for all taxpayers in the same occupation. It is, for instance, five francs for all tile makers whatever the conditions may be under which they carry on their industry.

The variable charge is intended to take account of the importance of the establishment and to proportion the tax to the size of the plant. The law selects in such occupations whatever appears to be the best index of the probable profits. Thus a brewery is taxed according to the capacity of its boilers; a hat maker, according to the workmen he employs; a chocolate manufacturer, according to the number of workmen and machines in his factory. . . .

The Proportional Duty

The proportional duty is based on the rental value of both the dwelling house of the taxpayer and the premises used in the profession or industry. The rate of this duty is not uniform, and is regulated by the provisions of a fourth schedule, Schedule D. For persons included in Schedule A the rate of the proportional duty varies from 2 to 5 per cent of the rental value; in Schedule B it is 10 per cent, with a few exceptions; in Schedule C it ranges from $1\frac{2}{3}$ per cent to 10 per cent. Often the rental of a taxpayer's dwelling is taxed at a different rate than the rental of the premises occupied by his business establishment. The so-called "liberal" professions, such as those of the lawyer, doctor, and the like, pay only the proportional duty in Schedule D, and are exempt from the fixed duties.

The rate of the proportional duty is generally $6\frac{2}{3}$ per cent of the rental value, but in exceptional cases it rises to $8\frac{1}{3}$ per cent.

This general scheme is sufficiently complex; but in its practical application further complexities appear. Thus a person who carries on two or more branches of industry in separate establishments, pays a separate fixed duty upon each establishment. If, however, he carries on two or more occupations in the same establishment, some reduction is made, the mode of computation being peculiarly complex. Similar intricate adjustments are prescribed for the proportional duty under the circumstances just described. Partnerships and corporations give rise to further complexities. The senior member of a partnership pays the entire fixed duty; while, in addition, the junior partners pay a fractional part of the duty proportioned to the number of members in the firm. The proportional duty is paid upon the residence of the senior partner and all the buildings occupied by the firm, but the dwellings of the junior members are exempt.[1] Corporations pay merely the fixed duty for every establishment they own. There is also a complicated system of exemptions.[2]

Unlike most parts of the French direct-tax system, the *impôt des patentes* is a rated, not an apportioned, tax. In 1901 its total yield was 211,000,000 francs, an increase of 46,000,000 francs in twenty years. Of this sum 134,000,000 francs was raised for the national government, and 77,000,000 for the departments and communes. The relative importance of the four schedules is shown by the following figures which give

[1] The result is heavier taxation of partnerships. Leroy-Beaulieu says that a manufacturer with 1000 employees in a certain branch of business would pay a tax of 10,266 francs if he carried on the business on his own account; whereas if he had two partners, the tax would rise to 15,336 francs.

[2] Government employees, artists, and teachers are exempt; also farmers, whose profits are supposed to be reached by the land tax.

the amount collected, under each schedule, of the principal[1] of the tax in 1902:

Schedule A	55,473,000 francs.
Schedule B	10,117,000 francs.
Schedule C	19,961,000 francs.
Schedule D	3,908,000 francs.

Thus the bulk of the tax is collected from the merchants and shopkeepers, large and small, who are included in Schedule A.[2]

The theory upon which the *impôt des patentes* is constructed is the same as that which underlies the *impôt personnel-mobilier.* Concerning it, Leroy-Beaulieu says:[3]

In taxing the profits of industry and commerce we have but three methods of procedure: (1) the government can undertake inquisitorial inspections of books and documents of the taxpayers; (2) the taxpayers may be required to declare their profits, under oath; and (3) we can use external signs, indicia more or less vague, which allow us to value approximately, not the profits of any particular establishment, but those of each category of merchants.

Each method has grave faults. In France, a somewhat unstable democracy where every one is afraid of arousing public envy, the people are very unwilling to allow tax officials to become conversant with their personal affairs. It is feared that, if the officials take a single step across the threshold, they will soon wish to take ten; and it seems preferable to keep them outside the house rather than to contend later to fix a limit to official intervention and control. The maxim "*principiis obsta*" is universally approved in this matter.

The second method, that of taxpayers' declarations, may be criticised on different grounds. No society is composed wholly of men who are invariably honest; and, when declarations are employed, there are too many temptations to fraud. Doubtless

[1] The principal of the tax is subject to additions both for national and local purposes. These additions, made on a percentage basis, bring the total yield up to the figures given above.

[2] Of the eight classes of taxpayers in this schedule, the fourth, fifth, and sixth representing establishments of moderate size, pay over three fifths of the tax.

[3] Traité de la science des finances, Pt. I, Bk. II, ch. 8.

this evil can be reduced by vigorous administrative control and shrewd inquiry by the tax officials; but then we fall back into the evils of the previous method. Even admitting, what one must be very skeptical to deny, that dishonesty is the exception, nevertheless the use of declarations has the fault of subjecting the most honest men to the suspicion of bad faith and evasion.

We do not say that these inconveniences of the two methods just discussed are not offset by numerous advantages; but the people of France have been less impressed by the advantages than the disadvantages of these methods. It is necessary, therefore, in this state of popular opinion, to adhere to a system of taxation according to legal presumption, to certain external indicia, which put the taxgatherers on the track, not of the profits actually realized by the taxpayer, but the possible or probable profits. This system is, by its very nature, defective; it can be improved, but can never be perfect. One of its chief defects is that it can throw no light upon the profits of each individual trader; its basis is, in fact, the assumed average profit which each class of traders can reasonably make under given conditions of business. Thus, in this system, cases of injustice to individual taxpayers will always be numerous; and every project for improvement will confine itself to providing that no branch of industry shall be favored at the expense of another.

From 1791 to the present day there has been a constant effort to make the *impôt des patentes* more nearly proportioned to the profits of the taxpayer. The more just our legislation has tried to be, the more complicated it has become. It is by making new distinctions, adopting new and more numerous indicia, that the law has succeeded in eliminating some of the crying injustices in the assessment of the business tax.

* * * * * * *

This tax is assessed in France according to the four principles that follow:

1. Profits are not the same for all industries. There are various industrial and commercial pursuits which, on their very face, differ greatly from one another in respect of their probable profits. Thus, it is fair to presume that a banker makes larger profits than a joiner, and that a grocer makes more than a cobbler. This is a presumption which is reasonable and justifies the

classification of industries according to their assumed importance.

2. For commercial enterprises of the same class the profits ordinarily are in some proportion to population of the locality where the trade is carried on. A grocer in Rouen has a better chance to make money than one in Yvetot; and the latter has a better chance than a grocer in a small village. This presumption, too, is not unreasonable so far as retail trade is concerned; but it is totally invalid in the case of manufacturing establishments. Therefore the law does not employ it in the latter case.

3. The profits of a manufacturer or merchant maintain usually a certain proportion to the size of the premises occupied, the number of machines used, and the number of employees. Thus a spinner operating a factory with one hundred thousand spindles has a prospect of larger profits than a competitor with an establishment having ten thousand spindles. A grocer with large stores can be presumed to have a better chance to make money than one who occupies a small store. A dealer in notions who has one hundred employees has a better chance than one who employs but ten persons. This presumption is not unreasonable; it is almost the only one applicable to large industries.

4. Business profits often stand in a certain relation to the dwelling that a person occupies; since the larger they are, the better the house that the recipient will occupy. This presumption, while not false, is the least accurate of the four. A man's dwelling may be an indication, rather, of the fortune he has previously acquired, of his personal tastes, or of the size of his family. Then, too, it can be said that, since a business man has already paid the *mobilier*, it is clearly unjust to tax him again upon his dwelling.

However the matter may stand, these four presumptions give rise to an extremely complicated system of taxes which are often faulty in particular cases; but, nevertheless, the best that can be invented if it is proposed to tax the business profits without resorting to declarations of the taxpayer or inquisitorial investigations by the taxgatherers. It is necessary, besides, never to lose sight of the fact, already mentioned, that the business tax does not attempt to tax profits actually realized so

much as the profits that can be reasonably expected under the given conditions. If these average, or probable, profits are not actually realized by the taxpayer, the treasury does not reduce its demands; if, on the other hand, they are exceeded, the demands of the treasury do not increase.

68. The Prussian Business Tax. — Prior to reforms effected in 1891 the Prussian business tax (*Gewerbesteur*) was modeled more or less after the French tax. Industries were divided into eleven classes, and the rate of the tax was graduated according to the size of the city or locality in which the business was carried on. The Prussian tax differed from the French model, however, in important particulars. In the first place, instead of fixing a hard and fast rate for each class of industries, the law levied an average rate upon all establishments of the same class located in the same locality, thereby leaving much to the discretion of the assessors. This average rate multiplied by the number of business enterprises gave the total amount to be collected from the persons in any given trade or occupation in any locality. Then for the purpose of dividing this quota among the different establishments to be assessed in each locality the law provided that the taxpayers of each industry should elect assessors from their own numbers. Such assessors, presumably, would be acquainted with the general condition of each taxpayer's business, and would be able to effect a just distribution of the tax, within the restrictions imposed by the law.[1]

In 1891, however, the Prussian tax was radically changed in many of its principal features, thereby losing all resemblance to the French business tax. These changes have been described by Dr. J. A. Hill, as follows:[2]

[1] The law provided, for instance, that no one should pay less than half the average rate for the class. This prevented disproportionate assessment of the large establishments.

[2] *Quarterly Journal of Economics*, Vol. VIII, pp. 82–92. Reprinted with consent of the author.

Such were the main features of the Prussian business tax previous to 1891. The law of that year introduced important changes. The old classification of industries has been abandoned, and the population of the place in which the business is located is now no longer taken into account in regulating the tax.

The basis of the new classification is for all kinds of business alike, either the annual earnings or the capital. There are four classes (*cf. Gesetz von Juni* 24, 1891, § 6): the first includes business or industrial undertakings which either yield annual earnings amounting to not less than 50,000 marks, or employ a capital (fixed and circulating) of not less than 1,000,000 marks; in the second class may be rated those businesses with annual earnings from 20,000 to 50,000 marks, or with a capital from 150,000 to 1,000,000 marks; in the third, those with earnings from 4000 to 20,000 marks, or with capital from 30,000 to 150,000 marks; and in the fourth, those with earnings from 1500 to 4000 marks, or with capital from 3000 to 30,000 marks. Any business in which neither the earnings amount to 1500 marks nor the capital to 3000 marks is exempt from the tax (*Gesetz*, § 7). It was estimated that this limit would exempt about 300,000 small business undertakings, or more than one third of the total number of businesses (865,940) assessed under the old law (*cf. Einleitung des Gesetzes*).

This double basis of classification may at first seem somewhat confusing, or even inconsistent with the plain rule of logic that a division must be founded on one principle or basis. But a further study of the law shows how the two bases are to be employed so as to avoid difficulty. Each business is classified on the basis of either its earnings or its capital. When it belongs in one class on the first basis and in another on the second, the tax officials have, with certain exceptions which we shall mention presently, practically the option of rating it in either class. Of course, having regard to fiscal considerations only, it would be natural to rate the business in the higher class, where it would yield considerably more to the public revenues than in the lower. Accordingly, the intention is that in general earnings shall be employed as the principal basis of classification; but it is deemed practically advantageous to use capital as a secondary or alternative basis, because

there are cases in which it is especially difficult to estimate the earnings, — as when a business is newly established or where it is carried on principally in foreign countries, although having its location or some one factory in Prussia. Furthermore, it is urged that this use of two bases meets with favor in business circles, where occasions for dissatisfaction would often arise if a business were transferred to a lower class or perhaps exempted from the tax altogether, simply because, owing to some special combination of circumstances (*Konjunctur*) or to some single error of management, its earnings had temporarily fallen below the limit of the class in which it had hitherto been rated (*Einleitung des Gesetzes*).

But, whichever basis of classification may be employed, the tax for each class, as we shall see, is graded with reference to the estimated earnings. It is apparently meant to be a tax on profits rather than capital. Therefore, if a business is correctly classified on the earnings basis, the fact that it may belong in a lower class on the basis of capital does not show that the tax on it is disproportionately high. That fact simply means that the business derives, relatively, large earnings from small capital, or, in other words, is unusually profitable, and may be taxed accordingly. The law allows no appeal from the classification in such cases as this.

The case is otherwise when the business is correctly classified on the basis of capital, but on the basis of earnings belongs in a lower class. Here the tax may prove to be higher in proportion to the earnings than was intended; and the law has taken such cases into consideration by providing that any business, even when correctly classified on the basis of capital, must be transferred to the next lower class on proof that for two years in succession the earnings have not amounted to 30,000 marks in Class I, 15,000 marks in Class II, or 3000 in Class III (*Gesetz* § 8). These amounts, then, represent the minimum limit of permanent earnings for these three classes respectively. Whatever the capital may be, the business cannot be retained in the class in question unless the earnings come up to this limit. The limit, it will be observed, is considerably below that which is adopted for the classification on the earnings basis. On that basis no business can be classified in

Class I, for instance, unless its earnings amount to 50,000 marks. If, however, its capital amounts to 1,000,000 marks, it may be classified on the basis of capital, and retained in Class I so long as its earnings amount to 30,000 marks. It does not follow, however, that, because under these conditions the business is retained in Class I, it must pay as high a tax as it would if its earnings were sufficient to rate it in that class, or that it must pay a higher tax than it would if, on the basis of earnings, it were transferred to Class II. This will be apparent when we come to consider the scale of rates.

There are no provisions corresponding to the above in case of Class IV, the lowest class. Therefore, no business with a capital of 3000 marks is exempt from the tax, however small its earnings may be; but under the scale of rates in that class the tax may readily be adjusted to cases in which the earnings are unusually low in proportion to the capital.

In determining what constitutes earnings or capital, the tax officials have to rely mainly on their own personal knowledge and judgment. But a few general principles are laid down in the law. The costs of the business are to be deducted from the gross receipts, and a proper allowance made for depreciation or loss in value (*Werthverminderung*),[1] and for the loss incurred by discarding machinery or other equipments of the business. But the interest on capital, whether borrowed or not, and on debts cannot be deducted. Neither can expenditures for the improvement or extension of the business, nor for the living expenses of the owner and those dependent on him. Fixed and circulating capital is briefly defined as comprising all the value permanently devoted to the prosecution of the business (*Gesetz*, §§ 22, 23).

The method of assessing the tax by means of a medium or average rate has, as we have said, been retained in the new law: it does not, however, apply to Class I. There its adoption was considered impracticable, owing to the wide differences in the earnings and capital of businesses rated in this class. Therefore, each business is assessed separately and independently.

[1] This, it seems, includes loss occasioned by wear and tear (*Abnutzung*) of the buildings and equipments and any depreciation in the value of wares or of the outstanding claims of the business, etc.

The tax is graded so as to collect approximately 1 per cent of the earnings. Thus, when the earnings are from 50,000 marks to 54,800 marks, the tax is 524 marks; and it increases 48 marks for every increase of 4800 marks in the earnings. In this class, then, the tax is simply a graded tax on earnings assessed directly on each business. The assessment districts are the provinces and the city of Berlin; and, of the assessors for each district, two thirds are chosen by the committee of the province (*Provinzialausschuss*), and one third are nominated by the Minister of Finance (*Gesetz*, §§ 9, 10).

For the other three classes average rates are prescribed: for Class II, 300 marks; for Class III, 80 marks; and for Class IV, 16 marks. This rate is the average tax to be collected from the taxpayers in any given assessment district. The assessment district for Class II is the *Regierungsbezirk;* for Classes III and IV, the *Kreis*. The taxpayers rated in the same class and district constitute a tax association (*Steuergesellschaft*), on which the total tax for that class in that district is assessed (*Gesetz*, § 13). This total is, of course, the product obtained by multiplying the number of business undertakings represented in the association by the average rate for the class in which it belongs. If, for instance, in a given district there are 100 businesses rated in Class III, the total tax in that association will be (80 × 100 =) 8000 marks. The distribution of this total among the individual taxpayers is intrusted to a tax committee, the *Steuerausschuss*, the members of which are elected by the association from its own members. But the chairman is a commissioner of the government appointed to represent the interests of the state (§§ 15, 25). In the election of the committee the suffrage is limited to one vote for each business taxed. The size of the business is, therefore, not taken into consideration; and, where there are several proprietors, only one of them can vote. In this way it is hoped to secure assessors who possess the confidence of the taxpayers, have a practical acquaintance with the local business conditions, and will distribute the tax equitably and satisfactorily. This feature of the law is not new. It was adopted when the business tax was introduced in 1820, and in its workings is said to have given general satisfaction.

In assessing any individual business, the committee is limited to a choice among the optional rates prescribed in the law for each class. In Class III, for instance, there are 18 such rates, ranging from a minimum of 32 marks to a maximum of 192 marks (*Gesetz*, § 14). Moreover, the rate selected in any case may not exceed 1 per cent of the earnings of the business taxed. This rule, however, does not apply to a business rated on the basis of capital when on the basis of earnings it belongs in a lower class (*Gesetz*, § 15, 2). Acting under these limitations, the committee is to distribute the tax according to their knowledge or estimation of the amount of the earnings.

In this intention to collect about 1 per cent of the earnings,[1] and in most cases not more, is found the explanation of the scale of rates which is given below. The maximum rate in each class is nearly 1 per cent of the maximum earnings in the earnings scale of classification; and the minimum rate, although considerably less than 1 per cent of the minimum earnings in that scale, is but little more than 1 per cent of the minimum earnings which a business might yield, and still be retained in the class in question on the basis of its capital.[2] The consequence is that the rates for the different classes overlap; that is, the minimum rate for each class is less than the maximum rate for the next lower class. This allows a considerate treatment of businesses which are rated in a given class on the basis of capital, but which, as regards earnings, belong in the next lower class. The arrangement is an ingenious one, and has some results which are worth noting.

[1] In studying the Prussian business tax, and most of the other taxes levied by European countries upon business or property invested in business, the American student should observe particularly the moderate rates of taxation which are imposed. He should contrast, for instance, the Prussian tax of 1 per cent of the presumed *income* with the American property taxes of 12, 15, and even 20 dollars in the thousand of the *capital value* of factory buildings, machinery, stocks of goods, and the like. A tax of 15 dollars on every 1000 dollars of capital invested in a business is, if the earnings are 6 per cent, — or 60 dollars per 1000, — equivalent to an income tax of 25 per cent. Undervaluation of the property may reduce the tax, and usually does so; but if the property is assessed for 50 per cent of its true value, the tax of 15 dollars is 12½ per cent of the income. — Ed.

[2] In Class IV there is, as we have remarked, no such minimum limit for the earnings. But the low minimum rate, 4 marks, makes it possible to keep the tax below 1 per cent until the earnings fall below 400 marks.

		Rates
		4
		8
EARNINGS from 1500 to 4000 marks, or CAPITAL from 3000 to 30,000 marks,	= IV . . .	12
		16 = average tax for IV.
		20
		24
		28
		32
		36
		40
		48
		56
		64
		72
EARNINGS from 4000 to 20,000 marks, or CAPITAL from 30,000 to 150,000 marks, and earnings not less than 3000 marks,	= III . . .	80 = average tax for III.
		88
		96
		108
		120
		132
		144
		156
		168
		180
EARNINGS from 20,000 to 50,000 marks, or CAPITAL from 150,000 to 1,000,000 marks, and earnings not less than 15,000 marks,	= II . . .	192
		228
		264
		300 = average tax for II.
		336
		372
		408
		444
		480
EARNINGS not less than 50,000 marks, or CAPITAL not less than 1,000,000 marks, and earnings not less than 30,000 marks,	= I	524 on 50,000–54,800 earnings.
		572 on 54,800–59,600 "
		620 on 59,600–64,400 "
		Etc. Etc.

In the first place, it is obvious that the transfer of any given business from one class to the next lower need not necessarily reduce the tax it has to pay; and conversely, of course, its transfer to a higher class need not raise the tax. For instance, a business with a capital of 150,000 marks, and earnings

amounting to 18,000 marks, might either be rated in Class II on the basis of capital or in Class III on the basis of earnings, without making any difference in the tax the owner is called upon to pay. For in either class he may be assessed 156, 168, 180, or 192 marks. In that case, it might well be a matter of indifference to him in which class he was rated; but in the yield of the tax to the public treasury it would make a very important difference. For, if the business is retained in Class II, it yields the average rate for that class, — namely, 300 marks, — which has to be raised by the association in which the business is taxed. If, however, it is transferred to Class III, it will only yield 80 marks, the average rate for that class. It is obviously for the interests of the treasury to have this business retained in Class II. Its transfer to Class III means a loss of 220 marks; and yet the owner of the business may, as we have seen, have no special inducement to protest against his retention in Class II. That is not the case, however, with the association to which he belongs; for it pays over to the public treasury 300 marks on his account, while it receives from him only 180 marks. It would therefore gain 120 marks if this taxpayer were transferred to Class III; and in that class he will be welcomed, for he adds but 80 marks to the total tax of the association, to which he contributes 180 marks.

The arrangement has this advantage, as it seems to me: It allows the taxpayer who is on the border line between two classes to pursue his own business affairs without giving himself much concern as to which class he is rated in. He can leave that question to be decided by the representatives of the associations interested and the government officials. In making the classification, the friction must come principally at this point. The fiscal interests of the state demand that the business should be classified in the higher class, those of the two associations that it should be classified in the lower. It is not the state *versus* the individual taxpayer, but the state *versus* a group of taxpayers, or their representatives, no one of whom has any special reason to be more interested in the decision than another. It is the classification which determines definitely the amount which the state is to receive from the tax and the amount which each association — not each individual taxpayer — is to

contribute. After the classification is settled, therefore, any further conflict of interests is between the members of the same association, each of whom will of course find it for his advantage to see that he does not pay more than his share of the total tax of the association, or, what is the same thing, to see that other members do not pay less than theirs.

It follows that, so far as the returns from the tax are concerned, it is only necessary to ascertain the earnings or capital of a business within rather wide limits, — namely, the limits which determine the classification,— and the taxpayer may be called upon to state where within these limits his business belongs (*Gesetz*, § 55); but any more definite statements as to his earnings or capital cannot be required of him. He may, however, be required to state in what business or businesses he is engaged, where they are located, the number and kind of workmen employed, the nature and quantity of machinery in use, including the motive power of the works, or to answer any other questions in regard to the outward indications of the extent of his business (*Gesetz*, § 54). The chairman of the tax committee, moreover, has the right to inspect any place of business or manufacture during working hours (§ 25). But the books of the business cannot be examined without the owner's consent (§ 27), and the assessors are bound by oath to keep secret all information obtained in the exercise of their office (§ 49).

It must not, however, be forgotten that in the assessment of the income tax the written declaration is required. These declarations can hardly fail to be of great assistance in the assessment of the business tax. In many cases, the personal income of the taxpayer will be identical with the earnings derived from the business in which he is engaged; and the Introduction to the business tax law calls attention to the urgent desirability of selecting for chairman of the tax committee the chairman of the income tax assessment commission for the same district, "on account of the substantial identity of the materials used in ascertaining industrial income and business earnings." [1]

[1] By a law of 1893 this tax was made a local tax. Its yield at a comparatively recent date was 20,000,000 marks. — ED.

69. License Taxes in Massachusetts. — Apart from the general property tax, which, of course, reaches capital, the common form of business taxation in the United States is the license tax. Many states and probably all municipalities impose license taxes upon various occupations.[1] Except in the South, the state taxes are confined largely to licenses for the sale of liquors; the Southern states, however, have a most extensive system of license taxes. Municipal licenses generally cover a wider range of occupations than the state taxes, and in Southern cities are frequently oppressive.

Confining our attention to the license taxes imposed by the states, we may consider first the case of Massachusetts:[2]

The commonwealth imposes a tax upon the privilege of selling spirituous and malt liquors within the commonwealth. Every person desiring to engage in such business must first obtain a license from the authorities of the city or town in which he desires to do business, and pay the license fee imposed. The amount thus collected is divided between the commonwealth and the city or town in which the license has been granted, the city or town receiving three fourths and the commonwealth the remaining one fourth of the receipts.

A statute of the year 1888 limited the number of licensed places in any city or town which votes to grant licenses, to one licensed place for every thousand persons of the population of the city or town, as enumerated in the last preceding state or national census. There are some exceptions to this general rule. The most important is that for the city of Boston, which is allowed to have one license for every five hundred persons of the population. Certain minor exceptions are also made in favor of summer resorts having no settled population the year round. Every town, however small, is entitled to grant one license.

* * * * * * *

The licenses are of six sorts. With the exception of the sixth class, which is distinguished by the person to whom the license

[1] For an account of license taxes, see Ely, Taxation in American States and Cities, 203–209. [2] From the Report of the Commission on Taxation, 1897, pp. 26–27.

is granted, the classification is based on two grounds of distinction; namely, (1) whether the liquor is to be drunk on the premises or not, and (2) on the sort of liquor to be sold. The classification in the statutes is as follows:

First Class. — To sell liquors of any kind, to be drunk on the premises.
Second Class. — To sell malt liquors, cider, and light wines, containing not more than fifteen per cent of alcohol, to be drunk on the premises.
Third Class. — To sell malt liquors and cider, to be drunk on the premises.
Fourth Class. — To sell liquors of any kind, not to be drunk on the premises.
Fifth Class. — To sell malt liquors, cider, and light wines, containing not more than fifteen per cent of alcohol, not to be drunk on the premises.
Sixth Class. — To druggists and apothecaries, to sell liquors of any kind for medicinal, mechanical, and chemical purposes only, and to such persons only as may certify in writing for what use they want it.

The license fee varies for the different classes. A statute of 1888 fixed the minimum fee to be charged by cities and towns at the following figures; for a license of the first class, $1000; for a license of the second class, $250; for a license of the third class, $250; for a license of the fourth class, $300; for a license of the fifth class, $150; for a druggist's license, $1. A city or town may charge as much more than these minimum fees as it may deem proper.

The following figures show the yield of the tax to the commonwealth, which is one quarter of the total yield, for a series of years:

1890	$426,309.62	1894	$544,292.50
1891	543,117.85	1895	682,099.36
1892	504,979.81	1896	669,602.17 [1]
1893	485,385.56		

70. License Taxes in Maryland. — Professor T. S. Adams gives the following account of license taxes in Maryland:[2]

[1] Since 1896 the revenue has been as follows:

1897	$780,977	1901	$811,683
1898	770,524	1902	843,146
1899	733,467	1903	775,665
1900	805,191	1904	802,294 — ED.

[2] Studies in State Taxation, edited by J. H. Hollander. Johns Hopkins University Studies in Historical and Political Science, Series XVIII. Reprinted by consent of editor, author, and publisher.

Licenses in Maryland date from an early period, although the most important were first levied in the second decade of this century. In 1780 the marriage license was imposed, and an annual tax of £15 upon billiard tables was levied in the same year. In 1819 the broker's license was introduced in the form of a tax of $500 per annum on every broker dealing in bank notes or lottery tickets. The trader's license, auctioneer's license, and ordinary's license date from 1827. From this time until about twenty-five years ago the state derived its principal revenue from this source. During the twenty-two years, 1877–1898, the various licenses yielded about 33 per cent of the total tax receipts.

Forms of license taxes.— Besides the quasi-license taxes to be treated with the corporation taxes, the following license taxes are imposed in Maryland:

1. Auctioneers in Baltimore city pay $450 to $750, according to the amount of sales. In the counties, auctioneers pay the trader's license upon the value of the stock on hand. Receipts in 1898, $3822.

2. Brokers pay special charges ranging from $100 for exchange, insurance, and pawnbrokers, to $18.75 for grain, coffee, cotton, and sugar brokers. Receipts in 1898, $18,952.65.

3. Hawkers and peddlers pay from $100 to $200 for each county in which they sell, according as they travel on foot or with horse and wagon. In eleven counties they pay $300 when they travel with a wagon and two horses. Receipts in 1898, $3012.91.

4. Traders' licenses vary from $12 paid on a stock of $1000 or less, to $150 paid on a stock worth $40,000 or more. Receipts, in 1898, $188,879.44.

5. Billiard tables. The annual license tax on billiard tables rented or conducted for a profit is $50. Receipts in 1898, $5604.27.

6. Liquor dealers selling in quantities of more than one pint pay licenses varying from $18 on a stock worth less than $500, to $150 on a stock worth more than $30,000. Dealers taking out an $18 license must pay in addition the trader's license of $12. Receipts in 1898, $10,696.88.

7. Ordinary keepers pay from $25, where the house occupied

has a rental value of $100 per annum or less, up to $450, where the house has a rental value of $10,000 or more. Receipts in 1898, $11,877.89.

8. Saloons and oyster houses in the counties pay $50 per year. Receipts in 1898, $33,044.44.

9. High liquor license. In Baltimore city and Ellicott city all liquor dealers, saloon keepers, etc., pay an annual license of $250. Receipts in 1898, $546,880.14.

10. Oyster dredger's license. Owners of boats engaged in dredging oysters pay $3 per ton annually. Receipts in 1898, $35,693.75.

11. Oyster tongers pay from $2 to $5 a year, according to length of boat. Receipts in 1898, $12,925.24.

12. Oyster canners pay one tenth of one cent upon every bushel of oysters shucked. Receipts in 1898, $4853.92.

13. Oyster measurers pay ten cents per 100 bushels measured. Receipts in 1898, $909.20.

14. Net fishing. Three cents for each square fathom of seine, and one cent for each square fathom of gill net. Receipts in 1898, $204.85.

15. Commercial fertilizers. Every manufacturer or importer of fertilizers is required to pay $5 for the first 100 tons sold, and $2 for each additional 100 tons. Receipts in 1898, $9150.

16. Exhibition licenses. Theatrical companies, shows, circuses, etc., pay in addition to local licenses, $30 per year, or $1 per exhibition, in the counties. In Baltimore city theatrical exhibitions and circuses pay to the state $3 each night; other exhibitors, $10 per week. Receipts in 1898, $3347.71.

17. Cigarette license. To sell paper-wrapper cigarettes dealers are required to pay a special license of $10 per year. Receipts in 1898, $11,160.20.

18. Race and fishery. To sell liquor at horse races and fisheries, special licenses are issued which cost $4.50 and $6.50 respectively. Receipts in 1898, $41.80.

Critical suggestions. — Judged by McCulloch's empirical standard, the license taxes are the best taxes we have. They are easily and cheaply collected, very productive, and cause little irritation or complaint. Considering how completely the faculty or *quid pro quo* theory fails to explain some of our most satis-

factory taxes (as, for example, the inheritance tax), there seems no reason why we should advocate the abandonment of license taxes because they have no apparent philosophical basis. Many of these licenses, notably the high liquor, cigarette, and exhibition licenses, are sumptuary measures. The first of these has had a most beneficial influence in Baltimore, and there seems little reason why we should not regulate by taxation if the measure of regulation desired by the public can be thus secured. The traders' licenses are not excessive and it is improbable that prices are appreciably affected by them. If the number of such fixed charges could be increased without causing more injustice or irritation than the average license of the present, the increase would seem, *pro tanto*, a most desirable substitute for the property tax.

Many of the licenses are specially devoted to the interests of the particular branch of trade from which they are drawn. Thus, most of the oyster licenses are imposed for the sole purpose of maintaining the supremacy of Maryland in the oyster trade. The same motive explains the fertilizer license. Baltimore is now the largest manufacturing center of the fertilizer industry in the country. In order to keep the standard of these goods high this license is imposed and the proceeds devoted to the maintenance of a chemical laboratory where the inspection and analysis of fertilizers is constantly going on.

In glaring contrast to most of the licenses are those required of peddlers and auctioneers in Baltimore. The latter occupation is a virtual monopoly in Baltimore, only eight licenses being issued in 1898. The law provides that auctioneers shall be appointed by the governor and shall pay $450 per annum if their sales — excluding real estate and houses — are less than $150,000. Where such sales amount to more than $150,000, the license costs $750. Whether this tax meets the approval of those who can afford to pay it, is not plain. But it certainly renders one legitimate vocation inaccessible to the poorer classes and undoubtedly diminishes the revenue that would accrue from this source if the licenses were of normal amount.

The excessive license charge required of peddlers furnishes another instance of explicable but unjustifiable trade antipathy. Scarcely a session of the General Assembly passes without these

charges being increased or extended over counties where formerly they did not apply. If auctioneers and peddlers thrive so well and it requires such an effort to repress them, it is only proof that they are performing some economic function better than the ordinary traders, and they should be encouraged, not discouraged. The excessive peddler's license is due in some degree to a survival of the Jew-baiting instinct. This charge is undoubtedly aimed at the industrious Jewish itinerant who peddles notions, since hawkers of fish and green provisions are exempt.

Licenses are granted by the clerks of the circuit courts. Sheriffs and constables are enjoined to make diligent search for violators of the law, and informants in every case are given one half of the penalty imposed. The law is generally well enforced and there are no wholesale evasions. Some of the penalties provided exhibit peculiar prejudices similar to those noted in the case of peddlers; for example, a penalty of $500 is imposed upon people doing a broker's business or keeping a public billiard table without a license, while the pecuniary penalty for selling liquor without a license varies from $50 to $200.

The more serious problem to be solved in connection with licenses is not whether they should be retained, but whether their proceeds should go to the state or the local division in which they are collected. The state retains one fourth of the proceeds of the high liquor license collected in Baltimore. It retains the entire proceeds of the traders' licenses collected in Baltimore — nearly $104,000 in 1898. Two questions are frequently asked by the citizens of Baltimore: Why should any of this money go to the state at all, and, if the state has a just claim to the proceeds of license taxes, why should it take a part in the one case and the whole amount in the other?

The answer to the latter question is not difficult to find. The city of Baltimore, in so far as its liquor trade is concerned, is subjected to heavier taxation than other local districts. A portion of this taxation, about equivalent to the amount of taxes collected from liquor dealers in other parts of the state, is retained by the state in order to place Baltimore upon an equality with other local divisions in this respect. The justice of this apportionment must be acknowledged if it be decided that the state

has a better claim to the proceeds of licenses than the several local divisions.

The mayor of Baltimore has recently criticised the practice of using the traders' and other licenses for state purposes. The public expenses entailed by traders are borne by the city; the logical fund for the payment of these expenses, he claims, is that derived from the licenses imposed upon traders.

The question involved is clearly one of equity, to be decided by reference to the general principle in accordance with which license taxes are imposed. If licenses are paid in return for and in proportion to public services rendered, the proceeds, speaking generally, should go to the local districts in which they are collected. If they are payments for the grant of public privileges, the proceeds should go to the state.

In origin, the license tax is closely akin to the modern franchise tax, and appears, in its historical aspect, as the price of the privilege to do business; in Mississippi, for example, the tax is still known as the privilege-license tax. The grant of such privileges lies wholly within the province of the sovercign power; it is not within the ordinary power of a municipal corporation either to authorize, prohibit, or circumscribe by license the pursuit of a calling or trade not inimical to the public health, morals, or safety. In consequence of these facts, the payments for the grants mentioned should be retained by the power which conferred them; and this power is the state. This interpretation of the nature of the license tax is further supported by the difference in the burden imposed upon the several kinds of business. The broker and the peddler have no extensive stocks or establishments necessitating the maintenance of police and fire departments, yet they pay higher licenses than ordinary traders. Moreover, the license charges are substantially uniform throughout the state, irrespective of the degree of protection afforded by the various local governments.

It is admitted that the above is an ultra-theoretical view of the nature of the license tax, but the distribution of taxation among individuals and the distribution of the proceeds of taxation among the several governmental divisions are problems which are essentially theoretic. It is also admitted that there are many weighty arguments which may be adduced in support

of the justice of the mayor's plea. But in the opinion of the writer, the distinctive features of the license stamp it unmistakably as a state tax as distinguished from a municipal charge.

71. License Taxes in Mississippi. — Even more inclusive is the system of license taxes of Mississippi and most other Southern states. Dr. C. H. Brough has written the following account of the Mississippi system:[1]

Mississippi, in accord with the general practice of Southern commonwealths, imposes a privilege-license tax on well-nigh every occupation. An examination of the present revenue laws reveals the fact that there are one hundred and nineteen occupations to which licenses must be issued as a condition precedent to the transaction of business.

The importance of the privilege-license system in Mississippi is conspicuous. From the time when the dominant landed proprietors of an antebellum régime demanded the taxation of other objects than their farms and estates, to the present day, when the need of revenue and a sentiment in behalf of local protection sustains what would seem to be a fiscal anachronism, the privilege-license system has been an important source of revenue.

Of recent years the number of occupations subject to the payment of licenses has multiplied and the charges have increased. In the early laws we found the privilege schedule limited to auction sales, billiard tables, bowie knives, nine-pin alleys, peddlers, race horses or tracks, taverns, groceries, and theaters. An examination of this list shows that the articles specified are principally luxuries, the restricted consumption of which was deemed desirable.

In striking contrast to this limited use of the privilege system is that implied in the revenue laws of 1898. Here the predominance of the idea of revenue over regulation permits of no discrimination between necessary goods and luxuries, and between useful and useless occupations. Railroads and lawyers are placed on the same footing with merry-go-rounds and dealers in

[1] Studies in State Taxation, edited by J. H. Hollander. Johns Hopkins University Studies in Historical and Political Science, Series XVIII. Reprinted by consent of the editor, author, and publisher.

hopfenweis. Bedspring dealers are as important in the eye of the law as boarding-house keepers.

This enlargement of the scope of the privilege-license system indicates a gradual movement away from sole dependence upon the general property tax, a movement accelerated by the practical defects of the latter and the need of applying a fiscal differential to the modern complex industrial organization. The rigidity of the state constitution has necessitated the taxation of corporations in the form of a privilege-license tax. That the taxation of corporations has taken definite form in the privilege-license system may be seen from the fact that railroad, express, sleeping-car, telephone, telegraph, and insurance companies are subject to the imposition of a privilege tax on those elements supposed to represent their taxable capacity.

Accident insurance companies pay $250 per annum; life insurance companies a graduated tax of $250 for the first year, $500 the second, $750 the third, and $1000 for the fourth year and thereafter. Insurance agents are also subject to a privilege tax, rated according to the size of the city or town where their business is transacted. Thus, an insurance agent doing business in a city of 5000 or more inhabitants, pays $40; in a city of more than 2000 and less than 5000 inhabitants, $25; in a town or village of less than 2000 inhabitants, $20; other insurance agents, $10.

Express companies pay a privilege tax of $500, together with a tax of $1 for each mile of railroad along which they operate, and a local property tax according to charter exemption and gross earnings. Railroads are divided into four classes according to gross earnings. The first class pays $20 per mile; the second, $15; the third, $10; and narrow gauge, $2. An interesting provision was inserted in the laws of 1898, whereby railroads claiming exemption from state supervision under maximum and minimum provisions in their charter are compelled to pay an additional privilege tax of $10. Sleeping and palace car companies pay $200 each. Telegraph companies pay $250; or if the line is less than 1000 miles, 25 cents per mile. Telephone exchanges are graded according to the number of subscribers. Thus, an exchange with 20 subscribers or less pays $5, while one with more than 150 subscribers pays $100.

Other corporations following specified lines of business fare the same as insurance, transportation, and transmission companies, paying a privilege tax, either fixed or graduated, on some element of some taxable capacity. The element of taxable capacity varies greatly according to the nature of the business. On cotton gins the tax is fixed; on cotton compresses it varies with baling capacity; on cotton-seed oil mills, with the amount of capital stock. Auctioneers, barber shops, bicycle dealers, brokers, coal dealers, ferries, hotels, junk dealers, livery stables, meat markets, photograph galleries, restaurants, theaters, warehouses, electric light, gas and water-supply companies, pay in proportion to the size of the city, town, or village in which they are located. Building and loan associations, fertilizer companies, and stores pay in proportion to the value of their stock. Brickyards, ice factories, liquor dealers, lumber yards, and sawmills pay in proportion to their output. Billiard and pool tables, bottling establishments, breweries, bands of gypsies, circuses, cigarette dealers, dealers in deadly weapons, dentists, druggists, guarantee companies, hack lines, horse traders, lawyers, lightning-rod agents, live-stock insurance companies, piano factories, second-hand clothiers, stave and spoke factories, pay a fixed amount.

Peddlers and railroad eating houses furnish interesting exceptions to the four bases of classification enumerated, *i.e.* location, value of stock, output, and fixed amount. Peddlers pay in proportion to their transportation facilities. Thus, a peddler with one horse or mule, and wagon, is taxed twice as much as a peddler on foot; a peddler with two horses or mules, and wagon, twice as much again. Railroad eating houses pay in proportion to the number of daily trains making stops for meals. Where two or more passenger trains are running on trunk lines, the privilege tax is $125; where there is only one such train, $50.

However variable may be the basis of assessment, the imposition and collection of the privilege tax are comparatively simple. The law provides that insurance, telegraph, express and sleeping car companies, building and loan associations, and commercial agencies shall pay the tax directly to the state auditor. All other corporations and persons obtain their license from the county sheriff. In any case where it is inconvenient to obtain

the license from the sheriff, it may be procured from the auditor. The auditor is required to prepare license blanks and issue them to the sheriff of the county, who is held responsible for the collection. Privilege taxes thus collected must be reported monthly and paid into the state treasury as other taxes, and any defalcation by a delinquent collector must be published at once by the auditor. Licenses are good from the day of issue, except in the case of dram shops, where they date from the granting of the license. No license can be granted in a "dry" county, or where the majority of the legal voters petition the board of supervisors to prohibit the opening of saloons. A failure to exhibit a license on demand is considered *prima facie* evidence that it has not been paid and that the privilege is unlawfully exercised. For non-payment or forfeiture a penalty is imposed not less than double the tax imposed, or imprisonment in the county jail not more than six months, or both.

Under no circumstances can any privilege be taxed by a county or municipality to an amount exceeding 50 per cent of the state license; and a privilege license imposed on insurance, telegraph, and sleeping-car companies, building and loan associations, is entirely exempt from county and municipal taxation. With the exception of the 50 per cent local tax referred to, the privilege-license system in Mississippi is solely a source of commonwealth revenue.

As a supplement of its pension system, the state exempts indigent Confederate soldiers and sailors, their wives or widows, from the payment of the tax on all privileges save those on dealing in liquors, cigarettes, deadly weapons, jenny-lind or pool tables, or like contrivances kept for amusement, second-hand clothing, and hotel keeping. Thus, the privilege-license system in Mississippi operates directly as a means of local prohibition and as a source of commonwealth revenue, and indirectly, as a bounty to Confederate soldiers and sailors. As a supplementary fiscal device levied on general categories, the system is popular and practically beneficent. Especially is this true of the railroad privilege tax.

Until very recently it has been well-nigh impossible to collect any property tax from railroads because of their claims of charter exemption. The privilege tax has been the only way of

reaching them. Thus, in 1888, a typical year, the percentage receipts from railroad property amounted to only $210, while the railroad privilege tax aggregated $140,792.

Recent reductions in the rate per mile of the railroad tax imposed,[1] and the legal compulsion placed upon railroads to pay both privilege and percentage taxes, have reduced both the absolute and relative importance of the railroad privilege tax. Thus, in 1898, the percentage receipts from railroads were $109,833, while the railroad privilege tax was only $26,625. It may, however, be confidently predicted that the decline in the importance of the railroad privilege is only temporary. An estimate of gross earnings is more satisfactory to all parties concerned as a basis of assessment than a valuation of property. An increase in the rate per mile to its old proportions would place the railroad privilege tax on an independent footing and avoid the double taxation to which railroads are now subjected.

Although regressive, easily shifted, and undemocratic in theory, the privilege-license system is warranted in Mississippi by its practical results. It furnishes the state a revenue of over $300,000 per annum, and is regarded favorably by business men as a license charge rather than a business tax. Criticism is to be directed, not against the system *per se*, but against some of the bases of its assessment.

In many instances the criterion is purely arbitrary, selected without any reference to the ability of the persons taxed. Thus, all fire, accident, and life insurance companies, which are members of any traffic association, are assessed fixed amounts; while non-traffic companies are taxed 2 per cent on their gross premiums. With few exceptions the solvent companies of the state are members of traffic associations; and because of their agreements to maintain rates, the amount of business transacted, gross earnings, and other elements of their taxable capacity are utterly ignored. This is a useless display of anti-trust demagoguery.

In other instances the criteria selected, while not arbitrary,

[1] In 1888 the average state railroad privilege tax per mile was $83.33⅓, besides a county railroad privilege tax of $41.66⅔. In 1898, the state railroad privilege tax on first-class roads was only $20, and there was no county tax imposed. (Compare Auditor's Report, 1888, p. 106, with Mississippi Laws, 1898, p. 23.)

leave room for evasion and bear no relation to earning capacity. Thus, heavily bonded cotton-seed oil mills can escape entirely the tax levied in Mississippi on the capital stock of cotton-seed oil mills. Large cotton warehouses, which pay in proportion to the size of the place in which they are located, may profit at the expense of the smaller competitors located in a larger place. On the basis of taxation according to output, lumber yards having a large output obtained at great expense, may suffer in comparison with those having a smaller output obtained at proportionately less expense. These are merely typical illustrations of some of the practical defects in the bases of privilege assessments in Mississippi.

While it would be hazardous to fix arbitrarily upon a test of taxable capacity applicable to all cases, nothing but good could result from making the bases selected more thoroughly applicable to their particular cases. If the standard cannot be made uniform, it can at least be made correct. This must be done if the license-privilege system in Mississippi is to serve to any extent as a corporation tax.

CHAPTER XVII

THE CORPORATION TAX

72. The General Corporation Tax. — The corporation taxes of the American commonwealths are either general taxes upon all corporations, with certain specified exceptions — for which special taxes are provided, or special taxes upon corporations engaged in certain branches of industry. The general corporation taxes sometimes apply to all companies, domestic or foreign, doing business within the state (as in the cases of Pennsylvania and New York), or to domestic corporations only (as in Massachusetts and New Jersey). The special taxes apply to railroads, banks, telegraph companies, insurance companies, and the like. This section will be devoted to the general corporation taxes.

The corporation tax of Massachusetts applies only to domestic corporations, and does not extend to banks, trust companies, and insurance companies, for which special methods of taxation are prescribed. The Massachusetts Commission of 1897 presents the following account of the working of the general corporation tax:[1]

First and most important is the general franchise tax on corporations chartered or organized under the laws of the commonwealth. This tax is designed to bring about the taxation of such corporations fully and fairly, in such manner as to reach all their property, and to reach it once and once only. It is unique in the tax experience of the states of the Union. No other state has adopted this precise mode of taxing the corporations whose corporate privileges depend on its laws.

[1] Report, pp. 14–17, 68–71.

In its main outlines the plan of the tax is as follows: The real estate and machinery of all corporations situated within the commonwealth are assessed by the local authorities, and the taxes on them are paid directly to the respective cities or towns. The remainder of the property of the corporation, as indicated by the market value of the outstanding shares, over and above the taxed value of the real estate and machinery, is taxed by the commonwealth under the corporation or franchise tax, and payment is made in the first instance to the treasury of the commonwealth.[1] The proceeds, however, do not accrue *in toto* to the treasury of the commonwealth, but are divided in large part among the cities and towns of the state.

All corporations chartered by the commonwealth of Massachusetts, or organized under the general corporation laws, for the purpose of business or profit, having a capital stock divided into shares, are subject to this annual tax, entitled a tax upon their corporate franchise. The tax affects, therefore, corporations of the most various kinds, — manufacturing and trading establishments, street railways, gas and electric lighting companies, electric power companies, private water-supply companies, telegraph and telephone companies, and certain insurance companies. There are some important exceptions, however, to the scope of the tax. Saving banks are taxed differently; banks and mutual insurance companies are also treated in a different way. For the banks a different method was devised, mainly because of the safeguards which the federal government has thrown about the national banks. Certain mutual insurance companies, on the other hand, are taxed on a different basis. Besides these important exceptions there are some others of less consequence; as, for instance, in the case of coal and mining companies and companies formed to build and operate railroads in foreign countries.

The general corporation tax is assessed by the tax commissioner with the aid of returns from the corporations and from the local assessors. Every corporation must return to the tax commissioner, under oath of its treasurer, a complete list of its shareholders, their places of residence, the number of shares

[1] By an amendment passed in 1903 the valuation of the intangible property of a corporation is not to exceed 120 per cent of the value of the tangible assets. — ED.

owned by each on the first day of May, the amount of the capital stock of the corporation, its place of business, the par value and the market value of the shares on the first day of May, and a statement of the works, structures, real estate, and machinery owned by the corporation and subject to local taxation within the commonwealth; in the case of railroad and telegraph companies, the whole length of their lines and the length of so much of their lines as is without the commonwealth; in the case of other corporations, the amount, value, and location of all works, structures, real estate, and machinery owned by them and subject to taxation without the commonwealth.

The assessors of each city and town also return to the tax commissioner by the first Monday in August the names of all corporations established in their respective cities or towns or owning real estate therein, and a statement of the works, structures, real estate, and machinery owned by each corporation, and the amount for which such property is valued for local taxation. From these returns, or otherwise at his discretion, the tax commissioner ascertains the true value of the shares of each corporation, which is described in the statute as the "true value of its corporate franchise." The shares of many corporations being sold from time to time on the open market, their market value is comparatively easy to ascertain; but with the greater number of corporations affected by the tax, the shares are seldom, if ever, sold or offered for sale in open market. In the case of such corporations the tax commissioner procures from the corporation a statement of the condition of the company, of its assets and liabilities. In case of refusal to render a statement of condition, the commissioner is authorized to examine the books and to examine on oath the treasurer and directors. From this information, and such other information as he may be able to procure, the commissioner proceeds to put upon the corporation what he considers to be a just estimate of the true value of its "corporate franchise."

From the aggregate value of the shares of the company thus determined, the tax commissioner makes the following deductions. First, in the case of railroad and telegraph companies whose lines extend beyond the limits of the state, such portion of the whole valuation as is proportional to the length of that

part of their line lying without the commonwealth is deducted; and, further, an amount equal to the value of their real estate and machinery located and subject to taxation within the commonwealth. Second, in the case of a telephone company, so much of the whole valuation as is proportional to the number of telephones used or controlled by it without the commonwealth, and also the value of all stock in other corporations held by it upon which it has paid a tax for the year preceding. Third, in case of an insurance company, the value of mortgages on real estate held by it subject to local taxation. Fourth, in the case of all other corporations, an amount equal to the value of the real estate and machinery subject to local taxation within or without the state. The total value of the shares, thus diminished by allowance for real estate and machinery already taxed, and by the mileage and other apportionment in the case of railroad and telegraph and telephone companies, may be called the taxable corporate excess.

This corporate excess is then taxed at a rate which is roughly the average rate of taxation in the commonwealth. It is determined by an apportionment of the whole amount of money to be raised by taxation upon property in the commonwealth during the current year upon the aggregate valuation of all the cities and towns for the preceding year.

The amount of the tax thus computed on corporate excess is then collected by the treasurer of the commonwealth. The tax commissioner notifies the treasurer of each corporation of the amount of its tax; and the ease and certainty with which penalties can be applied to domestic corporations cause the taxes to be paid, as a rule, promptly, and with a minimum of expense for collection.

The tax having been paid into the treasury of the commonwealth, it is in part distributed among the cities and towns, in part retained by the state. On the principle that personal property is taxable at the place of the owner's domicile, such proportion of the tax as corresponds to the proportion of stock owned by persons residing in the commonwealth is credited and paid to the several cities and towns where (as may appear from the corporation's list of stockholders or from such other evidence as the tax commissioner may procure) such shareholders

resided on the first day of May next preceding. The remainder of the tax, which represents the shares in Massachusetts corporations owned by persons who are not residents of any city or town in the commonwealth, is retained in the state treasury.

Yield of the Tax in 1896[1]

Net amount assessed by the tax commissioner	$3,829,528.02
Amount certified as due to cities and towns	2,729,665.85
Balance accruing to the commonwealth	$1,099,862.17

The taxation of shares in domestic corporations is in striking contrast with that of bonds, foreign stocks, and other securities taxable to the holder. Here there is no demand for a statement from the individual taxpayer, no doomage by local assessors, no guesswork, no possibility of evading or diminishing taxes by change of domicile, no question of double taxation. The real estate and machinery are assessed locally; doubtless not with perfect equality and justice, but probably as carefully as would be possible under any system. The corporate excess is taxed at a uniform rate by the state. The taxes are regular and certain. They are heavy, and they yield a large revenue. The rate of taxes on corporate excess for the last fifteen years has been from year to year not far from $15 per $1000, or about one and one half per cent on the capital. The assessment in 1896 was $3,829,528.02. Yet little complaint is heard regarding these taxes, — a signal proof that the taxpayers accommodate themselves, if not with ease, at least without serious complaint, to burdens which are steady, regular, predictable, and for which in consequence they are able to make calculations and adjust their affairs.

The corporation tax is particularly simple and is assessed with unerring exactness, in the case of large and well-known corporations, whose shares are regularly dealt in, and consequently have a publicly recorded value. Railways, banks, the larger

[1] In 1904 the gross receipts were $5,166,900, of which sum $1,203,000 was the share of the state. The total assessment fell upon the various classes of corporations as follows:

Street railways	$912,730
Other public service corporations	2,686,226
Business corporations	1,567,944
Total	$5,166,900 — ED.

manufacturing corporations, and others whose stocks are frequently quoted, are taxed without a word of inquiry and without a possibility of escape. A very large number of miscellaneous corporations are in a somewhat different position. Their shares are held by a few individuals, are rarely transferred, and are without a quotable market value. In these cases the statement required by law from the corporation itself as to the market value of its shares is important. The tax commissioner may further require a transcript of the balance sheet, and other information which he deems desirable. No doubt there is a possibility of understatement by a corporation of the value of its stock, and a possibility of manipulation of the balance sheet. There is reason to believe that sometimes the taxes on corporate excess are partially evaded in this way; but the evasions are insignificant, in comparison with those as to taxable securities. In any case they affect but a small proportion of the total taxes collected from Massachusetts corporations. As a whole, this part of our tax system is an excellent example of the method of taxing corporations at the source, and of refraining from any dealings with the individual holder of corporate securities, — a method admitted on all hands to be the simplest, most efficient, and most equitable in the taxation of corporate property.

It is unfortunate that similar accounts of the general corporation taxes of other states are not available for use in this volume, but the following data may be presented:

(*a*) New York has devised what have been called justly the "most complicated and clumsy" methods known of taxing corporations. Besides an "organization tax" upon newly formed companies, which yielded $474,667 in 1889, and miscellaneous taxes on special kinds of corporations, New York has a general corporation tax, in addition to taxes upon the property of corporations. Every corporation organized under the laws of the state must pay an annual tax computed upon the amount of its capital stock employed within the state, the rate of taxation depending upon the dividends which the corporation has paid. Foreign corporations, moreover, pay a similar tax for the privi-

lege of carrying on business within the state. In addition, real estate owned by corporations is taxed for state and local purposes; while their personal property is taxable for local purposes, although in most cases it manages to escape in whole or in part. Various exemptions and special taxes make the situation still more complicated.

(*b*) Pennsylvania imposes a general corporation tax upon all corporations, both domestic and foreign, except banks and foreign insurance companies, but makes certain exemptions for companies organized exclusively for manufacturing. This is in lieu of other taxation for state purposes. Companies subject to the tax pay five mills for each dollar of the actual value of their outstanding capital stock, common, special, or preferred; and four mills upon each dollar of the nominal value of their bonds or other outstanding obligations. In assessing the tax upon capital stock, suitable deductions are made for capital employed in other states.[1] The tax upon corporation bonds applies only to bonds owned by residents of the state, since those owned by residents of other states are not subject to the jurisdiction of Pennsylvania. In 1899 the tax on capital stock yielded $4,575,000; and that upon bonds, $1,149,000.

(*c*) The general corporation tax of New Jersey applies only to domestic corporations and does not extend to banks, railroads, and manufacturing or mining companies that have invested one half of their capital within the state. Of the corporations subject to the tax, some (such as telegraph, lighting, or insurance companies) pay a tax upon their gross receipts or earnings; while the remainder, which contribute the larger share of the receipts, pay a tax upon their capital stock. This latter tax is one tenth of one per cent upon the capital stock

[1] Thus domestic corporations receive an allowance for tangible property permanently located outside of Pennsylvania; foreign corporations pay only on the proportion of their capital invested or employed in Pennsylvania; railroads pay on a proportion of capital representing their mileage in Pennsylvania.

up to the sum of $3,000,000; one twentieth of one per cent upon capital stock in excess of $3,000,000 but not exceeding $5,000,000; and $50 upon each million of capital stock in excess of $5,000,000. This is a tax upon the franchise of the corporations, not upon their property, and does not exempt this property from other taxation. Therefore all real and personal property of corporations is taxable the same as the property of individuals;[1] but, as the state revenue is derived from other sources, the property of New Jersey corporations is in practice taxed only for local purposes. In 1899 the franchise tax yielded $1,332,000.

73. The Taxation of Public-Service Corporations: Report of the Connecticut Commission of 1913.[2]—The various methods of taxing public-service corporations are reviewed in the following extract from the report of a Connecticut commission:

I. The Various Methods of Taxing Public-Service Corporations

History

The early tax laws of Connecticut, as elsewhere in the United States, made no mention of corporations. Corporations were few in number, and it was simply assumed that they would be taxed upon their property under the general property tax in precisely the same manner as natural persons. This was the situation down to the middle of the nineteenth century. By that time corporations had developed greatly in number and importance, and one after another special methods of taxation began to be devised for the several classes of corporations. The development thus started has followed different lines in different states, and at different times in the same state, and has resulted in a bewildering variety of methods of taxation. Professor Seligman in his "Essays in Taxation" enumerates and discusses twelve distinct bases of corporation taxes. As a matter of fact almost

[1] This does not apply, however, to banks, railways, and some other corporations, which are taxed in other ways.

[2] Report of the Special Commission on the Taxation of Corporations, pp. 2–20. Hartford, 1913.

every possible method of taxing corporations has been tried by some state at some time. Many of the methods developed have been clearly defective in principle and have been proved failures by experience. At the present time it is safe to say that there are only three important methods of taxing public-service corporations which may fairly claim serious consideration. If we are to find the most satisfactory method of such taxation we must find it by choosing one of these three. A brief description and criticism of each of these three methods of taxation is therefore in order.

The Ad Valorem Basis

By this basis we mean that the tax is imposed upon the value of the property of the corporation, primarily the value of its physical property, although sometimes with an additional amount supposed to represent the value of "intangible property," "good will," "franchise," etc., etc. This was, of course, the original method of taxing corporations under the general property tax, excepting that at the start the valuation was made and the tax imposed by local officials in exactly the same way as for natural persons. This crude method of taxing corporations has been abandoned by practically all of the progressive states. It was long ago given up by Connecticut. The method is entirely indefensible and needs no further discussion here.

The *ad valorem* basis, however, as used and advocated in progressive states to-day is something different in that it involves a more or less expert valuation of the property of the corporation as a whole, made by a state board or officer. As thus administered this method of taxation has been advocated by some authorities and adopted by a number of important states. This method of taxation represents, therefore, an attempt to continue the property basis of taxing corporations while providing special machinery in order to obtain a true valuation.

Criticism of the Ad Valorem Basis

Even as thus administered, however, the *ad valorem* basis of taxation is subject to serious difficulties. Whatever method is adopted for obtaining the value of the corporations' property, the operation is difficult and expensive. To be properly per-

formed it requires the work of a large force of experts familiar with the technical details of the businesses of the corporations concerned. At best the element of personal judgment is sure to enter. The responsibility thus placed upon the assessing officers or board is very heavy. Since thousands of dollars in taxes may be at stake, depending merely upon the personal judgment of the official, the motive and opportunity for political interference or corrupt influence on the part of the corporations concerned is evident.

Besides practical difficulties, important theoretical questions arise. In the majority of cases there is, and can be, no such thing as an actual sale of the property of a public-service corporation. The selling price is, therefore, unavailable as a basis of valuation. Shall the appraisal, then, seek to determine the original cost of the property or the cost of replacement, and if the latter, shall allowance be made for the present condition due to depreciation? As illustrating the complicated character of such an appraisal and the heavy cost involved, we may refer to the experience of the state of Michigan. In the years 1900 and 1901 a valuation was made of the property of the railroad companies of Michigan for the purpose of taxation. This was the most thorough and scientific valuation of its sort ever attempted. It involved not only a physical valuation, but also an examination of the financial operations of the railroads. The physical valuation alone occupied a period of nine months and required a corps of some seventy-five engineers, although not all of these were employed during the whole time. The cost of the investigation was in the neighborhood of $60,000, which is in addition to an even greater sum required for the expenses of the tax commission, a large part of whose work was devoted to the same object.

Another difficulty with this method is its rigidity. Valuations when once made are very likely to remain for a considerable period of years without serious revision. This is caused partly by the very fact of the difficulty and expense involved in a thoroughgoing valuation. As a result, such valuations, no matter how successfully made at the start, very soon come to be unreliable.

Finally the valuation of property alone is, after all, not a true measure of the worth of the corporation, or of its tax-paying ability. The ordinary public-service corporation obtains its earnings

and its value from sources of which the value of its physical property is only one element. The United States Supreme Court found in the Ohio Express Company cases that "$23,400 worth of horses, wagons, safes, and so on, produced $275,446 in a single year." Practically every attempt to tax corporations upon the value of their physical property has shown the insufficiency of this basis by itself, and has led to the attempt to correct the results thus obtained by means of some other measure. Various attempts have been made to get at some measure of the value of intangible property, good will, franchise rights, etc. For example, the state of Michigan after making the elaborate investigation mentioned above was unable to adhere to the values thus obtained for the purpose of taxation, admitting that such values might either exceed or fall short of the true value of the whole system of the corporation. The Michigan commission was, therefore, compelled to correct its results by falling back upon the earning power of the corporations.

Enough has probably been said to show the serious defects of the method of taxation based upon an appraisal of the value of the property of the corporations. Connecticut does not at present use this method for the taxation of any class of public-service corporations, and it is not likely that the state would seriously consider a change to this method.

The Capitalization Basis

By this method we mean the imposition of a tax upon the value of the securities of the corporation. This sometimes includes only the value of the stock. To be correct, however, it should include the value of stock and bonds. This is the method at present used by Connecticut in the taxation of railroad corporations, the tax being based upon the market value of stock plus the value of funded and floating indebtedness, the whole being apportioned as between Connecticut and other states. As at present employed in Connecticut this method is decidedly unsatisfactory. Its defects will be pointed out in detail in the chapter on railroads. To a considerable extent, however, the weakness of Connecticut's method of taxing railroads is due to the numerous exceptions, complications, and other excrescences which have been gradually added

to the system during a long period of years. Leaving the discussion of these defects to the chapter on railroads, it is our purpose here to criticise the fundamental character of this method of taxation.

Criticism of the Capitalization Basis

There can be no question that the basis of the value of securities is far preferable to that of the physical value of the property. The market value of the securities of a corporation under normal conditions represents the real value of the corporation according to the estimate of investors and others who are best qualified to judge. When made to include not only the stock but the bonds, and perhaps also the floating indebtedness, this gives a real measure of the value of the investment in the corporation. There are, however, serious difficulties here also. In the first place it often happens that the securities of a given corporation are not regularly dealt in on the market. Sales may be few and scattered, and such scattered sales are quite apt to be entirely insufficient as a measure of the real value of the corporation's securities. The market value of corporation securities is also subject to considerable fluctuation from time to time, due to causes external to the business of the corporation, such as the condition of the money market, the general investment situation, etc. Market values are also subject more or less to variations in price due to intentional manipulation of those in control, or the result of speculative dealings or attempts to gain control of the management.

While it might be admitted that these are all considerations which actually do enter into the value of corporation securities, yet it cannot be denied that values thus determined are at best a poor index of tax-paying ability. In general the value of the securities of a corporation depends upon the earnings which are hoped for. When this is the case, the value of the securities is a true guide for the levying of taxes. Those who object to this basis of taxation do so, consciously or unconsciously, because of the feeling that the market values of securities are frequently based on something other than earning power. Since this is often the case, and in view of the other difficulties involved in the tax on capitalization, the question naturally arises, Why not impose corporate taxation directly upon the earnings them-

selves? Earnings are generally admitted to be the true index of tax-paying ability, which is sought more or less indirectly by other methods of taxation.

The Tax on Earnings

The earnings of a corporation are the real basis of the value of its property, the value of its securities, and its tax-paying ability. This statement will generally be admitted at once, and it is also demonstrated by the result of the experience of other methods of taxing corporations. As a matter of theory, the earnings of a corporation are the only true measure of its value and its tax-paying ability. The basis of earnings is also the simplest in practice and the one that involves the least administrative difficulty. The weight of authority of economists, practical experts, tax commissioners, and others is distinctly in favor of the earnings basis. This is the system which is coming into more and more favor to-day.

Net Earnings vs. *Gross Earnings*

Before going further into the discussion it is necessary to settle the question whether the tax shall be based upon net or gross earnings. There can be no question that it is net earnings which are the true measure of value. Gross earnings may be large or small according to the amount of operating expenses. The balance left after paying operating expenses out of gross earnings is what gives value to any enterprise. It would appear at first, therefore, that any tax system to be just should be imposed upon net earnings. Here, however, we are at once met with serious practical difficulties. While it is a simple matter to ascertain the total amount of earnings, it is by no means so simple to determine what should be deducted for expenses. Operating expenses are more or less a matter of bookkeeping definitions. To avoid serious inequality and evasion the tax on net earnings would require for administration a thorough examination into the accounts of every corporation taxed, together with strict rules as to how these accounts should be kept. All of this would be required in order to insure that each corporation would make exactly the proper deductions from gross earnings to obtain net earnings. It would be a continual source of

irritation between the corporations and the taxing officials. It would involve the most disagreeable inquisition into the accounts and business of the corporations, and in the end there would still remain room for personal judgment, thus leaving open the door to political intrigue and corrupt influence. The British system of taxing railroad corporations undertook to use net earnings as the basis. The Ontario Commission on Railway Taxation in 1905 found, however, that the British attempt to get at net earnings had been virtually abandoned, allowance for expenses being made by an arbitrary deduction from gross earnings.

The practical difficulties in the way of imposing a tax upon net earnings seem overwhelming. A further objection arises from the fact that a corporation might have no net earnings whatever in a given year, and therefore escape taxation entirely. While it is true that this might be perfectly just under a tax system based fundamentally upon income, we should bear in mind that the American tax system is to-day based upon property. The individual whose property has yielded him no income in a given year cannot offer that as a reason why he should not pay taxes upon his property. While the importance of treating corporations and individuals upon the same footing must not be stretched, there can be little doubt that a tax system which would allow corporations having no net earnings to escape taxation entirely would be out of harmony with the general tax system prevailing in America to-day.

II. The Gross-Earnings Tax

Advantages of the Gross-Earnings Tax

The tax on gross earnings avoids all the difficulties inherent in the tax on net earnings. No corporation can do business without having accounts which will at least show the amount of its gross earnings. Gross earnings are a definite fact, ascertained by a glance at the accounts, and incapable of argument or difference of opinion. The tax on gross earnings can be evaded only by perjury of the most obvious sort and capable of easy detection. The gross-earnings tax, therefore, has the great advantage of simplicity, certainty, and ease of administration. This is an advantage both to the corporation and to the state. The amount of the tax on gross earnings fluctuates with the prosperity or

adversity of the business and is, therefore, just to all parties concerned. Moreover, it enters each year into the accounts in a definite ratio, and can thus be counted on in advance.

Classification of Corporations Necessary

A serious question remains to be answered. Will not the tax on gross earnings be distinctly unfair on account of the great diversity between different corporations in their ratios of expenses to earnings? The answer is that such injustice is to be avoided by classifying corporations according to the prevailing ratio of net earnings to gross, and imposing different rates upon the gross earnings of the different classes of corporations.

Investigation shows, for instance, that the ratio of net earnings to gross is fairly uniform for the railroads of the country. In the same way there is a general prevailing ratio of net earnings to gross for telephone companies, for express companies, etc. Having determined what this prevailing ratio is for each class of corporations we are enabled to fix rates for each class which will make the tax on gross earnings just to all. It is true, of course, that absolute justice as between individual corporations of the same class is not obtained. The resulting injustice is, however, not great. Careful investigations by the Ontario Commission of 1905 and the California Commission of 1906 have demonstrated that no great injustice will result between different corporations engaged in the same business by a tax at a uniform rate upon the gross earnings of all. Some inequality is unavoidable, but the inequality thus resulting is distinctly less than can be easily shown to result from any of the other schemes of taxation which are before us. No tax system can be absolutely perfect, and it is not a valid objection against a proposed scheme to point out a defect which is present in even greater degree in each of the other possible alternative measures.

We conclude, therefore, that the tax on gross earnings presents distinctly the most advantageous method for the taxation of public-service corporations.

The Rate of the Gross-Earnings Tax

In establishing a system of taxation based on gross earnings the first and most important problem is to determine the rates at

which the tax shall be imposed upon different classes of corporations. The object is to determine rates which shall tax the different classes of corporations fairly as compared with the taxation borne by other forms of wealth. The ratio of net earnings to gross differs as between different classes of corporations, and this makes it necessary to impose the gross-earnings tax at different rates.

For example, suppose a certain corporation with gross earnings of $100,000 had expenses of $80,000, leaving $20,000 of net earnings. Suppose another corporation engaged in a different business, having also gross earnings of $100,000, shows expenses of $60,000, leaving its net earnings $40,000, or twice the net earnings of the first corporation. It is obvious that a tax upon gross earnings at a uniform rate would impose an unjust burden upon the first corporation, since net earnings are the true measure of what the tax burden should be. This injustice could easily be corrected, however, by imposing different rates. Suppose that we wish to impose a tax that shall be equal to 10 per cent of net earnings. This would be obtained by a tax of 2 per cent upon the gross earnings of the first corporation, and by a tax of 4 per cent upon the gross earnings of the second. In other words, whatever the amount of tax to be obtained, the rate imposed on the gross earnings of the second corporation should be twice the rate imposed upon the first.

Determination of the Rate of the Gross-Earnings Tax—Explanation of Method

The determination of the rate of the gross-earnings tax requires, therefore, a careful study of the situation of the different classes of corporations at the outset. Of the various possible methods of arriving at the proper rate the one employed by the California Tax Commission of 1906 is undoubtedly the most correct. We must first decide what is the measure of the tax burden to be imposed. Here we may fairly assume, as was done by the California Commission, that the object should be to impose a tax burden upon the corporations which shall be as nearly equivalent as possible to the burden of taxation borne by other wealth under the general property tax. This being the measure of the burden to be imposed, it then becomes necessary to find what rate imposed upon the gross earnings of the several classes of corporations will produce such a result. We may fairly as-

sume that wealth in general bears a tax burden equal to about 1 per cent of its true value. This was the result of the investigation of the California Commission, and this is the rate generally agreed to by tax authorities.

In order to compare a tax upon earnings with a tax upon the capital value of wealth it is necessary to translate the one into the other by means of a rate of capitalization, which in general is the rate of yield normally obtained by investment in the corporations in question.

For example, if the regular annual net earnings of a certain corporation are $600 and we assume that a fair rate of capitalization is 6 per cent, the capital value of this corporation is obtained approximately by dividing its net earnings, $600, by the assumed rate, 6 per cent, giving as a result $10,000. If wealth in general is assumed to bear a tax burden of 1 per cent, then this corporation should pay a tax equal to 1 per cent of $10,000, or $100. $100 is 16.66 per cent of $600. Therefore a tax of 16.66 per cent upon the net earnings of this corporation would be equivalent to a tax of 1 per cent upon its capital value. In general, to obtain the rate of a tax on net earnings which shall be equivalent to a given tax rate on capital value we divide the rate on capital by the rate of interest, or the rate of capitalization.

Our problem, however, is to find a rate, not on net earnings, but on gross earnings. To return to the above example, let us assume that the gross earnings of the corporation are $1800. The net earnings are therefore one-third of the gross. Then, to produce the same amount of tax, the rate imposed upon gross earnings must be one-third of the rate upon net earnings. In general, whatever is the ratio of net earnings to gross we must multiply the desired rate of a tax on net earnings by the ratio of net earnings to gross in order to obtain the equivalent tax rate to be imposed upon gross earnings.

It is probably not necessary to explain that net earnings are used in this calculation, not as a permanent basis of the tax, but in order to classify corporations at the outset so as to determine proper rates for the gross-earnings tax.

Since we are proposing to collect a tax equal to about 1 per cent of the capital value of the corporation's property, we must increase the rate of yield by 1 per cent in order to reach a fair rate of capitalization. To sum up the above discussion; we must ascertain, first, the rate of taxation borne by wealth in general under the general property tax; second, the proper rate at which

to capitalize the earnings of each class of corporations, which will be, in general, the rate of yield of the investment plus 1 per cent to allow for the tax; third, the prevailing ratio of net earnings to gross for each class of corporations. We then obtain the proper rate of the tax on gross earnings for each class of corporations by dividing the rate of the general property tax by the rate of capitalization and multiplying by the ratio of net earnings to gross. The result will give the rate which, imposed upon gross earnings, will cause a tax burden equivalent to that borne by wealth in general under the general property tax. This process may be expressed mathematically as follows:

Let t equal rate of the general property tax (upon full value).
Let i equal rate of capitalization.
Let r equal ratio of net earnings to gross earnings.
Let x equal required rate of the gross-earnings tax.

Then $$x = \frac{t\,r}{i}.$$

For example, suppose that it is determined that wealth in general is taxed at the rate of 1 per cent upon its true value. Suppose that inquiry establishes the fact that investment in the securities of the particular class of corporations we are concerned with yields a return of 5 per cent. Suppose, further, that investigation shows that the prevailing ratio of net earnings to gross for the class of corporations in question is 30 per cent. Then t is 1 per cent, i is 6 per cent (*i.e.*, 5 per cent + 1 per cent), and r is 30 per cent. Substituting these figures in the formula, we have:

$$x = \frac{\frac{1}{100} \times \frac{30}{100}}{\frac{6}{100}} = \frac{5}{100} = 5\%.$$

We should conclude, therefore, that the proper rate to impose upon gross earnings is 5 per cent, and that if the gross earnings of the corporations in question are taxed 5 per cent the result will be equivalent to the tax upon wealth in general at the rate of 1 per cent.

1. *Measure of the Burden of the General Property Tax*

The next question is to determine the facts necessary to the application of this formula. The rate of taxation borne by wealth in general is a matter of fact to be determined by careful investigation. It is obvious that a mathematically exact result is impossible on account of the prevailing undervaluation of

property and our inability to measure exactly what this undervaluation is. Those who have studied the question, however, have generally come to the conclusion that 1 per cent represents about the rate of taxation upon the full value of wealth in general. The California Tax Commission of 1906 came to this conclusion after a very thorough investigation of the tax conditions in that state. In Connecticut the average tax rate in 1911 as reported by the tax commissioner was 1.38 per cent on an assessed valuation averaging, according to assessors' reports, 89 per cent. This is equivalent to a rate of 1.23 per cent on the true value.

We are probably justified then in assuming that 1 per cent represents the average burden of the general property tax upon the full value of wealth in general.

2. *The Rate of Capitalization*

The rate of yield obtained upon investment in the securities of any given class of corporations is likewise a matter of fact. To obtain the utmost possible exactness requires an elaborate investigation of each corporation. (See the careful study of Mr. B. H. Meyer in U. S. Census Bulletin 21, 1905.) A fair approximation, sufficient for our purposes, may be obtained by comparing the amount of dividends paid upon stock or interest paid upon bonds with the market value of such stocks or bonds. This will do for normal conditions. Allowance must of course be made for peculiar circumstances. For example, suppose the stock of a given corporation is paying regular dividends at the rate of 9 per cent, by which we mean that each $100 share of stock pays an annual dividend of $9. Suppose that the market value of this stock is $150, which likewise means that each $100 of stock is worth on the market $150. The rate of yield upon an investment in this stock is determined by dividing the annual dividend by the market value of a share of stock. Thus:

$$\frac{9}{150} = .06 = 6\%.$$

This means that investors in the stock in question are willing to accept a yield of 6 per cent upon their wealth invested in the corporation in question. Such an investigation must be undertaken to determine what is the average rate of yield upon investments in the securities of each class of corporations with

which we are concerned. This is a simple matter for stocks paying regular dividends and regularly quoted on the market. It is, of course, obvious that any special circumstances affecting dividends and market value must be taken into account. It is also true that there will be certain corporations for which this method is not practicable. In general, however, for a whole class of corporations engaged in a particular business it is entirely practicable by this method to determine with sufficient approach to accuracy the prevailing rate of yield upon investments in the concerned.

3. *The Ratio of Net Earnings to Gross Earnings*

The ratio of net earnings to gross must also be determined by investigation. This is the factor in the problem which requires the most extended investigation. It is to be obtained by careful study of the accounts and the business circumstances of the class of corporations concerned. While the investigation must necessarily be technical and somewhat laborious, it is entirely possible by this means to determine with a sufficient degree of accuracy what actually is the prevailing ratio of net earnings to gross among the class of corporations concerned.

Qualifications

The method described above for determining the proper rate of the gross-earnings tax is subject to some qualifications, owing to the nature of the matters of fact which enter into the computation. In the first place, the assumption that the rate of the general-property tax is about 1 per cent upon the full value of property disregards the fact that a considerable amount of property escapes taxation entirely. The rate of 1 per cent represents the burden of taxation upon wealth which actually is taxed. Just what the result would be if we could take account also of wealth that evades taxation it is, of course, impossible to say. For Connecticut in particular it is important to remember in this connection that general-business corporations are not subject to state taxation and usually escape with a comparatively light burden of local taxes. A tax system for public-service corporations based upon this assumption therefore treats such corporations unfairly as compared with the general-business

corporations. This is a matter, however, which lies outside the scope of your commission's investigation. Therefore it must be borne in mind that our assumption that wealth in general bears a tax of 1 per cent is somewhat higher than would result if we could take an average including all wealth that escapes taxation as well as that which is taxed.

Secondly, the method of determining the proper rate of capitalization does not lead to mathematically exact results. Some additional allowance might perhaps fairly be made for the fact that large additions of new capital cannot be attracted into a business without offering a rate somewhat higher than satisfies present investors, as shown by the market value of the securities and the rate of dividends paid. For this reason, and to avoid injustice due to possible inexactness of the method, we may ordinarily take a rate of capitalization somewhat higher than the one determined by the method indicated.

As regards the ratio of net earnings to gross, the calculation will usually produce sufficiently correct results provided the accounts of the corporations are accurately kept. In many cases, however, the accounting methods of the corporations have not made sufficient allowance for depreciation. Where this is shown to be the case allowance must be made by some reduction in the apparent ratio of net earnings to gross. Taking these considerations all together it is likely that the rate of the gross-earnings tax as determined by the method here described will be somewhat higher than is actually warranted. In determining the rate of the gross-earnings tax, therefore, due consideration should be given to these facts in the final result.

Other Tests

The method just described for determining the proper rate of the gross-earnings tax upon a given class of corporations is the most scientific one and the one which in general will produce the most accurate results. These results, however, should be checked up by means of other tests which, though less correct, can be made useful in verifying the results or preventing injustice due to exceptional conditions.

(1) We may determine the market value of the securities of the corporations, including stocks and bonds and other

indebtedness which represents real investment of capital. Then assuming that the value of the securities represents in general the real worth of the property in the corporation, calculate the amount of a tax of 1 per cent upon this value and determine the rate which, applied to gross earnings, would produce this amount. For corporations whose securities are regularly quoted on the market this whole process is a simple mathematical calculation.

(2) We may perform the same calculation, but take as our starting point the book value of the corporation; that is, the sum of the capital, surplus, and undivided profits, or equivalent items. We then determine what rate imposed upon the gross earnings would produce an amount equivalent to 1 per cent of this book value.

(3) We may determine the actual value of the physical equipment of the corporation; that is, the net plant value. To avoid a special physical appraisement we may ordinarily accept the book value of the plant. We then calculate what rate, imposed upon gross earnings, will produce a sum equivalent to 1 per cent of this plant value.

Obviously, none of these tests is absolutely reliable, as we have already shown in discussing the proposal to use one or other of these bases as the basis of the tax itself. In particular the plant value is apt to give too low a result, since the actual value of the corporation as a going concern is generally considerably greater than the physical value of its plant. On the other hand, all other methods are apt to be too severe. The reason for this lies in our assumption that wealth in general is taxed about 1 per cent of its true value. This point has been discussed above.

Exemption of the Corporations' Securities

The gross-earnings tax as developed in the preceding sections is intended to be the equivalent of a tax upon the total property of the corporations. The imposition of such a tax should logically carry with it the exemption from taxation of the stocks and bonds of the corporations in the hands of the holders. Taxation of a corporation directly upon the total value of its property (at a rate determined by the method described above) and taxation also of its securities in the hands of the holders would be a flagrant case of double taxation. This theoretical

proposition is so clear that it needs no further discussion. The practical application is, however, far less simple. As a practical proposition, the necessity of exempting stocks from taxation will hardly be denied, and the difficulties in the way of carrying out the exemption are not so serious. As to the exemption of bonds, the practical difficulties are apt to be great. If bonds formerly have been subject to taxation, exempting them from taxation on the introduction of a new corporation tax is a pure gift to the bond holders, and brings no relief to the corporation except that future bond issues may perhaps be made at slightly lower rates of interest. Again, the situation of a given state may be such that it can hardly afford to grant exemption from taxation to all the holders of the bonds of a given class of corporations simply because it taxes such corporations directly upon their earnings or property. For instance, a state might be the place of residence of a large number of wealthy owners of bonds of a certain interstate corporation which did a very small business in the state. The state tax upon this corporation, based upon its share of the corporation's property or earnings, would be a small matter, and would hardly justify the exemption from taxation of all of the bonds of the corporation owned by citizens of the state. This situation is bound to be of common occurrence until some uniformity of taxation by the various states is reached. In the meantime it may often be practically inadvisable to entirely exempt bonds from taxation.

As regards the Connecticut situation, the commission has found no practical difficulty in the way of exempting from taxation in the hands of the holders the shares of stock of all corporations which are directly taxed by the state. This exemption, as a matter of fact, involves only slight change from the present situation, since the shares of stock of the corporations now paying taxes to the state are now practically exempt from taxation in the hands of the holders.

The bonds of railroad corporations paying taxes to the state are already exempt from taxation by statute, and the commission sees no reason for making any change. The bonds of other corporations paying taxes to the state are at present taxable as personal property in the hands of the owners. The commission is of the opinion that complete exemption from taxation of the bonds of all corporations paying taxes to the state of Connecti-

cut would not be justified under present conditions. This decision is based upon the reasons which have been explained in general terms above. The commission has concluded that a fair compromise will be the exemption from taxation, in the hands of the holders, of bonds of corporations holding their charters from the state of Connecticut, while leaving bonds of foreign corporations subject to taxation as at present. This is the recommendation which the commission has made for each of the classes of corporations which it has investigated.

III. Experience of Other States in taxing Public-Service Corporations

Very few states undertake to tax all public-service corporations by the same method. Detailed descriptions of the methods of other states will, therefore, come more properly in the chapters discussing the separate classes of corporations. In the present connection, however, it will be valuable to take a general survey in order to shed light upon the problem from the experience of the states.

The Ad Valorem Basis

The majority of the states still cling to the property basis in taxing corporations. Some of them have not gone beyond the old general-property tax. Others have gone further and provided more or less efficient state machinery for the assessment of the property of corporations. Michigan and Wisconsin have advanced farther than any others in the making of exhaustive valuations and the establishment of elaborate machinery for administration of the law. The old idea that corporations must be taxed upon the basis of property dies very hard. This is partly due to popular ignorance which has led people to cling tenaciously to the notion that the general-property tax is the one and only perfect method of taxation. It is also due in large measure to a very common notion that equality of taxation requires that all subjects be taxed by the same method. This supposed principle is even incorporated in many of the constitutions of the states, which are thus forced to continue with obsolete tax methods. It is, however, gradually declining, and the de-

cline is most noticeable in those states which have progressed farthest in wealth and industrial development. The weight of authority is generally against this method.

The "Stock-and-Bond" (Capitalization) Method

A considerable number of states use the value of stocks and bonds, or of stocks alone, as the basis for the taxation of all corporations or of certain classes, often in combination with local taxes on property. Massachusetts, New York, and Pennsylvania have general corporation tax systems based primarily upon this method. Massachusetts and New York take account of stock only, while Pennsylvania includes bonds. Various other states make more or less use of this method, often in connection with a tax based primarily upon the value of property. Even Michigan and Wisconsin, at present the chief advocates of the property basis, are unable to avoid considerable use of the stock-and-bond method. The difficulties with this method of taxation are generally recognized even in the states where the system is in use. While it is generally recognized that this method is far superior to the old property basis, few authorities will be found to urge this system as the best method of taxing corporations.

The Gross-Earnings Basis

Many states to-day which have departed from the old property basis use the gross-earnings basis for the taxation of certain classes of corporations. Among such states this is the favorite method for the taxation of telephone companies, telegraph companies, and express companies. It is also a common method for the taxation of sleeping-car and other car companies. Half a dozen states use it as a principal or important secondary method for the taxation of railroads. The weight of authority is most decidedly in favor of the gross-earnings tax. Without going into a discussion of authorities it should be mentioned that most of the recent state reports on this subject have recommended the gross-earnings basis for the taxation of public-service corporations. We may mention in particular the reports of the Ontario Commission on Railway Taxation of 1905, the California Commission of 1906, the Rhode Island Commis-

sion which reported in 1910, 1911, and 1912, and the Virginia Commission of 1911, all of which recommended the gross-earnings basis for public-service corporations. To this list might be added a long list of economists and tax experts who have recently urged the superiority of the gross-earnings tax.

The Experience of Michigan and Wisconsin

The important states of Michigan and Wisconsin, after an experience of many years with the gross-earnings tax as applied to railroads, abandoned this method about ten years ago in favor of the *ad valorem* basis. This event, being contrary to the general trend, besides being so important of itself, deserves special consideration. Thorough accounts of this movement in each of the states have been presented by the Ontario Commission and the California Commission, as well as in the reports of the tax commissions of the two states concerned. We can give here only a brief summary of what took place.

Michigan and Wisconsin had both had the gross-receipts tax as applied to railroads for a number of years. In both states the method was abandoned after several heated political campaigns. Michigan attempted to make the change in 1898, but found that her constitution stood in the way. In 1899 a tax commission was appointed and charged to investigate the subject. This commission, after an extensive investigation, reported in favor of the *ad valorem* basis. The constitution was accordingly amended in 1900, and in that year and the next a very thorough valuation was made of the railway property of the state. This involved a physical valuation as well as a valuation of the securities. It was carried out under expert direction with a large corps of engineers, and at heavy expense. The *ad valorem* method of taxation was then adopted, and after much opposition and litigation was finally upheld in 1906 by the United States Supreme Court.

In Wisconsin a similar movement started in 1899. A state tax commission was appointed which, after an investigation, advocated the *ad valorem* method. After a heated campaign the law was passed in 1903. The valuation of railroad property was not so elaborate or expensive as in Michigan. A permanent state commission was created, charged with the duty of valuing railroad property. It is understood that the commission de-

pends mainly upon the value of stocks and bonds and upon capitalized earnings. An attempt was made to preserve the independence of the commission by providing salaries of $5000 and fixing the terms of the commissioners at eight years, with other provisions to avoid sudden changes.

In both states, therefore, the operation of the law is placed in the hands of a tax commission, and in the last analysis the valuation placed upon railroad property depends upon the judgment of these commissions. Both states still find it necessary to make frequent reference to earnings in order to arrive at a fair valuation of railroad property.

IV. Problems of Interstate Commerce

Apportionment of Interstate Earnings

It is obvious that no state can fairly impose a tax upon the total gross earnings of a corporation derived from business done partly without the state. Just as a tax imposed upon the property of a corporation should fall only upon its property located within the state imposing the tax, so the tax on gross earnings must be imposed only upon such share of the gross earnings as may fairly be assigned to the state imposing the tax. We are for the present concerned only with the question of economic justice as between states and not with any constitutional question. Where corporations are doing business of an interstate character it is necessary, therefore, to devise some equitable rule by which the gross earnings may be apportioned as between the state imposing the tax and other states. To make the apportionment as exact as possible we should assign to the state imposing the tax all earnings from business performed wholly within the state. We should exclude all business done wholly without the state. We should then assign to the state in question its share of all business which crosses the state line. The latter might be accomplished in any one of a number of different ways. The most obvious is to keep track of each shipment, or message, or passenger, and apportion the earnings according to the mileage covered. Another somewhat similar method is to apportion the earnings from each transaction by a so-called rate prorate, according to which we assign to a given state its share of the charge for each transaction ac-

cording to the ratio of the rate on the distance covered within the state to the rate for the whole distance covered by the transaction in question. Such a method of apportioning gross earnings would give a high degree of exactness to the apportionment, but is subject to the objection that it involves a complicated system of accounting for every interstate transaction. This would be burdensome and expensive to the companies concerned, would be difficult for the state officials to check up, and would be hard for the general public to understand. Such difficulties as these should be avoided if possible, even though it may be necessary to adopt a less exact and more arbitrary rule of apportionment.

In general, a sufficiently exact apportionment of earnings may be made by adopting some arbitrary basis, such as the total number of miles of railroad track in the state as compared with the total miles of track of the whole system, or the mileage of wires of a telegraph or long-distance-telephone company, or the number of telephone instruments within and without the state for a telephone exchange company, etc. Such methods of apportionment have the advantage of being simple, easily understood, involving no complicated accounts, and being very easily administered. It is not difficult for each class of corporations to discover some such simple method of apportioning to a given state its share of the gross earnings of a corporation doing interstate business.

Constitutionality of the Gross-Earnings Tax

One of the obstacles which has hindered the development of the gross-earnings basis of taxing corporations has been the quite common notion that the taxation of gross receipts from interstate commerce was forbidden to our states by the Federal constitution. There can be no question that this popular notion comes from ignorance of the decisions of the United States Supreme Court, yet the notion has persisted, and even so able a body as the Ontario Railway Commission of 1905, after a study of American tax systems, was led into the popular error of supposing that the states were without power to levy taxes upon gross receipts from interstate commerce. Since so large a proportion of the public-service corporations are engaged in interstate commerce, this notion, if it were true, would obviously be an effectual bar

against this method of taxation. As a matter of fact, however, this notion is entirely erroneous.

This subject has been thoroughly studied by various authorities. A careful examination of the whole subject was made by the California Tax Commission of 1906, which examined a long line of decisions of the United States Supreme Court. Mr. A. E. Holcomb, in a paper read before the Fifth Annual Conference of the International Tax Association in 1911, presented a careful summary of the decisions of the Supreme Court on this matter. Willoughby in "Constitutional Law," published in 1910, reviews the subject. Finally, the Supreme Court itself in its opinion in Galveston, Harrisburg, and San Antonio Railway Company *vs.* Texas—210 U. S. 217—took occasion to review a long line of its own decisions upon this matter. In view of the thorough and able study that has been given to this question it is not necessary for this commission to discuss it at length. The conclusions may be briefly stated as follows:

First of all, there is no question of the general principle that all laws which impose taxes directly upon receipts from interstate commerce are in violation of the Federal Constitution and void. On the other hand, the right of a state to impose taxes upon the property of corporations within its borders is unquestioned, even though the corporations be engaged in interstate commerce. Again, a state may value the property of corporations by the "unit rule"; that is, may ascertain the total value of the entire system and then apportion to the state in question a share of the entire property according to the ratio of the mileage within the state to the total mileage of the system, or according to the ratio of business done within the state to the business of the whole system. In arriving at the value of the property of a corporation a state is free to make its earnings, either net or gross, the basis. The most important recent cases in which this matter has been settled are the following: In Maine *vs.* Grand Trunk Railway Company—142 U. S. 217—a tax based upon the gross receipts of railway companies was held valid on the ground that it was not a tax directly upon gross receipts, but only made use of gross receipts as a measure of the value of the franchise and property of the company. In Postal Telegraph Company *vs.* Adams—155 U. S. 688—the Court gave the clearest possible statement of the principle that a state tax is

valid if it is in commutation of a property tax and does not amount to more than the tax would have been upon the *ad valorem* basis. Finally in the case of Galveston, Harrisburg, and San Antonio Railway Company *vs.* Texas—210 U. S. 217—the Supreme Court of the United States examined its previous decisions and explained all apparent inconsistencies. The law at issue in this particular case was declared invalid on the ground that it was not the only tax upon the corporation concerned, but was in addition to another tax upon the whole property of the corporation.

We may sum up this discussion by the following quotation from Willoughby's "Constitutional Law":

> From the foregoing it would appear that the law with reference to the state taxation of the gross receipts of companies doing an interstate-commerce business is not in as definite shape as might be desired. One general principle may, however, be deduced from all the cases. This is, that a state tax is invalid whatever its form if, in effect, it lays a direct burden upon interstate commerce; and that, conversely, a state tax is valid, however measured or (if we follow the doctrine of Maine *vs.* Grand Trunk Ry.) whatever its form, which may be fairly held to be a tax on the property of the company, whether tangible or intangible. The tax being thus valid, if valid at all, only as a property tax, its non-payment may never involve a forfeiture of the right of the company to do an interstate-commerce business. The doctrine of Maine *vs.* Grand Trunk Ry. that a tax measured by the gross receipts may be sustained as a franchise or excise tax upon the right of the company to do business in the state is certainly unsound, and is, it would appear, as above indicated, so recognized in Galveston H. & S. A. R. R. Co. *vs.* Texas.
>
> Perhaps the general doctrine which we have been considering is best stated and illustrated in Postal Telegraph Cable Co. *vs.* Adams (155 U. S. 688), in which it was held that a state has the power to levy on a foreign telegraph company doing both a domestic and an interstate business a franchise tax, the amount thereof being graduated according to the value of the property within the state, such tax being in lieu of all other taxes. Though in terms a franchise tax, the tax was held valid as, in fact, taking the place of a property tax, which, of course, the state might constitutionally levy.

It appears, therefore, that there can be no question of the right of a state to impose a tax at a given rate upon the earnings of a corporation as an exclusive tax, and in lieu of all other taxes upon the property of the corporation, provided the resulting

burden is fairly measured so as not to be in excess of the burden which would be imposed by a tax on the *ad valorem* basis.

74. The Taxation of Public-Service Corporations: Report of a Committee of the National Tax Association.[1]—Certain important aspects of the taxation of public-service corporations are considered in the following report of another committee of the National Tax Association:

The committee upon the taxation of public-service corporations was asked to consider solely the question of the "equalization of taxation upon public-service corporations subject to *ad valorem* taxation." We have confined ourselves to this single subject.

After conference with the secretary of the tax association, the chairman of the committee formulated last spring a questionnaire designed to bring out fully the views of members of the committee; and by correspondence the committee began an interchange of opinions which continued during the spring and summer. On October 11 a tentative report, based upon the results of the correspondence, was submitted by the chairman for the consideration of the committee; and meetings were held at Buffalo, on October 22 and 23. The committee submits the following report which was adopted by a unanimous vote:

I

The taxation of public-service corporations by the several states is characterized by such diversity of methods that it is difficult to present any general statement upon the subject. Taxes upon property, capital stock, franchises, and earnings are all employed, sometimes alone and sometimes in combination. Little uniformity is found in the methods applied to the same class of corporations, and between different classes the diversity is naturally greater. It happens, however, that most of the problems connected with the equalization of the burden of taxation can be studied to best advantage in the taxation of railroads, and a statement confined to that class of corporations may serve as a useful introduction to this report.

At the present time three of the states[2] tax gross receipts in lieu of other taxation of the franchises and operating property of

[1] *Proceedings of the National Tax Association*, Vol. VII, pp. 372–383.

[2] Maine, Minnesota, and California.

railroads. At least seven other states,[1] however, employ gross-receipts taxes in addition to, or in combination with, taxes upon property or franchises.

Delaware levies a tax of fixed amount in lieu of all other taxation, and Pennsylvania imposes a tax levied at the rate of five mills upon the capital stock. In these states, therefore, the rate imposed upon railroads bears no relation to that levied upon other property subject to taxation.

In Maryland railroad property is locally assessed, and subject to taxation at local rates. In the remaining states all or some part of the railroad property, usually that described as operating property, is assessed by some state board or commission. These states tax railroads according to some kind of *ad valorem* method, but exhibit none the less considerable diversity.

Connecticut taxes the outstanding stocks and bonds at the rate of 1.1 per cent, which is assumed to represent the average rate imposed upon other property. Massachusetts taxes the capital stock at an average state rate, and deducts from the value of the stock the value of real estate and machinery subject to local taxation. In Rhode Island the tangible property is subject to local taxation at local rates, while the state levies a tax upon gross receipts in lieu of taxation of the intangible property.

The remaining states fall into two classes. Four states, namely, Michigan, Wisconsin, New Jersey, and New Hampshire, tax railroad property as a unit at an average state rate. Michigan and New Jersey impose the average nominal rate of state tax without equalization; while Wisconsin attempts to ascertain through the state tax commission the actual state rate, and New Hampshire has in the past equalized the valuation by reducing it so as to correspond with the valuation of other taxable property. We understand, however, that the New Hampshire commission now assumes that other property in the state is taxed at its full value, and therefore assesses railroads at the full valuation.

The other states provide for the assessment of all railroad property, or railroad-operating property, by some kind of state board or commission, and then apportion the assessed valuations among the local taxing districts for taxation at local rates. Of these states most, if not all, authorize some sort

[1] Maryland, Ohio, South Carolina, Texas, Virginia, Pennsylvania, and Rhode Island.

of equalization of railroad assessments with these placed upon property locally taxed. In Oregon this equalization seems reasonably effective, and in perhaps a few other states partial relief from over-taxation is afforded. But in general the state boards are unable to cope effectually with the problem under existing provisions of law, and in some cases make no attempt to do so. Recently Kansas, Arizona, and Colorado, and in somewhat less degree New Mexico, have made systematic efforts to bring local assessments of every class of property up to the full value, with the result that the rates now imposed upon public-service corporations in these states are tending to approximate the actual rates paid by other property.

It will be seen that the prevailing practice is assessment, by a state board or commission, of at least the operating property of railroads, and the subsequent apportionment of the taxable values thus ascertained among the local taxing districts. Comparatively few states have provided effectually for the equalization of taxation. Four states tax railroad property as a unit at an average state rate, but of these Wisconsin is the only one that now equalizes such taxation. Massachusetts taxes the capital stock at an average state rate which does not take into account the undervaluation of property subject to local taxation, and Connecticut taxes the stocks and bonds at a fixed rate of 1.1 per cent, which may be assumed to represent the average imposed upon other property. Your committee finds therefore that only in a small minority of states is provision made at the present time for equalization of taxation upon public-service corporations subject to *ad valorem* taxation.

Of the states that impose taxes upon gross receipts in lieu of other taxation of railroad property, we understand that Minnesota and California have endeavored to make the rate of taxation correspond as nearly as possible with the average imposed upon other property. In Maine we understand that special conditions have led to the imposition of a rate of taxation upon gross receipts that is somewhat lighter than that imposed upon other property.

The method of taxing other classes of public-service corporations cannot be considered in detail. It appears, however, that in most cases telegraph and telephone companies are taxed by methods similar to those employed in the taxation of railroads.

The same thing is true also, though perhaps not in equal degree, of express, parlor-car, and other transportation companies. Where *ad valorem* methods of taxation are employed it appears that only a small minority of the states have as yet undertaken to equalize taxation in any effective manner.

II

Your committee first directed attention to the question whether there should be any equalization of the taxes imposed upon public-service corporations under the system of *ad valorem* taxation. Upon this subject we find three theories which require consideration.

The first theory is that public-service corporations should be subject to special taxation much heavier than that imposed upon other classes of business or property because they hold special franchises of great value. In some cases also these franchises have been secured without adequate compensation and by methods that will not stand close examination. In this view of the case taxation is a logical and convenient means of recovering for the public treasury income that rightfully belongs to it.

A generation ago, before states and the nation had undertaken to regulate effectively, through commissions or otherwise, the service and charges of public-service corporations, this theory offered a natural and logical remedy for some of the evils of unregulated monopoly. Taxes upon the property of unregulated monopolies will tend, generally speaking, to fall upon the monopolists, and by their agency the government may secure a share of the profits of the monopolies. But the situation changes when public-service corporations are brought under effective regulation. Under the latter condition regulation of rates and service must proceed upon the theory that the corporations should be allowed to earn a reasonable return upon a fair valuation of their property. Special taxes upon regulated monopolies, therefore, merely increase the expense of providing the service and increase the rates necessary to yield a reasonable return, or else diminish the resources available for extending and improving this service. Effective regulation completely alters the incidence of special taxes upon monopolies, and at the same time removes the evils which led to the demand for such taxation.

Your committee believes that it is through public regulation and not through taxation that a correct policy towards public-service corporations must be worked out, and holds that our theories of taxation should be based upon the assumption that public-service corporations are to be subjected to public control. We therefore conclude that this first theory is based on conditions that are rapidly passing away and is unsuited to the present era of regulated public-service corporations. Of course our reasoning does not apply to existing contractual payments, sometimes called taxes, or require the relinquishment of such payments without compensation in the way of reduced rates or increased service. These payments present a special case which is an exception to the general rule.

A second theory assumes effective regulation of public utilities, and then holds that such regulation makes it unnecessary to equalize taxation of public-service corporations with the taxation of other business or property. Railroads, for example, might be exempted from all taxation provided that their charges were reduced or service improved in a measure corresponding to the benefits derived from such exemption; while, upon the other hand, railroad taxes might be increased to any desired extent without injustice to the roads, provided rates were increased in corresponding degree. In the former case the public would secure untaxed service; in the latter the government would employ the railroads as an agency for the collection of heavy taxes upon transportation. In neither case are the interests of the railroads affected, either favorably or adversely.

If one holds that in taxation there can be no such thing as equality, and that governments should be guided solely by the principle of plucking the most feathers with the least squawking, it is possible to accept this theory, and either exempt public-service corporations or single them out for special taxation. No special favor will be shown the corporations in the one case and no injustice done in the other; the whole question is one of feathers and squawking.

Again, if we hold to the principle of equality of taxation but consider merely equality in the taxation of different classes of investments under the property tax, no inequality would arise from the adoption of this second theory. Regulation of rates and services would transfer from the owners of public-service

corporations to the consumers of the services the benefits of tax exemption or the burdens of special taxation.

But if we interpret the principle of equality broadly and consider the effect of this policy upon different classes of citizens, we shall find the second theory untenable. Your committee believes that it is necessary to consider carefully the interests of two classes of people, the taxpayers and the consumers of the services of public-service corporations. It is sometimes assumed that between these two classes there is substantial identity of interest. It is supposed, for instance, that, if railroads are exempted, the persons who receive untaxed services are the same ones who bear the new taxes levied in order to produce the needed revenue; and that if, on the other hand, special taxes are imposed on railroads, the effect of such taxes is the same as that of taxes levied upon persons or property generally. Such an assumption is inadmissible.

With corporations national in scope it may be true that, if we leave out of account citizens residing abroad and foreigners residing temporarily in the country, the persons that consume the service are the same body of people that must pay the taxes; but it is by no means true that the extent to which particular persons use the service is the measure of the contributions they make to the national revenues. Even if all taxation were direct, and were, in fact as well as theory, levied proportionally upon property or income without exemptions of any description, it would be certain that all taxpayers would not use the services of public-service corporations in proportion to the amount of their property or income. When we consider that direct taxation is not necessarily proportional, either in theory or in actual operation, and that exemptions are both numerous and important, it becomes evident that the assumed identity of interest between consumers and taxpayers does not exist. With services local in scope the case is even stronger, since many taxpayers are likely to be nonresidents, while the service may be used extensively by persons who are employed in one locality during the day but have their domicile elsewhere. What identity of interest in this matter can there be between the taxpayers of a large city and the army of suburbanites using the local transportation facilities?

Since the interests of taxpayers and consumers are not identi-

cal, it follows that exemption of public-service corporations from taxation confers a special benefit upon consumers at the expense of taxpayers; and by a parity of reasoning it follows that the imposition of special taxes upon such companies relieves the taxpayers at the expense of the consumers. In exceptional cases special considerations may justify the grant of what is in effect a bounty to consumers, or justify the imposition of special taxes upon them; the rule of equality is not an absolute one which admits of no exception. But your committee holds that, as a general proposition, this second theory is inconsistent with the principle of equality in taxation, and for this reason we are compelled to reject it.

There remains the third theory, that the taxation of public-service corporations should be governed by the general rule of equality, which theory your committee approves. We hold that equality should be the controlling principle in governmental affairs, and that in none is it more necessary than in the matter of taxation. Absolute equality, of course, may be difficult and even impossible of attainment; in taxation, as in other affairs, we are obliged to do the best we can under all the circumstances. But the ideal should be equality, and in practice we should never lose sight of that ideal.

Equality of taxation, however, must be real and not formal merely. Where conditions differ widely, equality cannot be obtained by an iron rule of uniformity. Similar treatment of things essentially dissimilar produces inequality, not equality, as is well shown by the experience of the American states with the general property tax. This was recognized long ago by the Supreme Court of the United States, in a familiar case[1] in which the following language occurs:

> This court has repeatedly laid down the doctrine that diversity of taxation, both with respect to the amount imposed and the various species of property selected either for bearing its burdens or for being exempt from them, is not inconsistent with a perfect uniformity and equality of taxation in the proper sense of those terms; and that a system which imposes the same tax upon every species of property, irrespective of its nature or condition of class, will be destructive of the principle of uniformity and equality in taxation, and of a just adaptation of property to its burdens.

[1] Pacific Express Company *v.* Seibert, 142 U. S. 351.

Real equality in taxation, then, requires careful consideration of circumstances and conditions; in other words, it requires discrimination and classification. This tax association has from the beginning upheld the doctrine of classification, and in the successive conferences held under its auspices this doctrine has rarely been called in question. Your committee, in upholding the principle of equality, emphatically asserts the necessity of classification; and holds that, without classification, real, as distinguished from formal, equality is absolutely unattainable. Our tax laws must recognize the economic differences of the various classes of property. Household effects, intangible property, forests,—these and, doubtless, other classes of property need to be segregated and treated as the circumstances of each class require. In short, equality does not mean a uniform rule of taxation such as the constitutions of so many states now prescribe.

But classification can be approved only so far as the circumstances of each case justify it, and the presumption is always in favor of uniformity. Separate classification of any class of property is justified only so far as the economic characteristics of the class make such a course desirable and even necessary. The burden of proof undoubtedly rests upon the advocate of classification, and he should expect to be required to prove his case. There can be no justification for the claim sometimes made, both by advocates and opponents of the doctrine of classification, that the mere acceptance of that doctrine destroys the presumption in favor of uniformity and makes it unnecessary to consider the relative burdens imposed upon different classes of property and business. The aim should always be to secure equality, and classification is defensible only as a means to the end of securing real, as contrasted with formal, equality.

So far as the taxation of public-service corporations is concerned, your committee is unable to find any good reason for giving such companies a separate classification. No peculiar difficulties are encountered in finding and assessing the property of such companies. No reason appears why consumers should be given untaxed service at the expense of taxpayers, or why taxpayers should be relieved at the expense of consumers. Exceptional cases may, of course, be found; but these should be dealt with as they arise. The general rule should be equality of taxation of public-service corporations and of all property which

is not for good and sufficient reasons accorded a special classification. In other words, the taxation imposed upon public-service companies should be the same as that imposed upon property subject to the full rate of state and local taxation.

It will be observed that we do not think that the rate imposed upon public-service corporations should be reduced because some other kinds of property may be exempt or may be given a special classification and taxed at a lower rate. Such exemption or special classification should never be made except for special reasons relating to the economic nature of the property concerned and in no way pertinent to property left unclassified. The existence of such special classes of property in no way affects the status of others, and furnishes no more reason for separately classifying public-service corporations than it affords for extending similar treatment to real estate. Public-service corporations should be taxed like other property subject to full rate of state and local taxation unless it can be clearly shown that peculiarities inherent in this class of property justify a separate classification. If it is said that existing or proposed exemptions threaten to impose an excessive burden upon property remaining taxable at the full rate, this consideration furnishes a reason for not making the exemptions rather than a justification for other separate classifications.

III

Assuming that public-service corporations should be taxed at the same rate as real estate and such other property as may be subject to the full rate of state and local taxation, it remains to consider certain questions concerning the application of the principle. The first is whether the principle of equality requires *ad valorem* taxation in all cases and forbids the use of special taxes. We are clearly of the opinion that it does not. The rates of specific taxes, even taxes upon gross receipts, can be readily adjusted from time to time so as to make them substantially equivalent to the rates imposed upon all unclassified property. In this manner substantial equality of burden can and should be secured. Equality, as we have said before, does not imply uniformity of method in all cases, or exclude diversity of method when differences of conditions make it desirable.

A similar answer must be given the second question: Is the

principle of equality violated when public-service corporations are taxed, as units, at an average rate of *ad valorem* taxation which represents as nearly as may be the average rate of local taxation in the state? Here again, we reply, real and substantial, not formal, equality is the end at which we should aim; and in certain cases this may be more readily and certainly attained by state assessment at an average rate than by local assessment at local rates. This is especially true of such corporations as railroads, the operating property of which may be located in many or even all the counties of the state.

The third question concerns the method of valuation. If the valuation of public-service corporations is determined by capitalizing net earnings or ascertaining the value of outstanding securities, it is evident that all intangible assets are included in the assessment; and it is the practice of most of the states to disregard these elements in the taxation of other classes of property. Can such diversity of methods be reconciled with the principle that taxation should be equalized, or does equality require that intangible assets be taken into account in all cases or else disregarded in all?

Abstractly considered, there seems to be no doubt that it is inconsistent with the principle of equality to value the property of public-service corporations by methods that include intangible assets and to value other property by methods that exclude them. Since we do not consider it practicable to introduce methods of valuing public-service corporations that shall exclude these elements of value and tax the companies upon the valuation of their tangible assets solely, we hold that equality can be reached only by including the same elements in the valuation of other classes of property that are not given a separate classification. With corporations this can be done without difficulty. With other classes of property and business we believe it is extremely difficult, and probably impossible, to tax intangible assets equally under any system of property taxation, and that the difficulty cannot be solved until the states are ready to adopt some form of income taxation. In other words, the inequality which we encounter at this point is inherent in the nature of the present system of state and local taxation and cannot be eradicated without fundamental changes in this system. Between different classes of corporations, however, there should be no

difficulty in securing substantial equality in the methods of valuation, and this should undoubtedly be done.

The fourth and final question relates to the equalization of the tax rate itself. Property subject to local assessment is often undervalued, and some classes of it largely or wholly elude the taxgatherer. The result is that the rates of local taxation are greatly in excess of the rates which would prevail if all property were assessed, and at its true value; so that any class of property that is assessed at its true value is subject to grossly unequal taxation. This matter was well treated by the committee of this association which in 1911 reported upon "The Taxation of Banks and Financial Institutions."[1]

The committee holds that, whether public-service corporations are taxed at local or at average state rates, they should be subject to the true, and not the nominal, rates of state or local taxation. So long as undervaluation of other property continues, therefore, we hold that either the valuation of public-service corporations should be made on the same basis as that of other property, as is the practice in a few states, or that the corporations should be taxed at the true rate imposed upon other property, as is the practice in Wisconsin. Better still would be the eradication of the evil of undervaluation of property by the local assessors, as is now attempted in Kansas, Arizona, Colorado, and New Mexico; but this must necessarily be a work of time, and in the interim public-service corporations are entitled to fair play.

75. State and Local Taxation of Banks: by F. R. Fairchild.[2]— The taxation of banks is treated in the following selection:

Federal legislation at the time of the Civil War placed great restrictions upon the freedom of the states in the taxation of national banks and, indirectly, of all banking institutions. As a result, bank taxation has followed lines quite different from taxation of other corporations and now shows more uniformity of method. Serious difficulties still remain. But the point has been reached where agreement upon a satisfactory system seems quite possible. Since this is so, the problem of bank taxation is worthy of special attention.

[1] *Proceedings of the Fifth Conference*, pp. 313–324.

[2] Reprinted from the *American Economic Review*, December, 1916.

Banks were among the earliest corporations established, and some of the very first laws providing for special taxes upon corporations apply to banks. The first state law imposing a special tax on banks was passed by Georgia in 1805 and placed a tax of 2½ per cent upon the capital stock of banks and ½ of 1 per cent upon their note circulation. Taxes on the capital stock of banks were imposed by New Jersey in 1810 and by Massachusetts in 1812. Pennsylvania in 1814 introduced a tax based upon the dividends or net profits of banks at the rate of 6 per cent, raised in 1824 to 8 per cent. Other states followed with special methods of taxing banks, the most popular one being the tax upon capital stock, only a few states using the tax on dividends. Most of the states still clung to the old-fashioned general-property tax upon all the property of the banks. This was the situation down to the middle of the nineteenth century.[1] The whole course of events was then changed by the legislation of the Civil War.

In 1862 Congress established the national banking system and in the act of 1864 provided for certain federal taxes on national banks, which were to be in lieu of all existing taxes upon such banks.[2] The act goes on to specify, however, that the shares of stock in national banks may be taxed as personal property of the owners under the authority of the states in which the banks are located.[3] This provision has remained in force until the present day with only slight changes. The state legislatures are at liberty to determine the method of taxing the shares of national banks subject only to two restrictions: namely, that the taxation must not be at a higher rate than is imposed upon other moneyed capital, and that the shares owned by persons residing outside the state must be taxed only at the place where the bank is located. The real estate belonging to national banks is also expressly subject to state and local taxation the same as other real estate.

This legislation has had a profound effect upon the history of bank taxation. In the absence of such a law it is likely that the taxation of banks would to-day present the same diversity and confusion as is seen in the taxation of other kinds of corporations. Under the influence of this law, however, there is greater uniformity to-day in the taxation of banks than in any other class of corporations.

[1] *Cf.* Seligman, *Essays in Taxation* (eighth edition), pp. 151–161.

[2] U. S. Revised Statutes, sect. 5214.

[3] *Ibid.* sect. 5219.

The federal statute regarding the taxation of banks has been frequently interpreted by the courts, until at the present time there can be little question as to its exact meaning.[1] The term "other moneyed capital" has been so interpreted as greatly to restrict its meaning. It has been held to include only other taxable moneyed capital.[2] The fact that certain moneyed capital is entirely exempt from taxation will not stand in the way of the taxation of capital invested in national banks. Furthermore, it has been held that the term is restricted to capital competing with national banks.[3] Under the New York statute it was held that trust companies were not competitors of national banks.[4] This appears to be scarcely a tenable position, however, and there is reason to believe that it might be altered.[5] The courts have clearly held that savings banks and building-and-loan associations are not to be regarded as competitors of national banks;[6] special favors to such institutions therefore will not invalidate the taxation of national banks. The term, in brief, seems to include practically only capital invested in the stock of other commercial banks and (probably) trust companies, and money in the hands of individuals employed in a manner similar to the

[1] For a valuable digest of the decisions down to 1906, *cf. Report of the Commission on Revenue and Taxation of California*, 1906, pp. 230–235. The list of references in the California report is so full that reference is made in this article only to a few of the leading cases prior to 1906. *Cf.* also Judson, The Power of Taxation, ch. 9, "Taxation of National Banks."

[2] Van Allen *v.* Assessors, 3 Wall. 573; People *v.* Commissioners, 4 Wall. 244.

[3] Mercantile National Bank *v.* New York, 121 U. S. 138, and numerous later decisions. *Cf.* California report, *op. cit.*

[4] Jenkins *v.* Neff, 186 U. S. 230.

[5] Under the New York law, trust companies are now taxed by exactly the same method as national and state banks, except that the tax is assessed to the trust company by the state instead of to the individual shareholders. See the description of the New York law below. The question is therefore no longer of practical importance. There is reason to believe, however, that if the state law should seek to make a clear discrimination in favor of trust companies the present attitude of the Supreme Court might be modified. In the decision of a recent case (People of New York ex. rel. Amoskeag Savings Bank *v.* Purdy, 231 U. S. 373), the court referred to trust-company stock in such a way as to imply that it was "other moneyed capital" in the sense of the federal statute. The point was not material to the issue in this case, however.

[6] Davenport Bank *v.* Davenport Board of Equalization, 123 U. S. 83; National Bank of Redemption *v.* Boston, 125 U. S. 60; Mercantile National Bank of Cleveland *v.* Hubbard, 98 Fed. Rep. 465.

employment of bank capital. The restriction that the taxation of national-bank stock shall not be at a greater rate than that of other moneyed capital has been held to apply not only to the tax rate but to the assessment as well.[1] In other words, equality in tax burden is required. The decisions have also made clear that no property belonging to national banks may be taxed except real estate.[2] It has also been held that, even though the taxation of real estate together with the taxation of the total value of the shares of stock involves double taxation, this is no violation of the statute.[3] It is possible, therefore, to tax the entire value of all the capital stock of a national bank and in addition impose a tax upon its real estate, provided only that the same method is applied to other forms of moneyed capital. No deduction need be made from the valuation of the shares on account of investment of the capital in property either elsewhere taxed[4] or exempt from taxation, as United States bonds.[5] The law permits the state to require the bank to pay the entire tax upon its shares of stock.[6] This does not make it a tax upon the bank; the bank is assumed to be acting as the agent of the stockholders and has reserved the express right of charging the tax against each stockholder with a lien upon the dividends and shares of stock as security.[7]

The result has been that the states are practically restricted to one method in the taxation of national banks. Moreover, the requirement that there shall be no discrimination against the stock of national banks as compared with other moneyed capital has been so strictly interpreted as virtually (though not expressly) to mean that this method of taxing national banks is legal only in case other banks are taxed in practically the same way.[8] As a

[1] People of New York *v.* Weaver, 100 U. S. 539.

[2] Rosenblatt *v.* Johnston, 104 U. S. 462.

[3] Peoples National Bank of Lynchburg *v.* Marye, 107 Fed. Rep. 570.

[4] Pacific National Bank of Tacoma *v.* Pierce Co., 20 Wash. 675.

[5] Mercantile National Bank *v.* New York, 121 U. S. 138; Home Savings Bank *v.* Des Moines, 205 U. S. 503; Hager *v.* American National Bank, 159 Fed. Rep. 396.

[6] First National Bank *v.* Kentucky, 9 Wall, 353; Merchants and Manufacturers National Bank *v.* Penn., 167 U. S. 461.

[7] Merchants and Manufacturers National Bank *v.* Penn., 167 U. S. 461; Home Savings Bank *v.* Des Moines, 205 U. S. 503.

[8] *Cf.* California report, *op. cit.*, p. 229.

result, the method prescribed by federal law for the taxation of national banks has generally been extended by the states to other banking institutions. The old-fashioned taxation of banks on their property under the general-property tax has been practically abandoned. Banks are to-day not generally taxed at all except upon their real estate, which is taxed locally like other real estate, while the shares of stock in banks are taxed as personal property of the owners in conformity with the federal statute relating to the taxation of national banks.

It must not be concluded that the problem of the taxation of banks has been solved. There still remains opportunity for diversity in matters of detail, with serious inequality and injustice resulting. The various methods of taxing bank shares may be conveniently grouped into two classes. (1) Bank shares are taxed by local officers as part of the general-property tax. The value of the shares is assessed by local officers, and the tax rate is the local rate of the general-property tax. (2) The taxation is under a uniform method prescribed by state law. The assessment is uniform throughout the state and usually determined by a state officer or board. The rate also is generally uniform, though it is not always so, and several methods of determining it are in use.

In the majority of the states, taxation of bank shares is still a matter of local administration. The local assessor determines the value of the shares just as he assesses other property under the general-property tax. The assessment is relatively easy, since the banks may be required to furnish the necessary facts, including a list of stockholders with their residences and the number of shares held by each. Nevertheless the assessment is practically at the personal discretion of the assessor, and a confusing variety of rules and methods has resulted.

In most states the law requires that all property be assessed at its full cash value. In seeking to arrive at this value some assessors try to determine the market value of shares from available records of sales. In other cases the book value is taken; that is, the sum of capital, surplus, and undivided profits. Some assessors take capital only, paying no attention to surplus and undivided profits. In Colorado the state tax commission recently undertook to fix the value of bank shares by taking capital, surplus, average undivided profits for the year, and 4 per

cent of the total deposits. A Wyoming law of 1913 provides that bank shares shall be assessed on their par value plus the surplus and undivided profits in excess of 50 per cent of the capital. In North Dakota banks are assessed on the capital, surplus, and undivided profits, less an amount equal to 5 per cent of the loans and discounts, on the theory that banks may fairly be allowed to assume such a shrinkage in their assets.[1]

To add to the confusion, the values thus determined are frequently reduced by a certain percentage in recognition of the prevailing under-assessment of other kinds of property. The basis of assessment varies all the way from 100 per cent down to 25 per cent or less. In most cases the value of the shares of stock is reduced by deducting the value of real estate assessed to the bank.

Without going into further details, it is clear that inequality and injustice must result from this method of taxation. The greatest inequality between banks, even in the same state, is an inevitable result. For example, it is reported that in Kentucky the state board of assessment values bank stock at 80 per cent of the capital, surplus, and undivided profits, but local assessment in each of the 120 counties is at the personal discretion of the county assessor, with the result that assessment is anywhere from 60 per cent up to 100 per cent of the capital, surplus, and undivided profits. In addition there are city assessors, so that cases are on record of a bank assessed at 80 per cent of its book value for state purposes, 70 per cent for county purposes, and 100 per cent for city purposes.[2] A study of bank assessment in Montana indicated that for the year 1912 assessments in various counties varied from 18 per cent to 77 per cent.[3] The inequality caused by unequal assessment is of course intensified by the variety of local tax rates.

[1] For complete details the student must consult the statutes of the several states. For brief summaries of the tax systems of all the states, *cf.* U. S. Census, "Wealth, Debt, and Taxation," 1913, Vol. I. Much useful information is contained in the reports of state tax commissioners, boards of equalization, bank commissioners, etc. *Cf.* also numerous articles in *Proceedings of the National Tax Association*, especially Paton, "State Taxation of Banks," Vol. VII, pp. 315–341, and "Report of Committee on Taxation of Banks and Financial Institutions," Vol. V, pp. 313–324.

[2] Paton, *op. cit.*, pp. 329–330.

[3] *Ibid.* p. 332.

A comparison between bank stock and other kinds of property shows an injustice perhaps even more flagrant. With the information at his disposal it is an easy matter for the assessor to arrive at the full value of bank stock. Evasion and under-assessment are practically impossible except with the consent of the assessor. In the case of other kinds of property evasion and under-assessment are the rule. Even where some attempt is made to scale down the value of bank stock, the process is seldom if ever carried far enough to produce justice. Cases have been reported in Illinois of banks assessed on their full book value and farm lands at 20 per cent. An inquiry made in Missouri in 1911 showed instances of bank stock assessed two or three times as heavily as other forms of property. In some counties live-stock was assessed as low as 15 per cent, merchandise 20 per cent, real estate 10 per cent, but in only one county was bank stock assessed at less than 50 per cent. It is said that in some counties of Minnesota 60 per cent of the entire personal-property tax is paid by banks and that in some of the cities of Wisconsin banks pay from 15 to 30 per cent of the total personal-property tax. At one time the board of equalization of New Mexico officially recommended to the county assessors that all property be returned at actual cash value and that the assessment be 50 per cent of this valuation for bank stock and 35 per cent for real estate and personal property. It is claimed that in North Carolina real estate is valued at from one tenth to one half of its actual value, whereas bank stock is frequently assessed at a higher value than that at which it could be sold. In North Dakota it is reported that real estate and personal property are assessed at from 15 to 25 per cent of their value, while bank stock is assessed all the way from 25 to 70 per cent, according to the personal inclination of the county officials.[1]

There can be no doubt that as a general rule the assessment of bank stock is very much nearer actual value than that of other personal property or even real estate. Since bank stock must bear the regular rate of the general-property tax, it is obvious that it bears an unjust burden of taxation. That local taxation of bank stock is flagrantly unjust as between different banks and as between bank stock and other kinds of property cannot

[1] For further details of these and similar instances, *cf.* Paton, *op. cit.*

be questioned. This method might be dismissed with summary condemnation were it not for the fact that it is the method actually employed in many states and that attempts to remedy its injustice are being made which deserve critical analysis.

The remedy nearest at hand is obviously to require the assessor to scale down the value of bank stock so as to make it correspond with the prevailing under-assessment of other kinds of wealth. We have seen that assessors have sought to secure some measure of justice in this way. In many states the bankers have offered this as their suggestion for reform. The bankers of Indiana expressed themselves as fairly well satisfied when a uniform rule of assessing bank stock at 75 per cent of the capital, surplus, and undivided profits was adopted. Likewise in Iowa the bankers appeared to be fairly content with a rule of 20 per cent of actual value. In Missouri a committee of bankers has devoted itself to urging the state board of equalization and the various county boards to reduce the basis of assessment upon bank capital and has succeeded in obtaining slight reductions. In Kentucky the bankers succeeded in persuading the state board of equalization to cut the assessment of bank shares down to 80 per cent of capital, surplus, and undivided profits. In Nevada the state bankers' association presented the argument that "undivided profits cannot be considered a fixed investment, but rather a fund to meet expenses and such losses as the bank may sustain in the conduct of its business, and that to a certain extent the surplus fund should be considered in like manner." As a result the state tax commission agreed to eliminate undivided profits and assess only 75 per cent of the surplus. The economist will feel more sympathy with the result than with the argument by which it was obtained.[1]

There is little reason to hope that justice will be secured through the attempt to scale down the assessment of bank stock. The most that can be expected from this remedy is a palliation of the evil. The principal reason why bank shares are assessed at their true value is that it is so easy to ascertain the true value. Other property is often under-assessed on account of the difficulty of knowing what its value actually is. In most states the law positively requires the assessment of all property at its full value. Although much property is not actually so assessed, the

[1] For further details regarding these and other examples, *cf.* Paton, *op. cit.*

under-assessment is done more or less furtively and is not openly admitted. In the case of bank stock, however, it is practically impossible to put in any value except the real one without openly admitting an intentional under-assessment.

Some states, it is true, have seen this difficulty and have recognized in their statutes the prevailing under-assessment and required that bank shares be entered at values corresponding to the assessment of other kinds of wealth. In other states the same result has been accomplished by administrative action of tax commissioners or boards of equalization, and of course the local assessors exercise some discretion in the same way. Examples have been given above. In none of these cases, however, is more than a compromise probable. Neither by statute nor by administrative discretion is it likely that the full extent of prevailing under-assessment will be openly recognized. The result is to decrease somewhat the injustice against the banks, but not to remove it.

Justice might be obtained by the opposite process, namely, by raising the assessment of other kinds of property up to full value,—a process which would, of course, soon be followed by a lowering of tax rates. This result would be eminently desirable from every point of view. That it is likely ever to be generally accomplished is open to grave doubt. The whole history of the general-property tax has shown overwhelming forces leading to under-assessment of property. If these motives could be counteracted and all property actually assessed at its full value, one of the greatest difficulties of the tax would be removed. Under the American general-property tax in anything like its present form the motives for under-assessment are likely to remain too strong.

In short, the difficulties in the taxation of bank stock under local administration are inherent in the general-property tax itself, and attempts to bring relief by securing under-assessment of bank stock or full-value assessment of other kinds of wealth are bound to be futile, being able at the best to accomplish only a slight palliation of the present injustice.

We have now to consider the taxation of bank stock under methods prescribed by state laws which require uniformity throughout the state. Here the administration is generally in the hands of state officers, although the returns may be distributed either to the towns of residence of the stockholders or to the

towns where the several banks are located, or kept by the state. The two important problems here are the basis of assessment and the rate.

Of the various methods of valuing bank shares two are of special importance and deserve our careful examination. Shares of stock in banks may be valued for purposes of taxation either at their market value or at their book value. Under the theory of the general-property tax, market value is apparently the logical basis. Our local tax systems are still founded upon the general property tax. The problem is to bring the method of taxing bank shares into the greatest possible harmony with the present taxation of other kinds of wealth. The general-property tax assumes that all kinds of taxable property will be assessed at their true or actual value, which is practically synonymous with market value. Justice would therefore seem to require that bank stock be assessed at its market value.

The objections to market value as a basis for assessing bank stock are of a practical nature and arise from the difficulty of finding out what actually is the market value of the shares. There are, of course, many large city banks whose shares are regularly dealt in on the market. The market value is then a matter of public knowledge, and there is no difficulty in determining it for purposes of taxation. However, this is the exception rather than the rule. Most bank shares are not regularly bought and sold. Many banks are owned by small groups of men, and the stock is rarely exchanged. When sold it is apt to be by private arrangement between members of the inside group on terms which are not known to outsiders and which even if known might not fairly represent the actual value of the stock. The sales of stock of small local banks are so infrequent as to furnish no reliable indication of the value of the stock. The law requiring an assessment of the market value of stock imposes a very difficult burden upon the officer charged with the duty of assessment. In the majority of cases he is unable to find any quotation of actual market values and is forced to rely upon reports of brokers or statements furnished by the officers of the banks themselves. Ordinarily he has to estimate a fair market value from examination of the balance sheets and earnings of the banks. This introduces the element of personal judgment and is a fruitful cause of argument and dispute with

the representatives of the banks, all of which leads to friction, hard feeling, and inefficient assessment.

The argument is sometimes urged that market value, even when discovered, does not always represent the real value of the stock. Stock values are subject to fluctuations upon the market. These fluctuations may in general be assumed to represent changes in the condition of the bank and therefore in the real value of the shares, but they may also be caused by circumstances entirely foreign to the bank's condition, such as the situation of the money market, etc. It is also held that shares of stock in banks are often sold at prices far above their real value, due to sentimental reasons. There is great danger of exaggerating the importance of these objections, but such weight as they have simply strengthens the case against the use of market value. The real objection to market value, however, is the difficulty of determining it, and it is this consideration which furnishes the principal argument in favor of the assessment of bank stock at its book value.

Book value is a definite fact, easily determined from the balance sheet of any bank. The value of a share may ordinarily be determined by adding the capital, surplus, and undivided profits and dividing by the number of shares. This method of valuing bank shares does away with the difficulties inherent in the market-value basis. In the place of uncertainty, dispute, and guesswork, it substitutes a certain method, easy of administration. The book value is a definite thing, shown at any time by the balance sheet of the bank, and the room for argument or difference of opinion is reduced to a minimum. The book value is not subject to frequent fluctuations due to the condition of the money market or other external causes.

Certain objections have been raised to the use of book value as a basis of assessing shares of bank stock. In the first place, it is claimed that market value is the only true value, that all other values are more or less arbitrary, and that the real value of anything is the amount a purchaser is willing to pay for it. There is considerable truth in this contention, and it might furnish a valid case against the use of book value were it not for the impossibility of determining market value, already demonstrated.

The question remains whether book value does actually represent the true value of stock or whether it is arbitrary and subject

to manipulation. In particular, it is charged that by changing the valuations set upon its assets a bank may make its book value what it pleases. The officers of the bank may write off certain assets and put others in at lower figures so as materially to reduce the book value and evade taxation. While this procedure is of course open to the officers of any bank, it does not appear likely that it would often be availed of to escape taxation. The motives leading the ordinary bank officer to make as good a statement as he can of his bank's condition will generally be strong enough to prevent the scaling down of book value below the real value of assets merely to save a few dollars in taxation. On the other hand, if the use of book value should lead some banks to write off doubtful assets or reduce assets previously carried at inflated figures, the result would certainly be a desirable one and would not lead to any real evasion of taxes.[1]

The only methods of assessment deserving serious consideration are the two that have just been discussed. Certain states have adopted methods departing more or less from these two, but usually with unfortunate results. New Jersey, for example, formerly determined the value by deducting from capital, surplus, and undivided profits the assessed value of real estate and the book value of all non-taxable securities owned by the bank. The latter provision allowed a very great reduction from book value, and many banks were able to show non-taxable securities equal to their total capital, surplus, and undivided profits, so that they paid no tax at all except upon their real estate. In a number of cases banks have been actually ashamed to get off so easily and have permitted an assessment and paid taxes which they knew were not enforceable.[2] The somewhat similar experience of California is referred to below. As has been shown, the federal statute does not require the deduction of tax-exempt property or even of property which is elsewhere taxed. There is no reason why such deduction should be allowed.

[1] Regarding the relative merits of book value and market value, *cf. Proceedings of the National Tax Association*, Vol. IV, pp. 391–401; *Report of the Commission on Revenue and Taxation of California*, 1906, pp. 244–247; *Report of the Connecticut Commission on Taxation of Certain Corporations*, 1913, pp. 130–135.

[2] *Cf. Report of the New Jersey Board of Equalization of Taxes*, 1910, pp. 19–21, and 1911, pp. 21–22; also *Proceedings of the National Tax Association*, Vol. VII, pp. 318–319, 340–341.

Some states having assessed the stock at market or book value then proceed to scale the assessment down to a certain percentage. For example, under the Ohio law the state board of equalization assesses the book value and then fixes the assessment at 60 per cent.[1] Something of this sort is a necessity for the sake of justice, if bank stock is to be taxed at the same rate as other property. A more effective way of securing justice, however, is to make allowance for this in a uniform rate fixed by law. This brings us to the matter of the rate.

There are three ways of determining the rate of the tax on bank shares. First, to impose upon each bank the local rate of the general-property tax in the town where it is located. Second, to impose upon the banks a uniform rate equal to the average of the local rates of the general-property tax throughout the state. Third, the law itself may prescribe a uniform rate to be imposed upon all banks.

The first method leaves many of the evil results of local administration unremedied, although assessment may be just and uniform throughout the state. The actual burden of taxation will be unequal on account of different local rates. In particular, bank stock, being assessed at practically its full value, will be subject to an excessive tax as compared with other property. The only way to correct this is to make the assessment a certain fraction of the actual value, as is done in Ohio. This cannot secure justice for two reasons. It is practically certain that the reduction will not be enough to offset the prevailing under-assessment of other property, and even if this were done on the average, there would remain injustice on account of the varying degree of under-assessment in the different localities.

If instead of a tax on each bank at the local rate there is imposed upon all banks a tax at a uniform rate equal to the average of the general-property tax, uniformity is secured for all banks throughout the state. There still remains, however, the excessive burden upon bank stock as compared with other kinds of property, unless this is met by reduced assessment of bank stock to meet the prevailing under-assessment of property. In theory this would be a possibility, but practically there is little reason to expect a reduction sufficient to secure justice.

[1] *Report of the Ohio Tax Commission*, 1908, p. 12.

The only effective way of securing uniformity and at the same time equality as between bank stock and other kinds of wealth is to fix a definite rate low enough to make the tax paid by the owners of bank shares fairly correspond to the burden of taxation placed upon other kinds of wealth. Investigation of this matter has generally led to the conclusion that 1 per cent is a reasonable rate. This is the rate in New York and Connecticut. The California rate was originally made 1 per cent in 1911, but was raised to 1.2 per cent in 1915. The New Jersey rate is ¾ of 1 per cent. Pennsylvania gives the banks the choice between a rate of 4 mills upon book value and 10 mills upon par value of stock. The 4-mill rate is extremely low, and there appears to be no justification for the alternative 10-mill rate, whose chief effect is to cause injustice between large and small banks.[1]

In addition to the taxation of shares of stock, real estate owned by banks may lawfully be taxed and generally is so taxed. There appears no good reason why local taxation of bank real estate should not continue. It is probably also reasonable to leave the taxation of real estate in the hands of the local officers rather than to attempt to secure any uniform assessment or uniform rate throughout the state.

It is obvious that if the shares of stock are taxed at their full value by a rate which equalizes the burden with that borne by other kinds of wealth, and at the same time local taxation of real estate is allowed, double taxation results. As has been shown, such double taxation is not repugnant to the federal statute. New York expressly permits it and there is little complaint. In strict justice, however, some allowance should be made. Three methods are possible.

First, allow the bank to deduct from the tax paid upon its shares of stock the amount of local taxes paid upon real estate. This is the Connecticut method. It makes the tax on shares of stock measure the total burden of taxation. It produces justice so far as the shareowners are concerned. A difficulty remains, however, in that the banker loses all interest in the assessment and taxation of his real estate, and the door is opened for excessive assessment of such real estate without any protest on the part of the banker, as a result of which the local government

[1] *Proceedings of the National Tax Association*, Vol. VI, p. 159.

may secure more revenue than it is entitled to at the expense of the state revenue.[1]

A second method is to deduct from the valuation of shares of bank stock the assessed value of real estate, as is done in California. This accomplishes practically the same result as the first method. To a certain extent it is open to the same objection, although there is here some motive leading the banker to see that his real estate is not over-assessed. The local tax rate will normally be higher than the rate fixed for the tax upon bank shares. A banker, therefore, loses more through an excessive valuation of his real estate than he can gain by having that valuation deducted from the assessed value of the shares of stock. To this extent only will he be induced to use his influence against over-assessment of his real estate. There still remains to some degree the same opportunity for the towns to profit at the expense of the state.

The third method is to allow the unrestricted local taxation of real estate without deduction either from the amount of the tax or the assessed value of the shares of stock, but to make the correction by taking the real-estate tax into account when determining the rate of the tax upon the stock. It is easy to find the total amount of taxes paid by banks upon their real estate and to make a corresponding reduction in the uniform rate fixed for the tax upon bank shares. This is doubtless the best method. It protects the state revenue, it leaves each banker to safeguard his own interests as against the local assessors, and on the average it places a just burden of taxation upon the owners of bank stock. It may be objected that, while the average burden is just, injustice may be done in the case of certain bankers with large holdings of real estate. This objection need not be given much consideration. The ordinary commercial bank should not invest largely in real estate. If a bank does so, it adopts the course because it sees some advantage in it, in which case it should be able to bear the tax burden necessarily involved.

The foregoing analysis would seem to demonstrate that satisfactory results in the state and local taxation of banks are possible under a method whose main features may be briefly summarized as follows.

[1] *Cf. Report of the Connecticut Commission on Taxation of Certain Corporations*, 1913, pp. 134–135, 174.

A uniform tax is prescribed by state law. The tax is upon the book value of the shares of stock, which is obtained by adding together the capital, surplus, and undivided profits and dividing by the number of shares. No deduction need be made on account of property exempt from taxation or elsewhere taxed, with the possible exception of real estate. The rate of the tax is uniform throughout the state and definitely fixed in the law. The exact rate is a detail to be determined according to the circumstances in the given state. It appears that in general 1 per cent is a fair rate. Administration is preferably in the hands of state officers, although satisfactory results are obtainable under local administration. The tax is collected from the bank, acting as agent of the stockholders. The proceeds may go into the state treasury, or be distributed to the towns or counties according to the locality of the banks or the residence of the shareholders. Real estate belonging to banks is subject to local taxation like other real estate. Allowance for the local tax on real estate may be made in either of the three following ways, stated in the order of preference: (1) by a slight reduction in the rate of the tax upon shares, (2) by deducting the assessed value of real estate from the book value of the shares, or (3) by a deduction of the tax paid on real estate from the amount of the tax on shares. Of course the shares of stock are exempt from taxation in the hands of the owners.

This method, if applied to all commercial banks and trust companies, is in harmony with the federal statute, is certain and effective in administration, and should give substantial justice to all concerned. Some of the states have already approached very close to the method here indicated and others are tending that way. A glance at a few examples will be worth while.

The state of New York furnishes the best example of the method which has been recommended. The present law was enacted in 1901. Previous to that time bank shares were assessed locally. There was no fixed rule for their taxation, which was left to the judgment of the local assessors. An investigation made in 1899 by Mr. Charles Adsit, president of the New York Bankers' Association, showed that the assessment in different parts of the state varied all the way from 10 per cent to 119 per cent of the capital, surplus, and undivided profits. It was

also shown that banks were discriminated against as compared with trust companies, the average rate of taxation upon banks being about five times as great as that upon trust companies. Another result was that shares of bank stock were very unjustly burdened as compared with other kinds of personal property. In one city of 13,000 people the banks, with capital of $250,000, paid three fourths of the total personal-property tax, although more than one individual residing in the city owned more than the combined capitals of the banks and yet escaped personal taxation entirely.[1]

The essential features of New York's present system of taxation are as follows:[2] Each bank must report annually to the assessors of the tax district in which it is located, giving a list of its stockholders, their residences, and the number of shares of stock owned by each, together with all essential facts regarding its capital, surplus, and undivided profits. Assessment is made by the assessors of the tax district. The shares are assessed to the owners in the tax district where the bank is located, regardless of the residence of the stockholders. The law provides that the value of each share shall be determined by adding the capital, surplus, and undivided profits and dividing by the number of shares. The rate is fixed in the statute at 1 per cent of this assessed value. Owners are entitled to no deduction for debts or other causes. The tax is in lieu of all other state and local taxes on the shares of stock, and no state or local taxes are allowed upon the personal property of the banks. The tax is payable to the county treasury and is distributed to the various tax districts in proportion to their tax rates. In paying the tax the bank acts as the agent of the stockholders, from whom it is assumed to collect the amount paid. The bank has a lien upon shares of stock and any other property of the shareholders in its hands for reimbursement of taxes so paid. Real estate belonging to banks is subject to local taxation, and no deduction from the value of the shares of stock is allowed on account of taxes on real estate. The rate of 1 per cent is assumed to be enough lower than the ordinary rates of the general-property tax so that no injustice is caused by this additional taxation of real estate. This law has given general satisfaction.

[1] Paton in *Proceedings of the National Tax Association*, Vol. VII, p. 316.

[2] N. Y. Tax Law, sects. 13, 14, 23–26, 183, 188, 189, 191, 205.

New Jersey, after suffering for years under the defective system described above, has now a tax drawn on correct lines.[1] The new law is practically the same as the New York method except that the assessed value of real estate is deducted from the value of the shares and the rate is ¾ of 1 per cent.

Connecticut taxes banks and trust companies upon the market value of their shares of stock as determined by the state board of equalization.[2] The rate of the tax is fixed in the state law at 1 per cent. From the amount of the tax thus determined is deducted the tax paid on real estate in Connecticut. The tax is collected by the state and distributed to the towns in which the stockholders reside. The state retains the part paid on shares owned by persons residing outside the state, except that in the case of a national bank the tax on shares owned by non-residents is paid to the town in which the bank is located, as is required by the federal statute. The principal defect in the Connecticut system is the market-value basis of assessment. Connecticut has experienced in the administration of this law most of the difficulties which have been mentioned above in connection with this basis.

Pennsylvania taxes the shares of bank stock under a state law administered by state officers.[3] The basis of valuation is the capital, surplus, and undivided profits. The tax is assessed as to the stockholders but is paid by the banks. Real estate is taxable locally. Banks have the option of paying at the rate of 4 mills upon the above value or at the rate of 1 per cent on the par value of the stock alone. The tax is in lieu of all local taxation except taxes on real estate. The peculiarities of the Pennsylvania tax are the low rate and the optional feature. There appears to be no justification of the optional rate, and the normal 4-mill rate is about half of the tax paid by banks in other states where a uniform rate is fixed by law.

The state of California has had an interesting experience in the taxation of banks.[4] Until 1910 the state constitution required

[1] Laws of 1914, ch. 90.

[2] Gen. Stat. sect. 2331, as amended by Acts of 1903, ch. 204, Acts of 1905, ch. 54; sect. 2332–2335.

[3] Act of July 15, 1897. (P. L. 292.)

[4] *Report of the California Commission on Revenue and Taxation*, 1906, pp. 219–229. The entire chapter on Taxation of Banks in this report, pp. 219–253, is very valuable.

the taxation of all property in the state under a uniform rule. The law made banks taxable upon all of their property exactly like natural persons. This law was contrary to the provisions of the federal statute relating to the taxation of national banks. At first no serious difficulty resulted, as there were very few national banks in the state. During the period from 1890 to 1896 several new national banks were established and a number of state banks went into the national system, the reason being primarily to evade state taxation, since they realized that as national banks they could not be taxed upon their property.

To correct this situation the legislature in 1899 provided for the taxation of shares of stock in national banks in conformity with the federal statute, but further allowed stockholders to make from the amount of their shares of bank stock all the deductions permitted by law to the holders of moneyed capital in the form of solvent credits. Deduction was also allowed for real estate taxed and for all property exempt by law from taxation. At first this system seemed to promise well. Very soon, however, the banks realized that under the deductions allowed they could generally show exemptions exceeding the value of the stock and thus escape taxation entirely. Still worse, the federal courts decided in 1905 that, since national banks were taxed upon their shares of stock and state banks upon their property, this involved a discrimination against national banks in favor of state banks. It was therefore held that the law was invalid for the taxation of national banks. From that time on national banks were not subject to any taxation whatever except upon their real estate. A few of the national banks, realizing this situation, voluntarily submitted to an assessment which they knew was not legally enforceable and paid a certain amount of taxes. Obviously such voluntary taxation was not sufficient to produce any large revenue or to equalize the burden of taxation between state and national banks.

During all of this time the taxation of state banks also was unsatisfactory. They were taxable directly upon all their property in the same manner as individuals. Since, however, they were allowed to deduct debts, which included all of their deposits, the principal item of assets, loans, and discounts, was very frequently wiped out entirely by the deduction of deposits. Various other items of the banks' assets were incapable of ac-

curate assessment, and, finally, there was a great lack of uniformity in the practice of the local assessors. As a result, some banks practically escaped taxation entirely, others were severely penalized, and the whole system was marked by inequality, uncertainty, and justice.

In 1905 the whole matter was referred to a special state tax commission. As a result of their recommendations the constitution was amended in 1910, allowing classification of property for purposes of taxation, and in 1911 the legislature enacted a law,[1] under which all shares of stock of banks are assessed and taxed to the owners by the state board of equalization in the town or city where the bank is located. The value of the shares of stock is the amount paid thereon plus a *pro rata* share of the surplus and undivided profits. The tax is in lieu of all other state and local taxes upon the shares of stock and upon the property of the banks except real estate which is subject to local taxation like other real estate. From the value of the shares, determined as above, is deducted the assessed value of real estate. The remainder is the assessed value of the shares and is taxed annually at a uniform rate of 1.2 per cent. The tax is paid by the bank to the state in behalf of the stockholders. The bank has a lien upon the shares of stock and upon the dividends for reimbursement. With this law California has satisfactorily solved the problem.

[1] Acts of 1911, ch. 335, sects. 1, 4, 12, and 18, as amended by Acts of June, 1913, and Jan. 28, 1915.

CHAPTER XVIII

THE INHERITANCE TAX

76. State Inheritance Taxes in the United States: The Special Report of the Board of Tax Commissioners of Rhode Island.[1]— State inheritance taxes are well treated in the following extract from a special report of the Rhode Island Tax Commission:

Early State Inheritance Taxation

Pennsylvania was the first state to impose an inheritance tax; the law which was passed in 1826, although amended several times, remains practically as it was enacted. This law provided for a uniform rate of 5 per cent and an exemption of $250, and it did not apply to the inheritances of a father, mother, husband, wife, child, step-child, lineal descendant; and daughter-in-law. The law recognized the situs of personal property as the domicile of the owner, and did not impose a tax on the stock of domestic corporations owned by a non-resident decedent, and did not tax the securities of a foreign corporation owned by a non-resident decedent, even when such securities were kept within the state.

Louisiana was the second state to impose an inheritance tax. The law was enacted in 1828, was repealed in 1830, revived in 1842, and remained in force until 1877. The tax was imposed at the rate of 10 per cent on property passing to non-resident aliens. An attempt was made later, in 1894, to revive the statute of 1828, but the law was declared unconstitutional. The constitution was amended in 1898, limiting the power of the legislature in respect to inheritance taxation, fixing the maximum rate at 3 per cent for direct and 10 per cent for collateral heirs. Louisiana now has an inheritance-tax law which provides for a tax of 2 per cent on direct heirs, with an exemption of $10,000, and a 5 per cent tax on collateral inheritances with no exemption; the tax not to be operative, however, if it can be shown that the property has borne its just share of taxes prior to donation or inheritance.

[1] Special Report on New Sources of Revenue. Providence, 1916.

Virginia in 1844 imposed a collateral inheritance tax on estates of $250 or more passing to persons other than the decedent's father, mother, husband, wife, brothers, sisters, or lineal descendants. The law required the rates to be fixed by the legislature at each session, and the law was held to have been repealed because the legislature omitted to fix the rate in 1856. A collateral inheritance tax was again imposed in 1860, and with varying rates and periodic suspensions it continued in force until 1884, when it was repealed. A collateral inheritance tax was reimposed in 1896. Parents, grandparents, husband, wife, brothers, sisters, and lineal descendants were exempt and also certain bequests for public, educational, benevolent, and religious purposes.

Taxation of Direct and Collateral Heirs

The following states adopted collateral inheritance-tax laws which did not provide for the taxation of direct heirs, in the order named:

Pennsylvania, 1826; Virginia, 1844; Maryland, 1845; North Carolina, 1847; Alabama, 1848; Delaware, 1869; New York, 1885; West Virginia, 1887; Connecticut, 1889; Massachusetts, 1891; Tennessee, 1891; New Jersey, 1892; Ohio,[1] 1893; California, 1893; Maine, 1893; Vermont, 1896; Iowa, 1896; Missouri, 1899; Arkansas, 1901; North Dakota, 1903; New Hampshire, 1905; Kentucky, 1906; Texas, 1907; Kansas,[1] 1915.

Eleven of the twenty-two states which originally imposed collateral inheritance taxes have not extended the tax to direct heirs: Alabama,[2] Delaware, Iowa, Kentucky, Maryland, Missouri, New Hampshire, Pennsylvania, Texas, Vermont, and Virginia.

Eleven states which originally had collateral inheritance taxes only have extended them to include direct heirs: Arkansas, California, Connecticut, Massachusetts, Maine, New Jersey, New York, North Carolina, North Dakota, Tennessee, and West Virginia.

Two states, Kansas and Ohio, taxed direct inheritances originally, but now restrict the tax to collaterals and strangers.

[1] Had law providing for a tax on direct inheritances prior to date here given.
[2] Repealed in 1868.

There are twelve states which at present tax only collaterals: Delaware,[1] Iowa, Kansas,[1] Kentucky, Maryland, Missouri, New Hampshire, Ohio, Pennsylvania, Texas, Vermont, and Virginia.

Nineteen states have enacted laws imposing both direct and collateral inheritance taxes at the same time: Colorado, Georgia, Idaho, Illinois, Indiana, Kansas, Michigan, Minnesota, Montana, Nebraska, Nevada, Ohio, Oklahoma, Oregon, South Dakota, Utah, Washington, Wisconsin, and Wyoming.

Ohio[2] was the first state to tax all classes of property passing to direct heirs and also the first to apply progressive rates. The law which was passed in 1894 was held unconstitutional the year after its passage because of the progressive feature and certain provisions regarding the exemption of $20,000. In 1904 a direct inheritance tax was imposed at the rate of 2 per cent with a $300 exemption. This act was repealed in 1906. At present collateral inheritances only are taxed at 5 per cent with an exemption of $200.

A tax on direct inheritances has been applied in the following states in the order named:

New York, 1891—direct tax applied to personal property only, extended to realty in 1903; Illinois, 1895; Connecticut, 1897; Montana,[3] 1897; North Carolina, 1897; Louisiana, 1898; Michigan, 1899—direct tax applies to personal property only; Colorado, 1901; Nebraska, 1901; Utah, 1901; Washington, 1901; Oregon, 1903; Wisconsin, 1903; Wyoming, 1903; Ohio, 1904—repealed 1906, collaterals only taxed since 1906; California, 1905; Minnesota, 1905; South Dakota, 1905; Arkansas, 1907; Idaho, 1907; Massachusetts, 1907; Oklahoma, 1907—invalid, new law 1915; West Virginia, 1907; Kansas, 1909—repealed, 1913, collaterals only taxed since 1915; Maine, 1909; Tennessee, 1909; Arizona, 1912; Georgia, 1913; Indiana, 1913; Nevada, 1913; North Dakota, 1913; New Jersey, 1914.

[1] Delaware taxed only strangers in blood, 1883–1899. Kansas taxed both direct and collaterals, 1909–1913.

[2] The Louisiana law of 1828 provided for a tax on property passing to non-resident aliens, regardless of relationship. The New York law of 1891–1903 taxed personalty passing to direct heirs.

[3] Law apparently intended to exempt real estate passing to direct heirs, but the wording of the statute is obscure, and by strict interpretation said real estate so passing is exempt to all direct heirs *except* father, mother, husband, and wife; these are taxed at the collateral rate of 5 per cent.

The thirty states which at present tax both direct and collateral inheritances are Arizona, Arkansas, California, Colorado, Connecticut, Georgia, Idaho, Illinois, Indiana, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Montana, Nebraska, Nevada, New Jersey, New York, North Carolina, North Dakota, Oklahoma, Oregon, South Dakota, Tennessee, Utah, Washington, West Virginia, Wisconsin, and Wyoming.

Kansas and Ohio each have had taxes on direct inheritances which have been repealed and never reënacted. Alabama had a collateral inheritance tax, 1848–1868. The constitution of Alabama, adopted in 1901, imposes restrictions upon the legislature prohibiting the taxation of inheritances of father, mother, husband, wife, brothers, sisters, children, and lineal descendants, and limits the rate on taxable inheritances to 2½ per cent.

The inheritance-tax law of Kansas, adopted in 1909, was repealed in 1913 apparently for purely political reasons. In 1915 a law imposing a tax on collateral inheritances was adopted. This law provides for three classes: the first class, consisting of husband, wife, lineal ancestor, lineal descendant, adopted child, lineal descendant of same, son-in-law, or daughter-in-law, is not taxed; the second class, brothers and sisters, is allowed an unconditional exemption of $5000, with rates from 3 to 12½ per cent; third class, all others, no exemption and the rates are from 5 to 15 per cent. It is further provided that shares which net less than $200, after all deductions allowed are made, are not taxed.

Constitutionality of State Inheritance-Tax Laws as affected by Specific Constitutional Provisions

Inheritance-tax laws have been declared unconstitutional in many states because of their failure to conform to the restrictions and limitations imposed by the rule laid down in their constitutions that taxes shall be uniform and equal according to value.

The difficulty, under such constitutional restrictions, of formulating an equitable inheritance tax, which according to modern ideas and practice should provide for classified rates and exemptions as well as recognized degrees of relationship, is apparent.

The necessity of exempting small estates passing to direct heirs, and the desirability of progressive rates, and exemptions and classification in accordance with degrees of relationship, impelled legislators to incorporate these features in their laws, and the courts when appealed to on the grounds of constitutionality, while recognizing the right of the law-making body to impose inheritance taxes, in numerous cases declared the laws unconstitutional. The constitutional limitations on the law-making bodies applied to collateral as well as direct inheritances.

In New Hampshire, after operating under a collateral inheritance-tax law for four years, 1878-1882, the law was declared unconstitutional; later, in 1903, the constitution was amended, and the present law taxing collateral inheritances was passed in 1905.

Minnesota seems to have had the greatest amount of difficulty in complying with its constitutional provisions; the inheritance-tax laws of 1897, 1901, and 1902 were in turn declared unconstitutional, and the law of 1905 survived after considerable litigation. The question seems to have been settled by an amendment to the Constitution in 1906 which extended the powers of the legislature in the taxation of inheritances.

The Oklahoma law of 1907 was practically declared invalid, and a new law was passed in 1915. Missouri attempted to tax collateral inheritances in 1895, but the law was declared unconstitutional; later, in 1899, a law taxing collaterals was passed and is still in force. In South Dakota the law was declared unconstitutional, but upon rehearing was sustained.

The direct inheritance-tax law of Ohio was declared unconstitutional because of progressive rates and the exemption of estates of $20,000 or less, but the court ventured the statement that if that exemption or any other exemption had applied to every estate, it would have been valid; it was the inequality of the exemption, not the fact of an exemption alone, which was the determining factor.

Pennsylvania's direct inheritance-tax law was declared unconstitutional because of the exemption of $5000. In Tennessee a similar objection was not sustained.

The Wisconsin law of 1899 was declared unconstitutional because the exemption depended upon the size of the entire estate and not upon the separate shares. The Massachusetts

Supreme Court on the same point under a similar exemption said:

> The exemption in the statute under consideration is certainly large as an exemption of estates, but it is peculiarly within the discretion of the legislature to determine what exemptions should be made in apportioning the burdens of taxation among those who can best bear them, and we are not satisfied that this exemption is so clearly unreasonable as to require us to declare the statute void.[1]

In the same case the court sustained the right to distinguish between direct and collateral heirs and strangers in blood, both as to rates and exemptions, saying that the principle had the sanction of practice and reason.

Constitutional Difficulities at a Minimum in Rhode Island

The constitution of Rhode Island in relation to taxation says "and the burdens of the state ought to be fairly distributed among its citizens"[2] and "the general assembly shall, from time to time, provide for making new valuations of property, for the assessment of taxes, in such manner as they may deem best."[3]

It is apparent that our legislature is free from most of the restrictions and limitations imposed by the constitutions in a number of states, and that many of the perplexing questions in regard to constitutionality which have arisen elsewhere are not likely to occur in Rhode Island.

Growth of Taxation of Inheritances in Recent Years

After the passage of the collateral inheritance-tax law of Pennsylvania in 1826 and of the law taxing the inheritances of non-resident aliens by Louisiana in 1828, no further legislation on the taxation of inheritances was adopted for sixteen years. In the next four years Alabama, Maryland, North Carolina, and Virginia imposed collateral inheritance taxes. From 1848 to 1885 Delaware was the only state to adopt legislation of this character.

The year 1885 may properly be considered as the date from which the real development of inheritance taxation began in the

[1] *Minot* vs. *Winthrop*, 162 Mass. [2] Art. I, sect. 2. [3] Art. IV, sect. 15.

United States. Three states—Connecticut, New York, and West Virginia—adopted inheritance-tax laws from 1885 to 1890. During the period 1890–1900 inheritance taxation assumed a prominent place in legislation, and sixteen states either adopted inheritance taxation for the first time or expanded their old laws. The next ten years showed even a more rapid extension of this principle of taxation; twenty-three states passed laws on the subject, and from 1910 to 1915 six more applied the system.

Twelve states have either incorporated inheritance taxes into their fiscal systems or enacted new laws within the last three years, and many states have made important additions and amendments to their laws during the same period.

There are now but six states which do not tax inheritances in some form: Alabama, Florida, Mississippi, New Mexico, Rhode Island, and South Carolina.

A Tax upon the Transfer of Property

There has been much discussion as to whether the tax was upon the property itself or upon the transfer of the property. The decided weight of opinion, both legal and economic, is to the effect that it is a tax upon the transfer.

Differences between the States in Classification of Heirs, Exemptions, and Rates

There are wide differences between the twelve states which do not tax the inheritances of direct heirs, as to what transfers are taxed, and as to the rates imposed and exemptions allowed. In some state grandparents, brothers and sisters, and uncles and aunts are included in the exempt class; in others the exemption is confined to father, mother, husband, wife, adopted child, and direct lineal descendants of the testator.

Four states allow no exemptions and have a flat rate of 5 per cent, and their classifications of exempt heirs are not very dissimilar. Delaware has four classes, four rates, and a flat exemption of $500. Texas has three classes, three progressive rates, and exemptions of $2000, $1000, and $500 according to class.

In the states imposing a tax on direct inheritances the practices are very dissimilar, classes, rates, and exemptions varying between wide limits.

California and Minnesota afford perhaps the best examples of highly differentiated classifications as to relationship, exemptions, rates, and the points at which the highest rates apply.

In California in the class of direct heirs are included lineal ancestors of decedent, husband or wife, lineal issue, adopted or acknowledged child, lineal issue of either. In this class the exemption of widow or minor child is $24,000 and $10,000 to others. The rate on $25,000 or less is 1 per cent; $25,000 to $50,000, 2 per cent. The maximum rate of 15 per cent is reached at $1,000,000, and all sums in excess of this amount are taxed at this rate. Collateral heirs are divided into two classes, with exemptions of $2000 and $1000 according to nearness of relationship. Strangers in blood are allowed an exemption of $500. The initial rates for these three classes are 3, 4, and 5 per cent, respectively. The maximum rate in the case of collateral heirs applies to amounts over $1,000,000, and these rates are 25 and 30 per cent, respectively. The maximum rate applying to strangers in blood is 30 per cent, but it applies to amounts over $5,000,000.

In Minnesota the highest rate applies to inheritances of over $100,000 and in the case of a wife or lineal issue it is 3 per cent; husband, adopted or acknowledged child, or the issue of the same, 4½ per cent. The same rate applies to lineal ancestors, but the exemption in that case is but $3000 instead of $10,000 as in the first two classes. In the case of brother, sister, nephew, niece, son-in-law, or daughter-in-law the exemption is reduced to $1000 and the maximum rate is 9 per cent. In the next class, which comprises uncles, aunts, or descendants of same, the exemption is reduced to $250 and the maximum rate is 12 per cent; for strangers in blood the maximum rate is 15 per cent.

Tennessee affords an example of the simpler classification. There are but two classes: father, mother, husband, wife, child, and lineal descendants of decedent comprise the first class. Estates of decedents less than $10,000 are not taxed; estates of $20,000 or less are taxed at 1 per cent, and estates of over $20,000 at 1¼ per cent. The second class comprises all not named above; there is no tax on estates of less than $250, and for estates greater in value the tax is 5 per cent.

The lowest initial rate applied in any state to direct heirs is 1 per cent and the highest 2 per cent. The lowest ultimate rate is 1 per cent and the highest 15 per cent for the first class. As these classes vary to a great extent, and as there is a great difference in the amount of exemption allowed, the rates alone do not offer a very satisfactory basis for comparison.

Methods of Classifying Heirs

There are very wide differences between the several states in methods of classification. In those states which are said to tax collaterals only, we find considerable differences as to what constitutes direct heirship. Some states include lineal ancestors, sons-in-law, and daughters-in-law in the exempt class, while others do not. In the Kentucky law father, mother, husband, wife, lawful issue, son-in-law, daughter-in-law, adopted child, and lineal descendant of decedent are exempt, and all others are taxed at the same rate and the same exemption is allowed.

In Delaware the exempt class includes father, mother, grandfather, grandmother, wife, husband, child, adopted child, and lineal descendants, but collaterals are divided into three classes and different rates applied, and "all others" are taxed at still a different rate and allowed less exemption than the other classes.

States taxing direct inheritances show a similar difference in classification. Arkansas taxes the inheritance of father, mother, husband, wife, child, brother, sister, son-in-law, daughter-in-law, adopted or acknowledged child at the lowest rates, distinguishing between members of this class as to exemptions, and places all others in the second class. Tennessee limits the first class to father, mother, husband, wife, child, and lineal descendants, placing all others in the second class.

Massachusetts affords an example of a wide extension of the membership in the first class: husband, wife, lineal ancestor, lineal descendant, adopted child, lineal descendant of same, adoptive parent, lineal ancestor of same, son-in-law, or daughter-in-law. The second class is composed of brothers, sisters, of full or half blood, nephews and nieces, all others being in the third class. In some states uncles and aunts are in one class and

great uncles and great aunts in another. No general rule as to classification is found and no two states seem to be exactly alike in methods of classification. Some form of classification is found in all states imposing inheritance taxes but one, and the principle is amply sustained both from the legal and economic standpoint.

Progressive Rates

The question of the constitutionality of the progressive inheritance tax was settled definitely in cases brought under the Illinois statute of 1895. This law providing for progressive rates to distant relations and strangers was upheld both by the state courts and the Supreme Court of the United States.[1] The positive determination of this question was followed by a rapid application of the progressive principle in a number of states, and progressive rates are now applied to one or more classes in the following states: Arizona, Arkansas, California, Colorado, Connecticut, Idaho, Illinois, Indiana, Kansas, Maine, Massachusetts, Minnesota, Nebraska, Nevada, New Jersey, New York, North Carolina, North Dakota, Oklahoma, Oregon, South Dakota, Tennessee, Texas, Utah, Washington, West Virginia, and Wisconsin.

The states imposing inheritance taxes which do not employ progressive rates are: Delaware, Georgia, Iowa, Kentucky, Louisiana, Maryland, Michigan, Missouri, Montana, New Hampshire, Ohio, Pennsylvania, Vermont, Virginia, and Wyoming.

The principles of progressive rates, the classification of relationship, and the graduation of exemptions according to relationship have found such general application in the practices of the several states that they do not seem to require further justification.

To make a distinction between collateral kindred or strangers in blood and kindred in the direct line in reference to the assessment of such a tax, either by exempting the kindred in the direct line or by imposing on collaterals and strangers a higher rate of taxation, has the sanction of nearly all states which have levied taxes of this kind.[2]

[1] *Kochesperger* vs. *Drake*, 167 Ill. 122; *Magoon* vs. *Trust & Savings Bank*, 170 U. S. 283.

[2] *Minot* vs. *Winthrop*, 162 Mass.

The General Tendency

Notwithstanding this great variation in details above referred to, a decided general trend is apparent. All states taxing direct inheritances allow some exemptions. These exemptions vary in amounts for members of the first class from $3000 to $24,000, and there are but four states—Missouri, New Hampshire, Vermont, and Virginia—which do not allow some exemption, and these states do not tax direct inheritances. There seems to be a considerable agreement, so far as can be determined by the different practices, that direct and collateral heirs and strangers in blood should have different amounts of exemption allowed, diminishing as the degree of relationship becomes more remote, and thirty of the forty-two states taxing inheritances apply to a greater or less degree this principle.

Classification according to relationship is found in every state taxing inheritances, except Utah, which has one class, an exemption of $10,000 applying to the whole estate, and progressive rates.

The great majority of states employ progressive rates varying both in accordance with the amount of the inheritance and the remoteness of relationship. There is no uniformity of practice either as regards the rate of progression or as to the point at which the maximum rate is applied, or as to what point in relationship the rate, or exemption, or both, are changed. The general acceptance, however, of the principles that small inheritances to direct heirs should be exempt, that the rates should be progressive both as regards the amount of the inheritance and according to the degree of relationship, that exemptions should be graduated according to relationship, and that the maximum rate should apply to the excess over a certain fixed amount, is worthy of attention.

The Question of Situs for Purposes of Taxation and the Danger of Double Taxation

There is little interstate comity in the taxation of inheritances, and a resultant double taxation in many cases. The proper situs of taxation for real estate is recognized as the location of the property. The real difficulty appears in the taxation of transfers of intangible property. Serious efforts have been made by some

states to avoid double taxation by the introduction into their laws of so-called "reciprocal clauses," which provide for a relief from taxation of property taxed in another state in a similar manner; but if the rates are dissimilar and the foreign rate is less, they impose a tax at a rate which represents the difference between the two rates. Some states impose the tax upon corporate securities owned by a non-resident decedent kept within the state, whether the corporation is chartered within the state or not. In some instances transfers of the securities of domestic corporations are taxed regardless of the physical location of the securities or the domicile of the decedent. These states are actuated by a desire for revenue rather than by any consideration of sound economic theory. Under existing conditions double or even multiple taxation may readily occur.

In the formulation of an inheritance-tax law certainly one of the most difficult questions involved is the determination of the situs at which the various classes of property should be taxed. In the case of real estate the question is definitely settled; it is taxed universally in the jurisdiction where it is located; but beyond this nothing is positively determined.

The practice in regard to real estate, so far as it applies to inheritance taxation, seems to meet the requirements of justice and sound economic principle, and there is no reason and apparently no desire to change or modify it. But even here when there is conversion of the real estate in one state for the purpose of paying a legacy or legacies, it has been held that the proceeds of the conversion were intangible and liable to taxation at the domicile of the testator in another state.

The real difficulty arises in the transfer of personal property, and in this regard there is a bewildering diversity of practice and opinion which results in double or multiple taxation in an unjustifiable form, and annoyance and unnecessary expense in administration.

In any consideration of double or multiple taxation it is necessary to determine the different kinds, and to separate those which are bad and avoidable from others which are justifiable or unavoidable.

In its ordinary use the term "double taxation" is applied in such a manner as to convey the idea of injustice and oppression, and so well founded in the popular mind has this meaning be-

come that any system of taxation to which it may be applied is at once condemned without considering the nature or effect of the double taxation.

An illustration of double taxation which is perfectly just and proper from both the economic and moral standpoint is afforded by the usual local tax assessed in this state. The local tax and the state tax are separate and distinct taxes at different rates on the same property at the same time. This is a perfect example of a proper double tax. This tax might be a multiple tax and still be perfectly justifiable, and the only objection which could be properly made would be on the grounds of expense or inconvenience, or some other reason which has nothing to do with the tax itself. The test in this case is the amount of the tax, not how many times the tax is assessed. If the citizens of a state prefer to raise the necessary amount of revenue by several levies on the same property instead of one, it may be expensive and inconvenient, but it is not unjust from the economic or moral standpoint.

A similar condition is brought about by a federal and a state income tax. There is no valid objection on the ground of double taxation in this case. Real estate taxed in one state and the income from it taxed in another—the domicile of the owner—is also perfectly justifiable legally and economically. Double taxation of these kinds is not objectionable and is probably unavoidable.

These statements relative to the taxation of personalty hold good regarding the ordinary forms of state and local taxation of property generally. They do not apply, however, to inheritance taxes. If an inheritance tax is held to be a tax on a civil right or privilege it should be levied but once. Taxes on the same inheritance by more than one jurisdiction do not appear to be justifiable economically.

An example of objectionable and avoidable double taxation is afforded by the taxation of wealth in one state and the evidences of wealth in another. A corporation may be taxed upon its entire property and the holders of its securities also taxed at their full value by the same jurisdiction at the same time and rate, or these securities may be scattered throughout many states and taxed according to the domicile of the owners at approximately the same rate.

As there are no constitutional limitations upon the levying of an inheritance tax upon personal property both by the state in which the property may be considered to be located and the state of domicile of the former owner, double taxation may and does occur to a great and even distressing extent. There are of course other considerations than domicile of the former owner, and situs independent of such domicile, which may determine jurisdiction, but these two conditions are the only ones used in the United States. Some states impose inheritance taxes according to the situs of the physical property, others according to domicile, and still others according to the location of the securities. The legal and constitutional right to impose each of these taxes is clear and well established, and the economic injustice is equally clear.

An example of the foregoing is furnished by a corporation incorporated and owning property in one state, a part or even the whole of the stock and bonds owned by residents of another, and the securities kept in still a third state. This combination of circumstances, by no means rare in practice, furnishes an opportunity for multiple taxation.

No doubt it would be of great advantage to the country and to the individual states if principles of taxation could be agreed upon which did not conflict with others, and a common scheme could be adopted by which taxation of substantially the same property in two jurisdictions could be avoided, but the constitution of the United States did not go so far, and a state was not bound to make its tax laws harmonious in principle with those of other states.[1]

States which have large amounts of corporate property within their jurisdiction, with the stocks and bonds of the corporation owning the property held wholly or in large part by non-residents, lean perhaps naturally to the theory that the situs of the property should determine the imposition of the inheritance tax. This theory is carried out in the laws of a number of states, and those maintaining it argue in substance, in sustaining their position, that while the tax is legally a tax upon the transfer of property and not upon the property, the tax is nevertheless measured by the value of the property and is usually made a lien upon it, and the burden falls ultimately upon and is borne by the property. They argue further that taxation is for the

[1] *Kidd* vs. *Alabama*, 188 U. S. 730.

maintenance of government, and as the chief purpose of government is the protection of property and the administration and enforcement of the laws of property, therefore the tax which is borne by property within a given jurisdiction should accrue to the use of that jurisdiction, whether levied upon the transfer, devise, succession, interest therein, or property itself.

The difficulty of drafting and administering an inheritance-tax law based on this principle is generally admitted to be great, and by some it is considered practically insurmountable. Mr. Lawson Purdy, President of the Department of Taxes and Assessments for the City of New York, in a discussion of the subject said that to administer a transfer tax drafted thoroughly in accordance with this theory would be a task of "frightful intricacy."[1] Wherever the attempt has been made to administer such a law the difficulties encountered have been very considerable, to say the least.

The Correct Principle

The weight of authority, both legal and economic, in the United States does not seem to sustain this line of argument:

> If the inheritance tax is considered to be a tax on privilege it seems clear that the sovereignty which confers the privilege should impose the tax. The great weight of authority in the United States supports the conclusion that if the law of the owner's domicile says that a certain heir shall receive personal property, the law of the place where that personal property happens to be recognizes the transfer on principles of comity.[2]

The relative merits of imposing inheritance taxes according to the situs of the personalty and the domicile of the former owner are ably treated in the report of the Committee on Double Taxation and Situs for the Purposes of Taxation made to the Ninth National Tax Conference. The Committee says:

> We believe that the correct principle underlying taxation of inheritances is that the state which determines the devolution of property should levy the inheritance tax thereon. If this principle is adopted, most questions of situs with relation to inheritance taxation will have been settled. Real estate devolves in accordance with the laws of the state in which it is situated. Personal property devolves in accordance with the laws of the state of domicile of the former owner. Applying the principle stated, it

[1] *Proceedings of the Sixth National Tax Conference*, p. 311. [2] *Ibid.* p. 309.

follows that real estate should be taxed by the state in which it is situated; personal property by the state in which its former owner was domiciled.

A brief summary of the arguments sustaining their conclusions relative to personal property follows:

Against taxation of personal property according to situs: Personal property may be said to have a situs for taxation in several states other than that of domicile. Extent of power to impose inheritance taxes on personal property on ground of situs not determined, a serious objection. Does not avoid double taxation. Difficulty of drafting law based on taxation according to situs. Administrative difficulties and cost of collection. Large number of states may be involved in settlement of one comparatively small estate. Involves dealing with fractional parts of estates rather than the whole. Increases number and decreases size of estates taxed. Difficulty in apportioning indebtedness and exemptions. Annoyance, delay, and expense to taxpayers. Requires ancillary administration in each state where personal property is located. Burden to taxpayer greater than resultant advantage to taxing state. Especially inapplicable when progressive rates are employed. Inequalities arise between tax on residents and non-residents, favoring latter. Bad effect on investments.

For taxation of personal property according to domicile: Avoids double taxation. Question of domicile seldom arises. Adjustment of taxes not very difficult. In accordance with fundamental legal theory. Reduces necessity for ancillary administration to a minimum. Simplifies administration, avoids delay and expense to taxpayers and state alike. Power to transmit or receive granted or may be regulated by state of domicile, therefore state of domicile should regulate tax. Deals with estates as a whole, but one set of rates and exemptions to be adjusted and but one appraisal to be made. Has less effect on investments.

77. A National Inheritance Tax, by E. R. A. Seligman.[1]—The case for a national inheritance tax is presented in the following selection:

The preparedness campaign and the consequent need of increasing the revenue of the national government have brought

[1] Reprinted from the *New Republic*, March 25, 1916.

forward a fiscal problem more important than any which has hitherto confronted the nation. We have gone through three stages in our fiscal history. Apart from the short-lived experiment made almost at the outset by the Federalists, the national government depended for its support for over half a century, and with only a slight interlude during the war with Great Britain, well-nigh exclusively upon one form of indirect taxation—the customs revenue. The Civil War taught the country the inadequacy of this primitive system and added as a permanent feature the other side of indirect taxation known as the internal revenue. After almost half a century's experimenting with this second phase, the country reverted in 1909 to Hamilton's original idea and decided to draw a part of its fiscal support from direct as well as indirect taxation. Beginning with the corporation or excise tax, it soon added an income tax and is now seriously considering the imposition of an inheritance tax.

This transition from indirect to direct taxation is an interesting phenomenon. Regarded as a democratic movement, it represents a world-wide tendency to bring existing systems of taxation into harmony with the principle of ability to pay and the endeavor to lighten the load which rests upon the less wealthy classes. In the United States the particular form which the movement is assuming is in no small degree influenced by the consideration that, although the direct taxes levied by the states and localities do not bear with special hardship upon the poor, it is precisely the larger fortunes that are escaping their fair share of the public burdens. It is natural, therefore, to witness, in this third stage of our fiscal history, a movement which attempts at the same time to diminish the burden on the poor by a reduction of the indirect taxes and to augment the burden on the rich by federal direct taxes.

That this movement may be pushed too far is probable. More direct taxes are indeed needed; but an exclusive, or even a preponderant, reliance on direct taxes is both hazardous and unnecessary. It is hazardous because the history of every nation has taught that the narrower the base of taxation the greater are the difficulties. The fiscal objections to a single tax apply to a single system of any kind. Exclusive reliance for local, state, and federal revenues on any combination of direct taxes alone would necessitate such high rates as greatly to multiply the in-

herent difficulties in any system. It is a significant fact that even the most democratic countries like England, Australia, and Switzerland continue to rely in large part upon indirect taxation, and that in Canada, as well as in Great Britain, the recently added war burdens have been divided between indirect and direct taxes. Those who enthusiastically contemplate a total abandonment by the national government of its indirect taxes are living in a fool's paradise.

Furthermore, such an abandonment is as unnecessary as it is hazardous. Many think of indirect taxation as being virtually taxation on the consumption of the poor. That this has been in large measure true in the past is undoubted; but that it is necessarily true is incorrect. For, in the first place, it is possible to apply to indirect taxation the graduated or progressive principle which is now becoming so popular in the case of direct taxation. Why should not taxation on consumption be so graded as to fall with heavier impact on the consumption of the wealthier classes? Why should not the whisky tax be imposed at a higher rate on the better grades? Why should not the tobacco tax be so arranged as to increase progressively with the price of the cigar? If we apply graduated taxation to incomes, inheritances, and property, why should we not utilize the same principle as far as practicable in the case of articles of consumption? And, in the second place, indirect taxes are by no means limited to consumable commodities. In the shape of certain stamp taxes they can be applied to transactions so as to combine with great revenue a relatively slight burden on business and a still slighter burden on the small business man. If the necessities of the national revenue should one day become really urgent, it will be found that we shall not only be unable to dispense with indirect taxes but that it will be possible to frame a system of indirect taxation which will be in large measure free from the objections that are usually advanced.

For the immediate future, however, it may be conceded that a relatively larger proportion of national revenues should be derived from direct taxation; and the question before the country now is as to what form it should take. This has brought into the forefront of discussion a matter which has hitherto engaged the attention of only a few students of public finance: the relations of national, state, and local fiscal systems. As long as the

revenue needs were few and simple, it was possible to live, as it were, in water-tight compartments, with a strict division between the national and state systems. But as soon as revenue needs became important, we were bound to witness the emergence of the same difficulties that have confronted the older federal states. As soon as the national corporation excise tax was introduced, careful thinkers began to ask, What should be its relation to the state tax on corporations? As soon as the national income tax was enforced, it affected the problem of the possible reform of our state and local systems through a state income tax. And now, when we hear mutterings of a national inheritance tax, we are met by the insistent demand of the states that they should be left in complete possession of a field which some of them have already begun to cultivate.

The complex problem of the relations of national and state taxation of corporations and of individual incomes cannot be disposed of in a few words. It is a subject that will require careful thinking and statesmanlike action in the not distant future. But even with the restoration of the sugar tax, and the doubling of the yield of the income tax, it is more than likely that additional revenues will have to be provided in the immediate future for the national government. The question at once arises, Why should not this additional revenue come from an inheritance tax?

It is obvious that we have here an almost untapped source of income. In 1913, the year of the latest census report, inheritance taxes were levied by thirty-five states with a total yield of a little over $26,000,000. In the same year Great Britain raised over $135,000,000 from its inheritance tax. Yet the national wealth of Great Britain at present is only between $70,000,000 or $80,000,000 as compared with between $180,000,000,000 and $200,000,000,000 in the United States. It would be entirely safe to assert that if inheritances in the United States at the present time were to be taxed at the same rate and with the same effectiveness as in England before the war, we could easily raise $350,000,000 from this source alone. Compared with this, $26,000,000 that we are now receiving is a beggarly pittance. The yield with us is so insignificant not only because our rates are low but because the well-known complexities of interstate taxation facilitate an evasion of the tax which would be altogether impossible under a national law.

The fact remains, however, that the states now need and will continue to need a revenue from the inheritance tax. How, then, can this three-pronged problem be solved? How, in other words, can we dispose once and for all, first, of the need of increasing revenue on the part of the national government; second, of the retention or increase of such revenue for the state governments; and, third, of the present undertaxation of some inheritances, and double taxation of others, due to our interstate complexities?

The solution, I venture to assert, is a simple one: the taxation at a progressive but comparatively low rate of all inheritances by national law and the distribution of a part of the proceeds back to the states. If the national government were to levy both a direct and a collateral inheritance tax at even one-half the rates found in England before the war, and if it were to return 40 per cent to the states, not only would the national government have an additional hundred millions of revenue, but the states would receive two or three times as much as they are now able to secure from this source. In other words, a national inheritance tax, with an equitable division of the yield, would benefit state and nation alike and would go far to solve our most pressing fiscal problem.

The question will at once arise, Is such a project constitutional? When the present writer first advanced this scheme several years ago, some of our prominent lawyers shook their heads in grave doubt. The last few years, however, have seen a great change in sentiment, and it is now reasonably certain that the plan can be worked out either directly or indirectly.

The Constitution gives the national government the power to levy taxes, but does not restrict the government in its power to dispose of the proceeds. In 1836 the national government distributed to the separate states twenty-seven millions of its surplus. Time and time again the national government has turned over to the states its property consisting of lands, and has apportioned to the states all manner of aid or contributions from the national treasury. There are not a few ways in which the projected scheme could be realized. The national government might, for instance, utilize the machinery of administration of the inheritance tax as practised by the several states, and might distribute to them a certain share of the proceeds as compensation therefor. Or the government might retain the entire pro-

ceeds of the inheritance tax and then by a separate measure provide for a periodical deposit among the states of certain sums. The execution of the plan presents no insuperable difficulties; the important thing is a realization of its need and its justice.

As I have pointed out in another place, the old doctrine of separation of sources, as between federal and state revenues, needs to be supplemented by the newer doctrine of division of yield. Until our statesmen realize that the fiscal problem of the United States must be envisaged as a whole, and that neither state jealousy nor national usurpation can be allowed to dominate—not until then can the problem be solved. Whether the inheritance-tax bill is introduced as a separate measure, or whether inheritances are to be included as income within the new income-tax bill, it is important to realize that we are standing on the threshold of an entirely new system. Upon the wisdom with which the inheritance-tax issue is treated in the present Congress will depend in large measure the precise character of the impending reforms in the American state as well as national finance. It is time that the discussion be put upon the high plane which it deserves.

CHAPTER XIX

THE INCREMENT TAX: LOCAL TAXATION IN FRANKFORT

78. The New British Land Taxes.—Professor Carl C. Plehn, in a recent report to the State Tax Commission of California, presents the following account of the new taxes introduced in Great Britain in 1910:[1]

The New English Land Taxes

Introduction

The new English land taxes (duties) are interesting from many different points of view. Historically they recall to mind the old land tax of 1692, and especially the bargain, good or bad, which was made with the landowners by Parliament in 1798, by which the tax might be redeemed, and under which a large part has been redeemed. The new taxes are, to be sure, very different in theory, as also in force and effect, from the old land tax. But one of them, at least, that is, the "Undeveloped Land Duty," can, without stretching the point, be regarded as a repudiation of the ancient contract of immunity. In the political field their enactment caused a well-nigh revolutionary struggle over the rights and powers of the House of Lords, and in so far as these taxes may eventually diminish the value of private ownership or rights in land, and hence the dignities attaching thereto, they may eventually alter the constituent character of that house. But this, of course, is problematical.

Economically they distinctly recognize the argument that land values, excluding capital invested in the land, and especially that the increments in land values, are the result of social progress, and hence, if that is not a *non sequitur*, are appropriable by gov-

[1] The New English Land Taxes. State Tax Commission, Sacramento, California.

ernment to promote that progress. As yet they go but a little way toward the appropriation of the entire increment, but, of course, they may be increased. In a more emphatic way they assert that there is a public duty attaching to the ownership of land, the duty to develop and use it, and hence to enhance the wealth of the nation. One of them looks distinctly like a penalty for nonuse of land. It may, however, be regarded as a tax on unrealized income.

Sociologically they are held to contain the possibility of changes in the constituent classes in England. This, again, is problematical.

Financially they involve several interesting and novel experiments. Their administration requires the establishment of very costly machinery. Especially has this machinery been costly in the installation. Although the revenues are very small, as yet, and may continue so, especially in view of war conditions, particularly when compared with the "great engine of finance," the income tax, yet this subsidiary engine has the promise of developing considerable power. The Napoleonic wars and their resulting fiscal burdens fastened on England the income tax, which had been introduced as a temporary expedient. It is possible that the World War will rivet the new land taxes to the British tax system, although it is possible that the costliness of their administration will militate against that. At all events, since the new machinery was so nearly perfected before the war, it may be exploited to meet the increased burdens. The possession of power leads to its use.

Obviously it will be years before we shall be able to judge of the political, social, and economic effects of these new taxes. In the immediate future many of the financial results will be obscured by the disturbances in expenditures and by the extraordinary calls on the revenues due to the war.[1] But there are some features of the new taxes that can be profitably studied without waiting for further developments. One of these is the method of valuation laid down. This is full of instruction on the whole problem of values and of valuations.

[1] In support of this we may quote from the *London Economist*, which said of Mr. McKenna's Budget Speech of September 21, 1915: "It was a plain, unvarnished statement of unparalleled revenues, an inconceivable expenditure, and an unimaginable deficit, followed by a list of fresh taxation which imposed, as he said, an unprecedented burden on the country."

The List of New Taxes

"The Finance (1909–10) Act, 1910" (this jumble of words and numbers being the legal title of the act provided for it by Parliament), established four new taxes on land. They were by name and briefly characterized:

1. The Increment Value Duty.
2. The Reversion Value Duty.
3. The Undeveloped Land Duty.
4. The Mineral Rights Duty.

The Increment Value Duty is a tax on the increase in the value of land after April 30, 1909. The Reversion Value Duty is a tax on the value of the "windfall" the owner receives when leased property upon which a tenant has made improvements, or which has otherwise enhanced in value during the term for which it was leased, reverts to the owner by termination of the lease. The Undeveloped Land Duty is an annual tax on the capital value of the kind of land described by the name of the duty. The Mineral Rights Duty is a tax on the annual rental value of mining rights.

Exempt from these taxes are: all agricultural lands, except such as may be worth more for other purposes than they are for agriculture; all small holdings; and lands used for a public or quasi-public purpose. Exempt, also, from the undeveloped land duty is all land of that description which is worth less than £50 ($243) per acre. They are then taxes on urban and suburban lands and on mines.

The New Doomsday Book

The first and third, and to a lesser extent the second, of these taxes involved establishing the value and character of all the land of England, at a given date, as the point of beginning. The value to be established was the capital value. As the English people reckon value very often in rental or annual value and frequently without reference to the capital or principal value, this was a somewhat novel mode of approach. More so, at all events, than it would be in this country. They are the only English taxes, except the inheritance taxes, levied according to capital value.

All land was to be included in the valuation, because the fact of its taxability or exemption had to be established and, moreover, because any given piece might at any time pass from the

exempt to the taxable class or classes. The date selected as the point of beginning was the 30th of April, 1909. This date was long before the final passage of the act. It was the day after the budget speech by Mr. Lloyd George, Chancellor of the Exchequer, in which the new taxes were proposed. Owing to the opposition of the House of Lords, necessitating an appeal to the country, and a new parliamentary election, the act was not passed for a year, less a day, after the date with reference to which the values were to be determined. This was a concession to the landowners, as it was assumed that the mere announcement of the proposed taxes depressed the value of land. Hence, to use the higher value, as of the day of the announcement, rather than the depressed value after the announcement, meant using a smaller value for the taxable increments.

The new taxes, therefore, involved writing a new Doomsday Book, a record, or register, as it is variously called, or a *cadastre* of all lands in the United Kingdom, and their ownership, as they stood on the 30th of April, 1909. This was a gigantic undertaking, the more so as it had to be done practically *de novo*, there being nothing of the kind in existence save the basic maps. It was estimated that it would take four years and that it would cost, when completed, approximately £2,000,000, or nearly $10,000,000. In April, 1913, when, it is perhaps safe to assume, the work was at or near its height, it is reported that there were 4153 officials employed and that their annual salaries were £492,620. It was reported at a recent date, January, 1916, that the survey had been completed as to 95 per cent of the land, but further work thereon had been suspended on account of the war. The enforcement of the taxes, however, necessarily involves a continuance of a large part of the staff. The cost of the Doomsday Book may be regarded as a capital investment good for many years to come. It was the original plan to have the values revised once every five years, although this revision would have little to do with the enforcement of the taxes or the determination of their amount except as to the Undeveloped Land Duty.

The Administration

The making of the Doomsday Book and the whole administration is in the hands of the Commissioners of the Inland Revenues. The country was originally divided into 128 districts,

in each of which there is a head valuer, whose work is supervised by traveling inspectors. The administration was highly centralized, nothing being finally passed until approved by the commissioners. Hearings of interested parties were also provided for. The assessment districts being large, the officer in charge was a man of responsibility. As one of the best-known facts concerning landed property in England is the rental value, that served largely in determining the capital value.

Land. The Meaning of the Term

Thus far we have used the term "land" loosely. It is necessary before going further to note the meaning of that term in English law. By the so-called "Interprêtation Act" of 1889, Parliament decreed that unless the contrary intention appears, the expression "land shall include messuages, tenements, and hereditaments, houses and buildings of any tenure."[1] For this the nearest American equivalent in tax law is "real estate and any interest therein." Thus we must bear in mind then that in English law "land" is not merely the God-given soil, or the surface of the earth, but minerals under and man-made improvements on and under the surface. This, however, is not what is taxable under these taxes. It is only the "site value" which is taxable. This is a somewhat intricate conception and difficult to arrive at. For the first we may say that "site value" is approximately what the American would call the value of the "bare land," or what our tax laws mean by land values when they distinguish between land and the improvements thereon, if we exclude improvements like grading, drainage, or embankments.

[1] "Messuage," it may not be amiss to explain, means a dwelling house, with its appurtenant buildings, yards, and gardens. "Tenements and hereditaments," possibly best read together, sum up all property, or property rights, in land, or related to land present and future, temporary or permanent. The Finance (1909–10) Act, 1910, excludes "incorporeal hereditaments issuing or granted out of the land." Dr. Napier, the great legal authority, explains that this means generally "advowsons, tithes, rights of common, way, water and light, offices, dignities, franchises, or rents," a miscellaneous list of privileges or burdens, which would theoretically increase or diminish the value of land or of the lands from which they spring, or on which they fall. As burdens on one piece they may enhance the value of other pieces to which they inure as a benefit. Thus, if the owner, or user, of one piece of land must leave light for a neighbor, the one loses and the other gains the value of the "incorporeal hereditament."

There is another term to which the English law gives a meaning different from that which it has in this country, and that is "owner." The act says that the term "owner" means the person "entitled in possession to the rents and profits of the land in virtue of any estate of freehold, except that where land is let on lease for a term of which more than fifty years are unexpired, the lessee under the lease, or if there are two or more such lessees, the lessee under the last created under-lease, shall be deemed to be the owner instead of the person entitled to the rents and profits as aforesaid." Thus the tenant who has a long lease of which fifty years are unexpired is to be regarded as the owner. As much of the land in England is leased, this is important. The explanation of this provision seems to be that in the first place any increase in the value of the land would accrue to the tenant at least for the period that the lease still has to run, and, in the second place, the increase that might accrue to the owner will, in any event, be covered by the second of the new duties, the Reversion Value Duty.

In the intricacies of English land tenure, simplified as that has been by legislation during the last century, there still remain some forms of landholding which are unknown and others which are uncommon in the United States, and, what is more important to a clear understanding of the English law, there are shades of meaning, wholly unfamiliar to us, which attach to those terms which are in common use in both countries. It is difficult for one not to the manner born to appreciate these differences. But there are some of them which it is necessary to try to distinguish. At the very beginning of the act we encounter the term "fee simple of the land." Dr. Napier says that "fee simple" is "the fullest and most complete right of ownership known to English law." Joshua Williams, the learned author of "The Law of Property," tells us that "English law recognizes property in, but not absolute ownership of, land." In fact, if not in theory, "fee simple" is a right of ownership, not quite but yet very nearly as complete and free as the rights conveyed by a United States patent. The Crown has theoretical rights in land which is held in fee simple that exceed our recognized governmental rights of eminent domain. But the exercise of these rights is not common. Possibly a helpful way of expressing the distinction, at least so far as transferability of title

is concerned, is to say that the American conception of fee simple is less personal than the English. Thus we speak of "patented land" as if the patent were a concrete condition attaching to the land, although, of course, the owner's personal rights do arise from the patent. But the English use of the term "fee simple" suggests first of all the owner's personal rights and yet implies also a condition attaching to the land. For our present purpose this subtle distinction is of only minor importance, since the act contemplates that the tax will reach every "interest in the land." Thus leasehold interests of all sorts are separately treated. But a mortgage on land is not considered an interest therein.

"Copyholds" and "customary freeholds" are two terms not known in the United States. They are forms of tenure little short of "fee simple." The act provides that these shall be resolved into their constituent elements and treated either as (1) ownerships or as (2) leases, according as their terms run. Thus, under the "Copyhold Act of 1894," or under the common law, copyholds and customary freeholds may be "enfranchised" and the "lord's seigniorial rights or interest in the land" released, by a bargain between the lord and the copyholder. The consideration which would have to be paid to obtain enfranchisement is treated as lessening the value of that interest in the land that is held under copyhold.

Relation of These Taxes to Other Taxes

These are new and additional taxes. They make, save in one minor point, no material change in prior existing taxes or government charges on land or on the income or rent therefrom. Thus the old land tax, if it has not been redeemed, goes on as before. There is some three and one-half million dollars of this old tax still collected each year. So, too, the local "rates," which are in various ways too complex to set forth here, relating to land or to its rentals, continue unchanged. A plan to donate half the proceeds of the new taxes to local highways, which was embodied in the act, has been abandoned. So these new taxes work no relief in local taxation directly. There is no change on account of the new taxes, in the income-tax schedules A and B, which cover income received from land. Nor are the several inheritance taxes affected, save that in computing the principal value of an

estate subject to these taxes, there is to be a deduction made equal to the amount of the increment tax paid on the same occasion. As this deduction is from the value, and not from the tax, it will make a relatively insignificant reduction in the death duties.

Theory of These Taxes

The general theory of these taxes seems to be that the "site value" of land, in so far as it is not attributable to any expenditure, skill, or foresight on the part of the owners, and excluding such expenditure, is a result of social and economic progress, a consequence of the growth of population, and therefore is a subject peculiarly fit for taxation. Under this theory, then, the increment in the value of land from time to time is preëminently a fit subject for taxation. By the same test the attempt to make a speculative profit by holding land idle and out of use is equally a proper subject of special taxation. The theory assumes that the increase of land values "is a perpetual stream of communal wealth deposited from year to year on the property of the fortunate owners of land," as Dr. Napier expresses it.

But these taxes are not the "single tax" of Henry George, nor do they approximate it. The resemblance is superficial and lies in the single fact that both taxes rest on the assumption that the increment of land values is the result of the growth of population. The object of the single tax is to take from the owner of land the enjoyment of the annual value of the ground rent. But the increment value tax leaves the owner in full enjoyment of the rentals until an "occasion" arises, and then takes only a part. The single tax makes the government at least a partner with the owner, if not the owner in chief, but the increment taxes make the government a quasi-heir to the owner's interest, or to a part thereof. Furthermore, these taxes might, conceivably, be defended on the same grounds that higher rates for the income tax have been applied to some kinds of income. Thus, if it is proper to tax income from investments, "lazy incomes," as Gladstone called them, more heavily than incomes which are gained from work, then it might be urged that the increment in the value of one's land is a very "lazy" income.

Further light is thrown on the theory of these taxes by the meaning that is given to the "site value" that is to be the basis

of the tax. Site value has been variously described as "the prairie value" or as the "pure economic rent" of land. A given piece of land in its present state, ready to be built upon, may have been drained or graded; roads may have been built to provide access to it; the old land tax, or the old tithe, originally a church contribution, on it may have been redeemed; parks, squares, and boulevards may have been laid out at the owner's expense to enhance its attractiveness; and advertising may have lent it popularity or created a vogue for it. Whatever value any of these things or other things, if done at the owner's or his ancestors' expense, may add to the value of the land is excluded from the taxable site value. It is not, however, prairie value alone, but that plus the value that has been added by the community through growth of population and the development of its institutions, good schools, churches, public works and the observance of law and order and the like. On the other hand, the land may be subject also to burdens, fixed charges, easements, restrictions, or cumbered by buildings, forests, or shrubs, unsuited to its proper use, all of which lessen its value. Dr. Napier points out that "it may, indeed, be that the assessable site value is a minus quantity, as where the nominal value of a rent charge issuing out of the land, either of itself or with the cost of roads, drainage, or embankment exceeds the value of the land free from that charge." What is subject to the tax is then pure economic rent or the value of the "original and indestructible powers of the soil," in the market as that market is now constituted.

Exemptions

The theory of the tax would have required that it should be imposed on all land, but agricultural lands were exempted. It was stated by the proponents of the new taxes that they would eventually be extended to cover all land, but agricultural land in England at the time of the imposition of these taxes was not advancing but declining in value. It was claimed that agricultural land had decreased in value from 1878 to the time the act was proposed by between 20 and 25 per cent. These taxes are, therefore, primarily taxes on city lands, and fall especially on suburban lands, the value of which it is said has been increasing rapidly.

How the Site Value is to be Determined

How the site value is arrived at and assessed is of peculiar interest. The act is very explicit on this point, and has been supplemented and interpreted by rulings of the Commissioners of the Inland Revenue, so it is possible to get at this very fully.

While the values are to be finally fixed by the commissioners, the taxpayers must assist, and any one connected with the use of the land may be called upon to assist in the work. As we shall see, the assessment requires a great deal of information, and the administration was regarded by the landowners as extremely "inquisitorial." Most of the opposition centered around one of the schedules or reports that the landowner is required to file. This was known as "Form IV," which had to be filled out by every "owner of land and by any person receiving rent in respect of land." In a way it appealed to divergent interests, since it makes the landlord tell tales on his tenant and the tenant on his landlord. It is a cumbersome schedule, this "Form IV," a really appalling document. It calls for information on everything that can possibly throw light on the value. The owner may fix a value which then must be "considered" but is in no way binding or limiting on the commissioners. The latter must, however, submit a "provisional" valuation, to which the owner has the privilege of objecting. Finally, an appeal lies to a referee and from him to the courts.[1]

The definition of value is that it shall be the value which it would be expected that land would realize "if sold . . . in the open market by a willing seller in its then condition." This definition contains as many doubtful elements as do the American property tax value definitions. But who can frame a better one?

The Four Values

There are in all four different values which the commissioners are to fix, three of which enter into the computation being used to ascertain the fourth. They are: (1) the "gross value"; (2) the "full site value"; (3) the "total value"; and (4) the "assessable site value." The definitions given in the act are:

[1] The intervention of the courts has held up the revenues. But this is another matter, which cannot be taken up in this paper.

The gross value of land means the amount which the fee simple of the land, if sold at the time in the open market by a willing seller in its then condition, free from incumbrances, and from any burden, charge, or restriction (other than rates or taxes) might be expected to realize.

The full site value of land means the amount which remains after deducting from the gross value of the land the difference (if any) between that value and the value which the fee simple of the land, if sold at the time in the open market by a willing seller, might be expected to realize if the land were divested of any buildings and of any other structures (including fixed or attached machinery) on, in, or under the surface, which are appurtenant to or used in connection with any such buildings, and of all growing timber, fruit trees, fruit bushes, and other things growing thereon.

The total value of land means the gross value after deducting the amount by which the gross value would be diminished if the land were sold subject to any fixed charges and to any public rights of way or any public rights of user, and to any rights of common and to any easements affecting the land, and to any covenant or agreement restricting the use of the land entered into or made before the thirtieth day of April, 1909, and to any covenant or agreement restricting the use of the land entered into or made on or after that date, if, in the opinion of the commissioners, the restraint imposed by the covenant or agreement so entered into or made on or after that date was when imposed desirable in the interests of the public or in view of the character and surroundings of the neighborhood, and the opinion of the commissioners shall in this case be subject to an appeal to the referee, whose decision shall be final.

The assessable site value of land means the total value after deducting

(*a*) The same amount as is to be deducted for the purpose of arriving at full site value from gross value; and

(*b*) Any part of the total value which is proved to the commissioners to be directly attributable to works executed, or expenditure of a capital nature (including any expenses of advertisement) incurred *bona fide* by or on behalf of or solely in the interests of any person interested in the land for the purpose of improving the value of the land as building land, or for the purpose of any business, trade, or industry other than agriculture; and

(*c*) Any part of the total value which is proved to the commissioners to be directly attributable to the appropriation of any land or to the gift of any land by any person interested in the land for the purpose of streets, roads, paths, squares, gardens, or other open spaces for the use of the public; and

(*d*) Any part of the total value which is proved to the commissioners to be directly attributable to the expenditure of money on the redemption of any land tax, or any fixed charge, or on the enfranchisement of copyhold land or customary freeholds, or on effecting the release of any covenant or agreement restricting the use of land which may be taken into account in ascertaining the total value of the land, or to goodwill or any other matter which is personal to the owner, occupier, or other person interested for the time being in the land; and

(*e*) Any sums which, in the opinion of the commissioners, it would be necessary to expend in order to divest the land of buildings, timber, trees, or other things of which it is to be taken to be divested for the purpose of arriving at the full site value from the gross value of the land, and of which it would be necessary to divest the land for the purpose of realizing the full site value.

Where any works executed or expenditure incurred for the purpose of improving the value of the land for agriculture have actually improved the value of the land as building land, or for the purpose of any business, trade, or industry other than agriculture, the works or expenditures shall, for the purposes of this provision, be treated as having been executed or incurred also for the latter purposes.

At first reading the definitions and the method they prescribe seem roundabout and involved. It requires a little study to see what they mean and the reasons for the involved language. Thus it seems strange to be told that to find the "total value" you must take from the "gross value" the difference between the "total value" and the "gross value." Surely if one knows the "total value" to begin with, why compute it?

The fact is that the "total value" is substantially the market value of the land in the broad sense, including the improvements. It will be, in most instances, the first ascertainable quantity,—an ascertainable fact. It is the price that is paid when the "land" is sold. The "gross value" is a hypothetical quantity, set up merely to call attention to certain factors which, in most cases, diminish the "site value" but are not necessarily included in the "total value," in fact, are generally reasons why the "total value" is low. These factors are, according to Dr. Napier, "easements, fixed charges, and restrictions arising out of contract and many other burdens."[1]

The "total value" or the market price would, generally speak-

[1] Form IV enumerates six groups of such items.

ing, be less than the gross value. It is, of course, conceivable that a given piece of land might enjoy rights from or over other lands of a greater aggregate value than the easements it granted to other lands. But as most of these easements and the like are to the public, the usual effect is that the gross exceeds the total value. Yet, although the gross value is hypothetical it is not necessarily hard to arrive at. Dr. Napier suggests that it is what the man in the street estimates to be the value of a given house looking at it from the street and knowing nothing of the easements, fixed charges, and other burdens attaching to the title. The rules of the commissioners direct the valuers to arrive at the gross value by "an independent calculation and without *necessarily* being bound by the actual consideration paid." To illustrate: An experienced valuer, viewing a factory building and site, decides that it is worth, say £10,000. He finds, however, that it actually sold for £8000. On inquiry he finds that it is subject to a right of way leading to a neighboring factory, and that another neighbor has a right to free space for air and light, and that the property must pay the upkeep of a little park in front of it. These easements account for the difference. By considering these easements separately and in the light of the gross value he has more information than he would otherwise have as to the reasonableness of the "total value." Furthermore, "gross value" is useful in equalizing between different pieces of property, the more especially as the relative values are disturbed by the easements.

"Full site value" is also defined in the same roundabout way as "total value." It would have seemed simpler to have said that it is the "total value," less what a buyer would include in that value for the buildings, plus the value of the easements which make up the difference between "gross" and "total" value. The treatment of the value of the buildings and other structures is very interesting and suggestive. The most important thing is the emphasis laid on the idea that buildings and other structures are to be valued, not at cost, nor at reproduction cost, nor depreciated cost, but simply and solely at what they add to the value of the entire complex of which they form a part. In the same way expenditures on the site to adapt it to use are valued not at what they cost but at what they add to the site without reference to cost. A sea wall may add greatly more than its cost

to the value of a salt marsh. Again, there are to be deducted "any sums . . . it would be necessary to expend in order to divest the land of buildings, timber, etc." The reason for this curious provision is that the act had in contemplation lands on the suburbs of cities, from which the old farm buildings and other stuff would have to be removed before it could be used for building purposes. Again, we find that a deduction may be allowed for "expenses of advertising." That is, intangible as well as tangible values attaching to the land and resulting from the owner's own efforts or expenditures are to be deducted. Even "good will or any other matter personal to the owner" is to be deducted.

The wide extent to which lands in England are leased, to which reference has already been made, makes it necessary to split up the interests in many cases. Rents for lands, annuities paid out of them, and the like have to be separated. This is done by computing the present values of the different incomes, whether for a fixed term of years, for life, and so on. It is interesting to note that in making these computations 4 per cent was used for computing the values of the fee simple and 6 per cent for computing leasehold interests.

The Occasions

The Increment Value Duty is levied and is payable on occasions. The occasions are (1) the transfer or sale of the fee simple of the land or of any interest in the land, or the grant of a lease for over fourteen years, unless the contract for the sale or the lease was made before the act took effect, *i.e.*, April 29, 1910; (2) on the death of any person dying after the passage of the act where the fee simple of the land or any interest therein is subject to the estate duty;[1] (3) where the land is held by a body corporate or its equivalent, then the occasions on which the tax is levied are the 5th of April, 1914, and every subsequent fifteenth year thereafter. But the tax is then payable, if the corporate body so elect, in fifteen annual installments. The granting of a short lease, that is, one for not more than fourteen years, is not an occasion.

[1] The estate duty is the chief inheritance tax. Unlike most American inheritance taxes, it is levied on the estate of the deceased, not on the distributive shares, which, in England, are subject to another tax.

The Basis of the Tax

On each occasion the "site value" is reascertained in substantially the same manner as it was for the new Doomsday Book. If there has been a sale, of course the price paid is the important matter. Each interest is separately assessed, but the tax applies only to the one that is the subject of the occasion. The unit is each piece in separate occupation or use.

The tax is levied on the "increment value," or the difference between the "site value" as assessed on the "occasion" and the "original site value" set down in the new Doomsday Book, if the former exceed the latter. No duty is payable unless the increment is more than 10 per cent of the original site value and the duty is collected only on that part of the increment which exceeds this 10 per cent. The duty on the 10 per cent is "considered paid," which is a curious-sounding provision, but one that has its effect on the computation of the tax on subsequent "occasions." If on occasions after the first the increment is not more than 10 per cent of the site value on the last occasion preceding, no duty is due, and so on. But these deductions may not be accumulated so as to exceed 25 per cent of the original value in any period of five years. These 10 per cent deductions are explained as covering any expense the owner may have been put to by the act and as a margin for possible mistakes in the valuations. No duty is payable unless the site value on an occasion exceeds the original site value. Thus, if a piece of land shrinks in value and then later recovers but does not exceed the original value, no duty is payable on the increment from the low value to which it fell.

It will be observed that it is in the interest of the owner to have a high value placed upon the property in the first instance. Consequently those owners who had reason to claim that their lands were depreciated on the 30th of April, 1909, had a grievance. They were given relief in 1911, when the act was amended permitting them to substitute any value, which they could prove, by evidence, such as a sale, had been the value during a period of twenty years prior to April 30, 1909.

The Rate

The rate of the Increment Value Duty is one pound in every full five pounds of taxable value. That is, one-fifth, or 20 per

cent, of the increment in value is to be taken by the government, whenever the owner harvests the increment.

Collection

The duty is collected as a stamp tax on the instrument of transfer. Thus, if it is not paid the transfer is invalid and the instrument worthless, so that the vendee will see to it that the stamps are attached.

Illustrative Examples

Let us assume that there is a lot of land known as Whiteacre, which is a factory site and on which there is a suitable factory building. On April 30, 1909, it was found to be worth: "Gross value," £10,000; "total value," £9000; "full site value," £2000. Then, by the rule laid down in the definitions, the "original assessable site value" is £9000 — (£10,000 — £2000) — the sum of the various deductions. If it appeared that there had been expended on a retaining wall £100, for street work £300, to redeem the old land tax of £5 per annum, £100, then the total of the deductions is £500. Then 9000 less 8000 less 500 gives 500, and the assessable "site value" is £500.

Let us now assume that A is the owner of the fee simple and that there is no lease or other interest in the land. On January 1, 1912, A sells the fee to B for a price which, by the same method as was followed above, but with, of course, new values for the different items, gives a new "site value" of £1000. This, then, is the first "occasion" on which the tax is to be paid. The tax is one-fifth of the difference between £1000 and £500, or £100, but the amount to be paid is only £90 because the tax on one tenth of the original site value is "considered as paid."

A year later B leases the property to C for ninety-nine years. For the purposes of this tax the lease is considered in the same light as a sale. On this the second "occasion" for the imposition of the tax the "site value" is found from computing the value on the basis of the rent to be £1250. The increment accruing to B is $250. He would apparently be entitled to a deduction (or to "consider as paid") for the tax on 10 per cent of £1000, or £20 in tax. But it will be observed that this £100 plus the £50 allowed to A on the first "occasion" makes £150, which exceeds

25 per cent of the original site value of £500 and is, therefore, more than is allowed in any one five-year period. Hence the calculation is changed about; £500 plus 25 per cent of itself is £625. The total increment duty that can be collected is, therefore, £125, that is, one-fifth of the difference between £1250 and £625. But of that total, £90 has been paid by A, so the tax on B is £125 less £90, or £35. He thus pays £5 extra for making his money so fast.

Twenty years later, C underleases the property for twenty-one years to D. There are now three parties at interest: D, who has the property in use; C, who holds D's lease and has a reversion in expectancy on his own leasehold interest after twenty-one years, or for a period of fifty-eight years remaining after D's lease falls in; and B, who has a reversion in expectancy after seventy-nine years. The consideration for the lease paid or agreed to be paid by D and other factors now show a site value of £2000 on this third "occasion." The last site value was £1250, hence the increment on this "occasion" is £750, and in computing the tax there is to be deducted the tax on 10 per cent of £1250, leaving a tax computable of £125. But this has to be apportioned between C and B, only one of whom, namely C, has realized his increment. The computation is as follows: £2000, the site value, at 4 per cent, would yield £80 a year; £80 a year for the next fifty-eight years, the term of D's lease, is worth now £1794, 8s. Hence, C's interest is to B's interest as 1794.4 is to 2000. C, therefore, pays that fraction of £125, or £116, 12s, 9d.

The Incidence of this Tax

The imposition of these taxes, nay, even their first whispered announcement, at once depressed the value of land. This is not only in accordance with the accepted theory of the incidence of these taxes, but an acknowledgment of that effect is written into the act itself in several important particulars. First, there was the rule that the original site value should be reckoned as of a date before the effect of the announcement of the new taxes was felt. Second, there was the concession that the highest price that was obtained at any time during twenty years before the new taxes were levied should be the basis from which to start. The consequence was that the owner at the time of the imposition

of the tax was obliged to assume the whole burden of the tax forever, in so far as the amounts thereof could be foreseen. For each purchaser or lessee would naturally deduct from the price he would be willing to pay the "present value" or capitalized value of the tax that he would have to pay and also that of the taxes which his successors would have to pay and which in turn they would deduct from him. In computing the effect there are two uncertain factors—one is the amount of the increment, and the other is the times when the occasions will occur. These two uncertainties introduce into the study of the incidence of these taxes certain very interesting and complex considerations which will be considered in another place.

The Reversion Value Duty

The reversion duty in England rests on a practice common in that country and not nearly so common in the United States of leasing land for long terms. The lessee then builds on the land, makes various improvements, and may, under the conditions of the original lease, sublet. At the termination of the lease the whole property reverts to the owner of the fee. The terms of the leases are usually such as to protect the interests of the various parties. But they vary greatly. If, for example, it is expected that the buildings put up by the tenant will outlast the lease, or if he is required by the lease to keep such improvements as will outlast the lease, then there may be some compensation to be paid by the landlord at the termination of the lease, or it may be that he makes an abatement in the rent charge to cover such improvements. But since all the developments of the future cannot be foreseen when a long lease is written, it not infrequently happens that a considerable windfall accrues to the landlord. This is the more likely to happen in the case of land that is rapidly appreciating in value. It was to cover these windfalls, which are somewhat akin to an "unearned increment," that the Reversion Value Duty was added to the list of the new taxes. That, despite all attempts to equalize the benefits which may have been made in the original lease, an added value is found to fall to the landlord is stated by Dr. Napier as follows: "It usually happens that on the expiration of a building lease the owner of the fee simple expectant upon the lease comes into a property

worth much more than the fee simple of the property at the time when his predecessor in title made the lease." This profit, consisting of the increase in site value and whatever building or improvement values there may be over and above what was anticipated by the terms of the lease written long years before, is the subject of the reversion duty.

The theory of the tax is that the owner of the fee simple has received a safe interest on his money or investment for many years and on the termination of the lease gets back his money or the principal with added values. Such a windfall is to be shared with the government. Since the holder of a long lease is regarded as the owner with reference to underleases it may also fall on a tenant.

The rate of the reversion duty is one pound in every full ten pounds of the value of the benefit accruing by the reversion. The rate is lower than that of the increment duty by reason of the fact that the benefit is not wholly economic rent. In proportion to the value of the whole property it is possible, however, that in many cases this tax will be heavier than the increment-value duty. It is apparently not intended that an increment duty and a reversion duty shall both be collected for that portion of the benefit which is increment in the site value, in case the "occasions" overlap or coincide.

For obvious reasons the values and methods of valuation for the reversion duty are not those for the increment-value duty. In the first place, the thing to be valued includes buildings as well as the underlying earth. The original value, moreover, is that at the time the lease was written and is to be computed on the basis of all payments and considerations in the lease. The value of the property at the end of the lease is our old friend "total value," as explained in connection with the increment-value duty. There is deducted from this before the original value is subtracted the present value attributable to any expenditure by the lessor during the life of the lease, and any compensation he may have to pay to the lessee by the terms of the lease.

Exempt from this duty are agricultural lands, and leases for short terms (which for this purpose are those not exceeding twenty-one years), leases covered by the Mineral Rights Duty, and leases of public property, or such as is used for charitable,

educational, and other quasi-public purposes not resulting in private profit.

The reversion duty is not a lien on the property. The beneficiary of the reversion must report to the commissioners under heavy penalty for failure. But there is no danger that the collection will be jeopardized, because there is in England so much publicity as to the essential facts arising under the administration of the income tax and of the local rates that concealment from the officials is practically impossible.

NUMERICAL EXAMPLE

Selling value of the entire property at the end of the lease		£2000
Expended by lessor on betterments	£300	
Compensation for fixtures	200	
Total deductions		500
Amount that the lessor receives by reversion		£1500
Original values:		
Premium paid for lease	£300	
Annual rental of £20, taken at twenty-five years' purchase	500	
Total original		800
Benefit taxable		£700

Tax at 10 per cent, £70.

The Undeveloped Land Duty

Undeveloped land is defined as follows: "Land shall be deemed to be undeveloped land if it has not been developed by the erection of dwelling houses or of buildings for the purpose of any business, or trade, or industry other than agriculture." Land once developed may revert by virtue of nonuse, or owing to the buildings becoming derelict. Land in process of development, or being marketed, is considered developed if £100 per acre has been spent on roads, sewers, etc., within the past ten years.

The assessment is on our old friend the "assessable site value," ascertained as explained above. For the first five years the assessment is on the "original site value" as of the 30th of April, 1909. A new assessment or valuation is to be made every five years. In the interval between the quinquennial assessments lands passing into the "undeveloped" class must be valued. When the increment tax has been paid the "site value" is reduced by the amount of the increment that was taxed.

Exempt are: Land whose site value is less than £50 per acre; parks, woodlands, and the like devoted to public use, or recreation, or to which the public enjoys access amounting to a public benefit. In the case of undeveloped land actually in use for agriculture, if the sight value be over £50 per acre, and the sight value for purposes other than agriculture exceeds the value for agriculture, the excess is considered the undeveloped value, and that excess is taxable. But small holdings of this class not worth over £500 are exempt. A free acre of land is allowed with a dwelling house, and gardens or pleasure grounds not in excess of five acres, whose value for the purposes of building, etc., does not exceed twenty times the annual value adopted for the income tax, are exempt.

The Rate

The rate of the Undeveloped Land Duty is one-half penny for every twenty shillings of assessable site value. Interpreted in the common terms of American tax rates, the rate is $2.08 per thousand, or twenty cents and eight mills per $100, or two mills and a little over per $1. By itself it is a trivial tax. But conjoined to and added to the other taxes and charges falling on land it is not unimportant. As the tax could not be determined until the valuation was completed it was made payable retroactively to and for the year ending March 31, 1910, and each subsequent year.

The tax is a sort of penalty for not using the land or for not selling or leasing it so that it may be used.

The tax is not expressly made a lien on the land, but the act contains the dictum that the tax "shall be borne by that owner (*i.e.* 'the owner for the time being' presumably when assessed) notwithstanding any contract to the contrary." It is not very probable that the tax can be shifted by the owner, but if it should be the case that economic forces dictate a shifting, say to the purchaser, this dictum of the law will be as potent as Canute's command to the tide, of which it smacks.

Numerical Illustration

This tax is so simple in the main that no example is necessary, except for the case of land used for agriculture pending the opportunity to sell it at a profit. Thus "Blackacre" may have an agricultural value of £500 and a "site value," in view of the

growth of the neighboring town, of £1000. The duty is on the difference, or £500. If subsequently leased for market gardens its agricultural value may rise to £700 and at the same time the site value for a factory may be £1500; then the duty is on the £800.

Mineral Rights Duty

The fourth of the new duties proved to be the largest revenue getter, during the first period of the life of the new taxes. Down to the 31st of March, 1913, it had yielded in all £1,250,000 ($6,087,000), while all the other three together yielded only £250,000 ($1,217,000).

The tax with which we now deal is not a tax on the capital value of the minerals. It is a tax on the annual or rental value, a basis as familiar to the English people as it is unfamiliar to us. It is based on the annual rental value of all rights to work minerals and of all mineral way-leaves.[1] The rate is one shilling for every twenty shillings of the rental value paid by the working lessee, or its estimated equivalent if the proprietor works the mine himself. The year for the rental is the year ending September 30th. If the proprietor receives an increased rent in consideration of making developments, the amount he expends on the development is deducted. If the working lessee holds from one who is himself a lessee, intermediate between the proprietor and the working lessee, the latter may deduct from the rent he pays the proportionate part of the tax. Clay, brick clay, or brick earth, sand, chalk, limestone, and gravel are not minerals subject to the duty.

The reversion duty is not payable on the termination of a mining lease, nor is the grant of such a lease an "occasion" under the increment value duty.

But although mineral rights are subject to such a heavy tax, that is not all of these new taxes which may fall on minerals in some cases. In the first place, when minerals are sold, apart from the land, as if they were a separate parcel of land, they are liable, as other land, to the Increment Value Duty, on their capital value. The same is true if they pass by death when they are not being worked.

Minerals which were being worked at the time of the passage

[1] A "way-leave" is the right to convey minerals over or under private lands, or to use shafts or tunnels for ventilation, or drainage, passing over or under private land.

of the act, and continue to be worked without an idle period of two years or more, pay only the Mineral Rights Duty.

But special provisions as to the Increment Value Duty are made to apply to minerals opened and worked that were not being worked when the act was passed, or which may be opened and worked after any period of two years or more of idleness. In such cases there is an ingenious application of the Increment Value Duty which turns it from a lump sum "occasional" tax into an annual tax. In assessing this form of the Increment Value Duty the first step is to ascertain the original capital value at the time the act was passed, or on becoming idle for a period of more than two years. This is done as nearly as may be according to the methods already explained for ascertaining site values. The next step is to compute the annual value corresponding to this capital value, which is fixed at "two twenty-fifths parts of the capital value," which cumbersome fraction is, of course, equivalent to 8 per cent. If, when the minerals are worked, the annual rental in any year exceeds the sum fixed by the second step as the original value, then the increment tax is based on that excess. If, however, a part of the rental is return for capital expended in development work during the fifteen years, a deduction is allowed.

It is not intended that both the annual increment value tax and the full Mineral Rights Duty shall be paid, but whichever is the higher is the measure of the total to be paid, the other, if paid, being allowed as a deduction.

General Comment on all Four Taxes

As we have seen, these four taxes are cunningly woven together. The undeveloped land tax might appear to stand alone, but there is one important respect in which it holds up the others. It has been noted that for the Increment Value Duty the owner will endeavor to have a high value fixed in the original assessment, for then the taxable increment thereafter will be smaller. But if he succeeds in this endeavor and his land is "undeveloped" he will have to pay a higher undeveloped land duty than otherwise. Then, too, a high original value fixed for the Increment Value Duty may rise up to plague his heirs when the estate duties (inheritance taxes) have to be paid. Moreover, there is always the possibility of increased rates.

Aside from one or two harsh features the act is full of tenderness and mercy for the taxpayer. The taxes, except for the Undeveloped Land Duty, fall only on realized values, and deductions and exemptions are allowed with the utmost liberality. In some cases the allowances, as for example those for advertising and good will, are almost fanciful.

The Yield

The Report of the Commissioners of His Majesty's Inland Revenue for the year ended March 31, 1915, gives the following as the "Net Receipts" of the several duties for each of the five years since they have been in force.

Duty	Year 1910–11	Year 1911–12	Year 1912–13	Year 1913–14	Year 1914–15	All Five Years
Increment Value Duty .	£127	£6,127	£16,981	£34,199	£48,316	£105,750
Reversion Value Duty .	257	22,621	47,974	80,435	19,313	170,600
Undeveloped Land Duty	2,351	28,947	97,852	274,916	8,652	412,718
Mineral Rights Duty . .	506,290	436,193	273,915	345,343	337,680	1,899,421
Totals	£509,025	£493,888	£436,722	£734,893	£413,961	£2,588,489

There are several features of these results that need a little explanation.

The only one of these duties that went into full effect at once was the Mineral Rights Duty. The others could not even begin until the new Doomsday Book was completed. By March, 1915, it was reported 95 per cent of all the land in Great Britain had been valued. The report, however, states that owing to the depletion of the staff by mobilization and the departure to the war of the owners and others who had a voice in the valuations all further work on the valuations was suspended. In 1914 the collection of the Reversion Value Duty and of the Undeveloped Land Duty were suspended by court decisions adverse to certain features of the valuation method. In the nature of things the Increment Value Duty could not be expected to yield much at first, as the "increment" ripens only with the passage of time.

I have tried to guess what the rate of increment was. This cannot be done with an accuracy, as the Report does not give the "assessable site" value; it gives only "total values." The "total values" for all lands are reported as £4,555,285,522. The

"occasion" valuations made for the purposes of Increment Value Duty to March 31, 1915, gave £490,920,918. How much of this was site value it is impossible to ascertain. Various writers (see Stamp, British Incomes and Property, pp. 339 ff.) have estimated the site value as being anywhere from one-fifth to one-half of the total value. The best guess seems to be one-third. In number the "units" which were revalued were about one-tenth the whole original number of valuations made, and if we allow for the increment, about one-tenth of the original values were revalued. So that it is possible to guess that the pieces revalued were fairly representative of the whole. Beyond this point the estimate is still further guesswork. The only sure facts are the total increment duty assessed, which was £153,234, representing a total increment taxed of £766,170. On each of the pieces taxed there was exempt 10 per cent of the original site value, whatever that was, and of the greater mass of the revalued properties the increment was less than 10 per cent, nil, or minus. The best that can be done is to guess that the 9937 lucky pieces that were also so unfortunate as to have to pay the tax increased in value not more than 14 per cent in the five years. But this is only a very rash guess.

The Incidence of Increment Value Taxes

The most interesting scientific problem in connection with these taxes is their incidence,—upon whom do they fall and how.

For a study of this the essential features of increment value land taxes are (1) that they are based on the increase in the capital value of land; (2) that they are assessed and collected on "occasions" at more or less irregular intervals of time, when some event such as a sale or a transfer on account of death permits the increase in value to be ascertained.

According to the prevailing theory of the incidence of all land taxes the burden falls on the owners and not on the tenants or any indirect users, such as those who consume the products of the land. Also, in so far as the future taxes can be calculated in advance, the burden of them is capitalized and thrown entirely upon those who are owners at the time of their enactment; that is, so far as any future owner is concerned the tax is amortized, is dead, in that he acquires the property at its value, based on

all earnings, less a sum which put at interest would pay the taxes. This general rule, applicable to all kinds of land taxes, would have little bearing if the taxes were made so heavy as to appropriate the full annual ground rental (in that case not merely the increment) and thus materially alter the entire economic organization of society.

This broad principle being accepted, the next problem is to calculate the amount of the depreciation in the private-property value of the land (the total use value not being affected) which will be occasioned by the enactment of a law imposing any given increment value tax. This problem differs from that presented by a tax based on the entire capital value of land payable at regular intervals, and from any regularly recurrent tax that takes a definite proportion of the annual rental value. In both of these cases we have only to capitalize the amount of the annual tax and the result is the amount by which the value of the land is depreciated. The main difficulty in the case of increment value taxes arises from the fact that the increment value tax leaves the owner in full enjoyment of the rentals until an "occasion" arises. Thus they can never appropriate or destroy all present value. The depreciation caused is therefore less than that which would be caused by a regular annual tax in approximately an equal amount. Further, unless it is to his interest to sell the land, the owner will not have to pay the tax until his death.

Inasmuch as the increment taxes are uncertain as to the date of their payment, they become, so far as calculable at all in advance, insurable risks, and to that extent they are analogous to any foreseeable inheritance tax which may be insured against as a risk. Indeed, in some aspects, these taxes are analogous to an added inheritance tax imposed on inheritances in the form of landed estate.

In their more common forms and in the case of the British increment taxes these taxes are primarily for revenue purposes and only incidentally, or in lesser degree, designed to change existing social and economic conditions. Thus the maximum rate of the British Increment Value Duty is less than 20 per cent of the increment. Similarly, the German Imperial Zuwachssteuer has a rate which approaches 30 per cent of the increment as a limit. If, for fiscal or for social reasons, the rate should

eventually be raised so as to approach 100 per cent, the whole problem is altered; the effect will be different not merely in degree, but in kind, since it would influence one of the main motives to land ownership.

Every increment value tax, at the time of its enactment, predicates two values in land. One is the present value, and the other is the future increase in that value. But on closer analysis the present value in turn contains two elements: one is the capitalized value of the income that is now being received or which could hypothetically be received by using the land, assuming that this will not decrease in the future; the other is the present value of such additions to the income as are expected to accrue in the future, in so far as those additions can be foreseen at the present time. There may be, some day in the future, now unexpected additions to the income (real or potential), the so-called windfalls which will, on the day they can be foreseen, add to the value of the land. But these add nothing to the present value. The increment value tax falls on two elements, one represented in the present value of the land and one not. Only in so far as it falls on the value of the expectation of future value now represented, in discounted form, in the present value can the increment tax reduce present values. The tax on the unexpected will in turn fall entirely on him who is the owner at the time the unexpected becomes foreseeable.

The depreciation, therefore, that will result from the enactment of an increment value tax is that due to the necessity of providing a fund for the care of the reduction in value caused by the tax as an invasion of the expected increase.

Although so far as any selected pieces of land are concerned the future increase in values may prove to be very irregular, yet the new taxes, regarded as revenue measures, obviously assume that by and large there will be a steady growth in land values. To study the effect on present values we must assume some rate of growth, and for simplicity it must be a regular rate. What rate to assume is a question which involves some difficulties. If, as economists teach us, rent is to be looked at as a differential value attaching to certain pieces of land as compared with the least advantageous piece of land (no-value land) then the propriety of adding these differentials together and striking an average is decidedly questionable. But if rent, as most business

men seem to hold, is to be regarded as the differential value attaching to land as against all other possible uses of funds, then we may properly strike an average. This is, perhaps, the attitude of the average investor.

As a preliminary example and to illustrate the method which it is here proposed to use, let us take the case of a landowner who confidently expects that his rentals will increase 10 per cent every seven years, and who does not now intend to sell and hence assumes that the first tax will be paid on the "occasion" of his death. If his expectation of life is twenty-eight years, he might set down the end of the twenty-eighth year as the time or "occasion" for the payment of the first tax.

Theoretically we might set up the hypothesis that the increment will go on growing forever. But this has no practical meaning. Such an assumption soon runs into those unreasonable figures which one plays with in computing compound interest, for example, since the year of our Lord. Practically the business man's horizon is always limited. He expects the increase to stop somewhere, and it is not an unreasonable assumption that he will refuse to pay good money down now for any hoped-for gain beyond, say, the average expectations of life of his group or, let us say, more or less arbitrarily, beyond twenty-eight years. Hence we may assume that he will regard the rentals as settling down to a straight perpetuity after twenty-eight years.

The following examples are worked on the basis of 4 per cent interest, and all capital values relate to $1 a year rental to begin with.

Under the foregoing assumption our landowner would reckon somewhat as follows:

I am to receive $1 a year for the first seven years;

Then, $1.10 a year for the second period of seven years;

Then, $1.21 a year for the third period of seven years;

Then, $1.331 a year for the fourth period of seven years.

At the end of the twenty-eighth year I shall have, to pass on, a property yielding $1.4641 a year and worth then, at 4 per cent, $36.60 for every $1 of present income.

As twenty-eight years is my expectation of life, my heirs will then have to pay the Increment Value Duty on this, which I believe will be the first "occasion."

Now the present value of the series of annual payments above set down, plus the present value of $36.60 to be received twenty-eight years hence, would be $30.924, provided there were no tax to pay. But it is less by the present value of the tax, and being less the tax is correspondingly a trifle larger than one-fifth of the difference between one and one-tenth times $30.924 and $36.60. To find the present value as influenced by the Increment Value Duty we proceed as follows: The present value of the property equals $30.924, less the present value of the tax. The tax equals one-fifth the difference between $36.60 and 1.10 times the present value of the land. From this it is easily computed that the present value equals $30.74, and the tax is $0.557 payable twenty-eight years hence. The reduction in present value caused by the tax is $0.1856, which is 0.6 per cent of the value unaffected by the tax.

If we were to assume that the rentals double every seven years for twenty-eight years, the present value is $169.18, the future value $400, the tax $14.26, and the reduction 7.77 per cent.

These illustrations will suffice to show the principles.

Some of the propositions concerning these taxes are interesting:

(*A*) If there be any material exemption based on a percentage of original value, as in the British tax, the more frequently the "occasions" occur, the less the revenue. Thus, in our first example, when the property was assumed to increase in value 10 per cent every seven years, if an "occasion" fell every seventh year there would be no revenue at all.

Hence, in a country where transfers of land are frequent, the exemption (or abatement) should take the form of a percentage of the increment or a lower tax rate, and not of the original value.

(*B*) Even if the tax is 100 per cent of the increment, the present value is never entirely wiped out nor is the owner deprived of all enjoyment of the increments. Thus, if we assume that land will double in value every seven years (which is certainly very rapid) and the tax takes the whole increment, and that the first occasion is at the end of twenty-eight years, the present value is still $75.10 per $1 rental at the start as against $183.45 untaxed (or $25.00, if there were no expected increment).

(*C*) For any considerable area of land the increment value taxes are not likely to yield much revenue, unless the rates are very high and the exemption or abatement next to nothing.

(*D*) Under any conditions that are at all within the reasonable expectations, the yield of an increment-value tax will be very small for the early years. It takes considerable time for the increments to ripen.

The Incidence of the Undeveloped Land Duty

The effect of the Undeveloped Land Duty is simpler than that of the Increment Value Duty. Thus, in the English tax it is one-half penny in the pound value, or a little over one-fifth of 1 per cent, and if the land were to stay undeveloped means that for every $100 of value before the tax the new value would be $95. But as it is natural that undeveloped land should ripen in some period of time and the tax disappear, the effect is less. The tax at one-fifth of 1 per cent for each dollar a year income for fourteen years is about $2.01. Hence, under this supposition the value is reduced from $100 to $98.

Comparison of the British Increment Value Duty with the General Property Tax

Under the general property tax the increment of value in land becomes subject to taxation as fast as it matures. Thus, if a piece of land is worth $1000, and seven years hence is found to be worth $1500, it will then be assessed on the basis of $1500, the $500 of increment value being included. Moreover, as long as this value continues to exist, it is taxed at the regular rates of the general property tax.

If we take the same examples which we used to illustrate the working of the British Increment Value Duty (namely, (1) a case in which the value increases 10 per cent every seven years up to the twenty-eighth year, and (2) a case in which the value increases 100 per cent every seven years up to the twenty-eighth year), we have the following computations as to the results of the general property tax, assuming the tax rate to be 1 per cent of the true value, and 4 per cent as a basis of capitalization.

EXAMPLE NO. 1

For every $1 of income (ground rent) which the owner is receiving the government is also receiving 25 cents. Both the

owner's and the government's shares increase by the condition of the problem 10 per cent every seven years. Thus the taxes on the increment alone will be

For the 8th to the 14th years, inclusive, at $.025	$.175
For the 15th to the 21st years, inclusive, at .0525	.3675
For the 21st to the 28th years, inclusive, at .08275	.57925
Total taxes	$1.12175

and further, the government continues presumably forever thereafter to collect $0.116025 a year on the accumulated increment alone.

Under the British increment value tax the increment was found to be taxed $0.557, and this sum was not collected until the twenty-eighth year. Its present value is $0.1856. Now the present value of the series of taxes on the increment alone under the general property tax, including the perpetuity, is $1.48. But of this we may use only four-fifths for comparison with the $0.1856 of the British increment tax, because that was computed on the basis of $1 a year total ground rent, and the $1.48 for the general property tax was computed on the basis of $1.25 a year total ground rent, of which $1 went to the owner and $0.25 to the government. Hence the comparison is between $0.1856 (British) and $1.184 (general property tax), or 6.38 fold.

Thus we find that the general property tax on the increment is more than six times as heavy in the related example as is the British increment tax.

But it must be borne in mind that the effect of the permanent appropriation of 1 per cent of the capital value of all land (including the value of the increment) lessens materially the value of all private ownership of land. The series of rent payments on land assumed in our example which we found above to be worth $30.924 untaxed would, if subject to the general property tax at 1 per cent, be worth only $24.74.

EXAMPLE NO. 2

If the land doubled in value every seven years for twenty-eight years, then, following the same method as above, the government would collect in taxes on the increment alone, under the general property tax, $20.25, and have a tax interest of $3.75 a year in perpetuity thereafter, all on the increment alone.

This series of taxes (including the perpetuity) has a present value of $39.51, and four-fifths of that is $31.61. As against this the British increment value tax would be $42.78 receivable twenty-eight years hence, of a present value of $14.26. In this example the general property tax is 2.2 times as heavy as the British increment tax. The present value of the private owner's interest in the land under the general property tax would be $115.15 as against $169.18 under the British increment value tax.

If, therefore, the aims of the increment tax are (1) to get revenue from the increment value, and (2) to reduce the social significance of land ownership, it is clear that the method of increment taxation, unless the rate is much higher than that of the British increment value tax, is much inferior to the general property tax even at so low a tax rate as 1 per cent.

In short, we are getting much more in taxation out of the increment in land value in the United States to-day than Great Britain could ever get by the increment value tax at its rate of one-fifth of the taxable increment, and, for that matter, even at much higher rates.

Furthermore, as frequent transfers will nullify the British tax while they merely serve to enhance the general-property-tax revenues, the effectiveness of the general property tax is still greater.

79. The German Imperial Tax on the Unearned Increment.—Professor R. C. Brooks has written the following account of the German imperial tax on the increment of land value:[1]

In an earlier issue of the *Quarterly* and elsewhere[2] may be found a discussion of the principles upon which the new German unearned-increment taxes are based, together with some account of the forms these taxes have assumed in a few of the larger municipalities of that country. A brief statement regarding the subsequent development of the movement, culminating in the

[1] Reprinted from the *Quarterly Journal of Economics*, Vol. XXV, pp. 682–709.

[2] R. Brunhuber on "Taxation of the Unearned Increment in Germany," in this *Quarterly*, Vol. XX, pp. 83–106 (November, 1907); also article by the present writer on "The New Unearned Increment Taxes in Germany," *Yale Review*, Vol. XVI, pp. 236–261 (November, 1907).

passage of an imperial law on the subject, February 14, 1911,[1] may be of interest at this time.

A tax of this sort was introduced by the Naval Department of the German Imperial Government in Kiao Chau as early as 1898. First adopted at home by Cologne in 1905, the new tax promptly started upon a triumphal progress through the German municipalities. Before the end of 1907 it had been introduced by eleven cities, among which, besides Cologne, the more considerable were Dortmund, Essen, and Frankfurt-am-Main. Since that date the accessions have continued with increasing rapidity until by April 1, 1910, no fewer than 457 German cities and towns had adopted the unearned-increment tax.[2] In Prussia alone 159 cities (*Städte*) and thirteen rural counties (*Landkreise*) had introduced it prior to 1910. As the new form of taxation found most favor in rapidly growing places of large or considerable population the true significance of the foregoing is greater than the bare figures might indicate. Of the Prussian cities and towns which had introduced the tax prior to April 1, 1910, twenty-seven had more than 100,000 inhabitants, seventy-two between 20,000 and 100,000, and sixty-four between 5000 and 20,000. Berlin (2,018,279 pop.), after rejecting the new principle in 1907, finally accepted it in March, 1910. Nearly all the hustling suburbs of the metropolis had anticipated it in this action. Among other large cities not already mentioned which

[1] The text of the law with a brief introduction is published in convenient form under the title Zuwachssteuergesetz v. 14. Februar, 1911, by Heymann, Berlin, 36 pp. A very useful commentary with the complete text of the law has been issued by Dr. Walter Boldt, Stadtrat in Dortmund, under the title: Das Reichszuwachssteuergesetz v. 14. Februar, 1911, mit Anmerkungen, Erläuterungen und Beispielen für Steuerberechnungen, also published by Heymann, 171 pp. Finally the administrative orders and forms (*Ausführungsbestimmungen*) for the execution of the law, officially issued March 27, 1911, have been reprinted by the same publisher in a pamphlet of 80 pages. Among other texts of earlier date which have been found useful are Justizrat Herman Kausen's Die Reichswertzuwachssteuer, Köln, Neubner, 1910, 155 pp.; Georg Haberland's Die Wertzuwachssteuer, Berlin, Unger, 1910, 60 pp.; and the Protokoll d. Hannoverschen Städtetags, Hannover, Jänecke, 1910, 69 pp., which contains the government's bill in its original form together with the changes made at its first and second readings.

[2] Of these 457 cities and towns, 301 were in Prussia, 77 in Saxony, 22 in Hesse, and the rest scattered throughout the other states of the German Empire. *Cf.* Boldt, p. 8.

have introduced the unearned-increment tax are Hamburg (874,878 pop.), Leipsic (503,672), Breslau (470,904), Kiel (163,772), and Wiesbaden (100,953). Altogether it is estimated that by April 1, 1910, the tax had been introduced into German cities and towns with an aggregate population of 15,000,000.

In 1909 the Reichstag devoted a great deal of attention to the reform of imperial finances. The possibility of employing the unearned-increment tax as one of the means to this end was first seriously considered by the Imperial Diet in that year. Every party faction in the Reichstag expressed itself favorably upon the general principle involved,—a remarkable tribute to the impression made by the municipal experiments and also to the thoroughness of the propaganda of the land reformers and economists on the subject. However, the Bundesrat postponed action on the ground that a thorough study of various kinds of real estate, and also of the interests of the municipalities which had already introduced the tax, should be made before a law on the subject could be properly drafted. Temporarily the place in the imperial budget to be occupied finally by an unearned-increment tax was filled by a stamp tax (of ⅔ of 1 per cent) on the selling price in real-estate transactions, and the government was given until April 1, 1911, to bring in the proposed unearned-increment tax.

Almost a year before the latter date, however, the imperial chancellor presented a bill on the subject to the Reichstag. The reason assigned for this prompt action was that it had become necessary to put an end to the uncertainty prevailing in the real-estate market and among the municipalities of the country. After thorough consideration and numerous amendments the bill finally passed the Reichstag on February 1,[1] and received the imperial signature on February 14 of the present year. Formally the law went into effect on April 1, but it contains retroactive features that will be discussed later.

As compared with the earlier municipal legislation on the

[1] On final passage the bill was carried by a vote of 199 to 93, 20 members not voting. For the bill the Conservative, National-Liberal, Economic-Unionist, and Free Conservative parties voted almost solidly. A majority of the Centrum and a part of the Independent party also voted for it. The Social-Democrats and a part of the Independent party voted against it, while the Poles abstained from voting.

subject the new imperial law is distinguished by its greater length and thoroughness. Hence any discussion of its text, even one so general as that attempted in the present article, must of necessity be somewhat detailed and mercilessly dry. Even so it must be understood that many of the following statements are subject to further qualification and definition. Those interested in the minutiæ of the new law are referred to the accompanying translation of its text.

A small number of exemptions from the tax are allowed. The Empire itself, princes of the German states, the states themselves, and municipalities are on the free list. Associations for colonizing purposes, for the housing of the working classes, and similar semi-philanthropic purposes are also exempted, provided they limit themselves strictly to 4 per cent interest annually upon their investments. A number of carefully defined transactions connected with inheritances, marriage settlements, and the redrawing of boundary lines among scattered strips of real estate are freed from the tax. Sales of whole parcels of real estate not to exceed 20,000 marks in value, or of unimproved real estate not to exceed 5000 marks, are exempt, provided that the income of the seller and his wife in the preceding year did not exceed 2000 marks, and provided further that neither of them is engaged in the real-estate business. Unearned-increment taxes which amount to less than 20 marks are not collected.

The method of computing unearned increment is, of course, fundamental in all legislation of this sort. Three main items are involved. Stated in the simplest forms they are (*a*) the price paid for the property at the last purchase, (*b*) the cost of permanent improvements since made upon it, and (*c*) the selling price. Roughly speaking, the unearned increment is the difference between the selling price and the other two items.

One of the hardest fights made in the Reichstag over the bill turned upon the point as to whether in calculating unearned increment the cost of permanent improvements should be subtracted from the selling price or added to the purchase price. In other words, using the notation indicated above, should increment be figured as $c-(a+b)$, or as $(c-b)-a$? Of course the gross amount of the result would be the same by either method. But, as will be shown later, the rate of tax is determined by the percentage of the unearned increment to the cost

price *plus such additions to it as the law allows.* If, now, the value of permanent improvements made since the last purchase be added to the cost, the percentage of increment will be materially reduced, and consequently the tax rate.

Omitting everything except the three elements immediately concerned, the following illustration may serve to bring out the point clearly. A real-estate operator buys a piece of unimproved property for (*a*) 5000 marks, erects upon it a building worth (*b*) 80,000 marks, and sells the property for (*c*) 110,000 marks. Deducting the cost of permanent improvements from the selling price (110,000 marks minus 80,000 marks), the result is 30,000 marks, and further subtracting from this the original cost of the land (30,000 marks minus 5000 marks), the gross amount of the unearned increment is 25,000 marks. If, on the other hand, the cost of permanent improvements be added to the original cost of the land (80,000 marks plus 5000 marks), and the sum, or 85,000 marks, be subtracted from the selling price of 110,000 marks, we obtain the same result, or 25,000 marks, as the gross amount of the unearned increment. In the former case, however, the percentage of unearned increment is determined by the ratio of increment to cost price of the land alone, *i.e.*, of 25,000 marks to 5000 marks, or 500 per cent. In the latter case the percentage is determined by the ratio of increment to the cost price of the land plus permanent improvements, *i.e.*, of 25,000 marks to 85,000 marks, and the result is a percentage of increment of only 29.4 per cent. Now a 500 per cent of increment would be taxed at the maximum rate, 30 per cent,[1]—yielding under the illustration 7500 marks to the public treasury. An increment of 29.4 per cent, on the other hand, would be taxed at a rate of only 11 per cent, yielding in the present instance only 2750 marks.

Naturally the land-owning interest favored the latter method of computation. As originally drafted, however, the bill provided that the value of permanent improvements should be subtracted from the selling price instead of being added to the purchase price. A very large number of the more recent municipal ordinances had already introduced this method of computation. Tax reformers supported it on the ground that increments of value shown by real-estate transactions are due in the great majority of cases to the increase of pure land value, not to

[1] See table, p. 745.

improvements. They pointed out, further, that the bill provided for the full, even generous, reckoning of the value of all permanent improvements at their first cost. It is one of the peculiar omissions of German unearned-increment-tax legislation that depreciation in the value of buildings and other improvements is not taken into account. As a consequence, improvements made early in a long period of ownership may be allowed to go to rack and ruin, and thus greatly depreciate its selling price. This, of course, might greatly reduce or even wipe out a considerable increment in the value of the naked land, with the consequence that the seller would escape the tax in part or altogether. To allow the land-owner thus to profit by depreciation while at the same time he added the full original value of improvements to the purchase price of his property was energetically protested against by the friends of the new tax. After a bitter fight, however, the land-owning interests succeeded in having the bill amended exactly as they wished,—the most important by far of a long series of concessions which they obtained from the Reichstag. Under the imperial law, therefore, cost of permanent improvements is added to, or rather merged with, the purchase price in calculating the percentage of unearned increment. As a consequence such percentages will be greatly reduced, and with them the tax rates. By this one change the annual revenue from the new tax will be reduced by many millions of marks.

To return to the three fundamental elements of unearned-increment taxation, namely, (*a*) the price paid for the property at the last purchase, (*b*) the cost of permanent improvements since made, and (*c*) the selling price. Additions allowed to the first two of these items, and deductions made from the third, will, of course, reduce the amount of unearned increment. This much is obvious, but unless it is constantly kept in mind the bearing of the numerous and intricate qualifications which must now be dealt with will be utterly lost.

(*a*) *The Last Price paid for the Property.* In determining this item the price at which the property was purchased at its last transfer serves as a basis. Four per cent of this amount is added to cover the original costs of acquisition, including fees connected therewith. If it can be shown that the costs of acquiring the property were really higher, the larger amount will be added to the purchase price instead of the regular allowance of 4 per cent.

The new imperial tax is frankly retroactive — indeed it is retroactive in three distinct ways. First, it reaches back to December 31, 1910,[1] three months prior to the date the law went into effect, to cover sales of real estate during this period. This was done, of course, to get hold of fictitious real-estate transactions undertaken with the purpose of evasion. As it had been certain for a long time previous that the Empire intended to impose a tax of this character, and as many cities were considering similar action, it is believed that sales of this sort running into millions of marks have occurred throughout the country.

A second retroactive provision in the law is designed to get hold of other methods of evasion practised in the recent past and to prevent their employment in the future. All over Germany, whenever it has seemed likely that a city was about to enact an unearned-increment tax, large owners of real estate have hastened to create corporations and have then transferred their property to these corporations at prices sufficiently high to anticipate any increase in its value for years to come. By this ingenious device they hoped not only to avoid any immediate imposition of the tax, but also to escape it permanently, since they could thereafter virtually transfer ownership by selling corporate stock instead of selling the property outright. During the first five months of 1907, when Berlin was considering an unearned-increment-tax ordinance, one hundred and seventy-four limited-liability companies of this character were organized in that city. Rings were also formed in old-established real-estate corporations to buy up and then sell to the corporation desirable tracts which, it was thought, were thus brought under legal shelter from the impending tax. The imperial law reaches back six years, that is, to March 31, 1905, to cover such transactions. Instead of accepting the price at which the land was turned into the corporation it provides for an independent appraisal of its real value. The unearned increment is to be calculated from the value so determined, provided this value is 25 per cent less than the price paid by the corporation and the circumstances show that an evasion of

[1] In the first form of the bill this date was fixed at April 1, 1910, several days preceding the introduction of the bill into the Reichstag by the chancellor. Though the date was subsequently changed, there never was a time during the consideration of the bill in the Reichstag when evasion by this method appeared possible.

part of the tax was intended. Another section of the law places stock transactions of real-estate corporations on the same basis with reference to the tax as direct transactions in real estate. By these provisions of the new law millions of marks of real-estate values which owners had thought safely concealed will be brought under contribution.

Thirdly, and most important of its retroactive features, the new law reaches back for its basis in computing unearned increment to the last sale of the property (with exceptions to be stated later) even if that sale occurred before the enactment of the present law. Moreover, it reaches much further back than most of the municipal ordinances already in existence. Cologne, for example, leaves all unearned increment which accrued prior to the passage of its ordinance entirely free; Magdeburg taxes increment accruing since April 1, 1904; Duisburg, since January 1, 1900; Berlin and Breslau, since January 1, 1895; and Hannover, since April 1, 1885. Dortmund goes back to the last exchange, but if this occurred prior to January 1, 1860, a fixed tariff of land values is assumed instead. Hamburg goes back to the last sale without limit of time.

The corresponding retroactive feature of the imperial law is not so severe as in some of the municipal ordinances, but still it is fairly stringent. In computing unearned increment the price paid at the last sale shall be taken as the cost basis or purchase price, if this sale occurred since January 1, 1885. If it occurred prior to this date, an appraised valuation of the property as it stood on January 1, 1885, is assumed in calculating unearned increment, unless the present seller can show that he or his predecessors actually paid more for property, in which case the latter sum is taken as cost basis instead of the appraised valuation. The first of January, 1885, will remain basic in this way until 1925, when the taxgatherer will be reaching back a full forty years in computing increment on properties which are changing hands for the first time since 1885. After 1925, when properties are sold that have not changed hands for more than forty years, an appraised valuation of the property as it stood forty years before the date of sale will be taken as the cost basis in computing unearned increment, unless the seller can show that he or his predecessors actually paid more than the appraised valuation, in which case the higher actual purchase price will be used as a basis.

Various criticisms have been made against this complicated arrangement. Even for the present it will not be easy to fix a satisfactory estimate of the values of many pieces of property as they stood in 1885. Between taxpayers and tax officials frequent differences of opinion are sure to occur and be taken to the courts. To reach back a full forty years in making such estimates will be an even more ticklish and contentious matter. After 1925, moreover, the tax officials will no longer be looking back to a single fixed date but to a series of dates forty years earlier than each transaction involving this application of the rule and advancing constantly as time goes on. From the point of view of tax technique, therefore, this provision of the law is likely to prove troublesome.

Gratified as they were at the determination of the imperial authorities to make the law strongly retroactive, many tax reformers nevertheless objected to the cumbrous form given this part of the measure. Some of them boldly proposed to fix the basic date permanently at January 1, 1871. The Empire was founded about that time and special records of land values which could be referred to were made then. Moreover, even in the cities real-estate values had not then begun to make the mighty strides which have so increased rents, and in the end called forth the whole movement for the taxation of unearned increment. Between 1871 and 1885, on the other hand, Germany's economic development was very rapid, there was much wild speculation, and in the larger cities, at least, real-estate values advanced considerably. By limiting the retroactive effect of the law to the year 1885 much of this increment will escape taxation. On the other hand, the real-estate interests in the Reichstag of course bitterly fought both the temporary limit to 1885 and the later permanent limit of forty years. While the dates were finally fixed as stated, important concessions, to be noted later, were secured by the land-owning interests in other parts of the law.

(*b*) *Cost of Permanent Improvements.* It will be recalled that under the imperial law the cost of permanent improvements is to be added to, or rather merged in, the purchase price in computing unearned increment. What, then, are to be included under permanent improvements?

Theoretically expenditures for repairs and generally for the

purpose of maintaining a property in its original condition are not so included. Depreciation, as we have seen, is not considered in any way. But sums spent since the last purchase of the property, or since the date at which its value was fixed under the terms of the law, for building, rebuilding, and for other special permanent improvements, form the basis of this item. Five per cent of the total amount so expended is added to cover the owner's trouble in directing the making of the improvements. If the owner is engaged in the building industry and has himself undertaken the making of the improvements, 15 instead of 5 per cent may be added to their actual cost on this score.

Next to be added to this general item are the costs of street improvements, sewerage, and other similar public improvements to which the property owner contributed, plus 4 per cent annually thereon from the time such contributions were made until the property is sold, not, however, to exceed a period of fifteen years.

Finally, an extremely complicated item is added, based both upon the original purchase price and the permanent improvements just considered. If taken together they show the property to have cost less than 100 marks an are ($964 per acre), or three times as much in the case of vineyard land, an amount equal to 2½ per cent per annum from the time of purchase in the case of purchase price, and from the time of making improvements in their case, shall be added. In the case of land which on the same basis represents a higher value per are, there shall be added on such excess, if unimproved, 2 per cent per annum; if improved, 1½ per cent. If the period of ownership has been less than five years and the land has remained unimproved, these additions are reduced one-half.

This extremely awkward double-barrelled provision of the law is designed to accomplish various ends. In the first place it favors agricultural land with a high percentage, because increase in the value of such land in Germany is frequently due largely to the unremitting labor of peasant owners. Particularly is this true of vineyard lands; hence the special clause bringing them under the 2½ per cent rate up to a value of 300 marks per are ($2892 per acre). The lower additional rates allowed on the value of land and improvements above 100 marks per are are designed to let the tax burden fall more heavily on real estate

that has ceased to be used agriculturally and is either built upon or ripe for such uses. Last, this whole provision is designed to meet objections urged against the strong retroactive feature of the law. During a period ranging from twenty-six up to a maximum of forty years the monetary standard of value can decline very materially in purchasing power. Relative to a higher general range of prices a large apparent increase in land values may be real only in part or even totally deceptive. Without some safeguard, therefore, sellers of real property who for a long time owned and occupied it ran the risk of being heavily taxed on an alleged increment which, considering a higher general range of prices, really did not exist. Hence the allowance of a small, steady annual rate of interest upon purchase price and improvement costs.

While admitting the justice of this reasoning in general, tax reformers objected to the actual arrangement made in the law on the ground that it unduly favored the "millionaire peasant" type, familiar in the neighborhood of large German cities. It would be no less favorable, they complained, to that class of land speculators whose practice it is to acquire at little more than agricultural prices large tracts some distance out from the edge of cities and then to hold them for long periods until they are demanded at high prices for building purposes. So far as account is taken in this paragraph of changes in the purchasing power of money it would also appear that while the state has sought to protect the property owner against the consequences of a depreciating standard of value and higher general prices, it has not in any way safeguarded itself against the consequences of an appreciating standard of value and lower general prices. During periods of the latter character unearned-increment taxes are not likely to be very productive.

(*c*) *The Selling Price.* From the selling price—the third element of importance in computing unearned increment—are to be deducted the costs of the transaction incurred by the seller, including fees. Further, if the seller can show that he failed to realize an annual income of 3 per cent on the cost of the property plus improvements, the amount by which he fell short of this income for any period not exceeding fifteen consecutive years may be deducted from the selling price. The enormous advantage which this provision gives to the speculator who holds un-

improved land for long periods is apparent. In connection with the additions allowed to the purchase price it enables him to escape taxation altogether for at least fifteen years unless his increment grows at a rate faster than 4 per cent or 5 per cent a year.

Having thus defined the elements upon which the determination of the unearned increment depends, the law next fixes the rates of taxation upon a progressive scale. The rates are based on the percentage of unearned increment to the purchase price of the property plus the cost of permanent improvements and the various additions allowed thereto. Beginning at an increase of value of 10 per cent or less, the tax rate is fixed at 10 per cent of the increment. The tax rate increases 1 per cent for each additional 20 per cent of increment until it reaches a rate of 19 per cent on increments of from 170 to 190 per cent. Beyond this point the tax rate increases 1 per cent for each 10 per cent additional of increase of value until it reaches a maximum rate of 30 per cent, which is imposed on all gains of 290 per cent and over. However, the taxes levied under these rates are subject to a deduction of 1 per cent of their amount for each completed year since the last sale of the property. If the last sale occurred prior to January 1, 1900, this reduction shall be computed at the rate of 1½ per cent annually for the period up to January 1, 1911. In order to present a clear picture of the tax-rate provisions of the law the table on the opposite page has been prepared. It shows the basic tax rate for the various percentages of unearned increment, and also the rates as they will be reduced, under the provision just mentioned, after ten, twenty, and thirty years of possession.

Comparing imperial rates with those fixed in municipal ordinances, it should first be stated that the new law does not exempt low percentages of unearned-increment taxation. In most of the local enactments increases of value of less than 10 per cent were left free. If full value is admitted on all permanent improvements, as is certainly the case in the imperial law, it is hard to see why such exemptions should be allowed. To this position the government adhered in spite of the opposition of the landed interests.

TABLE SHOWING RATE OF TAX ACCORDING TO PERCENTAGE OF UNEARNED INCREMENT AND LENGTH OF POSSESSION UP TO THIRTY YEARS[1]

Percentage of Increase of Value to Cost Price Plus Value of Permanent Improvements, etc.	Tax Rate	Tax Rate after Ten Years of Ownership	Tax Rate after Twenty Years of Ownership	Tax Rate after Thirty Years of Ownership
10% and less	10%	9.00%	8.00%	7.00%
Over 10% and up to 30%	11	9.90	8.80	7.70
" 30 " " 50	12	10.80	9.60	8.40
" 50 " " 70	13	11.70	10.40	9.10
" 70 " " 90	14	12.60	11.20	9.80
" 90 " " 110	15	13.50	12.00	10.50
" 110 " " 130	16	14.40	12.80	11.20
" 130 " " 150	17	15.30	13.60	11.90
" 150 " " 170	18	16.20	14.40	12.60
" 170 " " 190	19	17.10	15.20	13.30
" 190 " " 200	20	18.00	16.00	14.00
" 200 " " 210	21	18.90	16.80	14.70
" 210 " " 220	22	19.80	17.60	15.40
" 220 " " 230	23	20.70	18.40	16.10
" 230 " " 240	24	21.60	19.20	16.80
" 240 " " 250	25	22.50	20.00	17.50
" 250 " " 260	26	23.40	20.80	18.20
" 260 " " 270	27	24.30	21.60	18.90
" 270 " " 280	28	25.20	22.40	19.60
" 280 " " 290	29	26.10	23.20	20.30
" 290	30	27.00	24.00	21.00

As regards the scale of tax rates, ranging in the imperial law from 10 to 30 per cent, the following list of the extremes in number of the more important local ordinances may be of interest:

	Tax Rate	
	Lowest	Highest
Hamburg	1 %	12½ %
Dortmund	3	15
Essen	3	15
Frankfurt-am-Main	2	25
Berlin	5	20
Breslau	6	25
Cologne	10	25

[1] Adapted from Justizrat Hermann Kausen's Die Reichswertzuwachssteuer, p. 98, with changes made to conform to the final text of the act of February 14, 1911. Actually the deduction of 1 per cent per annum is to be made from the gross amount of tax due under the basic rate, but the results would be exactly the same under a table such as the above.

Under municipal tax ordinances, however, the high rate of 25 per cent is, as a rule, imposed upon unearned increments of about 150 per cent, whereas under the imperial law a 25 per cent rate is not reached until the increment amounts to 240 per cent. Moreover, owing to the addition of the value of permanent improvements to the purchase price, the higher percentages of unearned increment will seldom be attained under the imperial law. Finally, experience in various cities has shown that the highest percentages of unearned increment emerge only on long-term property holdings. The reductions of the tax by 1 per cent per annum will save such large percentages of increment from the higher rates. Thus a case of unearned increment amounting to 290 per cent, accruing after thirty years' ownership, will pay at the rate of 21 per cent instead of at the maximum rate of 30 per cent first fixed in the law.

By way of summary of the various provisions of the new law regarding computation of unearned increment and tax rates, a typical example may be of service.[1] Let us assume that on April 3, 1905, a piece of unimproved property with an area of 1.63 ares was bought for 3939 marks. In 1906 a dwelling house was erected upon it, and the city made street improvements upon which the owner had to pay an assessment. The property was sold, February 5, 1911, for 35,000 marks. Omitting minor details, the computation of unearned increment would be as follows: Add to the purchase price of 3939 marks (1) 4 per cent to cover the costs of purchase including fees, or 158 marks; (2) the cost of the dwelling erected in 1906, which was, say, 20,000 marks; (3) 5 per cent of the cost of this building to repay the owner for his work in directing the making of this improvement, or 1000 marks; (4) the assessment of 1000 marks paid by the owner for street improvements made by the city in the same year; (5) 4 per cent thereon for the four full years elapsing between 1906 and the date of sale, or 160 marks; (6) the allowance of 2½ per cent on the value of the property up to 100 marks per are for five full years, amounting to 20 marks; (7) the allowance of 2 per cent on the value in excess of this amount per are as long as the property remained unimproved, or one year, which makes[2]

[1] Adapted from Boldt, p. 156.

[2] From the purchase price, 3939 marks, increased by costs of acquisition figured at 4 per cent, or 158 marks, is subtracted 163 marks, the value of 1.63 ares at 100

79 marks; (8) the allowance of 1½ per cent on this excess plus the expenditures for the dwelling (20,000 marks) and directing its erection (1000 marks), from the time this improvement was made until date of sale, or four years, making 1496 marks.[1] The sum of these various items, or 27,852 marks, is the total cost of the property as determined under the imperial law. Next subtract from the selling price of 35,000 marks the amount by which the owner fell short of a 3 per cent income on his investment during the year the property remained unimproved, or 123 marks,[2] and the result, 34,877 marks, is the selling price of the property as determined under the imperial law. Legal selling price (34,877 marks) minus legal cost (27,852 marks) gives a gross unearned increment of 7025 marks. The ratio of this amount to legal cost (7025 to 27,852 marks) shows the percentage of increment to be 25.2; and, accordingly, the tax rate is 11 per cent. Eleven per cent of the 7025 marks, figured as the gross amount of the unearned increment, is 772.75 marks, but this must be reduced by 38.65 marks, which is 1 per cent of the tax for the term of five years during which the property was in possession of the present seller. With this final deduction, therefore, the amount of tax actually to be collected on the transaction is 734.10 marks.

Next in interest to the provisions regarding the computation of unearned increment and tax rates was the question of the division of the income from the tax among the Empire, the states, and the cities or other local government bodies. It will be recalled that the municipalities of Germany began the development of this form of taxation several years before the Empire entered the field. Strong pressure put upon them from above forced them to this solution of their financial difficulties.[3] Naturally, there-

marks per are, leaving 3934 marks on which this allowance of 2 per cent for one year is made.

[1] To the 3934 marks figured in the preceding note is added the cost of building the dwelling plus the 5 per cent allowed the landlord for directing the making of this improvement, and the sum, or 24,934 marks, is the basis for this allowance at the rate of 1½ per cent for four years.

[2] In this case, also, to the actual purchase price of 3939 marks is added 4 per cent, or 158 marks, to cover the costs of acquisition including fees.

[3] See article by the present writer on "Berlin's Tax Problem" in the *Political Science Quarterly*, Vol. XX, p. 666 (Dec., 1905); also *Yale Review*, Vol. XVI, p. 242 (Nov., 1907).

fore, they protested on every possible ground against any invasion of what they had come to look upon as their own bailiwick.[1] Legally and logically, however, the position of the cities was open to attack. Against the unquestioned constitutional right of the Empire to enter upon taxation of this character the cities could urge only their moral right based upon prescription. As a matter of logic it was impossible for the cities to deny the right of the Empire, and, for that matter, the right of the state and other local government bodies as well, to participate in the revenue derived from the taxation of unearned increment. The use of the term "unearned" in this connection is subject to qualification. Primarily, of course, it means unearned by the landlord. We have already seen what pains were taken in the law to assure owners the benefit of every possible contribution made by them in the form either of investments or of labor. If anything remained after these deductions were fully and fairly made it was clearly not due to the exertions of the landlord, and, hence, so far as he was concerned, deserved to be called unearned. Now the cities declared their intention of taking by taxation a portion of such residual amounts on the ground that they were due to a considerable extent to the beneficent operations of municipal government. In other words, part of the increment *unearned* by the landlord was clearly *earned* by the city. On exactly the same grounds, however, it cannot be denied that other parts of the increment unearned by the landlord were due to the beneficent operations of imperial, state, and local governments other than municipal. In the case of Berlin and the capital cities of the various states, of military and naval stations, of cities in which great public institutions with their administrative forces were located, the contributions of imperial and state governments to local land values were direct and undeniably very great. And even in other places the work of imperial and state governments in maintaining peace and order, furthering commerce abroad and at home, fostering manufacturing, agriculture, and other industries, and so on, must have contributed materially to the growth of land values.

[1] In addition to the general references cited in the note, p. 734, and especially the minutes of the Hannoverian Städtetag, consult the Mitteilungen d. Zentralstelle d. deutschen Städtetags, Band ii, Nos. 19–20, p. 489.

Nearly all the representatives of city interests conceded the general validity of this argument. Unfortunately it furnishes no quantitative basis for a just and universally applicable division of the revenue arising from a general unearned-increment tax.

Indeed it is clear that the division of the increment unearned by the landlord into quotas assumed to be earned by imperial, state, and local governments respectively cannot justly be accomplished upon the same basis for all localities. If, nevertheless, some uniform rule had to be adopted, the advocates of city interests were quite certain that it should apportion by far the larger share of the revenue to the municipal governments. City governments, they held, were closer to the local property owner, and the services of such governments in providing or supervising public utilities, safeguarding public health, furnishing facilities for public amusements, and so on, contributed in the main much more directly and materially to the growth of land values than the services of state or imperial governments. A division of the revenue, giving two thirds to the cities and one third to the Empire, was accepted as fair by some of the advocates of city interests.[1]

Apart from the vital point as to their quota under the imperial law the interest of the cities was identical with that of the Empire, and opposed to that of the landowning class. In other words, as partners in a common tax undertaking, both city and Empire desired as strong and productive a measure as possible. One other point, however, made by the advocates of municipal interests against the proposal of an imperial tax is of sufficient importance to deserve notice,—namely, that owing to the wide variations of conditions in different localities, and particularly as between city and country, no unearned-increment-tax legislation applicable uniformly over the Empire could be just. In proof of this assertion attention was called to the wide and numerous differences shown by a comparison between the various local ordinances enacted prior to 1911. It is impossible to deny a certain validity to this argument, and future amendments to the imperial law may have to take it into account. The differences discoverable in the earlier

[1] See p. 150 of Stadtrat Boldt's earlier work on Die Wertzuwachssteuer, Dortmund, 1909. This suggestion assumed that the cities were to do the work of assessing and collecting the tax, and thus left the states out of account.

ordinances, however, are said to be due largely to the varying degrees of strength and tenacity with which the landlord interest fought them in municipal councils.

In favor of an imperial unearned-increment law various arguments besides the general points already noted were made. One was that local property owners were often strong enough to cause the rejection or emasculation of unearned-increment-tax ordinances in city councils. Imperial legislation and administration, it was hoped, would be more free from this influence. At one stroke unearned-increment taxation would be introduced by an act of the Reichstag over the whole of the German Empire. While the latter point was well taken and of unquestioned weight, we have already seen that the landlord interest proved itself far from lacking in influence in the Imperial Diet. Finally the advocates of legislation by the Empire urged that the tax rates could readily be made high enough to insure those cities which already had ordinances of their own, incomes as large as they were already enjoying from this source.

Let us turn from the arguments on this point to actual adjustment of imperial with local interests made by the law of February 14, 1911. The lion's share of the income from the new tax, 50 per cent altogether, goes to the Empire; 10 per cent of the amounts collected in their respective territorities goes to the state governments as reimbursement for the costs of administering the law; and the remaining 40 per cent is left to the municipalities or other local government corporations. Further, the state governments are given power to deal on their own account with this last 40 per cent. The municipalities may, therefore, find themselves forced to stand for further reductions imposed upon them by the various state diets for the benefit of the counties (*Kreise*), provinces, or of the state itself. Some consolation may be derived by the cities from the fact that, with the consent of the supervisory authorities of the state, they may add local levies on their own account to the imperial tax rates, but these supplements (*Zuschläge*) will not be allowed to exceed in revenue-producing power the amount due the city under the imperial law, *i.e.*, 40 per cent of the total amount collected. Further, the imperial and local rates taken together may in no case take more than 30 per cent of the unearned increment.

With these limitations additional local rates may be variously fixed according to the different kinds of property involved and the length of the period during which it has been in the possession of the seller. Some room for local adjustment is thus allowed even under the terms of the imperial law. Indeed one of the arguments in defence of the low scale of tax rates provided by the imperial law was that the rates must be so fixed in order that cities desiring it would have room to add *Zuschläge* of considerable size on their own account. It is believed, however, that real-estate interests will make it extremely hard for city councils to proceed far in this direction.

One further concession is made to those communities which, prior to April 1, 1909, passed an unearned-increment-tax ordinance to take effect before January 1, 1911, or in which prior to the latter date an ordinance had gone into operation with retroactive effect back to April 1, 1909. In case such communities can show that their average yearly income under their ordinances was in excess of the portion allotted to them under the imperial law, the difference is to be paid them out of the share of the Empire until April 1, 1915. Or instead of this a community, with the consent of the imperial chancellor, may retain its existing ordinance for the same period, paying over to the Empire, however, all income in excess of the average which it received from its own tax prior to April 1, 1911. It is left to the imperial federal council (*Bundesrat*), by the way, to determine what this average has been in given cases. So far no general method of computing such averages has been promulgated. Owing to the great diversity of municipal ordinances on the subject it will be a matter of great difficulty to do so, and any solution is certain to cause friction between city and imperial officials. For the time being, therefore, the *Bundesrat* has decided to avoid general rules and to deal only with individual cases as they come up.

By these transition provisions of the new law those cities which anticipated the Empire in unearned-increment taxation are guaranteed against any diminution of their income from this source during a period of four years. After 1915, however, all local legislation will be permanently superseded by the imperial law administered uniformly throughout the whole country. So

far as the continuation of local ordinances is concerned a recent announcement by the imperial chancellor is of great interest.[1] For the present he has determined to grant permission to retain existing ordinances for periods of one year only. This will enable municipalities having their own ordinances to study results obtained under the imperial law in other cities. If the latter prove satisfactory, the uniformity contemplated by the law may be attained, with the full consent of the interested cities, earlier than 1915.

From an American point of view those aspects of the new imperial law which we have just been considering are interesting. They show the federal government of Germany reaching down to abrogate or rearrange in thoroughgoing fashion a detailed part of the tax systems of many municipalities and local governments scattered through its separate states. Under our constitutional system such interference by Washington in affairs of local taxation is, of course, quite out of the question.

In accordance with the usual German practice the actual administration of the new unearned-increment tax is turned over to the various state governments, subject, however, to the supervision of the imperial plenipotentiaries for customs and taxes. Ample provision is made in the law for the hearing and decision of all complaints made by taxpayers. Fines are provided for various offences. In the opinion of the German Municipal Conference the administrative provisions of the law are so unduly complicated that they will greatly increase the amount of work and the costs necessary to collect the tax, and will lead to much litigation.[2]

Experience has shown that no prophecies are more apt to be misleading than those regarding the income to be yielded by an unearned-increment tax. All the factors affecting the real-estate market, including the perturbations and evasions caused by the impending tax itself, and all the complicated legal paraphernalia for the computation of unearned increment, play a part

[1] Mitteilungen d. Zentralstelle d. deutschen Städtetags, 10. Juni, 1911, p. 137.

[2] Antrag d. Vorstandes d. deutschen Städtetags betr. Reichszuwachssteuer v. 1. Nov., 1910. Mitteilungen d. Zentralstelle d. deutschen Städtetags v. 12. Dez., 1910, p. 489.

in the final result. Over a very wide field, such as that covered by the new imperial law, however, fluctuations in the many local real-estate markets will perhaps tend to compensate each other. As to the probable income which the new tax may be expected to yield, all cautious prophets are silent. Only one line of speculation may be suggested regarding this matter. In 1909 a stamp tax was placed in the imperial budget with the understanding that the unearned-increment-tax law should be worked out later and substituted for it. Now to enable the government to dispense with this stamp tax an annual income of at least 20,000,000 marks from the unearned-increment tax would be necessary. And as the Empire was to receive only half of the income from such a tax, a total revenue of 40,000,000 marks ($9,528,400.00) was to this extent indicated. Whether or not the government's original bill would have produced so much is highly problematical. But it is absolutely certain that the amendments made in the Reichstag enormously reduced the revenue-producing power of the act. That the government shares this view is proved by the later action of the Reichstag, which, upon the urgent representations of the imperial secretary of the treasury, postponed the substitution of the unearned increment for the stamp tax from 1911 to 1914.

In its main outlines, therefore, the new imperial law may be described as fairly strong in its retroactive features and weak elsewhere. Financially its present importance is very slight. In its extreme complexity the law is a true product of the German intellect. As experience is obtained in its administration and as decisions are handed down by the courts regarding its interpretation, the difficulties arising from this course may be greatly reduced. Still it remains a very vital question, particularly from the point of view of more democratic countries which may wish to follow Germany's example, as to how far the complexity of unearned-increment taxation is inherent in the nature of the subject itself. As the law stands it is not satisfactory to the Empire from the point of view of productivity, nor to the cities as regards their share of the income, nor to the real-estate interests which, of course, are fundamentally opposed to all taxation of this sort. Between the three it is certain to be considerably amended soon after its effects become manifest. German land-

tax reformers are inclined to lament that the new law has "no teeth in it." A fairer statement would be that it has simply cut its milk teeth and may be expected to develop mature molars and incisors later. Taking all things into consideration, however, the new imperial law is one of the largest and most significant practical applications of the single-tax idea that has ever been attempted.

CHAPTER XX

THE CUSTOMS REVENUE OF THE UNITED STATES

80. The Financial Aspects of the Customs Revenue. — Dr. R. F. Hoxie discusses the financial aspects of our customs duties, as follows:[1]

A system of duties on imports for the support of the national government was established by the first Congressional revenue act under the Constitution of 1789. It seems to have been the popular desire, at that time, that customs duties alone should supply the federal revenue. But distrust, notably on the part of Hamilton, of the ability of this source to supply fully the fiscal needs of the government, led to the establishment also of a system of internal revenue duties. These two systems were on trial together for a decade. The result was definite. Though more than 88 per cent of the tax income was derived from import duties, that source continued to be regarded with favor by the people, while the internal revenue duties were steadily opposed. Nor was the opposition merely passive. In the case of the Whiskey Rebellion, it developed into armed resistance to federal authority, and, rapidly increasing in force, assumed at length the proportions of a national political issue. As such it accomplished a tax revolution. In the campaign of 1801 the maintenance of internal duties was one of the objections urged against Federalist rule. The triumph of the Republicans was immediately followed, as a political necessity, by the abolition of the internal taxes. This verdict of the people was final; it definitively established customs duties alone as the American system of national taxation. From that time until

[1] The Adequacy of the Customs Revenue, *Journal of Political Economy*, Vol. III, pp. 43–64. Reprinted with consent of the author and the *Journal of Political Economy*.

the end of the Civil War, resort was had to other forms of taxation "only on occasions of special exigency," marking the breakdown of the customs tax system.

Since the Civil War, indeed, the internal revenue duties imposed, during that emergency, to supplement the income from import duties have been in part retained, but with no intention of displacing the traditional American system. On the contrary that system has been constantly strengthened. The internal duties may be regarded as taxes of convenience, retained simply to bolster up the regular tax system. The fairly steady stream of income flowing from them reduces, to that extent, the amount of revenue to be derived from import duties. But in no way does it remove from the customs revenue system the responsibility for adequacy. Customs duties then, may, with propriety, be subjected to the test of adequacy, as the American system of taxation, from the tax revolution of 1802 to the present time.

It now remains, before entering upon the historical discussion, merely to indicate briefly the data necessary for the examination and the method of procedure. The most essential data for the inductive test about to be attempted are the figures of government expenditure, and of the income from customs duties in the United States, during the whole period under discussion. These figures have been collected and will be found in tables in the Appendix. Further, because of defects in the sources from which it was necessary to obtain these data, and also, because of the intimate relation existing between customs revenues and imports, the amounts of total and of dutiable imports have been added to the tables. For convenience in use all these figures have been incorporated into two charts (see below). In the first of these charts is represented the actual values of total imports and customs revenues from 1790 to 1893 inclusive, and the value of dutiable imports from 1821 to 1893. In the second chart is represented the per cent of customs revenues to net ordinary governmental expenditures from 1790 to 1893. It will be the aim of the following discussion to interpret these charts by the aid of the events of contemporaneous history; and the examination will be separated into several convenient parts, corresponding to the periods into which our history naturally

divides itself when viewed with reference to political and industrial conditions.

1. The years from the adoption of the Constitution of 1789 to the outbreak of the War of 1812 form a distinct period in the national and industrial development of the United States. The conditions were those of a young but vigorous agricultural and commercial nation subjected to strong foreign influence. The current national expenditure, though varying from year to year, was never excessive. Taxation was moderate, as proved by the general prosperity of the people and the rapid payment of the public debt. Under these conditions, the income from an efficient system of taxation, ought not to have violated to any great extent the principles of fiscal adequacy. A glance at Chart II, however, shows that throughout the period, and especially in the last decade when customs duties were the only source of public revenues, the income did seriously violate these principles. While the revenue was in the main much more than sufficient to supply current fiscal demands, its great and rapid fluctuations, when compared with government expenditures, rendered it an extremely variable basis upon which to place public finances. Chart I clearly shows the reason for this instability. Imports, upon the value of which customs revenues were dependent, reflected, not the demands of our government, but every marked change in European diplomacy and war.

Previous to the year 1802 the general state of European war had proved, in the main, advantageous to our commerce. Still the instability of customs revenues had been remarkable. Starting with a production in 1791, 41.5 per cent above the government expenditure, the income from this source fell the next year to more than 58 per cent below public expenditure, rose again in 1793 to 110.3 per cent, fell immediately to 76.2 per cent, and then rose with fluctuations violent but less extreme till, in 1802 when the internal duties were discarded, it stood at 155.9 per cent or more than three millions above the demand for current expenditure. The stability of public income was not increased by basing the national revenue system upon customs duties alone. The temporary cessation of hostilities in Europe in 1802 was accompanied by an immediate fall in the value of imports to $40,558,000 as compared with $64,720,000 in the

previous year. The renewal of European wars again produced a gradual increase of American commerce, until in 1807 the value of imports had risen higher than ever before, exceeding $78,000,000, while the revenue from customs duties was 89.6 per cent in excess of ordinary public expenditures. This surplus revenue, though in general indicating an unsound condition of the finances, did not prove burdensome to the treasury at the time, as an outlet for it was provided in the payment of the revolutionary war debt. The productiveness of taxation, therefore, gave rise to high expectations and led so conservative a financier as Mr. Gallatin to believe that the customs revenue system would prove an adequate basis in case of foreign war. In 1806 he raises the question whether some mode may not be devised to provide for the final and complete payment in a short period of the public debt. The next year he estimates that the surplus in the treasury at the end of 1808 will amount to $8,000,000, and that "an annual unappropriated surplus of at least $3,000,000 may henceforth be relied upon with great confidence." But in this he was quite misled. Already that series of events, foreign in origin, had commenced which, though not depriving the American people of the means for satisfying government needs, were destined speedily to all but annihilate American commerce and thus cut off from the government its source of supply. The Berlin and Milan decrees of Napoleon, followed by the British orders in council, the expiration of Jay's treaty, and Jefferson's unfortunate imposition of the embargo brought about an immediate falling off in the volume of American imports from $78,856,000 in 1807 to $43,992,000 in 1808 and $38,602,000 in 1809. The suspension of commerce meant the impairment of the revenue from customs duties. From 1807 to 1809 the income from this source fell from $15,845,000, or 89.6 per cent more than was called for by current government needs, to $7,257,000, a little more than 70 per cent of the government expenditures. The surplus for which Mr. Gallatin had been seeking employment was immediately swept away. In his report for 1808 the secretary's tone has entirely changed. "If the embargo and the suspension of commerce shall be continued," he writes, "the revenue arising from commerce will in a short time entirely disappear. In case of war some part of

that revenue will remain; but it will be absorbed by the increase of public expenditures. In either case, new resources to an unascertained amount must be resorted to." From this time to the end of the period in 1812 a series of rapid changes in the aspect of foreign affairs was faithfully reflected by fluctuations in the source of revenue. In 1808 England opened the ports of Spain and Portugal, and early in 1809 the embargo was suspended — importations responded in 1810 by a rise from $38,602,000 to $61,008,000. Napoleon, in 1810, seized the American shipping in European ports, and the embargo was reënforced in the same year as regarded England — importations fell in 1811 to $37,377,000. Shortly after, Russia and Sweden opened their ports to American shipping in defiance of the Berlin and Milan decrees — imports rose rapidly to $68,534,000.

A more comprehensive idea of this period may perhaps be obtained from an examination of the charts and tables than from the previous discussion. But such an examination serves only to strengthen the evidence revealing the inadequacy of the customs revenue system. From Chart II it will be seen that in the twenty-one years here included, though the revenue was on the whole much above government expenditure, yet it fell below that amount no less than nine times — a most remarkable exhibition of instability. Further, after 1802, when customs became the sole source of revenue, the public income, as shown by the tables, ranged from 30 per cent below to 89 per cent above expenditures; yet in one year only did it approach nearer than 27 per cent above or below that amount. In a word, the revenue seemed utterly uncontrollable either by reduction when it was too large or by increase when it was too small. Taken as a whole, then, the examination of this period indicates clearly that when the commerce of a nation is exposed to serious disturbances, on account of foreign influence, great instability in the revenue derived from this source is the inevitable consequence, and disordered finances the result. Under such circumstances it must be extremely dangerous to base the public finances upon customs duties alone.

2. With little change in industrial conditions, the United States passed from the period of foreign influence into a period

of foreign war. Peace was formally abrogated at about the close of the fiscal year 1812, and normal conditions were not restored until near the end of the fiscal year 1816. Roughly speaking, these dates mark the limits of the war period. Were it reasonable, during this time, to judge of the adequacy of the customs revenue system by means of a simple comparison between the income from import duties and the necessary expenditures of the government, no elaborate discussion would be necessary in order to reach a very definite conclusion. The great depression of the broken line on Chart II clearly and conclusively indicates the utter failure of the customs revenue to support the government adequately. It must be borne in mind, however, that this period was a crisis in the life of the nation when it may be doubted whether the current national income was sufficient to satisfy both the total wants of the government and the imperative individual needs of the people. No tax system in such a case could be required to furnish the whole of the necessary government income.

This fact was recognized at the time, and influenced the financial plan of the war. Mr. Gallatin, secretary of the treasury, in outlining this plan, calculated that taxation might be safely depended upon to defray the ordinary expenses of the peace establishment, together with the interest on the public debt, and that, with this tax income as a basis, the extraordinary expenses might be defrayed by loans, without injury to the credit of the nation. In pursuit of this policy, he proposed that the whole of the tax income should, as heretofore, be drawn from customs duties. These calculations seem to have been reasonable. Imports, though varying, had risen in 1812 to more than $68,000,000 — an ample source from which to obtain the peace revenue — while there was an abundance of loanable capital in the country.[1] The war policy, then, was rational. Further, it was conditioned on the character of the revenue from customs duties. Unless, therefore, it can be shown that the nation was exhausted or the people disaffected, the adequacy of the customs

[1] In 1808 Mr. Gallatin said: "The embargo has brought in and kept in the United States almost all the floating capital of the nation, . . . at no former time has there been so much redundant and unemployed capital in the country."—*Report of the Secretary of the Treasury*, 1808, *Finance Reports*, Vol. I, p. 377.

revenue system during this period is to be judged by the success of the war policy.

From the outset, the financial operations of the war were inadequately supported by the tax revenue. In accordance with his plan Mr. Gallatin had recommended that customs be immediately increased 100 per cent. June 30, 1812, therefore, duties were doubled, but the anticipated increase of revenue was not forthcoming. The income was, indeed, larger for the calendar year 1813 than in the years preceding, owing to the great amount of imports in 1812, but it fell immediately thereafter far below the peace level, and during the continuance of the war remained utterly insufficient and wholly inflexible. Nor could the result have been otherwise. For the amount of imports progressively fell as public expenditure rose, until, in 1815, the total value of imported merchandise was less than the ordinary income from customs duties, and not one third of the amount of public expenditures. The credit of the government declined almost from the beginning. Of the six government loans only the first was placed at par, though 6 per cent was offered and various tempting inducements held out to capitalists. The depreciation of the public credit is shown in the discount of 35 per cent at which 6 per cent stock was sold in 1814. The successive issues of treasury notes which were resorted to after the fiscal year 1813 also suffered severe depreciation. By 1815, so low had the credit of the nation fallen, that payments in state bank paper, though the banks had suspended specie payment, were universally preferred to payments in the paper of the government.

The failure of the customs revenue system to produce an abundant revenue, and this consequent deplorable state of the public finances, were not due to national exhaustion. The resources of the country were ample, but they could not be reached through the channel of customs duties. Nor, in spite of the opposition of New England, can the fall of public credit be ascribed to the unwillingness of the people to bear further taxation. Secretary Campbell distinctly denied both suppositions, and his denial is borne out by the fact that the internal duties, reluctantly placed when it became evident that the customs revenue system had broken down, produced a fairly abundant income up to the end of the period. No valid excuse, then,

for the insufficiency of the public revenue being found in the want of public wealth or the popular support of the government, it must follow that the failure of the financial plan of the war, conditioned as it was upon customs duties, is evidence of the inadequacy of that system of taxation to serve as the source of national income.

The evidence against the customs revenue system furnished by this period is not, moreover, all brought out in the discussion of the failure of the war policy. The instability of the revenue from import duties was, further, most strikingly illustrated by the events following the close of the war. As soon as the artificial restraints on foreign intercourse were removed, the volume of imports rose to a great height. In 1815 the value of imported merchandise stood at only $10,645,000; the next year it was $129,964,000, more than a twelvefold advance. The 100 per cent increase in the rate of customs duties, now that the imperative need for it was past, now that it was too late to save the credit of the nation, became enormously productive. For the year 1816 the customs revenue was five times greater than for 1815, while in 1816 and 1817, together, $63,589,000 flowed into the treasury from import duties, as against $13,280,000 in the two years preceding. This remarkable increase of revenue, coming so near the close of the war and yet causing no stay in the progress of the nation, is indicative of the tax income that should have been realized while the war was actually in progress. Had the $63,000,000 of revenue now received from customs duties been distributed over the three or four preceding years there is every reason to believe that the war might have been more vigorously prosecuted, the credit of the government sustained, and much less public debt incurred..

3. Oppressive foreign influence in the United States disappeared with the War of 1812. A new era was then entered upon, characterized chiefly by vigorous and healthful national growth, the payment of the public indebtedness, and the rise of manufactures. The limits of this period, as distinctly shown in Chart I, are 1816 to 1835. For the purposes of this paper the leading events may be very briefly summarized.

Though foreign trade declined rapidly after 1816, customs revenues were in the main more than sufficient to meet govern-

ment expenditures. The evils of redundant income were avoided by the rapid payment of the public debt. Unfavorable industrial conditions, however, in this manufacturing era, as in the commercial and war periods preceding, rendered the revenue extremely uncertain. Especially in the crises of 1819 and 1824 the income, as shown in Chart I, fluctuated abruptly and widely about government needs. During the earlier crisis these fluctuations were almost as marked as those of the foreign war period. Chart I shows the cause. Imports which had risen in 1818 to $102,323,000 fell successively, through 1819, 1820, and 1821, to $67,959,000, $56,441,000, and $43,696,000 respectively. Customs revenues consequently decreased, falling from $20,283,000, in 1819, to $15,005,000, in 1820, and $13,004,000 in 1821. Nor did the income fully recover until after the crisis of 1824. The serious effect upon the treasury of this unexpected decrease of revenue is shown by the following extract from the report of the secretary for 1819: "It is not probable that any modification of the existing tariff can supersede the necessity of resorting to internal taxation if the expenditure is not diminished. . . . Whether the revenue be augmented or expenditure be diminished a loan to some extent will be necessary." Yet the revenue was ordinarily redundant and two years before had been 31.4 per cent greater than the government expenditures, and further, this was in a time of peace and average prosperity, when, if ever, the income should have proved adequate. However, from the crisis of 1824 to the end of this period in 1835 little criticism can be made of the revenue system. Imports rose rapidly, and the income from customs duties continued to be for the most part far above the current government expenditures. Though this was in direct violation of the rule of sufficiency it furnished a welcome means of debt payment, and the period closed with confidence in this source of revenue unshaken.

4. Between 1835 and 1843 a brief period of unhealthful speculative expansion, and the inevitably painful return to normal conditions, succeeded the vigorous growth of the preceding years. The national debt was practically liquidated at the close of the year 1835, and the speculative spirit which developed was undoubtedly due in great part to surplus revenue no longer to be disposed of by debt payment. This surplus, accumulated mainly

through excessive sales of public lands, added to the ordinary customs tax income.

An unappropriated surplus is always a greater financial evil than a moderate deficit, since it so far unnecessarily reduces the income of the people and leads to false estimates of the taxpaying capacity of the nation. At this time, therefore, the income from a legitimate system of taxation, through its elasticity, should have declined so that the total government income might meet exactly the demands of ordinary public expenditures. It was not so with the income from the customs tax system. Though the secretary of the treasury recognized the danger and repeatedly endeavored to bring about a reduction in the tax income, the revenue from customs during the years of speculation rapidly increased (see Chart I), rising from $16,214,000, in 1834, to $19,391,000, in 1835, and $23,409,000, in 1836. The ridiculous spectacle was presented of a sovereign people taxing themselves far beyond the needs of the government and yet wholly unable to obtain relief, while a growing surplus was becoming more and more a source of anxiety. At last, in June, 1836, the reduction of the revenue being out of question, Congress passed an act for the disposal of the surplus. It ordered the distribution of $28,000,000 among the states in the form of quarterly payments beginning January 1, 1837. Before the last deposit was made the aspect of affairs was entirely changed. Over-speculation had precipitated the crisis of 1837. The sale of public lands ceased. Government income at once fell from forty-eight to nineteen millions. The same secretary, who, a year before, had urged a reduction of income now spoke dolefully of a prospective deficit at the beginning of 1838 of over five millions. The need now was for an immediate increase of the tax revenue. But the income from the customs tax system instead of rising to meet this need dropped from $23,409,000 to $11,169,000. A glance at Chart II will best indicate the state of affairs. Though two years before, when the treasury was overflowing with income from an incidental source, import duties had furnished 10.3 per cent more than the total needs of the government, they now brought in less than 30 per cent of necessary government expenditures. Secretary Woodbury, commenting upon the situation, said: "It is impossible, . . .

that, with sources of revenue so fluctuating as ours, and so dependent on commercial prosperity, any fiscal operations should be long continued with ease, vigor, and uniformity, without some such regulator as a power to issue and redeem treasury notes, or to invest and sell the investment of surpluses. By any other course we should constantly be exposed to great deficiencies or excesses with all their attendant embarrassments."

Frequent though less severe fluctuations in the customs revenue continued in the troubled years succeeding the crisis, nor did it again meet government demands till after the close of the period in 1843. This condition of affairs called forth from the secretary in 1839 the following complaint: "The principal sources of our revenue are sensibly affected by fluctuations, not only in commercial prosperity, but in the crops, the banking policy, and the credit systems of even foreign nations. The influence of these causes seems to become yearly more changeable and uncertain in its extent." National finances in consequence were most seriously affected. It was found necessary to create a new national debt. Two loans and five issues of treasury notes were resorted to between 1837 and 1843, while the credit of the government "stood at a lower ebb than ever before in times of peace." The examination of this period of speculative expansion and collapse furnishes then a double exhibition of utter inflexibility of the customs tax system, when it should have been most flexible, and of extreme sensitiveness to changes in commercial and industrial conditions, when it should have been most stable.

5. The two decades following 1843 form another period of vigorous national growth accompanied by remarkable commercial activity. Reference to Chart I shows the rapid and enormous increase of foreign trade. Imports rose from $96,390,000 in 1844 to $336,282,000 in 1860. Mr. Walker speaks of 1846 as beginning a "new commercial era" in which "many causes combined to augment the trade among nations." The Mexican War and the crisis of 1857 were the only events which, in twenty years, seriously interfered with industrial prosperity. The demands of the government were at no time beyond the revenue that could have been obtained from legitimate taxation, while more than ordinary efforts were made to bring the tax income

into exact conformity with public expenditures. A most favorable opportunity therefore existed to test the adequacy of the customs revenue system.

The financial history of the period, however, while it reveals a closer conformity of the tax income to the demands of the government than previously, does not present the customs system in a favorable light. A high rate of specific duties had been levied in 1842 to enable the income to recover from the effects of the crisis of 1837. The first result was an increase considerably beyond government needs. By 1845 customs duties were producing 19.4 per cent more revenue than was called for by public expenditures. Then, though imports continued to increase, the income began seriously to decline. Mr. Walker, secretary of the treasury, declared that this decline "rose from the prohibitory character of specific duties," and that "the revenue under the tariff of 1842 must have continued to sink so rapidly as soon to have caused a great deficit, even though in time of peace, and thus have required ultimately a resort to direct taxes or excises."

As high specific duties had failed to produce adequate revenues, the secretary proposed a reduction, with *ad valorem* duties. Congress therefore enacted a revenue law along these lines, designed to aid in vigorously carrying on the war with Mexico. But though the revenue from customs was thus increased, it fell far short of satisfying government needs during and immediately following the war. Only 43.2 per cent of the necessary public income was received from such taxation in 1847, 66.6 per cent in 1848, and 65 per cent in 1849. With the year 1850, however, the income began to increase rapidly,[1] and by 1853 "a large surplus accumulated in the treasury and became a cause of alarm in commercial circles." Expenditures increased, but still the surplus grew. Alarm was felt that the accumulation of specie in the treasury might bring on financial stringency. An act was therefore passed, in 1857, reducing customs duties. This attempt to bring about an equilibrium of income and expenditure, like previous efforts, miscarried. It was impossible to reckon on the certainty of customs revenues. The crisis of 1857 brought with

[1] Not so rapidly as appears from the tables (see Appendix I). Before 1850 customs revenues are net — after 1850, gross.

it an immediate fall in the tax income of over $22,000,000. Before the end of the year 1857 Congress was obliged to authorize an issue of $23,716,300 in treasury notes and six months later to place a loan of $10,000,000. During the remainder of this period the receipts remained inadequate, exhibiting extreme sensitiveness to the political movements preceding the Civil War. A threatened revolution of a political character late in 1860 drew the following complaint from the secretary of the treasury: "Already has the treasury been seriously affected by these causes. The receipts from customs for the last few days have greatly fallen off, and the limited amount received is composed each day of an increased proportion of treasury notes not yet due." Thus with an income insufficient even in time of peace and prosperity, the country entered upon a period of civil war.

6. Though on a vastly greater scale, the financial conditions and results of the Civil War were quite similar in character to those of the War of 1812. A very brief discussion of the later period will therefore suffice for the purposes of this paper. If, in the Civil War as in the War of 1812, the income from customs duties be contrasted with government expenditures, the result is even more unfavorable to this form of revenue. This is readily seen by a glance at Chart II and by a comparison of the following tables:

WAR OF 1812

(,000 omitted)

Year	Government Expenditures	Customs Revenues	Per Cent of Customs Revenues to Government Expenditures	Value of Imports
1810 . .	$8,474	$8,583	101.2	$61,008
1811 . .	8,178	13,313	162.7	37,377
1812 . .	20,280	8,958	44.1	68,534
1813 . .	31,681	13,224	41.4	19,157
1814 .	34,720	5,998	17.2	12,819
1815 . .	32,943	7,282	22.1	10,645
1816 . .	32,196	36,306	112.7	129,964
1817 . .	19,990	26,283	131.4	79,891

CIVIL WAR

(,000 omitted)

Year	Government Expenditures	Customs Revenues	Per Cent of Customs Revenues to Government Expenditures	Value of Imports
1860 . .	$63,200	$53,187	84.1	$336,282
1861 . .	66,650	39,582	59.3	274,656
1862 . .	469,570	49,056	10.4	178,330
1863 .	718,734	69,059	9.6	225,375
1864 . .	864,969	102,316	11.8	301,113
1865 . .	1,296,817	84,928	6.5	209,656
1866 . .	523,565	179,046	32.2	423,470
1867 . .	357,542	176,417	49.3	378,158
1868 . .	377,340	164,464	43.5	344,808
1869 . .	322,865	180,048	55.7	394,440

In the Civil War, however, as in the War of 1812, it was believed to be impossible to obtain the whole of the necessary government revenues by means of taxation. The financial plan of the war, as detailed by the secretary of the treasury, provided that the bulk of extraordinary income should be drawn from loans, taxation being relied upon to furnish only the means for the discharge of the ordinary demands, for the punctual payment of interest on loans, and for the creation of a gradually increasing fund for the reduction of the principal. Such a tax revenue, it was confidently expected, would maintain the credit of the nation unimpaired. "The preference always evinced by the people of the United States, as well as their legislature and executive, for duties on imports" determined the secretary, when making provision for the necessary tax income, to recommend only such modifications of the existing tariff as would produce the principal part of the needed revenue, and such resort to direct taxes or internal revenue duties or excises as circumstances might require in order to make good whatever deficiency might be found to exist. Customs duties were then distinctly regarded as the war taxes, and the success of the war policy is the test of their adequacy.

From the beginning of the struggle the capacity of the cus-

toms revenue system was strained to the utmost. Additional import duties were imposed during the extra session of Congress in the summer of 1861. A further increase was made in December, soon after the next regular session had convened, and "from that time till 1865 no session, indeed, hardly a month of any session, passed in which some increase of duties on imports was not made." The results were ridiculously meager. For the years 1861–62–63 the revenue remained almost absolutely inflexible, scarcely rising above the ordinary peace level. As early as 1863 Secretary Chase was forced to admit the failure of the policy of relying on customs revenues. In his report he said: "It is possible that a limited additional amount of income may be derived from judicious modifications of some provisions of the laws imposing duties on foreign imports, but the chief reliance for any substantial increase, and even for the prevention of possible decrease, must be on internal duties." Nevertheless a supreme effort was made in the great act of 1864 to bring about a substantial increase in the customs revenue. Imports were universally taxed, and at the highest rates that Congress dared impose. The result was disappointing, and was a remarkable illustration, both of the inflexibility and the instability of the customs system. The excessive rates caused an immediate reduction of imports, and, instead of an increase, there was a fall in the amount of customs revenue, for 1865, of more than seventeen millions of dollars.

In consequence of the meager income from taxation, the credit of the government early began to decline. Though all loans were nominally placed at not less than par, it was par in depreciated paper currency. The following table exhibits the rapid fall of public credit by showing the specie price of all obligations issued during the war:

For the Years Ending	Gross Receipts from Debts Created	Gold Value of Gross Receipts	Percentage Realized
December 31, 1862 . . .	$470,562,306	$420,657,784	89.39
" 31, 1863 . . .	663,748,162	451,687,251	68.05
" 31, 1864 . . .	754,938,393	384,462,432	50.93
September 30, 1865 . . .	675,984,729	438,540,163	64.87

The spectacle of a powerful and wealthy nation placing its loans at a discount of almost 50 per cent is strong evidence against its system of taxation.

Though condemned by the failure of the war policy, the actual inferiority exhibited by the customs system in this emergency can be best shown by a comparison of the revenue received from it with that derived from internal revenue duties. The internal revenue system was only gradually put in operation after the beginning of the war, and first became productive in 1863. In the next three years, however, $628,436,000 were covered into the treasury from this source as against $336,290,000 from the customs tax system pushed to its greatest capacity. At the period of greatest stress, when the revenue from customs duties stood absolutely inflexible, the revenue from internal duties, though already greater than that from imports, was made to increase $100,000,000 in a single year. Further, while the income from customs was extremely uncertain, the flow of revenue from internal duties was a steadily rising stream, increasing from $109,000,000 in 1864 to $209,000,000 in 1865, and $309,000,000 in 1866.[1] It is true, indeed, that after the stress of war was passed, customs duties furnished an enormously increased revenue, but quickness of response to financial measures is an absolute essential to adequacy. Here lay the chief merit of the internal revenue system. Its manifest superiority over the customs system goes only to confirm the conclusions reached by the comparison of the two systems in the War of 1812. It is probable, as H. C. Adams suggests, that had the internal revenue machinery been in operation two years earlier the war might have been brought to a more speedy termination, while the credit of the government could not have suffered as it did.

7. The Civil War period financially considered closed about the year 1869, when the government ceased to borrow to satisfy the demands incurred on account of the war. The succeeding years down to the present time form a period in which the general conditions were nearly the same in character as those following the War of 1812. In this as in the former period, commercial, industrial, and national expansion followed

[1] Allowance must be made, however, for the fact that internal revenue duties were payable in depreciated paper currency.

the war; in this period also these manifestations of growth were accompanied by serious industrial disturbances; in both periods a great national debt was saddled on the government. The financial history of the two periods is, naturally, quite similar. One great difference, however, exists. The internal revenue duties, which were abolished as soon as possible after the War of 1812, were, in the later period, in part retained. From them the government has received a fairly steady and abundant revenue in addition to the income from customs duties. This fact may perhaps be taken as cause for denying the possibility of testing, by means of the fiscal criteria, the adequacy in this period of the customs revenue system. But the objection seems really without foundation. Customs duties are still regarded as the traditional, national system of taxation. They are only supplemented by the internal duties; but this fact is, in itself, highly significant. That it has been deemed necessary in recent years thus to bolster up the customs system is, *per se*, one of the strongest proofs of the failure of that system to serve as an adequate source of national revenue. It will be admitted, however, that the employment of the internal duties does render a direct comparison between customs revenues and public expenditures useless for the purposes of this paper. Yet a brief survey of the period is of great value to bring out two points — the over-abundance and inflexibility of customs revenues in a period of general prosperity, and, at the same time, the extreme instability of the income from this source.

At the beginning of this period speculative activity grew rapidly, commerce was greatly stimulated, and the tax income was in consequence remarkably large. As early as 1870, the revenue was more than $100,000,000 greater than current public expenditures, and the next year the excess was nearly as great. The public debt, though payments were made rapidly, could not absorb so great a surplus. It became a menace to the prosperity of the nation. An immediate reduction of taxation was therefore called for, and in 1872 a reduction of 10 per cent in the rate of customs duties was effected. But on account of the instability of the revenue the step proved disastrous. Crisis and industrial depression almost immediately followed, and both imports and customs duties were suddenly and extensively

decreased. Imports fell nearly $100,000,000 in a single year and did not rise again to their normal volume until 1880. The revenue from customs which had stood at $216,370,000 in 1872 dropped to $188,089,000 in 1873 and $163,103,000 in 1874. Then it became necessary for the government, which but three years before was contending with a $100,000,000 annual surplus, to resort to borrowing. In alarm, Congress, in 1875, restored the 10 per cent which had been taken from the rates of customs duties in 1872. But the revenue system which had proved so sensitive to commercial changes, did not respond to the effort of the government. The fall in the value of customs revenues continued until in 1878 it was $86,000,000 less than five years before.

The revival of trade, however, which came about 1879, soon carried customs revenues to a higher point than ever before. By 1881 the secretary of the treasury was again complaining of an embarrassing surplus revenue. This was estimated, in 1883, at $85,000,000 per annum, and in 1886 Secretary Manning reported that during the last years the surplus had averaged over $100,000,000. How to dispose of the immense hoard in the treasury became again the great financial problem. Congress had risked revenue reduction with disastrous results. It dared not again adopt this means of avoiding surplus. Naturally,[1] therefore, it now resorted to the other alternative — extravagant expenditure. By means of enormous appropriations the surplus was soon depleted. But here again Congress had failed to take sufficient account of the instability of the customs revenue system. The crisis of 1893 was at hand; the revenue from customs fell rapidly; a deficit resulted, and the government has again been forced in a time of peace to make use of its credit. Thus the nation is repeating, apparently in the same order as before, the financial experiences of the earlier part of the period; and the dreary alternative of embarrassing surplus and embarrassing deficit bids fair to continue as long as the present revenue system exists.

[1] As Secretary Cobb has said: "When public revenues *happen* to be abundant, many projects are listened to and adopted by Congress, without careful regard to the burdens they may permanently impose." — *Report of the Secretary of the Treasury*, 1857, p. 10.

The direct historical examination of the customs revenue system, in connection with the fiscal criteria previously laid down, has now been completed. This examination has extended over the whole experience of the United States in the use of the customs revenue system as a national source of income. No period, therefore, remains whose events may contradict the conclusions drawn from this study so far as they relate to American financial history. It will be well briefly to sum up the results of this discussion.

In the historical survey a variety of national, industrial, and commercial conditions have been encountered, yet the testimony throughout is strikingly in accord. In the first period examined, while the nation was yet in its youth, and subject to strong foreign influences, the customs revenue, though on the whole abundant, was found to be uncertain to such an extent as rendered it an extremely precarious base on which to place the public finances. In the second period, under the stress of foreign war, the financial policy based upon the customs revenue system utterly broke down, as a result of the insufficiency and inelasticity of this form of income. The generally favorable conditions of the third period, while accompanied by a redundancy of revenue, did not insure the nation against great instability of income, resulting from transient industrial disturbances. The fourth period under examination furnished a striking illustration of redundant customs revenue both as effect and cause of speculative expansion, and of the extreme instability of this form of revenue in time of acute commercial crisis. In the fifth period, under remarkably favorable general circumstances, the customs revenue, though on the whole abundant, still proved extremely sensitive to industrial and commercial disturbances. The Civil War period served only to illustrate on a larger scale the defects of the system that were found to characterize it in the War of 1812. And finally, in the full vigor of the nation, and in time of average prosperity, this form of revenue was found to be alternately, according to the transient character of industrial and commercial conditions, greatly in excess of and far beneath the income necessary for the support of the financial operations of the government.

It will be seen that two factors are common to all these periods,

viz. redundancy of revenue in time of commercial and industrial activity, and insufficiency and instability of revenue in time of stress and depression. On the whole it may be asserted, without fear of contradiction, that, throughout the history of the customs revenue system in the United States, the income from this source has been determined, not by government need, but, almost wholly, by the character of temporary industrial and, more especially, temporary commercial conditions. As a consequence, in war the current public income has proved utterly insufficient, unstable, and inflexible; in peace it has shown itself extremely uncertain, fluctuating with every crisis and even with the changes in the policy and condition of foreign nations; in times of prosperity it has forced upon the treasury embarrassing surpluses, leading to extravagant expenditure, speculation, and crisis; in adversity it has left the treasury empty, necessitating the lavish use of the public credit.

APPENDIX TO CHAPTER XVIII

IMPORTS, CUSTOMS REVENUE, AND EXPENDITURES OF THE UNITED STATES, 1791–1893

(,000 omitted)

Year	Total Value Imports	Value of Dutiable Imports	Government Expenditures	Value of Customs Revenue	Per Cent of Customs Revenue to Government Expenditures
1791	$28,687	—	$3,107	$4,399	141.5
1792	29,746	—	8,269	3,343	41.6
1793	28,990	—	3,846	4,255	110.3
1794	28,073	—	6,297	4,801	76.2
1795	61,266	—	7,309	5,588	76.6
1796	55,136	—	5,790	6,567	113.4
1797	48,379	—	6,008	7,549	125.6
1798	35,551	—	7,607	7,106	93.4
1799	33,546	—	9,295	6,610	71.1
1800	52,121	—	10,813	9,080	83.9
1801	64,720	—	9,393	10,750	114.4
1802	40,558	—	7,976	12,438	155.9
1803	51,072	—	7,952	10,479	131.7
1804	48,768	—	8,637	11,098	127.3
1805	67,420	—	9,014	12,936	143.5
1806	69,126	—	9,449	14,667	155.2
1807	78,856	—	8,354	15,845	189.6
1808	43,992	—	9,061	16,363	180.5
1809	38,602	—	10,280	7,257	70.5
1810	61,008	—	8,474	8,583	101.2
1811	37,377	—	8,178	13,313	162.7
1812	68,534	—	20,280	8,958	44.1
1813	19,157	—	31,681	13,224	41.4
1814	12,819	—	34,720	5,998	17.2
1815	106,457	—	32,943	7,282	22.1
1816	129,964	—	32,196	36,306	112.7
1817	79,891	—	19,990	26,283	131.4
1818	102,323	—	20,018	17,176	85.2
1819	67,959	—	21,522	20,283	94.2
1820	56,441	—	18,285	15,005	82.0
1821	43,696	$41,965	15,849	13,004	82.5
1822	68,395	64,841	15,000	17,589	117.2

IMPORTS, CUSTOMS REVENUE, AND EXPENDITURES OF THE UNITED STATES, 1791–1893 (*Continued*)

(,000 omitted)

Year	Total Value Imports	Value of Dutiable Imports	Government Expenditures	Value of Customs Revenue	Per Cent of Customs Revenue to Government Expenditures
1823	$51,310	$48,684	$14,706	$19,088	129.7
1824	53,846	50,763	20,273	17,878	88.1
1825	66,395	62,687	15,857	20,098	126.7
1826	57,652	53,002	17,037	23,341	137.0
1827	54,901	52,010	16,139	19,712	122.1
1828	66,975	62,963	16,394	23,205	141.5
1829	54,741	51,259	15,184	22,681	142.7
1830	49,575	46,063	15,142	21,922	144.7
1831	82,808	77,300	15,237	24,224	158.9
1832	75,327	68,330	17,288	28,465	164.6
1833	83,470	63,258	23,017	29,032	126.1
1834	86,973	47,248	18,627	16,214	87.0
1835	122,007	64,211	17,572	19,391	110.3
1836	158,811	88,690	30,868	23,409	75.8
1837	113,310	62,333	37,243	11,169	29.9
1838	86,552	48,391	33,864	16,158	47.7
1839	145,870	80,682	26,896	23,137	85.6
1840	86,250	44,139	24,314	13,499	55.5
1841	114,776	57,698	26,481	14,487	54.7
1842	87,996	64,650	25,134	18,187	72.3
1843	37,294	25,722	11,780	7,046	59.8
1844	96,390	79,705	22,483	26,183	116.4
1845	105,599	89,934	22,954	27,528	119.4
1846	110,048	91,401	27,261	26,712	97.9
1847	116,257	100,419	54,920	23,747	43.2
1848	140,651	125,705	47,618	31,757	66.6
1849	132,565	118,854	43,581	28,346	65.0
1850	164,034	148,051	40,948	39,668	96.8
1851	200,476	182,565	47,821	49,017	102.5
1852	195,387	173,737	44,560	47,339	106.2
1853	250,157	225,424	48,164	58,931	122.3
1854	276,088	253,535	57,916	64,224	110.8
1855	231,650	201,736	59,502	53,025	89.1
1856	295,650	246,047	69,111	64,022	92.6
1857	333,511	283,569	67,997	63,875	93.9
1858	242,678	187,385	74,556	41,789	56.0
1859	316,823	249,966	68,993	49,565	71.8

IMPORTS, CUSTOMS REVENUE, AND EXPENDITURES OF THE UNITED STATES, 1791–1893 (*Continued*)

(,000 omitted)

Year	Total Value Imports	Value of Dutiable Imports	Government Expenditures	Value of Customs Revenue	Per Cent of Customs Revenue to Government Expenditures
1860	$336,282	$267,891	$63,200	$53,187	84.1
1861	274,656	207,235	66,650	39,582	59.3
1862	178,330	128,487	469,570	49,056	10.4
1863	225,375	195,348	718,734	69,059	9.6
1864	301,113	262,950	864,969	102,316	11.8
1865	209,656	169,559	1,296,817	84,928	6.5
1866	423,470	366,349	523,565	179,046	32.2
1867	378,158	361,125	357,542	176,417	49.3
1868	344,808	329,661	377,340	164,464	43.5
1869	394,440	372,756	322,865	180,048	55.7
1870	426,346	406,131	309,653	194,538	62.8
1871	500,216	459,597	292,177	206,270	70.6
1872	560,419	512,735	277,517	216,370	77.9
1873	663,146	484,746	290,345	188,089	64.7
1874	567,443	414,748	302,633	163,103	53.8
1875	526,260	379,795	274,623	157,167	56.5
1876	464,586	324,024	265,101	148,071	55.8
1877	439,829	298,989	241,334	130,956	54.2
1878	438,422	297,083	236,964	130,170	54.9
1879	439,292	296,742	266,947	137,250	51.4
1880	627,555	419,506	267,642	186,522	69.6
1881	650,619	448,061	260,712	198,159	72.0
1882	716,213	505,491	257,981	220,410	85.0
1883	700,829	493,916	265,408	214,706	80.8
1884	667,575	456,295	244,126	195,067	79.9
1885	579,580	386,667	260,226	181,471	69.7
1886	625,308	413,778	242,483	192,905	79.5
1887	683,418	450,325	267,932	217,286	81.0
1888	712,248	468,143	297,924	219,091	81.7
1889	741,431	484,856	299,288	223,832	74.7
1890	773,674	507,571	318,040	229,668	72.2
1891	854,519	466,455	365,774	219,522	60.0
1892	813,601	355,526	345,023	177,452	51.4
1893	844,454	400,282	383,478	203,355	53.0

(The figures for the next eleven years, stated in millions of dollars, were as follows:

Year	Total Imports	Dutiable Imports	Expenditures	Customs Revenues
1894	636.6	257.6	367.5	131.8
1895	731.2	354.3	356.2	152.2
1896	759.7	390.8	352.2	160.0
1897	789.3	407.3	365.8	176.5
1898	587.2	295.6	443.4	149.6
1899	685.4	385.8	605.1	206.1
1900	830.5	463.8	520.9	233.2
1901	807.8	468.7	524.6	238.6
1902	899.8	503.3	485.2	254.4
1903	1007.9	570.7	517.0	284.5
1904	981.8	527.7	583.7	261.3

— Ed.)

CHAPTER XXI

THE INTERNAL REVENUE SYSTEM OF THE UNITED STATES

81. The Taxation of Spirits (1862–1870). — The Civil War compelled our national government to create a most extensive and complicated system of internal taxes, — upon incomes, upon commodities, upon transactions. Of the war taxes upon commodities none had a more interesting or instructive history than that upon distilled spirits, the history of which was thus narrated by Mr. David A. Wells:[1]

Previous to the war the manufacture of spirits was free from all specific taxation or supervision by either the national or state governments; and being produced mainly from Indian corn, at places adjacent to the localities where this cereal was cultivated, was afforded at a very low price — the average market price in New York for the five years preceding the year 1862 having been 24 cents per proof gallon; with a minimum price during the same time of 14 cents per gallon. The price of alcohol during the same period ranged from 45 to 65 cents per gallon. Under such circumstances the consumption of spirits, for a great variety of purposes, in the United States previous to the war had become enormous; the estimated product for the year 1860 having been in excess of 90,000,000 of gallons; while the maximum quantity exported in any one year was not in excess of 3,000,000 of gallons. One of the purposes for which this product of spirits was extensively used at this time, which was previous to the discovery and use of petroleum, was the manufacture of "burning fluid" — an illuminating agent composed

[1] David A. Wells, The Recent Financial, Industrial, and Commercial Experiences of the United States. Cobden Club Essays, second series. Reprinted. New York, 1872.

of one part of rectified spirits of turpentine, mixed with from four to five parts of alcohol; and so extensive was the manufacture and consumption of this article, that it was stated on the floor of Congress in 1864 that in the city of Cincinnati alone the amount of alcohol required every twenty-four hours for this industry was equivalent to the distillate of 12,000 bushels of corn. The excessive cheapness of alcohol also led to most extensive use of it for fuel in domestic culinary operations, for bathing and cleaning, for the manufacture of varnishes and patent medicines, and for a great variety of other purposes. It is also to be noted that nearly all preparations and washes for the hair, which at that time in other countries — as now universally — were prepared almost exclusively on a basis of fats and oils, were in the United States then composed almost wholly on a basis of alcohol; the comparative difference in the price of this article in the United States and Europe giving an entirely different composition to products of large consumption intended to effect a common object.

The immediate effect of the imposition and continued increase of internal taxes upon distilled spirits was to revolutionize all these branches of industry, and in some instances to utterly destroy them. The manufacture of burning fluid as an illuminating agent entirely ceased; the necessity of its employment being at the same time most fortunately supplanted by the discovery of vast natural supplies of petroleum, and by the use of its derivatives. And as illustrative of the compensations which invariably attend the losses immediately contingent upon industrial progress, through disuse of old methods and machinery, it may be stated that although the business of the manufacture of burning fluid ceased, the business of collecting, preparing, and exporting petroleum rapidly became one of the most important in the country; while the demand at home and abroad for glass lamps and their appurtenances, adapted to the use of the distillates of petroleum, was alone sufficient to employ the entire manufacturing capacity of the glassworks of the United States for a period of two years.

Druggists and pharmaceutists in the United States estimated the reduction in the use of alcohol in their general business, consequent upon its increased cost from taxation, at from one

third to one half. Manufacturers of patent medicines and cosmetics abandoned their old styles of preparation and adopted new. Varnish makers reported to the revenue commission a reduction in the use of spirits in their business to the extent of 80 per cent; while a manufacturer of horse medicines, using formerly 50,000 proof gallons per annum, testified that his business was in the main destroyed. The same result also happened to a firm engaged in the manufacture of a substitute for whalebone, which previous to the tax on spirits was coming into extensive use; and as further showing how curiously other and apparently remote industries were affected by this tax, a large business of exporting cider to the Pacific, which for transportation through the tropics required to be fortified with alcohol, was seriously curtailed; while the increased price of vinegar, before manufactured largely from whisky, so far affected the cost of the manufacture of pickles and white lead as greatly to diminish domestic consumption and almost entirely prevent exports.

The first tax imposed on distilled spirits, of domestic production, was, as already stated, 20 cents per proof gallon. This tax yielded for the year ending June 30, 1863, a revenue of $3,229,911, indicating a production of 16,149,955 proof gallons. The tax of 20 cents continued in force until March, 1864, when the rate was advanced to 60 cents per gallon. The revenue derived from distilled spirits for the fiscal year ending June 30, 1864, under the two rates as above indicated, was $28,431,000. On the 10th of July, 1864, the tax was further advanced to $1.50 per proof gallon, and on the 1st of January succeeding to $2. The revenue derived from this source, for the fiscal year ending June 30, 1865, from the two rates, was $15,007,000; and for the succeeding fiscal years 1866 and 1867, under the uniform tax of $2, was respectively $29,481,000 and $29,164,000.

With the advent of high taxes upon this article, however, the initiation and practice of frauds upon the revenue commenced upon a most gigantic scale, and soon became so successful and so reduced to a system that in 1868 it seemed as if the whole country and the government itself were becoming corrupted and demoralized.

In the outset, while the war and its varying fortunes were engrossing the attention of the government and the people, the

efforts made to repress and punish frauds in this particular were absolutely of no account whatever; and, indeed, it may be alleged with truth that the whole spirit and working of the statute was in the direction of the encouragement and promotion of fraud — Congress in the first instance, under the influence of speculators, having advanced the rate of taxation on two occasions, with ample premonition, and without making the advance applicable to stocks on hand manufactured in anticipation of the legislation in question; and secondly, by so devising the law and providing for its execution as to make the detection and proof of fraud virtually impossible. Under this state of things there were repeated instances where distillers manufactured, conveyed to market, and fraudulently sold spirits in quantities varying from 20,000 to 80,000 gallons and upward, without a suspicion on the part of the local officers that the business was not in all respects conducted legally and honestly. It was also sworn to before the revenue commission in 1865–66 that the determination of the strength of the distilled spirits preparatory to assessment was often made by mere physical inspection or taste, and that the use of instruments (for which no uniform standard was provided) was discarded as something entirely unnecessary. It was also not infrequently the case that the barrels were inspected and branded some days in advance of their being filled, and the future regulation, the filling and removal, left entirely with the manufacturer. Distillers and their workmen were sometimes constituted inspectors of their own products, and in one instance an assessor was known to have been appointed who did not possess sufficient intelligence to understand or correctly use either a gauging rod or a hydrometer. Thus it was at the commencement; but subsequently, and after the close of the war, when the administration of the laws became more intelligent and vigorous, and some degree of concealment to the projectors of fraud became necessary, the expedients successfully adopted for the evasion of the tax were in the highest degree characteristic of the ingenuity of the people.

One of the most fertile of these expedients was made available through a provision of law which allowed spirits to be made and stored in bond, or exported in bond without prepayment of the taxes. Thus, for example, spirits deposited in bond were,

through the connivance and corruption of poorly paid officials, secretly withdrawn from bond, the barrels filled with water, or some cheap compound, and subsequently exported. On receipt of the landing certificate, obtained through a consul of an inferior grade in some remote country, the bonds given by the manufacturer for the payment of the taxes were canceled, and the profits divided among all concerned; while the barrels and contents, being once placed beyond the jurisdiction of the United States, were left either in a foreign bonded warehouse, or on foreign wharves, to take care of themselves. And thus it was that from Turkish ports in the Levant, and from places in Southern Asia, Africa, and Central America there came, in due time and in succession, not a few official inquiries in respect to the disposition of American property for which there was no recognized owner.

In one instance a considerable quantity of what purported to be spirits left a bonded warehouse for transportation in bond by a long, slow voyage down the Mississippi to New Orleans. On arrival at the port of destination the entire contents of the barrels was found to have escaped, through shrinkage and imperfect construction of the packages; and proof being submitted of the loss, the bonds given for delivery were canceled. It is needless to say, that what left the warehouse was not the spirits for which the bonds were originally given, but a substitute of water flavored with spirit, and that the imperfect material and construction of the barrels was designed to effect the very object which was accomplished, namely, the accounting for the destruction of what was known to have been the product of the distillery.

In short, such a tax, of about 800 per cent on the manufacturing cost of the article in question, the enormous profits consequent upon the evasion of the law, and the abundant opportunity which the law itself, and the vast territorial area of the country offered for evasion, constituted a temptation which it seemed impossible for either manufacturers, dealers, or officials to resist; and the longer the tax remained at a high figure, the less became the revenue, and the greater the corruption.

During the year 1867 the revenue directly collected from dis-

tilled spirits, as already stated, was about *twenty-nine millions of dollars*, but during the succeeding year, 1868, with no diminution, but rather an increase of the quantity manufactured and consumed, the total revenue from the same source was but little in excess of *fourteen millions;* proof spirits, at the same time being openly sold in the market, and even quoted in price currents, at from *five* to *fifteen* cents less per gallon than the rate of tax and the average cost of manufacture. We have also in these figures the materials for approximately estimating the measure and strength of the temptation to evade the law, and the amount of profit that accrued in a single year from the results of such evasion; for, as the consumption of distilled spirits for all purposes in the country during the year 1868 was probably not less than *sixty millions of gallons*, and as out of this the government collected a tax upon only about *seven millions* of gallons, the sale of the difference, at the current market rates, $1.90, less the average cost of production, *thirty* cents, must have returned to the credit of corruption, a sum approximating *eighty millions of dollars.*

But notwithstanding the fact that the current price at which distilled spirits were sold in the markets was less than the amount of tax, was everywhere recognized, and commented on by the press; and notwithstanding that the existence and extent of the frauds in the manufacture and sale of the spirits was for three years officially reported upon in detail by officers of the treasury, it was with great difficulty that Congress could be induced to take any action, looking to remedies by the enactment of more perfect laws, providing for more efficient administration of the law, or for diminishing the temptation to fraud by reducing the tax; and it was not until the revenue from this source bade fair to disappear altogether, and the popular manifestation of discontent became very apparent, that anything really was accomplished; a report from the committee of ways and means to the house of representatives in favor of a new law and a reduction of the tax having been actually delayed a whole year by the appeal of a leading member from the state of New York for postponement, on the ground that it would be derogatory to the honor of a great nation, after having triumphed in the most gigantic of civil wars, to confess, by a reduction of the rates, its

inability to control the production and sale of whiskey. How expensive this speech and its resulting delay proved to the treasury is shown by the circumstance, that when the tax was reduced the next year from $2 to 60 cents per gallon, and the law in other respects modified, so as to prevent transportation in bond — holding every distillery liable to account, according to capacity, for each day's product, and forfeiting real estate as well as personal property connected with the performance of illegal acts — the revenue from all taxes, direct and indirect (licenses, etc.), in the manufacture and sale of domestic spirits, increased the very first year to the extent of $27,000,000; or, from $18,000,000 in 1868 to $45,000,000 in 1869, and $55,000,000 in the succeeding year, 1870.

82. Internal Taxation from 1870 to 1894. — Most of the duties upon commodities were repealed after the war, but a number of internal taxes were retained. The act of July 14, 1870, left in operation the duties upon spirits, fermented liquors, and tobacco; as well as stamp duties and some other taxes. The subsequent history of the internal revenue system is described by Dr. Frederic C. Howe, as follows:[1]

Previous to 1860, as we have seen, the excise had been viewed as a sort of fiscal reserve, only to be brought into action in case of urgent necessity; but at the termination of the Civil War, in view of the burden of indebtedness which it had entailed, it became apparent that the earlier resources were no longer adequate to satisfy the larger fiscal needs of the country. The war had, moreover, induced a more generous view of the Constitution, and the conservative hostility which had prevented the utilization of federal powers during the long tenure of the Democratic party no longer existed; while the subsequent inclination of the government to engage in all sorts of expenditure for various internal purposes rendered the utilization of inland sources as a portion of the permanent fiscal service a necessity. The reduction in expenditure between the years 1866 and 1870 rendered it possible

[1] Taxation in the United States, 215 *et seq.* (New York, T. Y. Crowell, 1896.) Reprinted with the consent of the author and publisher.

to dispense with nearly all the extraordinary war taxes, and to concentrate the system upon the broad and elastic basis of consumption. The income tax was retained until 1872, as were the bank taxes, and several unimportant duties on manufactured products. . . .

The suitableness of distilled and malt liquors and tobacco for taxation is recognized by nearly every civilized country, and it is the uniform practice of European governments to derive from them the largest possible revenue consistent with efficiency of administration. Of well-nigh universal consumption as they are, socially harmful in their effects, and non-essential to the comfort and well-being of a people, the payment of the taxes upon whiskey, beer, and tobacco may be viewed as a sum abstracted from the surplus fund of individual income. Furthermore, such taxes are but little obstructive of industrial freedom, and there is no evidence that even the highest rate imposed has ever proven productive of any very general discontent. From the mass of the people the cry for free whiskey and free tobacco meets no answering response; and in the past such agitation has been largely of a political character, for the purpose of distracting attention from an increase in the tariff rates, or an attempt to reduce a possible surplus in the treasury.

Since 1868 the history of the taxation of these subjects has been quite uneventful. The reduction of the rate on distilled spirits to 50 cents a gallon was accompanied with results most phenomenal. It is possibly too much to ascribe the subsequent increase in the revenues and improvement in their collection wholly to the reduction of the rates; for changes in the method of administration were also introduced, which greatly simplified collections, and rendered evasion by the ordinary methods well-nigh impossible. Since this time all taxes, specific, *ad valorem*, and license, have been collected by means of stamps, affixed to the packages containing the commodity or displayed in the place of business. The specific tax of 50 cents on whiskey, with the subsidiary capacity tax, remained in force from July, 1868, to August, 1872, during which period the tax was assessed upon an average production of 67,000,000 gallons, which yielded an average annual revenue of $34,000,000, indicating an average annual per capita consumption of 1.65 gallons.

By the same Act the rates upon manufactured tobacco and cigars were placed as follows:

Snuff	$0.32 per pound
Chewing and other tobacco prepared by hand	0.32 "
Smoking tobacco	0.16 "
Cigars	5.00 per 1000
Cigarettes	1.50 "

Alterations were also made in the method of assessment. Instead of the tax being collected after removal from the place of manufacture and sale, the duty from this time on was prepaid by means of soluble stamps,[1] placed upon the package at the place of manufacture. Goods were required to be placed in certain forms of packages, which were to indicate the manufacturers' name, place of manufacture, trade-mark, contents, and weight of package, etc. Itemized returns were also required from the producer in regard to his business. Failure to comply with these requirements rendered the producer liable to heavy penalties, as did any attempt to place untaxed goods on the market by a dealer. By the same Act existing taxes on mineral or illuminating oils and refined petroleum were repealed.

The revenues from tobacco immediately responded to the change. In 1868 the receipts were $18,729,000. In 1869 they rose to $23,430,707, a gain of four and three quarter millions. Again, in 1870, they increased to $31,350,707, and in 1871 to $33,578,907. Fraudulent evasion of the tax was greatly diminished. Some little loss did occur through the refilling and re-use of stamped packages, and the improper classifications of manufactured tobacco. It was easily possible for producers to take advantage of the difference of rates on chewing and smoking tobacco to place the former on the market at rates applicable only to the latter; and it was difficult to impute or prove fraud, or to correct the evil, save by a uniform rate, which change was later adopted.

But, despite the gratifying showing of the revenues, agitation was soon renewed for change. The profits previously secured by speculators and producers from legislative changes were too sweet to be willingly relinquished; and Congress was not deaf

[1] The stamps were printed in fugitive ink, which disappeared when washed for the purpose of re-use.

to the proposals for an increase of duties, by which gains were legislated into the pockets of speculators by increasing the rate without rendering it applicable to stock in bond. At the same time temperance agitators, who viewed a high rate on whiskey and tobacco as advisable on sumptuary grounds, advocated an increase in the duties, thinking it would serve as a deterrent to their use. In 1872, in response to this pressure, the rate upon whiskey was changed from the mixed one then prevailing, the barrel and capacity tax being repealed, while the specific rate was increased by 20 cents, or to 70 cents per gallon. The change was largely an administrative one, as the several duties then prevailing had aggregated between 65 and 70 cents per gallon. By the same measure all manufactured tobacco, whatever its value or use, was rendered dutiable at a uniform rate, the duty up to 1875 being 20 cents per pound.[1] While this was equivalent to a reduction of 6 cents per pound or of $22\frac{1}{3}$ per cent on the average rate for the two preceding years, the diminution in receipts from tobacco for the year 1873 was but little over one million dollars, while the increase in tax-paid production was over nineteen and one half million pounds, a result traceable in large part to the fact that unmanufactured tobacco under the new law was taxed at substantially the same rate as the manufactured article, whereas it had formerly been practically exempt.

These changes were uniformly in the line of improvement; for while it is to be acknowledged that there is some injustice in the taxation of any article like tobacco, whose value varies so widely, at a uniform rate, experience has shown that assessments are likely to be so arbitrary that a specific rate is preferable to an *ad valorem* one, for the latter offers great opportunities for fraudulent practice, false swearing, and complications in valuation.

Again, in 1875, the rate on spirits was advanced to 90 cents per gallon, where it remained unaltered until 1894. In the taxation of the latter article the experience of these years was marked by phenomena similar to those of the war, although less monstrous, and brought home to officials high in the government service. It is not true, however, as is frequently asserted,

[1] When it was again increased to 24 cents per pound.

that the frauds disclosed in 1875 were due to the increase in the rates; for, although discovered immediately after the passage of the Act of that year, they were traceable to complicity and conspiracy of officials, and had been in existence for many years previous to the change. That the increase of the rate to 90 cents was a source of gain to speculators there is no doubt, for the new duty was not made operative on stock in bond. During the three months previous to the date when the increased rate went into operation, there was made and stored sufficient spirits to cause a loss to the revenues of $1,400,000. This loss was but temporary, however; and from this time on down to the present day the revenues from this source have steadily increased in amount, and there is no reason to suppose that the tax was not as universally collected as under the earlier and lower rate.

With the general revival of trade which set in during the years immediately preceding 1880, the receipts from the several sources of internal revenue manifest a marked improvement. Beginning with 1878, they increase from $110,000,000 in that year to $124,000,000 in 1880, to $135,000,000 in 1881, and to $146,500,000 for the fiscal year 1882. At this time there remained, as a heritage of the war, taxes upon the following subjects, which produced for the fiscal year 1882 the following sums:

Friction matches	$3,272,258.00
Patent medicines, perfumery, etc.	1,978,395.56
Bank checks	2,318,455.14
Bank deposits	4,007,701.98
Savings-bank deposits	88,400.47
Bank capital	1,138,340.87
Savings-bank capital	14,729.38
	$12,818,281.40

At the same time taxes were collected by the treasurer of the United States from national banks as follows:

On national-bank deposits	$5,521,927.47
On national-bank capital	437,774.90
Collections from national banks	$5,959,702.37

making a total collection of $18,777,983.77.

As early as 1880 the commissioner of internal revenue had advised the repeal of all these taxes, and reiterated his suggestion

two years later, when he further advocated an abatement of 40 per cent in the special license charges then existing upon rectifiers, wholesale and retail liquor dealers, and tobacconists, from which an additional reduction in the revenues of $3,000,000 was expected.

The Act of March, 1879, had reduced the rate on manufactured tobacco by one third, or from 24 to 16 cents per pound; and a corresponding reduction on the rate on cigars would cause a further diminution in the revenue of $6,746,000, which the commissioner also recommended.

These suggestions were substantially followed in the abolition of all adhesive stamps imposed on matches, proprietary medicines, perfumes, and bank checks, the abatement taking effect July 1, 1883. The duties on bank deposits and capital ceased at the beginning of the same calendar year; while the rates on tobacco in all its forms, as well as the special license taxes, were reduced 50 per cent. The loss to the revenue from these combined abatements was variously estimated at from forty to forty-five millions, including the $6,000,000 collected from national banks by the treasurer. The loss fell much short of this estimate, however, the total decrease for 1884 being less than $23,000,000, a considerable gain being manifest in spirits and other sources. The chief loss lay in tobacco, from which the receipts fell from $47,391,000 in 1882, and $42,104,000 in 1883, to $26,062,000 in 1884. Inasmuch as the collections of 1882 were made under the old rate entirely, and those of 1884 wholly under the new one, it shows a falling off of $21,229,000, or nearly 45 per cent. When it is borne in mind that population was increasing at the rate of one and a quarter millions per year, it would seem to indicate that the consumption of tobacco was but little affected by the tax rate; for the increase in annual consumption after the reduced rate, as indicated by removal from bond, was but three and one half million pounds, the total withdrawals being less than the average quantity withdrawn for several preceding years at double the rates. At the same time a perceptible increase in the number of firms engaged in tobacco manufacture was remarked, a fact which seems to indicate the tendency of a high tax rate to concentrate the business into a few hands.

In 1890 another reduction of 25 per cent was made in the rates upon snuff, chewing and smoking tobacco, while all special license taxes upon the sale of tobacco were repealed.

The total receipts from tobacco in all its forms for 1893 were about $32,000,000, a sum which would have approximated $60,000,000 had the taxes existing in 1882 been allowed to remain unchanged. For the same year, the per capita revenue collected in the United States from this subject was but 48 cents, as against 90 cents in 1882, and as opposed to $1.71 in France, and $1.50 in Great Britain. Manifestly the revenues from this source are susceptible of increase. In recent years the growth in the consumption of tobacco has been phenomenal. In 1892 the per capita consumption of smoking and chewing tobacco was four pounds, while the number of cigars and cheroots returned for taxation was 4,548,799,487. As compared with other countries, the consumption of tobacco in America is about two and a half times as great as in England and France, slightly in excess of that in Holland and Belgium, and somewhat less than that of Germany.

The tax upon malt liquors has remained practically unchanged since the organization of the system in 1862, namely, at $1 per barrel of thirty one gallons.

In 1894, in order to obtain additional revenue, certain changes were made in the internal duties, as described by Dr. Howe:[1]

In addition to the duty upon incomes, the measure of Aug. 28, 1894, provided for a tax of 2 cents per pack upon playing cards sold within the United States subsequent to Aug. 1, 1894, as well as an increase of 22½ per cent in the rate upon distilled spirits, or from 90 cents to $1.10 per gallon, which increase was to be levied and collected upon all spirits in bond at the time of the passage of the Act or thereafter manufactured. This provision differed from previous legislation, in that the new rate was payable upon all spirits in bond rather than upon future production only. But, despite this provision, the gains which accrued to speculators were enormous, for it was evident as

[1] Taxation in the United States, 252–254.

early as June that the tax would be increased. As a consequence production was very active during this period, and speculators and distillers withdrew spirits in great quantities in order to anticipate the increase of the rate. During the months of July and August, 1894, 26,500,000 gallons more of spirits were withdrawn from the bonded warehouses than during the same months of 1893; while the total withdrawals during the two months previous to Sept. 1, 1894, were 36,554,088. Upon these withdrawals the old rate of 90 cents per gallon was paid, with the idea of holding the product until the new duty went into effect, when the stock would be disposed of upon the basis of the new rate. Assuming that the advantage which accrued upon withdrawals during the months previous to July offset any overestimate, the gains to distillers and speculators could not have been less than $7,000,000, all of which should have been saved to the treasury.

The measure further provided for an extension of the bonded period from three to eight years. In the past it has been the custom to collect the tax on tobacco, as well as the customs duties, when the commodity entered the market for consumption; but the principle has never been applied to spirits. The distiller has not only been required to pay the highest rate of tax imposed upon any product under the laws, but has been compelled to pay the same within a specified time, no matter what the demand for spirits or the condition of the market. This provision was frequently a cause of great hardship; and while an unlimited bonded period is not granted under the present law, as is permitted in tobacco and malt liquors, it has been extended to eight years, a provision which affords great relief to producers. How burdensome the former law was is shown by the large number of failures which occurred among distillers and holders of stock during the early days of the recent commercial depression.

From this increase of the rate to $1.10 a gallon, an annual gain of twenty millions of dollars is anticipated to the revenues.

83. The War Taxes of 1898. — In order to defray part of the expenses of the Spanish War, new internal taxes were established in 1898 and some of the existing duties were increased. Sub-

sequently all of these duties were repealed. The following account of the war taxes has been given by Professor C. C. Plehn:[1]

The United States government has never resorted to internal taxes except to pay the expenses of war, and with the single exception of the Mexican War, we have waged no war without the use of internal taxes. The first system of "internal revenue taxes," as we have learned to call them, was arranged by Hamilton, 1791, in the face of the most bitter opposition. An excise was declared to be "the horror of all free states" and "hostile to the liberties of the people." On account of the general hostility to that form of taxation — a hostility which led to armed resistance in the "Whiskey Rebellion" — the law was but feebly enforced. It was dubbed by Jefferson an "infernal system," and finally came to an end in 1802. To meet the expenses of the War of 1812 Congress again, reluctantly, resorted to internal taxation, but the taxes then introduced were never satisfactory and were hastily abandoned in 1817. From that time to the outbreak of the Civil War no internal taxes were levied for the support of the federal government.

The entire absence of any internal taxes and of any elastic element in the tax system at the outbreak of the Civil War added greatly to the difficulties involved in raising the revenues needed. Beginning in 1862, a vast and complex system of internal taxation was built up. Of this comprehensive system an acute French observer said: "The citizen of the Union pays a tax every hour of the day, either directly or indirectly, for every act of life; on his personal and real property; on his receipts and in his expenses; on his business and on his pleasures."[2]

The heavy expenses of the war debt necessitated the retention of many of these taxes even after the close of the war. As the years passed by, however, the most burdensome ones were removed. Still a sufficient number of important internal revenue taxes were permanently retained to yield about $150,000,000 a

[1] The Finances of the United States in the Spanish War, 434 *et seq.* Reprinted, with consent of author, from *The University Chronicle* of the University of California. Vol. I (1898).

[2] E. Duvergier de Hauranne, *Revue des deux mondes*, Aug. 15, 1865.

year. The continuance of these taxes in time of peace proved of great advantage when war broke out. That advantage was that they provided the administrative organization necessary for the collection of increased revenues. New taxes to be administered by the same machinery could be easily imposed and made remunerative within a very short time. Indeed there is almost no precedent in financial history for the immediate returns these new taxes yielded. The income from them during the very first month was over $12,000,000.

For the reasons explained in the last lecture, it was decided to raise the larger part of the revenue needed for the war by enlarging the existing system of internal taxes. The taxes of this kind in use were of three principal classes: (1) the group on spirits, yielding, in 1897, $82,008,543; (2) the group on tobacco, yielding $30,710,297; (3) the group on fermented liquors, yielding $32,472,162. The war revenue bill doubled the rates in two of these groups and rehabilitated a large number of the taxes used during the Civil War. The principles which guided the selection of the different taxes were stated by Mr. Dingley when explaining the bill to the house as follows:

"These taxes have been selected, first, because we have the machinery for the collection of them now, and they can be collected with but slight additions to the force and with but slight increase of expense. We have selected them also because they were a source of revenue successfully seized upon during the Civil War, and because they are taxes either upon articles of voluntary consumption or upon objects where the tax will be paid by those who are ordinarily able to pay them; and we have refrained from putting a tax in a direction where it would be purely upon consumption, unless the consumption was of an article of voluntary consumption, so that the consumer might regulate his own tax, following what is the accepted rule of taxation in all countries, with a view of imposing the least burden and disturbing the business of the country as little as possible."

Briefly summarized the aim of the bill was to obtain the money needed as quickly as possible. The question of the equal distribution of the burden among the people was not raised. The revenue bill was strictly an emergency measure. Although the senators showed a tendency to spin fine theories in regard to

the operation of certain taxes, yet the equality of the system as a whole was not considered. Senator Allison said of it:

"In the first place, this bill is here only because the government of the United States is involved in a war with a foreign country. If there were no war, there would be no necessity for this bill; and therefore it may be truly called, what it is denominated, a war measure."

It is not perhaps surprising, then, that the bill which was framed in this spirit contains a heterogeneous collection of taxes. It does not cull the fruit systematically from the orchard of industry, but plucks only a part of that which is most easily reached. The bill does not establish a system of taxation, but a group of taxes which absolutely defies classification.

We may study the war revenue bill under the following divisions: (1) Taxes already in use, the rates of which have been raised. (2) New excise taxes. (3) New business and corporation taxes. (4) Transaction taxes and business taxes in the form of stamp taxes on business documents. (5) Miscellaneous taxes.

Of the three groups of internal taxes in use at the time the internal revenue bill was presented, one, namely, that consisting of taxes on spirits, was left untouched. The rates imposed on the other two were doubled with the exception that the special taxes on dealers in beer and on brewers were left unchanged.[1]

The tax imposed on dealers in tobacco prior to 1890 was restored. The restoration of the tax on dealers in tobacco was regarded partly as a measure to enable the officers better to enforce the law in regard to the taxation of tobacco and cigars. No explanation was advanced during the discussion of the bill in Congress for not raising the rates on spirits. Had that class of goods been treated as beer and tobacco were treated, no other taxes would have been necessary. With the improved methods of administration now in use there could be no reason to fear the wholesale evasions which vitiated the attempt to levy high rates upon spirits during the Civil War. If, as was suggested in the last lecture, tea and coffee had both been made to contribute,

[1] Tax on beer, ale, and porter, increased from $1 to $2 a barrel, discount 7½ per cent. Tax on tobacco and snuff, 12 cents a pound; cigars and cigarettes, over three pounds per 1000, $3.60 per 1000; of less weight, cigars, $1, cigarettes, $1.50.

and, as now suggested, spirits had been treated as beer and tobacco were, we should have had ample revenues with the least possible additional cost. The amounts would have been :

Tea	$10,000,000
Coffee	70,000,000
Spirits	80,000,000
Beer	30,000,000
Tobacco	30,000,000
Total	$220,000,000

This is $70,000,000 more than the new taxes which were imposed yield, so that the additional rates need have been but two thirds of the increase suggested. Indeed, an increase of half the amount suggested in the taxes on tea, coffee, spirits, beer, and tobacco would have furnished over $100,000,000, or more than the amount which the House Committee on Ways and Means thought necessary to raise by taxation. It is needless to say that such taxation would have been very much more easily borne by the people than the multitude of new taxes imposed. Had that plan been followed, there would have been few of us who would know by actual experience that we were paying the expenses of a war.

New excise taxes to be collected by the use of stamps were imposed on patent and proprietary medicines and toilet articles, on chewing gum, and on wine.[1]

Little can be said in favor of these taxes ; they strike a vast variety of different articles of consumption and their effect is anything but uniform. Consumption is a very poor basis for taxation. The rates are so moderate, however, that there is little temptation to shift the taxes and the articles taxed are in

[1] Medicines and toilet articles.

Retail Price of Packages	Stamps
1 to 5 cents	⅛ of 1 cent
5 to 10 cents	¼ of 1 cent
10 to 15 cents	⅜ of 1 cent
15 to 25 cents	½ of 1 cent
For each additional 25 cents	⅝ of 1 cent

Chewing gum, 4 cents for each package of not more than $1 in retail price and 4 cents for each additional $1 in retail price, or fraction thereof.

Wine per bottle of one pint or less, 1 cent; per bottle of over one pint, 2 cents.

many instances monopoly products, the prices of which, it may be assumed, are already as high as they can be made without decreasing the sales. In some instances, therefore, these are not taxes on consumption but taxes on the profits of monopoly businesses. There has, indeed, been no general tendency to increase the prices of these articles. To be sure the imposition of the tax has checked the tendency to cut rates and to that extent may be said to have raised the prices of some articles widely regarded as necessities, but that effect will be only temporary. While, therefore, these new excise taxes have not added a very desirable element to our tax system, they are not seriously harmful.

The new business taxes are of two classes. The first are those laid on bankers, brokers, museums and concert halls, circuses and other public exhibitions, bowling alleys and billiard and pool rooms.[1] The second are those on refiners of petroleum and sugar and on pipe-line companies.

In the first of these classes the most serious difficulties that have arisen are clearly revealed in connection with the application of the law to foreign banks. The law makes no special provision for them and they do not come properly under the general provisions. Strictly speaking a branch of a foreign bank doing business in this country has no capital located here. Such banks would, therefore, pay but $50, the minimum tax which all bankers must pay. But as these houses often do a vast business such a tax would be obviously unfair. The law of 1864 which was partly copied in the new law was much more explicit. It provided a method for determining the capital of branch banks. The total capital of the bank was to be apportioned among the different branches according to the amount of the business done by each. This method was applied to foreign banks. That old law, however, laid a tax on deposits, dividends, and profits as well as upon capital, so that the burden fell with greater equality upon all the banks. While the inequality of this tax is best revealed by the difficulty

[1] Bankers, $50 a year and $2 for each $1000 over $25,000 of capital; brokers, $50; pawnbrokers and commercial brokers, $20; custom-house brokers, $10; theaters, etc., $100; circuses, $100 for each state in which they do business; bowling alleys, etc., $5 for each alley or table.

of applying the law to foreign banks, it also arises in every other case. The amount of capital used is never commensurate with the business done, nor with the ability of the bank to contribute. There are, for example, fifteen commercial banks in San Francisco. In one of these the capital is 19 per cent of the business being done, as measured by the total assets and liabilities; in another it is 79 per cent. Although the total assets and liabilities are only an approximate measure of the bank's ability to pay, yet this comparison shows that the new tax is many times as heavy on the second bank as on the first. Generally speaking, the smaller the bank, the heavier this tax is likely to be. The same inequality pervades the other special business taxes. A small theater or a small circus pays the same tax as a large one. Probably some of the smaller ones will be driven out of business. Possibly, however, this is not a result to be deplored. This whole group of taxes seems to have been snatched indiscriminately from the system of internal taxes developed during the Civil War. The old system was by no means a complete or a just one, and the scattered sections adopted in the new law form far less of a system.

The tax on refiners of petroleum or sugar and on pipe-line companies which was placed at a quarter of one per cent on the excess of gross receipts above $250,000 a year is the remnant of a tax on the gross receipts of nearly all corporations which was proposed by the majority of the Senate Committee on Finance. The minority of that committee, however, objected to such a sweeping tax, first, on the ground that it would burden many commodities several times over, and second, on the ground that many corporations, and especially the smaller ones, had to compete with unincorporated business houses and firms, and that the latter would be given an advantage. It was urged during the discussion that the tendency to form corporations was a public calamity, and should be checked by this form of taxation. A tax on the gross receipts of railroads, bridges, canals, express companies, ferries, lotteries, ships, barges, stages, steamboats, and telegraph and insurance companies had been used with great success during the Civil War. It was proposed to renew this tax and to extend it to all corporations in spite of the fact that many of them were heavily taxed by other parts of the law.

There were very large elements of injustice in the proposed tax, and the only argument advanced in favor of retaining the tax on the oil and sugar trust was that they were monopolies. The tax is not severe. It will not be above one and a quarter cents per hundred pounds of sugar nor above one and a half cents per hundred gallons of oil at the prevailing wholesale rates, so that there will be little temptation to shift the tax even if the companies would not lose more by reduced sales from an attempt to raise prices than they would gain by shifting the tax. There is little likelihood that the tax will affect retail prices.

A very large number of transaction taxes and of business taxes was levied in the form of stamp taxes on business documents and on the means of communication. These taxes are usually known as stamp taxes, but the name indicates merely the means of collection and shows nothing of the nature of the tax. In general these taxes are based upon recognition of the fact that when wealth is transferred from one person to another, its existence is manifested and a convenient moment occurs for the imposition of a tax. When such a transfer is accompanied by a document which is legal evidence of the title of the new owner, it is easy for the government to refuse legal recognition to such a document unless accompanied by the evidence that the tax has been paid. It is, therefore, practically impossible to evade such a tax. The most convenient way of collecting these taxes is by the sale of stamps which are to be attached to the documents as evidence of payment. There are two features of these taxes which commend them as emergency taxes. In the first place, even at a low rate they can be made to yield a considerable income, and the return is a quick one, as large the first month as at any time afterward. In the second place they are very inexpensive to administer: the taxpayer himself acts as tax collector and when he goes to the office to purchase the stamps, brings in the revenue. He cannot omit to pay his tax lest his document prove illegal. During the Civil War and for many years afterward stamp taxes of this sort were in use. Many of the provisions of the old law were transferred to the new law, and the changes and omissions are rarely for the better.

It would be tedious to enumerate all the transactions which

are taxed in this way, nor is it necessary, as I can comment on but few of them. The first thing that strikes one who carefully scans the long schedules of these taxes is that they are frightfully unequal. Only here and there are they graded according to the value of the thing taxed. Thus the tax on the issue of corporation stocks is five cents on each $100 of the par value, and on the transfer of the stock is two cents on each $100 of the par value. But the par value of a stock is a perfectly arbitrary thing, a mere name. It is usually $100, but the true value may be anywhere from one cent to $1000 or over, according to the success of the enterprise. So, too, with checks and drafts; whatever the value may be, the tax is always two cents. Indeed, in this particular case the form of the tax defeats its end as a revenue measure, for it has simply resulted in the writing of fewer and of larger checks, and more has been lost to the postal revenues through less frequent remittances than has been gained from the tax on checks.

All of that part of the law which deals with drafts and bills of exchange is so faultily drawn as to be practically unintelligible. The technical terms of banking are used in strange and unusual senses, and totally incongruous things, such, for example, as inland bills of exchange and certificates of deposit bearing interest are grouped together. These provisions should have been drawn by a practical banker. Had the new tax law not been supported by that patriotic sentiment which so largely aided its enforcement, this particular part of the law would have given rise to more lawsuits than revenue.

Included under the stamp taxes are certain taxes directed more or less vaguely at certain classes of corporations. These are the taxes on freight bills, express receipts, parlor and sleeping car tickets, telegrams and telephone messages, and passage tickets to foreign countries. The rates on the last are graded according to value, but on all the others are uniform at one cent each, except that no tax falls on telephone messages below fifteen cents. The tax on telephone messages is not collected by stamps. It is easy to see that this is a most unequal system. There has been much discussion as to whether it was the intention of the law that the stamp should be furnished by the companies or by their patrons. This is really a matter of little

moment. In some cases the tax is so slight as to be entirely immaterial. In such cases the companies have furnished the stamps themselves to save their patrons any annoyance, and have not changed their rates. In other cases the tax is so severe that if the companies furnish the stamps, they will be obliged to shift the tax by raising their rates, in order to live. If the tax were paid by the express companies, it would vary from 4 per cent of the gross receipts down to practically nothing. For doing a twenty-five-cent errand the express company would pay one cent, and no more for a shipment of $1,000,000 in gold. The express companies have asserted that if they have to pay the tax, it will take half of their profits. The tax is also very severe on telegrams. The average telegram, it has been estimated, costs 24.3 cents and the average profit is six cents, of which the tax is $16\frac{2}{3}$ per cent. Whatever may have been the intention of the law as to who should furnish the stamp in such cases, it is clear that the tax will be shifted to the patron of the company. If it is finally decided that the company must furnish the stamp, then the rates will have to be raised, and the patron will have to pay the tax just as much as if he furnished the stamp himself. Taxes which appropriate for the use of the government from 10 per cent to 50 per cent of the net profits of any business are bound to be shifted. Still the companies cannot escape considerable loss even by shifting the tax. If they raise the rates in order to cover the tax, their business will fall off, while the expense of doing it will not decrease in like measure. If they could raise their rates without loss of business, there is every reason to suppose they would do so, tax or no tax. On the other hand the public is the loser as well as the companies. In the first place it is obliged to pay the tax, or at least a part of it, and in the second place it is obliged by the increased cost to curtail its use of the facilities which the companies furnish. When taxation approaches confiscation, it strikes directly at the welfare of the whole people.

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Among the miscellaneous taxes there was also inserted one upon mixed or adulterated flour. The imposition of this tax is not mainly for revenue. It is for the purpose of regulation and to protect the public from unknowingly using inferior flour. On

oleomargarine there is a similar tax that has been in use for some time. It was asserted in Congress that as much as 75 or 80 per cent of all flour sold is adulterated by the use of ground clay, ground rock, "mineraline," or corn flour bleached by sulphuric acid. It is not claimed that all of the articles used for the adulteration of flour are injurious to health, but some of them are, and none of them has the same value for nutrition as wheat flour. The law requires these flours to be properly labeled, and by imposing a stamp tax on them the government can enforce this regulation. Without such a tax the federal government would not be competent to invade this sphere of state activities. A number of penalties are imposed for failure to comply with all the regulations. From now on it will be dangerous for any person to sell mixed flour under the guise of pure flour.

The general system of taxation imposed by this law is not particularly burdensome as a whole. In some instances individual parts of the system run very close to confiscation, and the system is frightfully unequal. At the same time most of the unequal taxes can be wholly or partly shifted and the severity of the burden is thus lightened by diffusion. The inequality and injustice of the system which we have noted all through the law is, perhaps, a necessary feature of any system that is adopted in an emergency, when the time is lacking for the full discussion of a logical and just system. It emphasizes the necessity, so often referred to, of arranging in time of peace a just and equitable system which can be readily expanded in time of war. During a war no nation can afford the luxury of tax reform for reform's sake. That is an enjoyment which belongs to times of peace.[1]

[1] Statistics showing the productivity of the various internal taxes at different times are given in the Appendix. — ED.

CHAPTER XXII

THE EARLY DEVELOPMENT OF PUBLIC BORROWING

84. The Views of David Hume. — In 1752, at a time when the rapid growth of public debts was alarming many persons, David Hume published his celebrated Essay on Public Credit.[1] In this essay he draws the following unfavorable contrast between the practice of public borrowing and the earlier policy of accumulating state treasures in order to meet unusual emergencies:

It appears to have been the common practice of antiquity, to make provision, during peace, for the necessities of war, and to hoard up treasures beforehand as the instruments either of conquest or defence; without trusting to extraordinary impositions, much less to borrowing, in times of disorder and confusion.[2] Besides the immense sums above mentioned, which were amassed by Athens, and by the Ptolemies, and other successors of Alexander; we learn from Plato, that the frugal Lacedemonians had also collected a great treasure; and Arrian and Plutarch take notice of the riches which Alexander got possession of on the conquest of Susa and Ecbatana, and which were reserved, some of them, from the time of Cyrus. If I remember right, the scripture also mentions the treasure of Hezekiah and the Jewish princes; as profane history does that

[1] In his Political Discourses, (1752).

[2] The earliest writers on finance believed that a prince should thus accumulate treasure. Bodin, for instance, after treating of public revenues and expenditures, devoted the remainder of the chapter to "the reserve that should be accumulated for time of need." The German cameralists strongly advocated this policy. In England, also, state treasures were advocated by such a writer as Thomas Mun, who declared that "a Prince that will not oppress his people, and yet be able to maintain his Estate and his Right, that will not run himself into Poverty, Contempt, Hate, and Danger, must lay up treasure, and be thrifty." . . . England's Treasure by Foreign Trade, ch. 17. (Published 1664; written prior to 1641.) — ED.

of Philip and Perseus, kings of Macedon. The ancient republics of Gaul had commonly large sums in reserve. Every one knows the treasure seized in Rome by Julius Cæsar, during the civil wars: and we find afterward, that the wiser emperors, Augustus, Tiberius, Vespasian, Severus, etc., always discovered the prudent foresight, of having great sums against any public exigency.

On the contrary, our modern expedient, which has become very general, is to mortgage the public revenues, and to trust that posterity will pay off the incumbrances contracted by their ancestors: And they, having before their eyes, so good an example of their wise fathers, have the same prudent reliance on *their* posterity; who, at last, from necessity more than choice, are obliged to place the same confidence in a new posterity. But not to waste time in declaiming against a practice which appears ruinous, beyond all controversy; it seems pretty apparent, that the ancient maxims are, in this respect, more prudent than the modern; even though the latter had been confined within some reasonable bounds, and had ever, in any instance, been attended with such frugality, in time of peace, as to discharge the debts incurred by an expensive war. For why should the case be so different between the public and an individual, as to make us establish different maxims of conduct for each? If the funds of the former be greater, if its resources be more numerous, they are not infinite; and as its frame should be calculated for a much longer duration than the date of a single life, or even of a family, it should embrace maxims, large, durable, and generous, agreeably to the supposed extent of its existence. To trust to chances and temporary expedients, is, indeed, what the necessity of human affairs frequently renders unavoidable; but whoever voluntarily depend upon such resources, have not necessity, but their own folly, to accuse for their misfortunes, when any such befall them.

If the abuses of treasures be dangerous, either by engaging the state in rash enterprises, or making it neglect military discipline, in confidence of its riches; the abuses of mortgaging are more certain and inevitable; poverty, impotence, and subjection to foreign powers.

According to modern policy war is attended with every de-

structive circumstance; loss of men, increase of taxes, decay of commerce, dissipation of money, devastation by sea and land. According to ancient maxims, the opening of the public treasure, as it produced an uncommon affluence of gold and silver, served as a temporary encouragement to industry, and atoned, in some degree, for the inevitable calamities of war.

It is very tempting to a minister to employ such an expedient, as enables him to make a great figure during his administration, without overburthening the people with taxes, or exciting any immediate clamors against himself. The practice, therefore, of contracting debt will almost infallibly be abused, in every government. It would scarcely be more imprudent to give a prodigal son a credit in every banker's shop in London, than to empower a statesman to draw bills, in this manner, upon posterity.

85. The Views of Adam Smith. — Twenty-four years later, Adam Smith discussed at greater length the development of public debts. After explaining that a disposition "to save and to hoard" prevailed in earlier times before the growth of extensive manufactures and commerce, he said:[1]

Among nations to whom commerce and manufactures are little known, the sovereign, it has been observed in the fourth book, is in a situation which naturally disposes him to the parsimony requisite for accumulation. In that situation the expense even of a sovereign cannot be directed by that vanity which delights in the gaudy finery of a court. The ignorance of the times affords but few of the trinkets in which that finery consists. Standing armies are not then necessary, so that the expense even of a sovereign, like that of any other great lord, can be employed in scarce anything but bounty to his tenants, and hospitality to his retainers. But bounty and hospitality very seldom lead to extravagance; though vanity almost always does. All the ancient sovereigns of Europe, accordingly, had treasures. Every Tartar chief in the present times is said to have one.

In a commercial country abounding with every sort of expen-

[1] Wealth of Nations, Bk. V, ch. 3.

sive luxury, the sovereign, in the same manner as almost all the great proprietors in his dominions, naturally spends a great part of his revenue in purchasing those luxuries. His own and the neighboring countries supply him abundantly with all the costly trinkets which compose the splendid but insignificant pageantry of a court. . . . How can it be supposed that he should be the only rich man in his dominions who is insensible to pleasures of this kind? If he does not, what he is very likely to do, spend upon those pleasures so great a part of his revenue as to debilitate very much the defensive power of the state, it cannot well be expected that he should not spend upon them all that part of it which is over and above what is necessary for supporting that defensive power. His ordinary expense becomes equal to his ordinary revenue, and it is well if it does not frequently exceed it. The amassing of treasure can no longer be expected, and when extraordinary exigencies require extraordinary expenses, he must necessarily call upon his subjects for an extraordinary aid. The present and the late king of Prussia are the only great princes of Europe who, since the death of Henry IV of France, in 1610, are supposed to have amassed any considerable treasure.[1] The parsimony which leads to accumulation has become almost as rare in republican as in monarchical governments. The Italian republics, the United Provinces of the Netherlands, are all in debt. The canton of Berne is the single republic in Europe which has amassed any considerable treasure. The other Swiss republics have not. The taste for some sort of pageantry, for splendid buildings, at least, and other public ornaments, frequently prevails as much in the apparently sober senate house of a little republic as in the dissipated court of the greatest king.

The want of parsimony in time of peace, imposes the necessity of contracting debt in time of war. When war comes, there is no money in the treasury but what is necessary for carrying

[1] Frederick William I, by persistent economy, had accumulated at the end of his reign a treasure of 8,700,000 thalers, besides plate worth 1,500,000 thalers. This treasure defrayed the greater part of the extraordinary expense of Frederick the Great's Silesian wars. In time of peace, Frederick, like his father, amassed a considerable treasure, which at his death amounted to 55,000,000 thalers. — ED.

on the ordinary expense of the peace establishment. In war an establishment of three or four times that expense becomes necessary for the defense of the state, and consequently a revenue three or four times greater than the peace revenue. Supposing that the sovereign should have, what he scarce ever has, the immediate means of augmenting his revenue in proportion to the augmentation of his expense, yet still the produce of the taxes, from which this increase of revenue must be drawn, will not begin to come into the treasury till perhaps ten or twelve months after they are imposed. But the moment in which war begins, or rather the moment in which it appears likely to begin, the army must be augmented, the fleet must be fitted out, the garrisoned towns must be put into a posture of defense; that army, that fleet, those garrisoned towns, must be furnished with arms, ammunition, and provisions. An immediate and great expense must be incurred in that moment of immediate danger, which will not wait for the gradual and slow returns of the new taxes. In this exigency government can have no other resource but in borrowing.

The same commercial state of society which, by the operation of moral causes, brings government in this manner into the necessity of borrowing, produces in the subjects both an ability and an inclination to lend. If it commonly brings along with it the necessity of borrowing, it likewise brings with it the facility of doing so.

A country abounding with merchants and manufacturers, necessarily abounds with a set of people through whose hands not only their own capitals, but the capitals of all those who either lend them money, or trust them with goods, pass as frequently, or more frequently, than the revenue of a private man, who, without trade or business, lives upon his income, passes through his hands. The revenue of such a man can regularly pass through his hands only once in a year. But the whole amount of the capital and credit of a merchant, who deals in a trade of which the returns are very quick, may sometimes pass through his hands two, three, or four times in a year. A country abounding with merchants and manufacturers, therefore, necessarily abounds with a set of people who have it at all times in their power to advance, if they choose to do so, a very large

sum of money to government. Hence the ability in the subjects of a commercial state to lend.

Commerce and manufactures can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the state is not supposed to be regularly employed in enforcing the payment of debts from all those who are able to pay. Commerce and manufactures, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government. The same confidence which disposes great merchants and manufacturers, upon ordinary occasions, to trust their property to the protection of a particular government, disposes them, upon extraordinary occasions, to trust that government[1] with the use of their property. By lending money to government, they do not even for a moment diminish their ability to carry on their trade and manufactures. On the contrary, they commonly augment it. The necessities of the state render government upon most occasions willing to borrow upon terms extremely advantageous to the lender. The security which it grants to the original creditor, is made transferable to any other creditor, and, from the universal confidence in the justice of the state, generally sells in the market for more than was originally paid for it. The merchant or moneyed man makes money by lending money to government, and instead of diminishing, increases his trading capital. He generally considers it as a favor, therefore, when the administration admits him to a share in the first subscription for a new loan. Hence the inclination or willingness in the subjects of a commercial state to lend.

The government of such a state is very apt to repose itself upon this ability and willingness of its subjects to lend it their money on extraordinary occasions. It foresees the facility of borrowing, and therefore dispenses itself from the duty of saving.

In a rude state of society there are no great mercantile or

[1] To this it may be added that, with the development of democratic government, the capitalists lend to a government which is under the control — to a very large extent, at least — of the propertied classes. *Cf.* H. C. Adams, Public Debts, 9 (New York, 1887). — Ed.

manufacturing capitals. The individuals who hoard whatever money they can save, and who conceal their hoard, do so from a distrust of the justice of government, from a fear that if it was known they had a hoard, and where that hoard was to be found, they would quickly be plundered. In such a state of things few people would be able, and nobody would be willing, to lend their money to government on extraordinary exigencies. The sovereign feels that he must provide for such exigencies by saving, because he foresees the absolute impossibility of borrowing. This foresight increases still further his natural disposition to save.

The progress of the enormous debts which at present oppress, and will in the long run probably ruin,[1] all the great nations of Europe, has been pretty uniform. Nations, like private men, have generally begun to borrow upon what may be called personal credit, without assigning or mortgaging any particular fund for the payment of the debt; and when this resource has failed them, they have gone on to borrow upon assignments or mortgages of particular funds.

What is called the unfunded debt of Great Britain is contracted in the former of those two ways. It consists partly in a debt which bears, or is supposed to bear, no interest, and which resembles the debts that a private man contracts upon account; and partly in a debt which bears interest, and which resembles what a private man contracts upon his bill or promissory note. The debts which are due either for extraordinary services, or for services either not provided for, or not paid at the time when they are performed; part of the extraordinaries of the army, navy, and ordnance, the arrears of subsidies to foreign princes, those of seamen's wages, etc., usually constitute a debt of the first kind. Navy and exchequer bills, which are issued sometimes in payment of a part of such debts and sometimes for other purposes, constitute a debt of the second kind; exchequer bills bearing interest from the day on which they are issued, and

[1] Such pessimistic views were common in Smith's time. Hume, it will be remembered, had dismal forebodings; and even prophesied "the natural death of public credit," through national bankruptcy. And Montesquieu, after enumerating the evils attending public borrowing, said: "These are the disadvantages: I do not know of any advantages." *Ésprit des lois*, Bk. XXII, ch. 17. — ED.

navy bills six months after they are issued. The bank of England, either by voluntarily discounting those bills at their current value, or by agreeing with government for certain considerations to circulate exchequer bills, that is, to receive them at par, paying the interest which happens to be due upon them, keeps up their value and facilitates their circulation, and thereby frequently enables government to contract a very large debt of this kind. . . .

When this resource is exhausted, and it becomes necessary, in order to raise money, to assign or mortgage some particular branch of the public revenue for the payment of the debt, government has upon different occasions done this in two different ways. Sometimes it has made this assignment or mortgage for a short period of time only, a year, or a few years, for example; and sometimes for perpetuity. In the one case, the fund was supposed sufficient to pay, within the limited time, both principal and interest of the money borrowed. In the other, it was supposed sufficient to pay the interest only, or a perpetual annuity equivalent to the interest, government being at liberty to redeem at any time this annuity, upon paying back the principal sum borrowed. When money was raised in the one way, it was said to be raised by anticipation; when in the other, by perpetual funding, or, more shortly, by funding.[1]

In Great Britain the annual land and malt taxes are regularly anticipated every year, by virtue of a borrowing clause constantly inserted into the acts which impose them. The bank of England generally advances at an interest, which since the revolution has varied from 8 to 3 per cent, the sums for which those taxes are granted, and receives payment as their produce gradually comes in. If there is a deficiency, which there always is, it is provided for in the supplies of the ensuing year. The only considerable branch of the public revenue which yet remains unmortgaged is thus regularly spent before it comes in.

[1] Funded debt, therefore, meant originally debt of which the payment of the interest (and sometimes of the principal) was secured by the pledge of certain taxes or other sources of revenue. In time, however, the meaning of the term has changed; and it now means usually debt which, by formal agreement, is to run for a considerable length of time or in perpetuity. See Palgrave, Dictionary of Political Economy II, 169. — Ed.

Like an improvident spendthrift, whose pressing occasions will not allow him to wait for the regular payment of his revenue, the state is in the constant practice of borrowing of its own factors and agents, and of paying interest for the use of its own money.

In the reign of King William, and during a great part of that of Queen Anne, before we had become so familiar as we are now with the practice of perpetual funding, the greater part of the new taxes were imposed but for a short period of time (for four, five, six, or seven years only), and a great part of the grants of every year consisted in loans upon anticipations of the produce of those taxes. The produce being frequently insufficient for paying within the limited term the principal and interest of the money borrowed, deficiencies arose, to make good which it became necessary to prolong the term.

In 1697, by the 8th of William III, c. 20, the deficiencies of several taxes were charged upon what was then called the first general mortgage or fund, consisting of a prolongation to Aug. 1, 1706, of several different taxes, which would have expired within a shorter term, and of which the produce was accumulated into one general fund. The deficiencies charged upon this prolonged term amounted to £5,160,459, 14*s*. 9½*d*.

(Smith then proceeds to explain how this operation was repeated in 1701, 1707, 1708, 1709, 1710, 1711, 1715, and 1717; so that a number of taxes pledged originally for the payment of principal and interest of temporary loans were pledged perpetually for the payment of the interest of perpetual loans representing the principal of temporary loans which had been allowed to go unpaid. — Ed.)

In consequence of those different acts, the greater part of the taxes which before had been anticipated only for a short term of years, were rendered perpetual as a fund for paying, not the capital, but the interest only, of the money which had been borrowed upon them by different successive anticipations.

Had money never been raised but by anticipation, the course of a few years would have liberated the public revenue, without

any other attention of government besides that of not overloading the fund by charging it with more debt than it could pay within the limited term, and of not anticipating a second time before the expiration of the first anticipation. But the greater part of European governments have been incapable of those attentions. They have frequently overloaded the fund even upon the first anticipation; and when this happened not to be the case, they have generally taken care to overload it, by anticipating a second and a third time before the expiration of the first anticipation. The fund becoming in this manner altogether insufficient for paying both principal and interest of the money borrowed upon it, it became necessary to charge it with the interest only, or a perpetual annuity equal to the interest, and such unprovident anticipations necessarily gave birth to the more ruinous practice of perpetual funding. But though this practice necessarily puts off the liberation of the public revenue from a fixed period to one so indefinite that it is not very likely ever to arrive; yet as a greater sum can in all cases be raised by this new practice than by the old one of anticipations, the former, when men have once become familiar with it, has in the great exigencies of the state been universally preferred to the latter. To relieve the present exigency is always the object which principally interests those immediately concerned in the administration of public affairs. The future liberation of the public revenue they leave to the care of posterity.

During the reign of Queen Anne, the market rate of interest had fallen from 6 to 5 per cent, and in the twelfth year of her reign 5 per cent was declared to be the highest rate which could lawfully be taken for money borrowed upon private security. Soon after the greater part of the temporary taxes of Great Britain had been rendered perpetual, and distributed into the Aggregate, South Sea, and General Funds, the creditors of the public, like those of private persons, were induced to accept of 5 per cent for the interest of their money, which occasioned a saving of 1 per cent upon the capital of the greater part of the debts which had been thus funded for perpetuity, or of one sixth of the greater part of the annuities which were paid out of the three great funds above mentioned. This saving left a considerable surplus in the produce of the different taxes which had

been accumulated into those funds, over and above what was necessary for paying the annuities which were now charged upon them, and laid the foundation of what has since been called the Sinking Fund. In 1717, it amounted to £323,434, 7*s.* 7½*d.* In 1727, the interest of the greater part of the public debts was still further reduced to 4 per cent; and in 1753 and 1757, to 3½ and 3 per cent; which reductions still further augmented the sinking fund.[1]

A sinking fund, though instituted for the payment of old, facilitates very much the contracting of new debts. It is a subsidiary fund always at hand to be mortgaged in aid of any other doubtful fund, upon which money is proposed to be raised in any exigency of the state. Whether the sinking fund of Great Britain has been more frequently applied to the one or to the other of those two purposes, will sufficiently appear by and by.

Besides those two methods of borrowing, by anticipations and by perpetual funding, there are two other methods, which hold a sort of middle place between them. These are, that of borrowing upon annuities for terms of years, and that of borrowing upon annuities for lives.[2]

During the reigns of King William and Queen Anne, large

[1] A sinking fund is a fund formed by the setting apart of annual surpluses, or moneys otherwise obtained, with a view to the ultimate application of the fund thus accumulated to the payment of public debts previously incurred. Sir Robert Walpole's sinking fund act of 1716, to which Smith refers, provided that the surplus taxes described by Smith, should "be appropriated, reserved, and employed to and for discharging the principal and interest of such national debts and incumbrances as were incurred before the 25th December, 1716, . . . and to or for none other use, interest, or purpose whatsoever." *Cf.* Palgrave, Dictionary of Political Economy, III, 405. — ED.

[2] Annuities for terms of years — terminable annuities, as they are called — yield the holder interest and an annual installment of the principal of the loan, the payments being so computed as to return the entire principal with interest at the expiration of a certain term of years. Life annuities provide for payments that continue to the end of the annuitant's life. The "perpetual debt," described by Smith in the earlier paragraphs, consisted of perpetual annuities, in which the government agreed to pay in perpetuity the annual interest on the loan. Such an annuity, however, could be canceled by returning the principal, and was not perpetual in the sense that it could never be retired. In Europe annuities have been a favorite method of borrowing money. In the United States the common method has been the issue of bonds which call for the payment of stated interest and the return of the principal at a stipulated date. — ED.

sums were frequently borrowed upon annuities for terms of years, which were sometimes longer and sometimes shorter. In 1693, an act was passed for borrowing one million upon an annuity of 14 per cent, or of £140,000 a year for 16 years. In 1691, an act was passed for borrowing a million upon annuities for lives, upon terms, which in the present times would appear very advantageous. But the subscription was not filled up. . . . In the reign of Queen Anne, money was upon different occasions borrowed both upon annuities for lives, and upon annuities for terms of 32, of 89, of 98, and of 99 years. In 1719, the proprietors of the annuities for 32 years were induced to accept in lieu of them South Sea stock to the amount of $11\frac{1}{2}$ years' purchase of the annuities, together with an additional quantity of stock equal to the arrears which happened then to be due upon them. In 1720, the greater part of the other annuities for terms of years, both long and short, were subscribed into the same fund. . . .

During the two wars which began in 1739 and in 1755, little money was borrowed either upon annuities for terms of years, or upon those for lives. An annuity for 98 or 99 years, however, is worth nearly as much money as a perpetuity, and should, therefore, one might think, be a sum for borrowing nearly as much. But those who, in order to make family settlements, and to provide for remote futurity, buy into the public stocks, would not care to purchase into one of which the value was continually diminishing; and such people make a very considerable proportion both of the proprietors and purchasers of stock. An annuity for a long term of years, therefore, though its intrinsic value may be very nearly the same with that of a perpetual annuity, will not find nearly the same number of purchasers. The subscribers to a new loan, who mean generally to sell their subscription as soon as possible, prefer greatly a perpetual annuity redeemable by parliament, to an irredeemable annuity for a long term of years of only equal amount. The value of the former may be supposed always the same, or very nearly the same; and it makes, therefore, a more convenient transferable stock than the latter.

During the two last-mentioned wars, annuities, either for terms of years or for lives, were seldom granted but as pre-

miums to the subscribers to a new loan, over and above the redeemable annuity or interest upon the credit of which the loan was supposed to be made. They were granted, not as the proper fund upon which the money was borrowed, but as an additional encouragement to the lender.

Annuities for lives have occasionally been granted in two different ways; either upon separate lives, or upon lots of lives, which in French are called Tontines, from the name of their inventor.[1] When annuities are granted upon separate lives, the death of every individual annuitant disburthens the public revenue so far as it was affected by his annuity. When annuities are granted upon tontines, the liberation of the public revenue does not commence till the death of all the annuitants comprehended in one lot, which may sometimes consist of twenty or thirty persons, of whom the survivors succeed to the annuities of all those who die before them, the last survivor succeeding to the annuities of the whole lot. Upon the same revenue more money can always be raised by tontines than by annuities for separate lives. An annuity, with a right of survivorship, is really worth more than an equal annuity for a separate life, and from the confidence which every man naturally has in his own good fortune, the principle upon which is founded the success of all lotteries, such an annuity generally sells for something more than it is worth. In countries where it is usual for government to raise money by granting annuities, tontines are upon this account generally preferred to annuities for separate lives. The expedient which will raise most money is almost always preferred to that which is likely to bring about in the speediest manner the liberation of the public revenue.

In France a much greater proportion of the public debts consists in annuities for lives than in England. According to a memoir presented by the parliament of Bordeaux to the king in 1764, the whole public debt of France is estimated at 2400

[1] The inventor was Tonti, an Italian banker, who lived in the seventeenth century. A tontine is "an annuity shared by subscribers to a loan, with the benefit of survivorship, the annuity being increased (to the surviving subscribers) as the subscribers die, until at last the whole goes to the last survivor, or to the last two or three," according to the terms of the loan. *Cf.* Palgrave, Dictionary of Political Economy, III, 548. —Ed

millions of livres; of which the capital for which annuities for lives has been granted, is supposed to amount to 300 millions, the eighth part of the whole public debt. The annuities themselves are computed to amount to 30 millions a year, the fourth part of 120 millions, the supposed interest of that whole debt. These estimations, I know very well, are not exact, but having been presented by so very respectable a body as approximations to the truth, they may, I apprehend, be considered as such. It is not the different degrees of anxiety in the two governments of France and England for the liberation of the public revenue which occasions this difference in their respective modes of borrowing. It arises altogether from the different views and interests of the lenders.

In England, the seat of government being in the greatest mercantile city in the world, the merchants are generally the people who advance money to government. But by advancing it they do not mean to diminish, but, on the contrary, to increase their mercantile capitals; and unless they expected to sell with some profit their share in the subscription for a new loan, they never would subscribe. But if by advancing their money they were to purchase, instead of perpetual annuities, annuities for lives only, whether their own or those of other people, they would not always be so likely to sell them with a profit. Annuities upon their own lives they would always sell with loss; because no man would give for an annuity upon the life of another, whose age and state of health are nearly the same with his own, the same price which he would give for one upon his own. An annuity upon the life of a third person, indeed, is no doubt of equal value to the buyer and the seller; but its real value begins to diminish from the moment it is granted, and continues to do so more and more as long as it subsists. It can never, therefore, make so convenient a transferable stock as a perpetual annuity, of which the real value may be supposed always the same, or very nearly the same.

In France, the seat of government not being in a great mercantile city, merchants do not make so great a proportion of the people who advance money to government. The people concerned in the finances, the farmers-general, the receivers of the taxes which are not in farm, the court bankers, etc., make the

greater part of those who advance their money in all public exigencies. Such people are commonly men of mean birth, but of great wealth, and frequently of great pride. They are too proud to marry their equals, and women of quality disdain to marry them. They frequently resolve, therefore, to live bachelors, and having neither any families of their own, nor much regard for those of their relations, whom they are not always very fond of acknowledging, they desire only to live in splendor during their own time, and are not unwilling that their fortune should end with themselves. The number of rich people besides, who are either averse to marry, or whose condition of life renders it either improper or inconvenient for them to do so, is much greater in France than in England. To such people, who have little or no care for posterity, nothing can be more convenient than to exchange their capital for a revenue, which is to last just as long, and no longer, than they wish it to do.

The ordinary expense of the greater part of modern governments in time of peace being equal or nearly equal to their ordinary revenue, when war comes, they are both unwilling and unable to increase their revenue in proportion to the increase of their expense. They are unwilling, for fear of offending the people, who, by so great and so sudden an increase of taxes, would soon be disgusted with the war; and they are unable, from not well knowing what taxes would be sufficient to produce the revenue wanted. The facility of borrowing delivers them from the embarrassment which this fear and inability would otherwise occasion. By means of borrowing they are enabled, with a very moderate increase of taxes, to raise, from year to year, money sufficient for carrying on the war, and by the practice of perpetual funding, they are enabled, with the smallest possible increase of taxes, to raise annually the largest possible sum of money. In great empires, the people who live in the capital, and in the provinces remote from the scene of action, feel, many of them, scarce any inconveniency from the war, but enjoy at their ease, the amusement of reading in the newspapers the exploits of their own fleets and armies. To them this amusement compensates the small difference between the taxes which they pay on account of the war, and those which

they had been accustomed to pay in time of peace. They are commonly dissatisfied with the return of peace, which puts an end to their amusement, and to a thousand visionary hopes of conquest and national glory, from a longer continuance of the war.

The return of peace, indeed, seldom relieves them from the greater part of the taxes imposed during the war. These are mortgaged for the interest of the debt contracted in order to carry it on. If, over and above paying the interest of this debt, and defraying the ordinary expense of government, the old revenue, together with the new taxes, produce some surplus revenue, it may perhaps be converted into a sinking fund for paying off the debt. But, in the first place, this sinking fund, even supposing it should be applied to no other purpose, is generally altogether inadequate for paying, in the course of any period during which it can reasonably be expected that peace should continue, the whole debt contracted during the war; and, in the second place, this fund is almost always applied to other purposes.

The new taxes were imposed for the sole purpose of paying the interest of the money borrowed upon them. If they produce more, it is generally something which was neither intended nor expected, and is, therefore, seldom very considerable. Sinking funds have generally arisen, not so much from any surplus of the taxes which was over and above what was necessary for paying the interest or annuity originally charged upon them, as from a subsequent reduction of that interest. That of Holland, in 1655, and that of the Ecclesiastical State, in 1685, were both formed in this manner. Hence the usual insufficiency of such funds.

During the most profound peace, various events occur which require an extraordinary expense, and government finds it always more convenient to defray this expense by misapplying the sinking fund than by imposing a new tax. Every new tax is immediately felt more or less by the people. It occasions always some murmur, and meets with some opposition. The more taxes may have been multiplied, the higher they have been raised upon every different subject of taxation; the more loudly the people complain of every new tax, the more difficult it becomes, too, either to find

out new subjects of taxation, or to raise much higher the taxes already imposed upon the old. A momentary suspension of the payment of debt is not immediately felt by the people, and occasions neither murmur nor complaint. To borrow of the sinking fund is always an obvious and easy expedient for getting out of the present difficulty. The more the public debts may have been accumulated, the more necessary it may have become to study to reduce them, the more dangerous, the more ruinous it may be to misapply any part of the sinking fund; the less likely is the public debt to be reduced to any considerable degree, the more likely, the more certainly, is the sinking fund to be misapplied toward defraying all the extraordinary expenses which occur in time of peace. When a nation is already overburdened with taxes, nothing but the necessities of a new war, nothing but either the animosity of national vengeance, or the anxiety for national security, can induce the people to submit, with tolerable patience, to a new tax. Hence the usual misapplication of the sinking fund.

In Great Britain, from the time that we had first recourse to the ruinous expedient of perpetual funding, the reduction of the public debt in time of peace has never borne any proportion to its accumulation in time of war. It was in the war which began in 1688, and was concluded by the treaty of Ryswick, in 1697, that the foundation of the present enormous debt of Great Britain was first laid.

On Dec. 31, 1697, the public debts of Great Britain, funded and unfunded, amounted to £21,515,742, 13*s*. 8½*d*. A great part of those debts had been contracted upon short anticipations, and some part upon annuities for lives; so that before Dec. 31, 1701, in less than four years, there had partly been paid off, and partly reverted to the public, the sum of £5,121,041, 12*s*. ¾*d*.; a greater reduction of the public debt than has ever since been brought about in so short a period of time. The remaining debt amounted only to £16,394,701, 1*s*. 7¼*d*.

In the war which began in 1702, and which was concluded by the treaty of Utrecht, the public debts were still more accumulated. On Dec. 31, 1714, they amounted to £53,681,076, 5*s*. 6$\frac{1}{12}$*d*. The subscription into the South Sea fund of the short and long annuities increased the capital of the public debts, so

that on Dec. 31, 1722, it amounted to £55,282,978, 1*s.* $3\frac{5}{6}d.$ The reduction of the debt began in 1723, and went on so slowly, that on Dec. 31, 1739, during seventeen years of profound peace, the whole sum paid off was no more than £8,328,354, 17*s.* $11\frac{3}{12}d.$, the capital of the public debt at that time amounting to the sum of £46,954,623, 3*s.* $4\frac{7}{12}d.$

The Spanish war which began in 1739, and the French war which soon followed it, occasioned a further increase of the debt, which, on Dec. 31, 1748, after the war had been concluded by the treaty of Aix la Chapelle, amounted to £78,293,313, 1*s.* $10\frac{3}{4}d.$ The most profound peace of seventeen years' continuance had taken no more than £8,328,354, 17*s.* $11\frac{3}{12}d.$ from it. A war of less than nine years' continuance added £31,338,689, 18*s.* $6\frac{1}{6}d.$ to it.

During the administration of Mr. Pelham, the interest of the public debt was reduced, or at least measures were taken for reducing it, from 4 to 3 per cent; the sinking fund was increased, and some part of the public debt was paid off. In 1755, before the breaking out of the late war, the funded debt of Great Britain amounted to £72,289,673. On Jan. 5, 1763, at the conclusion of the peace, the funded debt amounted to £122,603,336, 8*s.* $2\frac{1}{4}d.$ The unfunded debt has been stated at £13,927,589, 2*s.* 2*d.* But the expense occasioned by the war did not end with the conclusion of the peace; so that though, on Jan. 5, 1764, the funded debt was increased (partly by a new loan, and partly by funding a part of the unfunded debt) to £129,586,789, 10*s.* $1\frac{3}{4}d.$, there still remained (according to the very well-informed author of the Considerations on the Trade and Finances of Great Britain) an unfunded debt, which was brought to account in that and the following year, of £9,975,017, 12*s.* $2\frac{15}{44}d.$ In 1764, therefore, the public debt of Great Britain, funded and unfunded together, amounted, according to this author, to £139,516,807, 2*s.* 4*d.* The annuities for lives, too, which had been granted as premiums to the subscribers to the new loans in 1757, estimated at fourteen years' purchase, were valued at £472,500; and the annuities for long terms of years, granted as premiums likewise in 1761 and 1762, estimated at $27\frac{1}{2}$ years' purchase, were valued at £6,826,875. During a peace of about seven years' continuance, the prudent and truly

patriot administration of Mr. Pelham was not able to pay off an old debt of six millions. During a war of nearly the same continuance, a new debt of more than seventy-five millions was contracted.

On Jan. 5, 1775, the funded debt of Great Britain amounted to £124,996,086, 1*s.* 6¼*d.* The unfunded, exclusive of a large civil list debt, to £4,150,236, 3*s.* 11⅞*d.* Both together, to £129,146,322, 5*s.* 6*d.* According to this account, the whole debt paid off during eleven years' profound peace amounted only to £10,415,474, 16*s.* 9⅞*d.* Even this small reduction of debt, however, has not been all made from the savings out of the ordinary revenue of the state. Several extraneous sums, altogether independent of that ordinary revenue, have contributed toward it. . . . The debt, therefore, which since the peace has been paid out of the savings from the ordinary revenue of the state, has not, one year with another, amounted to half a million a year. The sinking fund has, no doubt, been considerably augmented since the peace, by the debt which has been paid off, by the reduction of the redeemable four per cents to three per cents, and by the annuities for lives which have fallen in; and, if peace were to continue, a million, perhaps, might now be annually spared out of it toward the discharge of the debt. Another million, accordingly, was paid in the course of last year; but at the same time, a large civil list debt was left unpaid, and we are now involved in a new war, which in its progress, may prove as expensive as any of our former wars.[1] The new debt, which will probably be contracted before the end of the next campaign, may perhaps be nearly equal to all the old debt which had been paid off from the savings out of the ordinary revenue of the state. It would be altogether chimerical, therefore, to expect that the public debt should ever be completely discharged by any savings which are likely to be made from that ordinary revenue as it stands at present.

[1] It has proved more expensive than any of our former wars; and has involved us in an additional debt of more than 100 millions. During a profound peace of eleven years, little more than 10 millions of debt was paid; during a war of seven years, more than 100 millions was contracted. (This note was added by Smith to the third edition of the Wealth of Nations, which appeared in 1784. The total British debt in 1783 had risen to £238,000,000. By 1816 the wars with France had increased it to about £876,000,000, the highest point ever reached. — ED.)

CHAPTER XXIII

THE NATURE AND ECONOMIC EFFECTS OF PUBLIC DEBTS

86. Early Optimistic Theories. — The earliest writers upon public debts generally held excessively optimistic or pessimistic views concerning their effects. Bishop Berkeley suggested that the public funds of Great Britain were to be considered "a mine of gold";[1] and Melon, a French mercantilist, declared:[2] "The debts of a state are debts owed by the right hand to the left, by which the body will be in no way weakened if it has the necessary nourishment and is able to distribute it."

But most, if not all, other panegyrists of public borrowing were outdone by Isaac Pinto, a Dutch merchant of Portuguese descent, who wrote:[3]

> I say that the national debt[4] has enriched the nation. Here is the way I prove it. At every loan the government of England, by granting the creditors the proceeds of certain taxes which are pledged to pay the interest, creates a new, artificial capital which did not exist before and now becomes permanent, fixed, and solid. This capital, by the agency of credit, circulates to the advantage of the public as if it were an actual sum of money by which the state had been enriched. Let us take, for example, the twelve millions Great Britain borrowed in 1760, and see what became of them. Is it not true that they were spent in great part within the nation itself? It is only the subsidies to other states and a part of the sums spent in Germany which were a pure loss. I say a part because even in

[1] The Querist, No. 233 (1735–37).
[2] Essai politique sur le commerce, ch. 23 (1734).
[3] Traité de la circulation et du crédit (1771).
[4] Pinto is here writing of the British debt. — Ed.

the war on the continent the English nation profited by various contracts for supplies and by the English subjects thereby given employment. Besides when they spent their money in Germany, they were simply fertilizing a land from which they draw gain through their commerce. The wealth of Germany redounds always to the profit of the trading nations. But I confine myself to the mere observation that it is incontestable that a great part of this loan has been employed and kept in circulation in the nation itself. England, therefore, will have saved a great part of these twelve millions diffused and absorbed in the nation itself; and furthermore the moneyed capital of the creditors — who are, in greater part, Englishmen — will be augmented by twelve millions which did not formerly exist.

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The enormous sum which composes the national debt has never existed at any one time; the magic of credit and of the circulation of money has produced this mass of wealth by successive operations with the same coins. . . . The existing supply of specie suffices to give each part of the public funds its intrinsic value as it comes into the market, without exceeding the limits of an easy and useful circulation. Public funds are the magnets which draw money; what I say is literally true. Here is the way in which possessors of former issues of government securities proceed when they undertake to make new loans to the government. Not only will they obtain some money in England by selling at a somewhat lower figure the consolidated annuities[1] they hold; but also, by offering these annuities as security, they will be able to arrange with foreign capitalists to obtain the large sums which the credit of individuals would not command. By this latter expedient they will gather in for some time a great deal of money from other countries, and may keep it until the circulation has had time to gain an equilibrium and the new loans can be distributed among a large number of purchasers. There is the solution of this great problem or phenomenon of finance. Every one was surprised, and even astonished, to see England borrow twelve millions annually for

[1] The consolidated 3 per cent stock, established in 1751, was long the principal part of the British debt. Hence the term "consols." — ED.

a series of years. This was done by means of former issues of the government, with the aid of credit and the monetary circulation.

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Reflect then on these principles — the nature, the essence, and the effects of public loans when properly made and employed. You will find that they effectively enrich the state and do not impoverish it; that they double the moneyed capital, and, consequently, the power of contracting more loans.

Pinto did not go so far as to think that this process of creating wealth by public borrowing could continue indefinitely. He said, in fact, a country could "accumulate too great a debt" and thereby embarrass itself. But he insisted that, within limits, public debt is an addition to the wealth of a nation, and, therefore, should never be wholly extinguished:

It follows from all I have just said that, even if England could, thanks to a long peace, the operation of her sinking fund, and the growth of her commerce, succeed in paying off the whole of her national debt, she ought not to do it. It would be very harmful to that kingdom not to preserve at least sixty millions sterling of its artificial riches, the utility and necessity of which I have demonstrated.

87. The Views of Alexander Hamilton. — Views similar to those of Pinto's were sometimes expressed by Alexander Hamilton, who, as secretary of the treasury, was obliged to give much study to the subject of public debts. Perhaps the most extreme statement made by Hamilton was the following:[1]

Trace the progress of a public debt in a particular case. The government borrows of an individual $100 in specie, for which it gives its funded bonds. These $100 are expended on some branch of the public service. It is evident they are not annihilated; they only pass from the individual who lent, to the individual or individuals to whom the government has disbursed

[1] Lodge's edition of Hamilton's works, VII, 407–408.

them. They continue, in the hands of their new masters, to perform their usual functions, as capital. But besides this, the lender has the bonds of the government for the sum lent. These, from their negotiable and easily vendible nature, can at any moment be applied by him to any useful or profitable undertaking which occurs; and thus the credit of the government produces a new and additional capital, equal to $100, which, with the equivalent for the interest on that sum, temporarily diverted from other employments while passing into and out of the public coffers, continues its instrumentality as a capital, while it remains not reimbursed.

In his celebrated Report on Public Credit, in 1790, Hamilton advanced the same argument, although perhaps more moderately, in favor of funding the mass of debts inherited from the old Confederation. He said:[1]

It is a well-known fact, that, in countries in which the national debt is properly funded, and an object of established confidence, it answers most of the purposes of money. Transfers of stock, or public debt, are there equivalent to payments in specie; or, in other words, stock, in the principal transactions of business, passes current as specie. The same thing would, in all probability, happen here, under the like circumstances.

The benefits of this are various and obvious:

First. Trade is extended by it; because there is a larger capital to carry it on, and the merchant can, at the same time, afford to trade for smaller profits; as his stock, which, when unemployed, brings him in an interest from the government, serves him also as money when he has a call for it in his commercial operations.

Secondly. Agriculture and manufactures are also promoted by it; for the like reason, that more capital can be commanded to be employed in both; and because the merchant, whose enterprise in foreign trade gives to them activity and extension, has greater means for enterprise.

Thirdly. The interest of money will be lowered by it; for this is always in a ratio to the quantity of money, and to the

[1] Works, II, 52 *et seq.*

quickness of circulation. This circumstance will enable both the public and individuals to borrow on easier and cheaper terms.

And, from the combination of these effects, additional aids will be furnished to labor, to industry, and to arts of every kind. But these good effects of a public debt are only to be looked for when, by being well funded, it has acquired an adequate and stable value; till then, it has rather a contrary tendency. The fluctuation and insecurity incident to it in an unfunded state, render it a mere commodity, and a precarious one. As such, being only an object of occasional and particular speculation, all the money applied to it is so much diverted from the more useful channels of circulation, for which the thing itself affords no substitute; so that, in fact, one serious inconvenience of an unfunded debt is, that it contributes to the scarcity of money.

This distinction, which has been little, if at all attended to, is of the greatest moment; it involves a question immediately interesting to every part of the community, which is no other than this: Whether the public debt, by a provision for it on true principles, shall be rendered a substitute for money; or whether, by being left as it is, or by being provided for in such a manner as will wound these principles, and destroy confidence, it shall be suffered to continue as it is — a pernicious drain of our cash from the channels of productive industry.

The effect which the funding of the public debt, on right principles, would have upon landed property, is one of the circumstances attending such an arrangement, which has been least adverted to, though it deserves the most particular attention. The present depreciated state of that species of property is a serious calamity. The value of cultivated lands, in most of the states, has fallen, since the Revolution, from 25 to 50 per cent. In those further south, the decrease is still more considerable. Indeed, if the representations continually received from that quarter may be credited, lands there will command no price which may not be deemed an almost total sacrifice. This decrease in the value of lands ought, in a great measure, to be attributed to the scarcity of money; consequently, whatever produces an augmentation of the moneyed capital of the country must have a proportional effect in raising that value. The

beneficial tendency of a funded debt, in this respect, has been manifested by the most decisive experience in Great Britain.[1]

At another time, after restating his belief that a funded debt operates as capital, he proceeded to make some important qualifications of the doctrine :[2]

The effect of a funded debt, as a species of capital, has been noticed upon a former occasion ; but a more particular elucidation of the point seems to be required by the stress which is here laid upon it. This shall accordingly be attempted.

Public funds answer the purpose of capital, from the estimation in which they are usually held by moneyed men ; and consequently from the ease and dispatch with which they can be turned into money. This capacity of prompt convertibility into money causes a transfer of stock to be, in a great number of cases, equivalent to a payment in coin ; and where it does not happen to suit the party who is to receive to accept a transfer of stock, the party who is to pay is never at a loss to find elsewhere a purchaser of his stock, who will furnish him, in lieu of it, with the coin of which he stands in need.

Hence, in a sound and settled state of the public funds, a man possessed of a sum in them can embrace any scheme of business which offers, with as much confidence as if he were possessed of an equal sum in coin.

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In the question under discussion, it is important to distinguish between an absolute increase of capital, or an accession of real wealth, and an artificial increase of capital, as an engine of business, or as an instrument of industry and commerce. In the first sense, a funded debt has no pretensions to being deemed

[1] Yet, Hamilton did not go so far as to say, as Pinto did, that the debt should never be wholly paid off. He said, in fact: "Persuaded as the secretary is that the proper funding of the present debt will render it a national blessing, yet he is so far from acceding to the position, in the latitude in which it is sometimes laid down, that 'public debts are public benefits' — a position inviting to prodigality, and liable to dangerous abuse — that he ardently wishes to see it incorporated, as a fundamental maxim, in the system of public credit in the United States, that the creation of debt should always be accompanied with the means of extinguishment. This he regards as the true secret for rendering public credit immortal." [2] Works, III, 346–347.

an increase of capital;[1] in the last, it has pretensions which are not easy to be controverted. Of a similar nature is bank credit, and, in an inferior degree, every species of private credit.

But though a funded debt is not, in the first instance, an absolute increase of capital, or an augmentation of real wealth, yet, by serving as a new power in the operations of industry, it has, within certain bounds, a tendency to increase the real wealth of a community; in like manner, as money borrowed by a thrifty farmer to be laid out in the improvement of his farm may, in the end, add to his stock of real riches.

There are respectable individuals, who, from a just aversion to an accumulation of public debt, are unwilling to concede to it any kind of utility; who can discern no good to alleviate the ill with which they suppose it pregnant; who cannot be persuaded that it ought, in any sense, to be viewed as an increase of capital, lest it should be inferred that the more debt, the more capital, the greater the burdens, the greater the blessings of the community.

But it interests the public councils to estimate every object as it truly is; to appreciate how far the good in any measure is compensated by the ill, or the ill by the good: either of them is seldom unmixed.

Neither will it follow that an accumulation of debt is desirable, because a certain degree of it operates as capital. There may be a plethora in the political as in the natural body. There may be a state of things in which any such artificial capital is unnecessary. The debt, too, may be swelled to such a size as that the greatest part of it may cease to be useful as a capital, serving only to pamper the dissipation of idle and dissolute individuals; as that the sums required to pay the interest upon it may become oppressive, and beyond the means which a government can employ, consistently with its tranquillity, to raise them; as that the resources of taxation, to face the debt, may have been strained too far to admit of extensions adequate to exigencies which regard the public safety. Where this critical point is

[1] This statement offers the sharpest contrast to the proposition laid down by Hamilton in the first extract here given. It is not possible to reconcile all of his remarks about public credit. — ED.

cannot be pronounced; but it is impossible to believe that there is not such a point.

88. National Debts as a "National Blessing." — During the Civil War our government frequently had difficulty in marketing its bonds upon the terms prescribed by Congress; and on several occasions employed a Philadelphia banker, Mr. Jay Cooke, as general subscription agent, to sell the bonds to investors. Mr. Cooke engaged a large number of sub-agents, and pushed vigorously the sale of the bonds. In the course of this work he published and distributed broadcast a pamphlet in which the national debt is represented as a national blessing. The following extracts from this pamphlet[1] are now presented:

We lay down the proposition that our national debt, made permanent and rightly managed, will be a national blessing.

THE BURTHEN OF INTEREST THE MEASURE OF A DEBT — NOT THE PRINCIPAL

In studying these Permanent Debts, and discussing the policy of maintaining them, or discharging them by payment, the mind should free itself from the tyranny of words. Great Britain is in debt to Great Britain. Great Britain does, indeed, owe Great Britain four thousand millions of dollars. The burthen of the debt crushes the mind in contemplation of it. But its vastness is not the measure of the obligation — for there is no engagement on the part of the debtor kingdom to pay the principal of the debt, and little if any expectation, and less desire on the part of its creditor subjects that it shall be paid. The principal of the debt being thus removed from our educated idea of a legal burthen, and of the necessity to discharge a pecuniary obligation, ceases to represent the burthen. The interest of the debt only becomes the measure of its burthen. Great Britain does owe to Great Britain confessedly four thousand millions. But practically, and by consent and harmonious arrangement,

[1] How Our National Debt may be a National Blessing, by Samuel Wilkeson. Issued by Jay Cooke (Philadelphia, 1865).

Great Britain owes to Great Britain only one hundred and twenty-seven millions of dollars a year. And that is a very small debt for the proprietors and workmen of the "Workshop of the world" to owe to each other. . . .

Such, too, should be the regard of our Debt. The United States will owe, mostly to the people of the United States, one hundred and sixty-five millions of dollars a year. The burthen nominally $86.72 upon every citizen, and less than that of the British debt, unlike that of Great Britain, will every year rapidly diminish by the rapid increase of our population by immigration and natural growth, and by the rapid augmentation of our wealth. For, among the other blessings of our War will probably be the transfer of the Workshop of the world, from England to America.

The British Debt added Four Thousand Millions to Previous British Capital

The Englishman who has £20,000 in 3 per cent consols at his banker's, and only ten guineas in his pocket, and who gives assent to a proposal made to him to go mine for coal on Vancouver's Island, has got £20,000 in cash to go into the operation. He knows that positively. The world knows it. British consols are cash capital. This cannot be controverted. And the four thousand millions of British debt is national cash capital to the industry and commerce of Great Britain. For half a century this seemingly and nominally huge and burthensome debt has served to vitalize the manufacturing and trading genius of the English people, and as money, has enabled the British to do for that long time the marine carrying for the world, and to make for the world, cloth, iron, steel, tin, and hardware. This enormous mass of capital, infused into the business of England at the close of her twenty-two years' war with the French Republic and Empire — almost always of par with gold — convertible daily and hourly into gold — accepted as gold in all transactions, was the source of that prodigious development of mechanical industry and accumulation of wealth, which so suddenly bore upward the English after the battle of Waterloo to the command of the trade and finances of the globe.

It was not the industry, persistency, and frugality of the British people — it was not their insular position — it was not their coals nor their iron stone that gave them supremacy on the ocean and in the money markets and trading exchanges of both hemispheres. Their insular position was against them. Their limited island territory was unfavorable to empire. Their want of space and their climate made them dependent upon other countries for their bread. They became supreme as merchants, manufacturers, and money lenders, simply because their national debt added four thousand millions of capital to their previously acquired wealth, and simply because this vast infusion of wealth, which had every business virtue of standard coin, spurred the industry of the island, developed its mineral resources, invented and put in motion a vast mass of machinery which spun, wove, and hammered for the world, and undersold the world, and sent the world to London to pay debt and to borrow money. What place among the cities of the world would not a permanent American debt of four thousand millions give New York?

* * * * * * *

Our Debt just so much Capital added to our Wealth

It is precisely so with the War Debt of the United States. Seven-Thirties are available for any enterprise to which unoccupied lands, undeveloped mines, unestablished arts, and unseized commerce, invite Americans. They are cash capital, literally, absolutely, and without figure of speech. Practically they are cash in bank and cash in the pocket. The artificial measures of their value which Stock Exchanges have succeeded in instituting, at times nominally gave fluctuation to their worth as they lie in the bureau drawers of farmers. But in reality the depreciation of Wall Street does not whittle off the thousandth part of a hair's breadth from that worth. Those farmers know that they are a first bond and mortgage upon all the United States, and on all the people in the United States, and upon their children, and their children's children. But whether 3 per cent above par or 1 per cent above par, holders of this War Debt of Three Thousand Millions can at any day and any

hour, from San Francisco to New York, and from Portland to New Orleans, convert it into cash.

The Funded Debt of the United States is the addition of three thousand millions of dollars to the previously realized wealth of the nation. It is three thousand millions added to its available active capital. To pay this debt would be to extinguish this capital and to lose this wealth. To extinguish this capital and lose this wealth would be an inconceivably great national misfortune.

Our National Debt the Bond of Our Union

This, our National War Debt, should be held forever in place as the political tie of the states and the bond forever of a fraternal nationality. It will give a common interest in the Union that nothing else can give. It will impart to a co-partnership between thirty-five millions of people the unity of feeling arising from a community of interest in a co-partnership capital of three thousand millions of dollars. Tied to the Union by the Union debt, nor Western states, nor Southern states — states beyond the Rocky Mountains nor states by the Atlantic Sea — states that plant nor states that weave — states that mine nor states that smelt and hammer, can ever find inducement in sectional interests to draw asunder from each other. . . .

Our National Debt Protection to our National Industry

Our National Debt should be held firmly in place as the foundation of a system of diversified national industry which shall relieve us from dependence upon Europe — shall give us the near and cheap home market instead of the distant and costly foreign market — shall double the profits of farming by doubling the markets for farm products — shall swell the class that is devoted to Agriculture, which is the sheet anchor of Democracies — shall free man by freeing Labor, by giving it many markets in which to sell itself to competing bidders. The maintenance of our National Debt is Protection. The destruction of it by payment is bondage again to the manufacturers of Europe.

89. The Views of Adam Smith. — A much less favorable view[1] of the nature and effects of a public debt was taken by Adam Smith who wrote:[2]

The public funds of the different indebted nations of Europe, particularly those of England, have by one author been represented as the accumulation of a great capital superadded to the other capital of the country, by means of which its trade is extended, its manufactures multiplied, and its lands cultivated and improved much beyond what they could have been by means of that other capital only. He does not consider that the capital which the first creditors of the public advanced to government, was, from the moment in which they advanced it, a certain portion of the annual produce turned away from serving in the function of a capital to serve in that of a revenue; from maintaining productive laborers to maintain unproductive ones, and to be spent and wasted, generally in the course of the year, without even the hope of any future reproduction. In return for the capital which they advanced they obtained, indeed, an annuity in the public funds in most cases of more than equal value. This annuity, no doubt, replaced to them their capital, and enabled them to carry on their trade and business to the same, or, perhaps, to a greater extent than before; that is, they were enabled either to borrow of other people a new capital upon the credit of this annuity, or by selling it, to get from other people a new capital of their own, equal or superior to that which they had advanced to government. This new capital, however, which they in this manner either bought or borrowed of other people, must have existed in the country before, and must have been employed as all capitals are, in maintaining productive labor. When it came into the hands of those who had advanced their money to government, though it was in some respects a new capital to

[1] Hume and others had already expressed unfavorable views. Hume, for instance, argued that public borrowing, (1) caused undue concentration of population and wealth at the capital; (2) tended, so far as public stocks served as credit money, to drive gold and silver out of the country; (3) caused injurious increase of taxes; (4) made a country tributary to foreigners in case any large amount of its debt was held in other lands; and (5) enabled fundholders to live a "useless and inactive life" at the expense of the industrious taxpayers. Essay on Public Credit.

[2] Wealth of Nations, Bk. V, ch. 3.

them, it was not so to the country; but was only a capital withdrawn from certain employments in order to be turned toward others. Though it replaced to them what they had advanced to government, it did not replace it to the country. Had they not advanced this capital to government, there would have been in the country two capitals, two portions of the annual produce instead of one, employed in maintaining productive labor.

When for defraying the expense of government a revenue is raised within the year from the produce of free or unmortgaged taxes, a certain portion of the revenue of private people is only turned away from maintaining one species of unproductive labor toward maintaining another. Some part of what they pay in those taxes might, no doubt, have been accumulated into capital, and consequently employed in maintaining productive labor, but the greater part would probably have been spent, and consequently employed in maintaining unproductive labor. The public expense, however, when defrayed in this manner, no doubt hinders more or less the further accumulation of new capital; but it does not necessarily occasion the destruction of any actually existing capital.

When the public expense is defrayed by funding, it is defrayed by the annual destruction of some capital which had before existed in the country; by the perversion of some portion of the annual produce which had before been destined for the maintenance of productive labor, toward that of unproductive labor.[1]

[1] Elsewhere (Bk. II, ch. 3) Smith had defined productive and unproductive labor as follows:

"There is one sort of labor which adds to the value of the subject upon which it is bestowed: there is another which has no such effect. The former, as it produces a value, may be called productive; the latter, unproductive labor. Thus the labor of a manufacturer adds, generally, to the value of the materials which he works upon, that of his own maintenance and of his master's profit. The labor of a menial servant, on the contrary, adds to the value of nothing. Though the manufacturer has his wages advanced to him by his master, he, in reality, costs him no expense, the value of those wages being generally restored, together with a profit, in the improved value of the subject upon which his labor is bestowed. But the maintenance of a menial servant never is restored. A man grows rich by employing a multitude of manufacturers: he grows poor by maintaining a multitude of menial servants. The labor of the latter, however, has its value, and deserves its reward as well as that of the former. But the labor of the manufacturer fixes and realizes itself in some particular subject or vendible commodity, which lasts for some time at least after that labor is

As in this case, however, the taxes are lighter than they would have been, had a revenue sufficient for defraying the same expense been raised within the year, the private revenue of individuals is necessarily less burdened, and consequently their ability to save and accumulate some part of that revenue into capital is a good deal less impaired. If the method of funding destroy more old capital, it at the same time hinders less the accumulation or acquisition of new capital, than that of defraying the public expense by a revenue raised within the year. Under the system of funding, the frugality and industry of private people can more easily repair the breaches which the waste and extravagance of government may occasionally make in the general capital of the society.

It is only during the continuance of war that the system of funding has this advantage over the other system. Were the expense of war to be defrayed always by a revenue raised within the year, the taxes from which that extraordinary revenue was drawn would last no longer than the war. The ability of private people to accumulate, though less during the war, would have been greater during the peace than under the system of funding. War would not necessarily have occasioned the destruction of any old capitals, and peace would have occasioned the accumulation of many more new. Wars would in general be more speedily concluded and less wantonly undertaken. The people feeling, during the continuance of the war, the complete burden of it, would soon grow weary of it, and government, in order to humor them, would not be under the necessity of carrying it on longer than it was necessary to do so. The foresight of the heavy and unavoidable burdens of war would hinder the people from wantonly calling for it when there was no real or solid interest to fight for. The seasons during which the ability of private people to accumulate was somewhat

past. It is, as it were, a certain quantity of labor stocked and stored up to be employed, if necessary, upon some other occasion. That subject, or what is the same thing, the price of that subject, can afterward, if necessary, put into motion a quantity of labor equal to that which had originally produced it. The labor of the menial servant, on the contrary, does not fix or realize itself in any particular subject or vendible commodity. The services of the menial generally perish in the very instant of their performance, and seldom leave any trace of value behind them, for which an equal quantity of service could afterward be procured." — ED.

impaired, would occur more rarely, and be of shorter continuance. Those, on the contrary, during which that ability was in the highest vigor, would be of much longer duration than they can well be under the system of funding.

When funding, besides, has made a certain progress, the multiplication of taxes which it brings along with it sometimes impairs as much the ability of private people to accumulate even in time of peace, as the other system would in time of war. The peace revenue of Great Britain amounts at present to more than ten millions a year. If free and unmortgaged, it might be sufficient, with proper management, and without contracting a shilling of new debt, to carry on the most vigorous war. The private revenue of the inhabitants of Great Britain is at present as much incumbered in time of peace, their ability to accumulate it as much impaired, as it would have been in the time of the most expensive war, had the pernicious system of funding never been adopted.

In the payment of the interest of the public debt, it has been said, it is the right hand which pays the left. The money does not go out of the country. It is only a part of the revenue of one set of the inhabitants which is transferred to another; and the nation is not a farthing the poorer. This apology is founded altogether in the sophistry of the mercantile system, and after the long examination which I have bestowed upon that system, it may perhaps be unnecessary to say anything further about it. It supposes that the whole public debt is owing to the inhabitants of the country, which happens not to be true; the Dutch, as well as several other foreign nations, having a very considerable share in our public funds. But though the whole debt were owing to the inhabitants of the country, it would not upon that account be less pernicious.

Land and capital stock are the two original sources of all revenue, both private and public. Capital stock pays the wages of productive labor, whether employed in agriculture, manufactures, or commerce. The management of those two original sources of revenue belongs to two different sets of people; the proprietors of land, and the owners or employers of capital stock.

The proprietor of land is interested, for the sake of his own

revenue, to keep his estate in as good condition as he can, by building and repairing his tenants' houses, by making and maintaining the necessary drains and inclosures, and all those other expensive improvements which it properly belongs to the landlord to make and maintain. But by different land taxes the revenue of the landlord may be so much diminished; and by different duties upon the necessaries and conveniences of life, that diminished revenue may be rendered of so little real value, that he may find himself altogether unable to make or maintain those expensive improvements. When the landlord, however, ceases to do his part, it is altogether impossible that the tenant should continue to do his. As the distress of the landlord increases, the agriculture of the country must necessarily decline.

When, by different taxes upon the necessaries and conveniences of life, the owners and employers of capital stock find that whatever revenue they derive from it will not, in a particular country, purchase the same quantity of those necessaries and conveniences which an equal revenue would in almost any other, they will be disposed to remove to some other. And when, in order to raise those taxes, all or the greater part of merchants and manufacturers, that is, all or the greater part of the employers of great capitals, come to be continually exposed to the mortifying and vexatious visits of the taxgatherers, this disposition to remove will soon be changed into an actual removal. The industry of the country will necessarily fall with the removal of the capital which supported it, and the ruin of trade and manufactures will follow the declension of agriculture.

To transfer from the owners of those two great sources of revenue, land and capital stock, from the persons immediately interested in the good condition of every particular portion of land, and in the good management of every particular portion of capital stock, to another set of persons (the creditors of the public, who have no such particular interest), the greater part of the revenue arising from either, must, in the long run, occasion both the neglect of land, and the waste or removal of capital stock. A creditor of the public has, no doubt, a general interest in the prosperity of the agriculture, manufactures, and commerce of the country; and consequently in the good con-

dition of its lands, and in the good management of its capital stock. Should there be any general failure or declension in any of these things, the produce of the different taxes might no longer be sufficient to pay him the annuity or interest which is due to him. But a creditor of the public, considered merely as such, has no interest in the good condition of any particular portion of land, or in the good management of any particular portion of capital stock. As a creditor of the public he has no knowledge of any such particular portion. He has no inspection of it. He can have no care about it. Its ruin may in some cases be unknown to him, and cannot directly affect him.

The practice of funding has gradually enfeebled every state which has adopted it. The Italian republics seem to have begun it. Genoa and Venice, the only two remaining which can pretend to an independent existence, have both been enfeebled by it. Spain seems to have learned the practice from the Italian republics, and (its taxes being probably less judicious than theirs) it has, in proportion to its natural strength, been still more enfeebled. The debts of Spain are of very old standing. It was deeply in debt before the end of the sixteenth century, about a hundred years before England owed a shilling. France, notwithstanding all its national resources, languishes under an oppressive load of the same kind. The republic of the United Provinces is as much enfeebled by its debts as either Genoa or Venice. Is it likely that in Great Britain alone a practice, which has brought either weakness or desolation into every other country, should prove altogether innocent?

The system of taxation established in those different countries, it may be said, is inferior to that of England. I believe it is so. But it ought to be remembered, that when the wisest government has exhausted all the proper subjects of taxation, it must, in cases of urgent necessity, have recourse to improper ones. The wise republic of Holland has upon some occasions been obliged to have recourse to taxes as inconvenient as the greater part of those of Spain. Another war begun before any considerable liberation of the public revenue had been brought about, and growing in its progress as expensive as the last war, may, from irresistible necessity,

render the British system of taxation as oppressive as that of Holland, or even as that of Spain. To the honor of our present system of taxation, indeed, it has hitherto given so little embarrassment to industry, that during the course even of the most expensive wars, the frugality and good conduct of individuals seem to have been able, by saving and accumulation, to repair all the breaches which the waste and extravagance of government had made in the general capital of the society. At the conclusion of the late war, the most expensive that Great Britain ever waged, her agriculture was as flourishing, her manufactures as numerous and as fully employed, and her commerce as extensive, as they had ever been before. The capital, therefore, which supported all those different branches of industry, must have been equal to what it had ever been before. Since the peace, agriculture has been still further improved, the rents of houses have risen in every town and village of the country, a proof of the increasing wealth and revenue of the people; and the annual amount of the greater part of the old taxes, of the principal branches of the excise and customs in particular, has been continually increasing, an equally clear proof of an increasing consumption, and consequently of an increasing produce, which could alone support that consumption. Great Britain seems to support with ease a burden, which, half a century ago, nobody believed her capable of supporting. Let us not, however, upon this account rashly conclude that she is capable of supporting any burden, nor even be too confident that she could support, without great distress, a burden a little greater than what has already been laid upon her.

When national debts have once been accumulated to a certain degree, there is scarce, I believe, a single instance of their having been fairly and completely paid. The liberation of the public revenue, if it has ever been brought about at all, has always been brought about by a bankruptcy; sometimes by an avowed one, but always by a real one, though frequently by a pretended payment.

(Smith then proceeds to consider such expedients as tampering with the coinage.)

90. The Views of Jean Baptiste Say. — To much the same effect, a generation later, the French economist, Say, wrote:

There is this grand distinction between an individual borrower and a borrowing government, that, in general, the former borrows capital for the purpose of beneficial employment, the latter for the purpose of barren consumption and expenditure. A nation borrows, either to satisfy an unlooked-for demand, or to meet an extraordinary emergency; to which ends, the loan may prove effectual or ineffectual; but, in either case, the whole sum borrowed is so much value consumed and lost, and the public revenue remains burdened with the interest upon it.

Melon maintains, that national debt is no more than a debt from the right hand to the left, which nowise enfeebles the body politic. But he is mistaken; the state is enfeebled, inasmuch as the capital lent to its government, having been destroyed in the consumption of it by the government, can no longer yield anybody the profit, or in other words, the interest, it might earn in the character of a productive means. Wherewith, then, is the government to pay the interest of its debt? Why, with a portion of the revenue arising from some other source, which it must transfer from the taxpayer to the public creditor for the purpose.

Before the act of borrowing, there will have been in existence two productive capitals, each of them yielding, or capable of yielding, revenue; that is to say, a capital about to be lent to the government, and a capital whereon the future taxpayers derive that revenue, which is about to be applied in satisfaction of the interest upon the capital lent. After the act of borrowing, there will remain but one of these capitals; *viz.* the latter of the two, whereof the revenue is thenceforward no longer at the disposal of its former possessors, the present taxpayers, since it must be taken in some form of taxation or other by the government, for the sake of providing the payment of interest to its creditors. The lender loses no part of his revenue: the only loser is the payer of taxes.

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National loans of every kind are attended with the universal disadvantage, of withdrawing capital from productive employment, and diverting it to the channel of barren consumption;

and, in countries where the credit of the government is at a low ebb, with the further and particular disadvantage, of raising the interest of capital. Who can be expected to lend at 5 per cent to the farmer, the manufacturer, or the merchant, while he can readily get an offer of 7 or 8 per cent from the government? That class of revenue, which has been called profit of capital, is thereby advanced in its ratio, at the expense of the consumer: the consumption falls off, in consequence of the advance in the real price of products; the productive agency of the other sources of production are less in demand, and, consequently, worse paid; and the whole community is the sufferer, with the sole exception of the capitalist.

The ability to borrow affords one main advantage to the state; *viz.* the power of apportioning the burden entailed by a sudden emergency among a great number of successive years. In the present state of public affairs, and on the present scale of international warfare, no country could support the enormous expense from its ordinary annual revenue. The larger states pay in taxation nearly as much as they are able; for economy is by no means the order of the day with them; and their ordinary expenditure seldom falls much short of the income. If the expenditure must be doubled to save the nation from ruin, borrowing is usually the only resource; unless it can make up its mind to violate all subsisting engagements, and be guilty of spoliation of its own subjects and foreigners too. The faculty of borrowing is a more powerful agent than even gunpowder; but probably the gross abuse that is made of it will soon destroy its efficacy.

Great pains have been taken, to find in the system of borrowing, as well as in taxation, some inherent advantage, beyond that of supplying the public consumption. But a close examination will expose the hopelessness of such an attempt.

It has been maintained, for instance, that the debentures and securities which form a national debt, become real and substantial values existing within the community; that the capital, of which they are the evidence or representative, is so much positive wealth, and must be reckoned as an item of the total substance of the nation. But it is not so; a written contract or security is a mere evidence, that such or such property belongs

to such an individual. But wealth consists in the property itself, and not in the parchment, by which its ownership is evidenced; therefore, *à fortiori*, a security is not even an evidence of wealth, where it does not represent an actual existing value, but when it operates as a mere power of attorney from the government to its creditor, enabling him to receive annually a specified portion of the revenue expected to be levied upon the taxpayers at large. Supposing the security to be canceled, as it might be by a national bankruptcy, would there be the least diminution of wealth in the community? Undoubtedly not. The only difference would be, that the revenue, which before went to the public creditor, would now be at the disposal of the taxpayer, from whom it used to be taken.

Those who tell us that the annual circulation is increased by the whole amount of the annual disbursements of the government, forgot that these disbursements are made out of the annual products, and are a portion of the annual revenue, taken from the taxpayer, which would have been brought into the general circulation just the same, although no such thing as national debt had existed. The taxpayer would have spent what is now spent by the public creditor; that is all.

The sale or purchase of debentures or securities is not a productive circulation, but a mere substitution of one public creditor in place of another. When these transfers degenerate into stockjobbing, that is to say, the making of a profit by the rise and fall of their price, they are productive of much mischief; in the first place, by the unproductive employment on this object of the agent of circulation, money, which is an item of the national capital; and, in the next, by procuring a gain to one person by the loss of another, which is the characteristic of all gaming. The occupation of the stockjobber yields no new or useful product; consequently, having no product of his own to give in exchange, he has no revenue to subsist upon, but what he contrives to make out of the unskillfulness or ill fortune of gamesters like himself.

A national debt has been said to bind the public creditors more firmly to the government, and make them its natural supporters by a sense of common interest; and so it does beyond all doubt. But, as this common interest may attach equally to a

bad or a good government, there is just as much chance of its being an injury as a benefit to the nation. If we look at England, we shall see a vast number of well-meaning persons induced by this motive to uphold the abuses and misgovernment of a wretched administration.

It has been further urged, that a national debt is an index of the public opinion, respecting the degree of credit which the government deserves, and operates as a motive to its good conduct and endeavor to preserve the public opinion, of which such a debt furnishes the index. This cannot be admitted without some qualification. The good conduct of government, in the eyes of the public creditors, consists in the regular payment of their own dividends; but, in the eyes of the taxpayers, it consists in spending as little as possible. The market price of stock does, indeed, furnish a tolerable index of the former kind of good conduct, but not of the latter. Perhaps it would be no exaggeration to say, that the punctual payment of the dividends, instead of being a sign of good, is in numberless instances a cloak to bad government; and, in some countries, a boon for the toleration of frequent and glaring abuses.

Another argument in favor of national debt is, that it affords a prompt investment to capital, which can find no ready and profitable employment, and thus must, at any rate, prevent its emigration. If it do so, so much the worse; it is a bait to tempt capital toward its destruction, leaving the nation burdened with the annual interest, which government must provide. It is far better that the capital should emigrate, as it would probably return sooner or later; and then its interest for the meantime will be chargeable to foreigners. A national debt of moderate amount, the capital of which should have been well and judiciously expended in useful works, might indeed be attended with the advantage of providing an investment for minute portions of capital, in the hands of persons incapable of turning them to account, who would probably keep them locked up, or spend them by driblets, but for the convenience of such an investment. This is perhaps the sole benefit of a national debt; and even this is attended with some danger, inasmuch as it enables a government to squander the national savings. For, unless the principal be spent upon objects of permanent

public benefit, as on roads, canals, or the like, it were better for the public that the capital should remain inactive, or concealed; since, if the public lost the use of it, at least it would not have to pay the interest.

Thus, it may be expedient to borrow, when capital must be spent by a government, having nothing but the usufruct at its command; but we are not to imagine, that, by the act of borrowing, the public prosperity can be advanced. The borrower, whether a sovereign or an individual, incurs an annual charge upon his revenue, besides impoverishing himself to the full amount of the principal, if it be consumed; and nations never borrow but with a view to consume outright.

91. The Views of Karl Dietzel. — The opinions of Adam Smith and of such disciples as Say had a profound influence upon the later development of financial theory. About the middle of the nineteenth century, however, a German economist, Karl Dietzel, raised a vigorous protest against the view of public debts then prevalent; and developed a theory which has had considerable influence upon later German writers. Dietzel said, in part:[1]

From Adam Smith's time down to the present a one-sided view of public loans has prevailed in financial theory, and is encountered in the work of most writers. It is based upon Smith's erroneous conception of capital and income. In brief the substance of this doctrine is as follows:

Taxes are paid out of income; loans, out of capital. If, therefore, the funds needed for extraordinary expenditures are raised by taxation, the people, as a result of their natural dislike of weakening their economic position, will restrict their consumption and endeavor to pay the taxes out of their net income. In this way the capital of the community is not diminished and industry is not disturbed; while the whole effect of the extraordinary expenditure is to cause a simple retrenchment in consumption.

If, however, the extraordinary outlays are met by loans, the funds will come from the capital of the community. By this

[1] System der Staatsanleihen, 159 *et seq.* (1855).

process the supply of capital will be reduced, and future production of wealth will be decreased. In this way society is permanently injured; for the capital thus expended is lost beyond recovery since it is destroyed in unproductive consumption which the state undertakes through its agency.

If this view were correct, the practice of public borrowing would thereby be unconditionally condemned. Fortunately the case is altogether otherwise. In Smith's view we encounter various fundamental errors of prevailing financial theory: a false conception of capital; a one-sided notion of productivity; and the arbitrary assumption of the existence of such a thing as a distinct net income.

Concerning the first two of these errors, we have already said enough; and so merely refer to the results of the previous discussion.[1] The third we have now to examine. "Taxes," it is said, "are paid out of net income," that is, out of that portion of the product of current industry which is not required for the maintenance of existing economic conditions, and which, therefore, can be used by the recipient for any purpose he pleases and will ordinarily be consumed. This doctrine rests on the erroneous conception that economic society is a mechanical contrivance which always remains the same, and in which the same factors yield every year the same result and ought to do so. Industry is conceived of as having two purposes, first, the production of goods needed to maintain the existing industrial fabric; and, second, the production of a surplus which, as net income, can be used for any purpose desired.

This view can be founded neither upon human nature as we know it nor upon the experience of practical life. The motive and purpose of all economic effort is everywhere the one effort to satisfy human needs. These needs, however, continually advance, of necessity; and for this reason, advance, progress,

[1] Dietzel had argued that Smith's conception of capital was altogether too narrow. Smith defined capital as that part of a person's "stock" which he expects to afford him a revenue. Wealth of Nations, Bk. II, ch. I. Dietzel would make the concept so broad as to include substantially all the material and immaterial possessions of a community. He even called the state a part of the capital of society. System der Staatsanleihen, 33–75. Dietzel's second criticism, *viz.* that Smith had an erroneous notion about productivity, has been presented sufficiently in a passage which we have already quoted. See § 7. — Ed.

must be regarded as the fundamental principle of economic society.

What led men to advance beyond the first rude conditions of primitive industry, what compelled them gradually to combine their labor power and to create capital, what carried them on from that rude beginning through so many intermediate stages to the present civilization and mastery over nature, is their inherent impulse to improve their condition and to satisfy their needs ever more completely. All goods newly produced at any time have this purpose: they may be immediately consumed, or may be used in such a way that they do not yield up the satisfactions they afford until a later time.

The assumption that a part of the product is devoted to the satisfaction of necessary wants, that is, to the maintenance of existing industry, — and is, therefore, not available for any other purpose, — while the other part may be devoted to any purpose whatever, is wholly arbitrary. The same is true of the concept of free income, which is founded upon this arbitrary assumption, — free income the disposition of which is less important than the disposition of the capital previously accumulated, so that its destruction by taxation is a matter of comparatively little moment; while it is thought that to take previously accumulated capital in the form of a loan exerts a destructive influence upon industry.

The truth is that all newly produced goods are at the outset disposable capital. All are created for the same purpose, the immediate or more remote satisfaction of needs; they are already destined to be capital, and must, therefore, be considered as capital. To take away any part of them is as truly a destruction of capital, as the destruction of capital previously accumulated would be. . . .

The ongoing of industry is continuous and without a break. It is the result of ceaselessly active forces; of human activity in working over raw materials and of ever-operating natural forces. The assumption of distinct periods of production is, for this reason, a thoroughly arbitrary one, admissible only for convenience of representation and logical arrangement. It is, therefore, to be confined to these uses alone, since there is nothing in reality that corresponds to it. The moment that we try to build an

argument upon such a foundation, the assumption then leads to an arbitrary severing of the natural course of things; and error is the necessary result.

This is true of the theory of net income which, of course, rests upon the assumption of distinct periods of production, since it would be unthinkable otherwise. Net income consists of the value of all the goods produced in any period after all the costs of production have been deducted, among which is included an appropriate allowance for the support of the producers. The surplus value continually produced by industry, and called net income, is destined just as little for any sort of unproductive employment that may be desired as are the goods accumulated prior to any productive period, which are usually called capital. The first is destined for the same end as the second, namely, under the continuous influence of human labor, to be converted into goods capable of satisfying more and more completely human wants, and then to be consumed for this object. Newly produced goods form a homogeneous mass with the goods previously produced, the whole being destined to serve as the basis of the subsequent industry of the people. They have merely this advantage that, in respect to them, people are free to choose in what form they will have them applied to the production of wealth. The decision of this point will depend upon a consideration of the way in which these goods will yield the greatest advantage. If they will have a greater value when employed in a private business enterprise, then it will be disadvantageous to take them for public purposes; but it is wholly immaterial whether they were previously net income or capital.

This whole theory of Smith's is at the bottom based upon his erroneous view of governmental activity. If one looks upon the state as unproductive and considers its operations as a destruction of values, then, to be sure, this cost of maintaining the state can come only from the surplus wealth created each year, — that is, will be taken from income, — because otherwise the capital and consequently the productive power of the community must continually diminish and finally come to an end. So far, then, we can say that taxes are paid out of income. But, as we have demonstrated, taxes are really a

part of the disposable capital created each year for the purpose of being converted by society into those goods which can be obtained only in this way. The production of taxes is just as good an end of economic activity as the production of any other goods. It is, therefore, clearly inadmissible to count the goods which protect the body against cold as among the costs of maintaining industry, on the ground that they are a necessary part of a man's subsistence, and, on the other hand, set over against them as "net income" the goods which protect personal freedom and industrial activity.

Equally incorrect, then, is the other half of the doctrine of Smith, — that loans are raised from the capital of the community, and therefore impair production and injure the economic position of the people. In this proposition the inadequacy and faults of the current definition of capital come to light most forcibly. Unless we are very much mistaken, this view was suggested by the facts, that subscriptions to loans are commonly made in large sums while taxes are paid in smaller amounts, and that in ordinary life we are accustomed to call the former capital since they can at once be loaned at interest while we do not consider the latter as capital because they are usually too small to find ready investment. Where now are we to look for the capital which is withdrawn from industry when loans are made. Clearly it must be capital already devoted to production since only in this case can it affect industry in any injurious manner. But it is evident that fixed capital cannot be turned over to the state, and this forms the largest and most important part of the whole supply of capital. And circulating capital is in the main so far advanced toward its conversion into some specialized form of goods that it is adapted only to the special needs of private individuals and not to those of the state. Therefore the state can take only that part of capital which is in the form of raw materials, or materials slightly transformed, which is still free capital and not yet ready for the use of private industry. Concerning the most useful disposition of this, it is possible and necessary to make a decision.

Of course this new disposable capital, in conformity with the purpose of all economic activity, is usually destined to replace the capital that is continually consumed and to make additions

to our general store of capital. Under special conditions, however, this method of employing new disposable capital may be thoroughly inexpedient. This would be the case if, on account of decreased demand for goods or because of an urgent demand of the state for goods, individual investors find there is no demand for their capital and that goods invested under such conditions would lose their value as capital. If, in such a case, this disposable capital is transferred to the state in the form of a public loan, it is because the investor had the conviction that it would produce a greater value in this employment than it would if invested in private industry. The view of the state securing the loan was the same; and the opinion of the two parties to the transaction must be assumed to be correct. For no one can pretend to judge the value of a good more correctly than the person who exchanges it for another. The outward sign according to which the opinion of the two parties is determined, and in which it expresses itself, is the rate of interest.

The disposable capital taken by the state in this way cannot, it is true, be employed in private business enterprises. In fact no increase of such enterprises can take place, and perhaps even the present volume of industry cannot be maintained. . . . But the reason for this is not that capital has been taken away, but rather the more general circumstance, that now, as a result of special conditions, there is less need of goods adapted to the immediate satisfaction of wants, and that other goods and other employments of capital have for the time a higher value. Therefore the employment of disposable capital in private enterprises in the production of goods of the sort previously wanted, would be useless, and such capital would be lost.

If, for instance, a dangerous war breaks out, it will be out of the question to satisfy new demands for luxuries, and often it will be impossible even to satisfy the former demand. It is necessary, instead, to secure the means of protecting and preserving the goods already on hand. A large or even larger production of costly silks, for instance, would be inadvisable; and if this occurred, the producers would probably lose money. Production of silks, therefore, is suspended or decreased; and the disposable capital of silk manufacturers, which under ordinary conditions would be reinvested in this industry, is loaned to

the government. By the government it is employed in the purchase or production of cloth needed to clothe the army, or something of a similar nature. In the same way less capital is invested in making pleasure carriages, and more ammunition or army wagons are built. So, too, the breeding of driving horses is checked, and more army horses are bred.

All these investments of disposable capital serve the purpose of procuring the good which is at the moment of the greatest value, — protection against foreign enemies or the successful termination of a war that has begun. The goods invested in this manner preserve their properties as capital, for they are converted into goods which represent their value because much needed and therefore in demand.

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With this falls the theory that public loans destroy capital, the theory which we meet in the works of most writers. It is, apart from the faulty conception of capital which we mentioned above, to be considered a necessary consequence of the theory that all public consumption is unproductive. We have already discussed the falsity of this theory.

This theory is wrong not only in regard to goods which had formerly served another purpose, but are now taken for public purposes because these seem to be more important (as in the example just given,) and offer the most needed sort of employment. But it is also especially wrong in regard to goods that pass directly from the disposable capital of the society into the hands of the state rather than into private industries. Such goods had not yet been used as capital, and in reality first became such when used by the state. It is questionable, indeed, whether they would have retained their value if they had passed into the hands of private enterprises.

The doctrine that taxes and capital come out of different parts of the wealth of the society and consequently exercise different, even opposite, effects upon the welfare and development of economic society, — because the former do not impair capital while the latter do impair it, — is wholly untenable. It is based upon an arbitrary separation of things naturally similar and inseparable. Both taxes and loans flow in the same manner from the disposable capital of society, and only the purposes for

which they are employed give rise to a fundamental distinction between them.

(Dietzel then proceeds to enlarge upon the advantages of public loans. They enable governments, he says, to raise large sums of money very quickly; make it unnecessary to increase taxation to an injurious extent; encourage saving; enable a country to draw on the resources of foreign investors; enable a government to place part of an extraordinary burden upon future generations; increase production; and add to the wealth of a country. — Ed.)

CHAPTER XXIV

SHOULD A NATIONAL DEBT BE PAID?

92. The Views of Mill. — The desirability of redeeming a national debt was urged by Mr. Mill as follows:[1]

When a country, wisely or unwisely, has burthened itself with a debt, is it expedient to take steps for redeeming that debt? In principle it is impossible not to maintain the affirmative. It is true that the payment of the interest, when the creditors are members of the same community, is no national loss, but a mere transfer. The transfer, however, being compulsory, is a serious evil, and the raising a great extra revenue by any system of taxation necessitates so much expense, vexation, disturbance of the channels of industry, and other mischiefs over and above the mere payment of the money wanted by the government, that to get rid of the necessity of such taxation is at all times worth a considerable effort. The same amount of sacrifice which would have been worth incurring to avoid contracting the debt, it is worth while to incur, at any subsequent time, for the purpose of extinguishing it.

Two modes have been contemplated of paying off a national debt: either at once by a general contribution,[2] or gradually by a surplus revenue. The first would be incomparably the best, if it were practicable; and it would be practicable if it could justly be done by assessment on property alone. If property bore the whole interest of the debt, property might, with great advantage to itself, pay it off; since this would be merely surrendering to a creditor the principal sum, the whole annual proceeds of which were already his by law; and would be

[1] Principles, Bk. V, ch. 7, §§ 2–3.

[2] Ricardo and others had advocated such a policy. *Cf.* Ricardo, Principles of Political Economy and Taxation, ch. 17. — Ed.

equivalent to what a landowner does when he sells part of his estate, to free the remainder from a mortgage. But property, it needs hardly be said, does not pay, and cannot justly be required to pay, the whole interest of the debt. Some indeed affirm that it can, on the plea that the existing generation is only bound to pay the debts of its predecessors from the assets it has received from them, and not from the produce of its own industry. But has no one received anything from previous generations except those who have succeeded to property? Is the whole difference between the earth as it is, with its clearings and improvements, its roads and canals, its towns and manufactories, and the earth as it was when the first human being set foot on it, of no benefit to any but those who are called the owners of the soil? Is the capital accumulated by the labor and abstinence of all former generations of no advantage to any but those who have succeeded to the legal ownership of part of it? And have we not inherited a mass of acquired knowledge, both scientific and empirical, due to the sagacity and industry of those who preceded us, the benefits of which are the common wealth of all? Those who are born to the ownership of property have, in addition to these common benefits, a separate inheritance, and to this difference it is right that advertence should be had in regulating taxation. It belongs to the general financial system of the country to take due account of this principle, and I have indicated, as in my opinion a proper mode of taking account of it, a considerable tax on legacies and inheritances. Let it be determined directly and openly what is due from property to the state, and from the state to property, and let the institutions of the state be regulated accordingly. Whatever is the fitting contribution from property to the general expenses of the state, in the same, and in no greater proportion, should it contribute toward either the interest or the repayment of the national debt.

This, however, if admitted, is fatal to any scheme for the extinction of the debt by a general assessment on the community. Persons of property could pay their share of the amount by a sacrifice of property, and have the same net income as before; but if those who have no accumulations, but only incomes, were required to make up by a single payment the equiva-

lent of the annual charge laid on them by the taxes maintained to pay the interest of the debt, they could only do so by incurring a private debt equal to their share of the public debt; while, from the insufficiency, in most cases, of the security which they could give, the interest would amount to a much larger annual sum than their share of that now paid by the state. Besides, a collective debt defrayed by taxes, has over the same debt parceled out among individuals, the immense advantage, that it is virtually a mutual insurance among the contributors. If the fortune of a contributor diminishes, his taxes diminish; if he is ruined, they cease altogether, and his portion of the debt is wholly transferred to the solvent members of the community. If it were laid on him as a private obligation, he would still be liable to it even when penniless.

When the state possesses property, in land or otherwise, which there are not strong reasons of public utility for its retaining at its disposal, this should be employed, as far as it will go, in extinguishing debt. Any casual gain, or godsend, is naturally devoted to the same purpose. Beyond this, the only mode which is both just and feasible, of extinguishing or reducing a national debt, is by means of a surplus revenue.

The desirableness, *per se*, of maintaining a surplus for this purpose does not, I think, admit of a doubt. We sometimes, indeed, hear it said that the amount should rather be left to "fructify in the pockets of the people." This is a good argument, as far as it goes, against levying taxes unnecessarily for purposes of unproductive expenditure, but not against paying off a national debt. For, what is meant by the word "fructify"? If it means anything, it means productive employment; and as an argument against taxation, we must understand it to assert, that if the amount were left with the people, they would save it, and convert it into capital. It is probable, indeed, that they would save a part, but extremely improbable that they would save the whole: while if taken by taxation, and employed in paying off debt, the whole is saved, and made productive. To the fundholder who receives the payment it is already capital, not revenue, and he will make it "fructify," that it may continue to afford him an income. The objection, therefore, is not only groundless, but the real argument is on the other side; the

amount is much more certain of fructifying if it is not "left in the pockets of the people."

It is not, however, advisable in all cases to maintain a surplus revenue for the extinction of debt. The advantage of paying off the national debt of Great Britain, for instance, is that it would enable us to get rid of the worse half of our taxation. But of this worse half some portions must be worse than others, and to get rid of those would be a greater benefit proportionally than to get rid of the rest. If renouncing a surplus revenue would enable us to dispense with a tax, we ought to consider the very worst of all our taxes as precisely the one which we are keeping up for the sake of ultimately abolishing taxes not so bad as itself. In a country advancing in wealth, whose increasing revenue gives it the power of ridding itself from time to time of the most inconvenient portions of its taxation, I conceive that the increase of revenue should rather be disposed of by taking off taxes, than by liquidating debt, as long as any very objectionable imposts remain. In the present state of England, therefore, I hold it to be good policy in the government, when it has a surplus of an apparently permanent character, to take off taxes, provided these are rightly selected. Even when no taxes remain but such as are not unfit to form part of a permanent system, it is wise to continue the same policy by experimental reductions of those taxes, until the point is discovered at which a given amount of revenue can be raised with the smallest pressure on the contributors. After this, such surplus revenue as might arise from any further increase of the produce of the taxes, should not, I conceive, be remitted, but applied to the redemption of debt. Eventually, it might be expedient to appropriate the entire produce of particular taxes to this purpose; since there would be more assurance that the liquidation would be persisted in, if the fund destined to it were kept apart, and not blended with the general revenues of the state. The succession duties would be peculiarly suited to such a purpose, since taxes paid as they are, out of capital, would be better employed in reimbursing capital than in defraying current expenditure. If this separate appropriation were made, any surplus afterward arising from the increasing produce of the other taxes, and from the saving of interest on the successive

portions of debt paid off, might form a ground for a remission of taxation.

It has been contended that some amount of national debt is desirable, and almost indispensable, as an investment for the savings of the poorer or more inexperienced part of the community. Its convenience in that respect is undeniable; but (besides that the progress of industry is gradually affording other modes of investment almost as safe and untroublesome, such as the shares or obligations of great public companies) the only real superiority of an investment in the funds consists in the national guarantee, and this could be afforded by other means than that of a public debt, involving compulsory taxation. One mode which would answer the purpose, would be a national bank of deposit and discount, with ramifications throughout the country; which might receive any money confided to it, and either fund it at a fixed rate of interest, or allow interest on a floating balance, like the joint stock banks; the interest given being, of course, lower than the rate at which individuals can borrow, in proportion to the greater security of a government investment; and the expenses of the establishment being defrayed by the difference between the interest which the bank would pay, and that which it would obtain, by lending its deposits on mercantile, landed, or other security. There are no insuperable objections in principle, nor, I should think, in practice, to an institution of this sort, as a means of supplying the same convenient mode of investment now afforded by the public funds. It would constitute the state a great insurance company, to insure that part of the community who live on the interest of their property, against the risk of losing it by the bankruptcy of those to whom they might otherwise be under the necessity of confiding it.

93. The Views of H. C. Adams. — This important question is discussed further by Professor H. C. Adams:[1]

The policy adopted by the United States with regard to the expungement of its obligations is not of wide acceptance. From the time that Gallatin assumed control of the federal treasury

[1] Public Debts, 240–247 (New York, D. Appleton and Company, 1887). Reprinted with consent of the author and the publishers.

to the present, the American people have manifested a strong dislike to the perpetuation of a funded debt, but in other countries this sentiment has failed to find response. It is true that England and Holland appear to appreciate the arguments for the extinction of public obligations; but the Latin peoples, whether in Europe or in South America, as well as those people of Eastern and Asiatic civilization who have come in contact with and imitate European manners, do not attach much importance to the necessity of reducing the principal of their debts. It thus appears that the advisability of debt payment admits of serious discussion.

Yet it should be clearly discerned at the beginning that this discussion does not turn upon a question of principle, but has wholly to do with methods of procedure. It is now universally admitted that a debt can only be paid out of surplus revenue, and all financiers readily accede to the proposition that financial burdens at any time imposed upon the industries of a country should be as light as possible. The real point in controversy pertains to the best way of attaining this end, a statement that may be easily understood if we consider for a moment the elements that go to make up the burden of a debt.

The constituent elements of this burden are the principal of the debt, or the amount to be paid; the annuity occasioned by the debt, or the annual interest demanded; and the industrial condition of the country, or the underpinning of the debt. This factor last mentioned should receive due recognition, since the argument in favor of perpetual indebtedness rests upon an overestimation of its importance; and it must be conceded that the true conception of a burden of any sort brings to mind not merely the weight carried, but compares that weight with the strength of him who carries it. It is at this point that the two schools of finance part company. The one would reduce the burden of the debt by extinguishing its principal, the other would accomplish the same purpose by developing national resources.

There are two classic arguments put forth by those who defend the policy of perpetual indebtedness. It is claimed, in the first place, that the pressure of a public debt is necessarily decreased from year to year by the gradual depreciation in the value of

the monetary unit in which all obligations are expressed; this depreciation being the result of constant additions made to the amount of money material, and of continued development of the mechanism of exchange. This argument, however, does not call for extended consideration. The fact which it states as a general fact, taking into view the variations of the precious metals from century to century, cannot be denied, although there is some reason for believing that the tendency of gold to fall in value has, at the present time, received a temporary check. But without relying upon such a suggestion for our decision, it certainly seems that gradual depreciation is too tardy in its workings to be worthy of serious consideration. Before the burden of a debt, like that, for example, which the United States is bearing, could be sensibly diminished through depreciation in the value of the monetary unit, an addition of a tenth of one per cent to the annual interest payments would have extinguished the principal.

The second argument for perpetual indebtedness is worthy more serious consideration. Why, it is asked, should a people bear a high rate of taxation for the purpose of reducing the principal of a debt, when all the practical effects of debt reduction may be realized through the natural growth and prosperity of the nation? A wise policy, it is claimed, demands that the entire energy of the country be given to the development of industries, and to the increase of wealth and numbers; since the financial ability of the country may in this manner be so greatly enhanced that the pressure of the debt will cease to be felt. The experience of England is often cited in support of this view. The pressure of her debt in 1815 is computed as equivalent to 9 per cent of her yearly income; in 1880 it was observed to be less than 3 per cent; but this reduction had been effected not by the expungement of her obligations but by the growth of national wealth. The actual result, so far as debt burden is concerned, is the same as though two thirds of the principal had been paid while the amount of her wealth remained stationary. In France, also, one may discover the working of the same principle, although in this instance the pressure of the debt remained constant, or is increased very slightly, while the capital sum of her obligations has greatly

increased. Thus the capitalized sum of the French debt was in 1840 $850,000,000, in 1870 it was $2,759,000,000; but the pressure of the annual payments demanded by these debts, computed upon the national income for the respective periods, is found to be .022 and .023. That is to say, the national income of France increased at a rate nearly as rapid as that of her debt, notwithstanding the extravagances of the empire. But it should, perhaps, be added, that this favorable exhibit has been destroyed by the financial disasters occasioned by the Franco-Prussian war.

It is upon such facts as these that the common argument in support of the policy of perpetual indebtedness is based, and, so far as the facts are concerned, there is no room for controversy. But the conclusion of the argument may not be so readily accepted, for, if it can be shown that the payment of the principal of a debt has no tendency to retard the industrial development of a nation, the entire course of reasoning falls to the ground. As opposed to the idea from which this reasoning must proceed, I venture to place the following proposition, which, if maintained, will furnish an incontrovertible argument in favor of the policy which the United States has adopted:

The payment of the principal of a debt tends neither to impoverish a nation nor to retard its material development; but, on the other hand, the maintenance of the principal and the constant payment of accruing interest tend to cripple the productive capacity of any people.

The two parts of this proposition should receive separate attention, and we are led first to inquire if the industries of a country are injuriously affected by the process of payment. It is admitted by all that somewhere in the course of deficit financiering — either at the time the debt was established, or during the period that it was carried, or at the date of its payment — a loss is sustained chargeable to the adoption of the loan policy. Should one reason from the analogy of private debts, he will conclude that this burden is borne at the time when the debt is paid; for when an individual debtor clears himself from obligations, he loses control over a certain amount of capital, and consequently lessens his importance as a member of industrial society. But such reasoning cannot be applied to the state. The state is not an individual, it has no life separate from the united lives of

all citizens, and it recognizes no interest but the collective interest of society. The state is the corporate representative of all citizens, creditors as well as debtors, and is not at all interested in the proprietary residence of capital, provided only it be judiciously employed. Since, then, the payment of its own obligations effects no more than a transfer of control over capital from one set of men to another, it cannot be said that the industrial development of the country is thereby obstructed.

The position here assumed may be easily understood if one hold firmly in mind the nature of capital. Capital is subsistence fund, and he who controls it has it in his power to direct labor. It is capital which the state wants when it borrows money, and in borrowing capital it draws to its own use that which, had it not been thus appropriated, might have been applied to some productive industry under private management. The obligations which the state creates against itself are written in the language of money, because this is the most convenient language known for the expression of indebtedness; but the state has no use for money except to effect the transfer to itself of control over existing capital.

Suppose a state to borrow a billion dollars; it cannot be said that industrial society is thereby necessarily rendered any the poorer. Capital is not destroyed by the borrowing. Before the loan was filled, the nation was possessor of a certain amount of capital, distributed in a thousand funds and under the direction of a thousand wills; after the loan the nation as a whole holds the same amount of capital as before, the only difference being that control over it has passed to the state. Whether or not this operation is industrially detrimental depends upon the use to which the state puts the proceeds of its loan. If it be consumed in the prosecution of a war, the nation is impoverished to the extent of the unproductive consumption, since capital, in the form of bacon, flour, clothes, implements, mules, and the like, has been destroyed. We may, then, conclude that the injury sustained on account of a loan for war purposes is sustained at the time the loan was contracted, and is due to the fact that the state has caused a certain amount of capital to disappear without hope of recovery.

Let us now turn to the process of payment. The obligations

which the state has created against itself call for the payment of a certain amount of money. The money, which it obtains by means of taxation, is held for a moment, then transferred to the public creditors, and in this manner the state becomes absolved from its indebtedness. It would of course be incorrect to say that this transfer of money from one set of citizens to another does not in the least disturb capital, for possession of money is the evidence of ownership in capital; but it may be rightly claimed that it does not destroy capital. Before the payment, one set of individuals controlled the subsistence fund of the country to the extent of the payment; after the extinction of the debt, ownership rests with another set of individuals. The government is freed from the necessity of providing an annual sum in the form of interest, and, measured by the amount of capital in the country, the nation is in no wise impoverished. There is the same amount of food for the subsistence of laborers, and the same amount of raw stuffs upon which to set them at work. If the new masters of capital are as enterprising as the old, the nation loses nothing by the payment of its debt. This is the explanation, and in the explanation lies the defense, of the proposition that the payment of a public debt does not necessarily impoverish a nation. The injury to industrial society is worked by the destruction of capital at the time the loan was contracted; the labor required to create again the capital thus destroyed constitutes the burden imposed upon the nation; the payment of the principal of the debt is at most but a readjustment of ownership in existing capital. It is a fallacy to argue that the expungement of public obligations destroys capital.

But how is a people impoverished by the maintenance of the principal of a debt? In so far as bondholders live from the proceeds of their bonds, they form a class not immediately interested in current industries. At some time in the past they may have furnished the government with large sums of capital, thus averting the inconvenience of excessive taxation or of a sudden change in rates; and, in return for this service, they received from the government the promise of an annuity until an equivalent of the original capital should be returned. Such persons are guaranteed a living without labor.

There is but one way in which the government may escape the necessity of supporting in idleness this class, and that is by paying its members their respective claims. The bondholders would in this manner be deprived of their secured annuity, but they would in its stead hold a sum of free capital; and if they wish to continue in the enjoyment of an income from their property, they must apply their funds to some productive purpose. In this manner the country gains by bringing to bear upon industrial affairs the interested attention of those who formerly were secured a living from the proceeds of public taxes. For another reason also is the payment of a debt advantageous. No people can long retain that hopefulness so essential to the vigorous prosecution of industries if the past lays heavy claims upon the present. As a rule, they only should partake of current product who are in some way connected with present production. Carelessness and jealousy are not characteristics of efficient labor, but they are sentiments naturally engendered by the payment of taxes for the support of a favored class. It is the permanency of this payment, rather than its amount, which exerts a depressing influence upon labor, and its extinction is a first step toward the establishment of confidence and contentment. It is for such reasons as these that we conclude that the policy of debt payment vigorously prosecuted will assist rather than retard industrial development.

CHAPTER XXV

SINKING FUNDS

94. The Theories of Dr. Price.[1] — During the eighteenth century various attempts had been made, as described by Adam Smith, to reduce the British debt by creating a sinking fund. These efforts proved ineffectual for various reasons, and finally Dr. Richard Price came forward with what was generally believed to be a demonstration of the efficacy of a permanent sinking fund inviolably pledged and applied to the extinction of a public debt. His theories found favor with the younger Pitt, and were embodied in a new sinking-fund law of 1786, known as Pitt's sinking fund. This act set aside £1,000,000 per year to be placed in the hands of sinking-fund commissioners, who were to apply it to the purchase of the national debt, and then to draw from the treasury interest on stock thus purchased and apply that to further purchases. It was intended that this should continue until the interest on the stock purchased (redeemed) and held by the commissioners should equal £4,000,000; when, with the £1,000,000 annual appropriation, the sinking fund would amount to £5,000,000 a year.[2]

The theory upon which this was done is most clearly set forth by Dr. Price in his Appeal to the Public on the Subject of the National Debt. The gist of his argument is contained in the following extracts:

[1] Dr. Richard Price (1723–91) was a dissenting clergyman and a well-known writer upon a variety of subjects. His principal works dealing with the theory of sinking funds were: Observations on Reversionary Payments (1769) and An Appeal to the Public on the Subject of the National Debt (second edition, 1772). We quote from the latter publication.

[2] See Palgrave, Dictionary of Political Economy, III, 405 *et seq.*

A Sinking Fund, according to the most *general* idea of it, signifies "any *Saving* or *Surplus*, set apart from the rest of the annual income, and appropriated to the purpose of paying off or sinking debts."

There are *three ways* in which a kingdom may apply such a saving.

1*st*. The *interests* disengaged from time to time by the payments made with it, may be themselves applied to the payment of the public debt.

Or, 2*dly*, They may be spent on current services.

Or, 3*dly*, They may be immediately annihilated by abolishing the taxes charged with them.

In the first way of employing a *Sinking Fund*, it becomes a fund always increasing itself. Every new *interest* disengaged by it, containing the same powers with it, and joining its operation to it; and the same being true of every interest disengaged by every interest, it must act, not merely as an *increasing* force, but with a force the *increase* of which is continually accelerated; and which, therefore, however small at first, must in time, become equal to *any* effect. In the *second* way of applying a *Sinking Fund*, it admits of no increase, and must act forever with the same force. — In other words, A *Sinking Fund*, according to the first method of applying it, is, if I may be allowed the comparison, like a grain of corn sown, which, by having its produce sown and the produce of that produce and so on, is capable of an increase that will soon stock a province or support a kingdom. — On the contrary. A *Sinking Fund*, according to the second way of applying it, is like a seed the produce of which is consumed; and which, therefore, can be of no further use, and has all its powers destroyed.

The *former*, be its income at first ever so much exceeded by the new debts incurred annually, will soon become superior to them and cancel them. — The *latter*, if at first inferior to the new debts incurred annually, will forever remain so; and a state that has no other provision for the payment of its debts, will be always accumulating them until it sinks.

What has been now said of the *second* mode of applying a fund is true in a higher degree of the *third*. For in this case, the disengaged interests, instead of being either added to the

fund, or spent from year to year on useful services, are immediately given up.

In short, a fund of the *first* sort is money bearing *compound* interest — A fund of the *second* sort is money bearing *simple* interest — And a fund of the *third* sort is money bearing *no* interest — The difference between them is, therefore, properly infinite. And this is so evident, that I cannot go on with this explanation without some reluctance. I will, however, rely on the candour of those who must be already abundantly convinced, while I endeavour to illustrate these observations by the following example.

Let us suppose a nation to be capable of setting apart the annual sum of 200,000*l.* as a fund for keeping the debts it is continually incurring in a course of redemption; and let us consider what its operation will be, in the *three* ways of applying it which I have described, supposing the public debts to bear an interest of 5 *per cent* and the period of operation 86 years.

A debt of 200,000*l.* discharged the first year, will disengage for the public an annuity of 10,000*l.* If this annuity, instead of being spent on current services, is added to the fund, and both employed in paying debts, an annuity of 10,500*l.* will be disengaged the *second* year, or of 20,500*l.* in both years. And this again, added to the fund the *third* year, will increase it to 220,500*l.*; with which an annuity will then be disengaged of 11,025*l.*; and the *sum* of the disengaged annuities will be 31,525*l.*: which added to the fund the *fourth* year, will increase it to 231,525*l.*, and enable it then to disengage an annuity of 11,576*l.* 5*s.* and render the *sum* of the disengaged annuities in *four* years, 43,101*l.* 5*s.* — Let any one proceed in this way, and he may satisfy himself, that the *original Fund*, together with the *sum of the annuities disengaged*, will increase faster and faster every year, till, in 86 years, the *fund* becomes 13,283,414*l.* and the *sum* of the disengaged annuities 13,083,414*l.* — The full value, therefore, at 5 *per cent.* of an annuity of 13,083,414*l.* will have been paid in 86 years, that is, very nearly, 262 millions of debt; And, consequently, it appears, that tho' the state had been all along adding every year to its debts three millions; that is tho' in the time supposed it had contracted a debt of 258 millions, it would have been more than discharged, at no greater

expence than an annual saving of 200,000*l.* — But if the same fund had been employed in the *second* of the three ways I have described, the annuity disengaged by it would have been every year 10,000*l.*; and the sum of the annuities disengaged would have been 86 times 10,000*l.* or 860,000*l.*; — The *discharged* debt, therefore, would have been no more than the value of such an annuity, or 17,200,000*l.* But besides this, it must be considered, that there will be an expense *saved*, in consequence of applying every year the disengaged annuities to current services, for which otherwise equivalent sums must have been provided by new taxes, or assessments; 10,000*l.* will be saved at the beginning of the *second* year; 20,000*l.* at the beginning of the *third;* 30,000*l.* at the beginning of the *fourth;* and 850,000*l.* at the beginning of the 86th year; and the sum of all these savings is 36,550,000*l.* which, added to 17,200,000*l.*, the debt *discharged*, makes 53,750,000*l.* Subtract the last sum from 262 millions, and 208,250,000*l.* will be the complete loss of the public arising, in 86 years, from employing an annual sum of 200,000*l.* in the second way rather than the first.

Little need be said of the effect of the same fund applied in the *third* way. It is obvious that the whole advantage derived from it, would be the discharge of a debt of 200,000*l. annually;* or of 17,200,000*l.* in all.

Similar deductions might be made on the supposition of lower rates of interest and shorter periods. — Thus; let a state be supposed to run in debt two millions annually, for which it pays 4 *per cent.* interest. In 70 years, a debt of 140 millions would be incurred. But an appropriation of 400,000*l. per ann.*, if employed in the *first* way, would, at the end of this term, leave the nation *beforehand*, six millions; whereas, if applied in the *second* way, the nation would be left in debt, 73 millions; and in the *third* way, 112 millions.

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But it is time to enter into a more explicit confutation of the plea commonly used to justify the alienation of the *Sinking Fund*, and which has been mentioned at the beginning of this Essay.

This alienation, it is well known, is become a fixed measure of Government among us. We owe it to our present heavy debt,

and if continued much longer, there will, I am afraid, be no possibility of escaping some of the worst calamities. It is, therefore, necessary that the reason on which it has been grounded, should be particularly examined and refuted. And in order to do this, I must beg leave to bring again to view some of the preceding observations.

There is, let us suppose, a million wanted for the necessary supplies of the year. It lies ready in the *Sinking Fund*, and a minister, in order to obtain leave to seize it, pleads, "That, since such a sum must be had, it is indifferent whether it is taken from hence, or procured by making a new loan. If the former is done, an *old* debt will be continued. If the latter is done, an *equal new debt* will be incurred, which would have been otherwise saved; and the public interest can be no more affected by one of these than the other. But the former is easiest. And it will save the disagreeable necessity of laying on a new tax." — This argument appears plausible: and it has never yet failed of success. — But what must prove the consequence? — If such reasoning is good one year, it is good every year; and warrants a total alienation of the *Sinking Fund*, if the annual expences of Government are such as always to require a sum equal to its income. And thus, it will lose its whole efficacy; and a Fund that, if not alienated, would have been *omnipotent*, will be converted into just such a *feeble* and *barren* one, as the *second* or *third* in the former account.

The fallaciousness of this argument consists in the supposition, that no loss can arise to the Public from continuing an *old debt*, when it cannot be discharged without incurring an *equal new debt*. — I have demonstrated this to be a mistake; and that by practising upon it, or *alienating* rather than *borrowing*, an *infinite* loss may be sustained. — Agreeably to this, I have in the Treatise on Annuities shewn, that had but 400,000*l*. *per annum* of the *Sinking Fund* been applied, from the year 1716 *inviolably, three millions per annum* of our taxes might now have been annihilated.

I will here add, that had the whole produce of it been thus employed, we might now have been in possession of a very considerable *surplus*, instead of being *in debt, a hundred and forty millions*. — But I will go farther. — Had even the money

that, at different times, has been employed in paying off our debts, been applied but in a different manner; that is, had it been made the produce of a *Sinking Fund*, which, from 1716 to the present year, had never been alienated; above *half* our present debts would have been cancelled. — Such is the importance of merely the *manner* of applying money. — Such is the prodigious difference, in the present case, between *borrowing* and *alienating*. — Nor is there anything in this mysterious. The reason has been sufficiently explained. — When a state borrows, it pays, I have said, only *simple* interest for money. When it alienates a Fund appropriated to the payment of its debts, it loses the advantage of money, that would have been otherwise improved necessarily at *compound* interest. And can there be any circumstances of a State which can render the latter of these preferable to the former? Or can the inconveniences, which may attend the imposition of a new tax, deserve in this case to be mentioned? What a barbarous policy is that which runs a Kingdom in debt, *Millions*, in order to save *Thousands;* which robs the Public of the power of annihilating *all* taxes in order to avoid a small present increase of taxes? — This, in truth, has been our policy; and it would be affronting common sense to attempt a vindication of it.

I confess myself incapable of speaking on this subject with calmness. — Let the Reader think of the facts I have mentioned: let him consider the difference in our favour, which an inviolable application of the *Sinking Fund* would have made: Let him compare what, in that case, we *should* have been, with what we *are;* and let him, if he can, be unmoved.

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From these observations the truth of the following assertion will be very evident.

"A State may, without difficulty, redeem all its debts by borrowing money for that purpose, at an equal or even any higher interest than the debts bear; and without providing any other Funds than such small ones, as shall from year to year become necessary to pay the interest of the sums borrowed."

For Example. Suppose our Parliament, 56 years ago, had resolved to borrow half a million annually for the purpose of redeeming the debts of the kingdom. The *National Gain*, sup-

posing the money applied, without interruption, to the redemption of debts bearing 4 *per cent.* interest, would have been a *hundred millions*, being *debt redeemed*, or the sum nearly to which an annuity of half a million will accumulate in 56 years.. — On the other hand. The *National Loss* would have been *twenty-eight millions;* being *debt incurred*, or the sum of all the loans. — The balance, therefore, in favour of the nation, would have been *seventy-two millions*. — During this whole period, the revenue account would have been the same that it has been, except that it would have been charged, towards paying the interest of the money borrowed, with an annuity increasing at the rate of 20,000*l.* every year. In the present year, therefore, this annuity would have been 55 times 20,000*l.*, or 1,100,000*l.* But it should be remembered, that 100 millions having been redeemed, the kingdom might have been now eased of the annual expence of *four millions*.

Again, Suppose only half a million annually to be now capable of being spared from the *Sinking Fund*. This, if applied to the redemption of the 3 *per cents.* at *par*, would pay off no more than 61 *millions* in 52 years. But let half a million be borrowed annually, for only 23 years to come; and 99 *millions* will be redeemed in the same time. That is; 38 millions more than could have been otherwise redeemed, at the extraordinary expence of only *eleven millions and a half*.

War, while such a scheme was going on, would increase its efficiency; and any suspension of it then, would be the *madness* of giving it a mortal stab, at the very time it was making the quickest progress towards the accomplishment of its end. — Suppose, for instance, that, within the period I have mentioned, two wars should happen; one to begin five years hence, and to last 10 years; the other to begin 35 years hence, and to last also 10 years, and both raising the interest of money in the *Funds* to $4\frac{1}{2}$ *per cent.* It may be easily calculated, that on these suppositions 145 *millions*, instead of 99 millions, would be paid off by such a scheme. But, should it be suspended during the continuance of the two wars, it would in the same time (that is, in 52 years) pay off no more than 40 *millions*.

I know these Observations will look more like *visions* than *realities*, to those who have never turned their thoughts to these

subjects; or who have not duly attended to the amazing increase of money, bearing compound interest. — The duration of the lives of *individuals* is confined within limits so narrow, as not to admit, in any great degree, of the advantages that may be derived from this increase. But a period of 50, or 60, or 100 years being little in the duration of *kingdoms*, they are capable of securing them in almost any degree: And if no kingdoms should ever do this; if, in particular, a nation in such circumstances as ours, should continue to neglect availing itself of them: one fact will be added to the many in the political world, which tho' they cannot *surprize* a philosophical person, he must consider with concern and regret.

Money bearing compound interest increases at first slowly. But, the rate of increase being continually accelerated, it becomes in some time so rapid, as to mock all the powers of the imagination. — *One penny*, put out at our Saviour's birth to 5 *per cent. compound* interest, would, before this time, have increased to a greater sum, than would be contained in *a hundred and fifty millions of earths*, all solid gold. — But put out to *simple* interest, it would, in the same time, have amounted to no more than *seven shillings and four pence* half-penny. — Our government has hitherto chosen to improve money in the *last*, rather than the *first* of these ways.

Many schemes have at different times been proposed for paying off the National Debt. But the inventors of them might have spared their labour. Their schemes could not deserve the least notice. The best scheme has been long *known*. It has been *established;* but, unhappily for this kingdom, it was crushed in its infancy. Still, however, if our deliverance is possible, it must be derived from hence. The strictest mathematical evidence proves, that the nature of things don't admit of any method of redeeming public debts so expeditious and effectual. — *Restore, then, the Sinking Fund.* And if the *whole* of it cannot be unalienably applied to its original use, let *some part* of it be so applied; that the nation may, at least, enjoy a *chance* of being saved. — "The *Sinking Fund* (says a great writer) is the last resort of the nation; its only domestic resource, on which must chiefly depend all the hopes we can entertain of ever discharging or moderating our encumbrances. And, therefore, the

prudent application of the large sums now arising from this fund, is a point of the utmost importance, and well worthy the serious attention of Parliament." I should offer an injury to truth, were I to say no more, than that I have pointed out the most *prudent* application of this *fund*. I am persuaded that I have pointed out the *only* application of it, that can do us any essential service. Time must discover whether the *Parliament* will think it worthy of any attention.

95. A Criticism of Dr. Price, by Robert Hamilton. — In 1813 Robert Hamilton, Professor of Natural Philosophy in the University of Aberdeen, published an elaborate refutation[1] of Dr. Price's theories. Hamilton begins by laying down the following "General Principles of Finance":

I. The annual income of a nation consists of the united produce of its agriculture, manufactures, and commerce. This income is the source from which the inhabitants derive the necessaries and comforts of life; distributed, according to their stations, in various proportions; and from which the public revenue, necessary for internal administration, or for war, is raised.

II. The portion of national income which can be appropriated to public purposes, and the possible amount of taxation, is limited; and we are already far advanced to the utmost limit.

III. The amount of the revenue raised in time of peace, ought to be greater than the expense of a peace establishment, and the overplus applied to the discharge of debts contracted in former wars, or reserved as a resource for the expense of future wars.

IV. In time of war, taxes may be raised to a greater height than can be easily borne in peaceful times; and the amount of the additional taxes, together with the surplus of the peace establishment, applied for defraying the expense of the war.

V. The expense of modern wars has been generally so great, that the revenue raised within the year is insufficient to defray it. Hence the necessity of having recourse to the system of

[1] Inquiry concerning the Rise and Progress of the National Debt of Great Britain (1813). The extracts are taken from the second edition (1815).

funding, or anticipation. The sum required to complete the public expenditure is borrowed on such terms as it can be procured for; and taxes are imposed for the payment of the interest; or perhaps to a greater extent, with a view to the gradual extinction of the principal.

VI. In every year of war, where this system is adopted, the amount of the public debt is increased; and the total increase of debt during a war depends upon its duration, and the annual excess of the expenditure above the revenue.

VII. In every year of peace, the excess of the revenue above the expenditure, ought to be applied to the discharge of the national debt; and the amount discharged during any period of peace, depends upon the length of its continuance, and the amount of the annual surplus.

VIII. If the periods of war compared with those of peace, and the annual excess of the war expenditure, compared with the annual savings during the peace establishment, be so related, that more debt is contracted in every war than is discharged in the succeeding peace, the consequence is a perpetual increase of debt; and the ultimate consequence must be, its amount to a magnitude which the nation is unable to bear.

IX. The only effectual remedies to this danger, are the extension of the relative length of the periods of peace; frugality in peace establishment; lessening the war expenses; and increase of taxes, whether permanent, or levied during the war.

X. If the three former of these remedies be impracticable, the last affords our only resource. By increasing the war taxes, the sum required to be raised by loan is lessened. By increasing the taxes in time of peace, the sum applicable to the discharge of debt is increased. These measures may be followed to such an extent, that the savings in time of peace may be brought to an equality with the surplus expenditure in time of war, even on the supposition that the periods of their relative duration shall be the same for centuries to come that they have been for a century past.

XI. When taxation is carried to the extent mentioned above, the affairs of the nation will go on, under the pressure of existing burthens, but without a continual accumulation of debt, which would terminate in bankruptcy. So long as taxation is

below that standard, accumulation of debt advances; and it becomes more difficult to raise taxation to the proper height. If it should ever be carried beyond that standard, a gradual discharge of the existing burthens will be obtained; and these consequences will take place in the exact degree in which taxation falls short of, or exceeds the standard of average expenditure.

XII. The excess of revenue above expenditure is the only real sinking fund by which the public debt can be discharged. The increase of the revenue and the diminution of expense are the only means by which this sinking fund can be enlarged, and its operations rendered more effectual: And all schemes for discharging the national debt, by sinking funds operating by compound interest, or in any other manner, unless so far as they are founded upon this principle, are illusory.

The greater part of these propositions are so incontrovertible, that it may appear superfluous to adduce any arguments in support of them, and the others may be inferred from these by a very obvious train of reasoning. Yet measures inconsistent with them have not only been advanced by men of acknowledged abilities, and expert in calculation, but have been acted on by successive administrations, and annually supported in parliament, and ostentatiously held forth in every ministerial publication. These seem to have gained possession of the public mind, and we hear them daily extolled and confided in by persons, in other respects, candid and intelligent. This not only supplies an apology for examining the principles minutely, but renders such an examination necessary.

Hamilton's twelfth proposition is supported by the following argument:

The progress and discharge of the debt of a nation are regulated by the same principles as those of an individual; and experience shows, that measures of public finance are often conducted with a degree of imprudence seldom exhibited in the management of private affairs. We may, however, extend our views to a greater length of time in regard to the former.

It is true that, upon abstract principles, the smallest sum lent

out for compound interest will, in length of time, increase to an indefinite magnitude: But it is obvious that the improvement of money in that way would be limited, at a certain amount, by the want of demand from borrowers, and the impossibility of investing it in productive capital of any kind. It is restricted within a much narrower limit by the mutability of human measures, and the actual impossibility of adherence to the same system, conducted by successive trustees through many generations. It is true that if the system were invariably adhered to, the sum would increase at the rate which calculation points out, until it was limited by the impossibility of finding borrowers, or employing it in any profitable manner.

The system of accumulating a national treasure has been long laid aside, and is not likely to be revived. We may, therefore, dispense with any further consideration of nations storing up wealth, and bestow our attention on the actual case of nations laboring under debt; sometimes endeavoring to discharge it: often obliged to increase it.

Suppose an individual has contracted a certain extent of debt, and afterward attains to circumstances which enable him to discharge it. If no oppressive and usurious measures be practiced against him by his creditors, and if he pay the interest regularly, the sum which he must pay altogether, before he be clear of debt, is the amount of money he borrowed, and the simple interest of each portion of the same, from the time of its being borrowed to the time of its repayment. Suppose he borrows £10,000, and that for 10 years he pays the interest, but no part of the principal. If the rate of interest be 5 per cent, he pays during that time £500 annually for interest, or £5000 altogether; and if, by a sudden acquisition of wealth, he is able to discharge the debt at the end of 10 years, he pays exactly £15,000 altogether. But suppose, by an amelioration of his circumstances, he is enabled to pay £1000 annually to his creditors, for principal and interest. The first year he pays £500 for interest and £500 toward the discharge of the principal. The remaining debt is £9500, and the interest of this being £475, if he can pay £1000 next year, he discharges £525 of the principal, leaving a debt of £8975. The interest of this is £448 15*s.* and next year, by paying £1000, he discharges

£551 5*s.* of the principal, and reduces the debt to £8423 15*s.* If he continue to act in this manner, the whole debt will be discharged in about 14¼ years; and the whole sum which he pays, including the £5000 paid during the first 10 years, is £19,250 nearly, being the amount of the principal, of 10 years' interest on £10,000, of 11 years' interest on £9500, of 12 years' interest on £8975, of 13 years' interest on £8243 15*s.* and so on; altogether, the principal, together with the simple interest of each portion of the same, from the time that the debt was contracted, till the time that portion was repaid. If he can only spare £750, and therefore discharge £250 of the principal the first year, it will require somewhat above 22 years to discharge the whole; and if he can only spare £600 and therefore discharge £100 of the principal the first year, it will require 37 years. In all these cases, it is the surplus of £500, of £250, or of £100, which the debtor can spare above the interest, that enables him to discharge the principal.

Instead of conducting the business in this manner, he may pay only the £500 of interest to his creditors and lend out the other £500 at interest, and lend again £500 more at the end of the next year, and so on, accumulating the sum lent by compound interest, till it amounts to £10,000, and then discharge his whole debt at once. It will require exactly the same time of 14¼ years to accomplish this. If he transact the business himself, the second way will be attended with more trouble, but the result will be the same. If he employ an agent to transact the loans, he will be a loser by following the last-mentioned methods, to the extent of the fees paid for agency.

If the debtor be able to pay no interest during the first 10 years, the creditors will either insist on accumulating the interest with the principal, in the manner of compound interest, or the debtor must borrow annually from other hands, to pay the interest annually to his original creditors, and must also borrow more each succeeding year, to pay the interest of the debts thus contracted. In either way, his debt at the end of 10 years will amount to £16,289, the interest of which being £814 9*s.* an annual payment of £1000 would discharge only £185 11*s.* of the principal debt the first year, and would require about 35 years to discharge the whole, whether he pay the

£1000 annually to his creditors to lessen the principal, after payment of the interest, or whether he accumulate the overplus by compound interest till he be able to pay the whole debt at once.

Substitute millions, or ten millions, for thousands, and the above reasoning is equally applicable to the public debt of a nation.

If the debt be ever discharged, which can only be done by a surplus revenue, and if the business be transacted as private affairs are, where the creditor is entitled to no more than the sum lent, together with the interest, the time required for the discharge of a public debt will be the same as that for a private one, when the proportion of surplus revenue is the same; and this holds whether the surplus is paid annually to the creditors, in discharge of part of the debt, so far as it will go, or accumulated in a sinking fund, in the hands of commissioners appointed for that purpose.

The whole sum paid to the public creditor, before the debt be discharged, is equal to the sum advanced by him, together with the simple interest of each portion of the same, from the time it was advanced to the time it is repaid, providing the interest be paid regularly from the time the debt is contracted. But if the payment of the interest be suspended for a certain time after the debt is contracted, then the whole sum paid is equal to the principal debt, together with the compound interest of the same, during the period of suspension, and the simple interest of each portion of this accumulated sum, from the time it is put in a train of payment, till that portion be paid.

Elsewhere Hamilton criticises Price's views more specifically, arguing, in part, as follows:

It will be proper, before proceeding, to state distinctly the points in which all agree, and the points at issue.

It is universally admitted, that every productive additional taxation tends to prevent the progress of the national debt, if it be in a state of accumulation; and to accelerate its discharge, if it be in a state of redemption.

That every increase of expenditure, whether arising from

necessity or profusion, tends to increase its accumulation, or retard its discharge.

That any sum of money, however small, improved by compound interest, will amount, in length of time, to an indefinite magnitude; and therefore,

That any surplus of national revenue above national expenditure, will be sufficient, if it continue for a long time, and be faithfully applied, to discharge any national debt, however great.

The doctrine maintained by Dr. Price is, that the formation and inviolable appropriation of a sinking fund, operating by compound interest, *in war as well as in peace*, is a measure of the utmost consequence, and that the effects of this system are greatly superior to those of any other application of a surplus, *the expenditure and taxation being equal.* . . . His work means this, or it means nothing: for it was never called in question that saving of expenditure, or increase of taxation, have a powerful effect on the state of national finance.

In opposition to Dr. Price's doctrine, it is maintained, that the separation of a sinking fund from the general revenue, is a measure of no efficacy whatever; — that the first and second methods of applying a surplus above mentioned[1] are merely different modes of official arrangement, leading to the same result; — that in time of war, when the expenditure exceeds the revenue, the preservation of the sinking fund, and consequent increase of loans, is a system from which no advantage can arise; — if it could be conducted without expense, it would be nugatory; as it is necessarily attended with expense, it is pernicious; — that at the conclusion of a war, any surplus revenue applied for the discharge of debt during the subsequent peace, operates by compound interest, during the continuance of peace. But the notion of uniting that period to another period of peace, or to a still longer period of alternate war and peace, in order to obtain the powerful effect of compound interest acting for a great length of time, is illusory.

[1] Hamilton here refers to Price's statement that there are three methods of applying a sinking fund: (1) interest released by previous payments on principal may be applied to further reduction of the debt; (2) interest thus released may be spent for current expenses; (3) or taxation may be reduced to that extent. — ED.

We return to the case supposed by Dr. Price, above mentioned,[1] and compare the effects of the first and second methods of applying the surplus, either in time of peace or war.

In time of peace, when the second method is followed, £10,000, being the interest of the debt discharged the first year, is applied to the current services of the second year; £20,000, the third year; and these sums are supposed requisite to complete what the service of each year requires; and as Dr. Price observes, they must have been borrowed, if the first method had been followed.[2] If loans be made for this purpose, either taxes must be imposed for the payment of the interest, or the sums borrowed accumulate by compound interest. In the former case, the nation is subjected to the burthen of taxes for payment of the interest of £10,000 the first year; of £20,000 more, or £30,000 altogether, the second year; and of £36,550,000 the eighty-sixth year; none of which would have been imposed according to the second method. It is this gradually increasing, and ultimately large additional taxation, that occasions the difference of £208,250,000 stated by Dr. Price, as the loss arising from the second method. If the same taxes be imposed when the second method is followed, their produce is not wanted for the services of the year, and must accumulate at the end of the period to the above-mentioned sum in favor of the public.

If taxes be not imposed to pay the interest of these loans, then to the £20,000 borrowed the second year, there must be added a sum sufficient to pay the interest of the loan of the former year; and, in like manner, a sum must be borrowed each succeeding year, equal to the interest of all the former loans, by which means the amount of these loans would accumulate by compound interest against the public.

The disengaged annuities under the second method, may be dissipated by profusion, and then there will be a difference

[1] Hamilton had devoted several pages to a presentation of Price's arguments. These pages have been omitted here, since Price's arguments to which Hamilton refers may be found in the preceding selection. — ED.

[2] Price, it will be recalled, had argued that his first method of applying a sinking fund would reduce the debt even though "the state had been all along adding every year to its debts three millions." See p. 535. — ED.

between the methods equal to what Dr. Price states; but it is the profusion, and not the mode of application, that is the cause of that difference. They may be applied to the construction of canals, harbors, and other objects of national utility; and the benefits accruing from these to the public, may repay the expense of their execution, or otherwise; but the propriety of this mode of application of surplus revenue, does not belong to our present inquiry.

In war, let us adopt Dr. Price's supposition of three millions being required annually in addition to the sums raised within the year, and of continuing the application of £200,000 as a sinking fund; which sum is comprehended in the loan of three millions. The debt contracted in three years, is nine millions; and the additional taxes for payment of interest at 5 per cent come to £450,000. The national debt redeemed by a sinking fund of £200,000, operating by compound interest in three years, is £630,500, and therefore the additional unredeemed debt is £8,369,500.

If no sinking fund be continued during the war, a loan of £2,800,000 only will be required the first year, the interest of which is £140,000. But the taxes imposed that year amount to £150,000 (for we suppose the extent of taxation in both methods equal), therefore there is a surplus of £10,000 applicable to the service of the second year. The loan required for the second year will therefore be £2,790,000; the two loans together, £5,590,000; and the interest upon them, £279,500. The additional taxes imposed the two first years amount to £300,000, leaving a surplus of £20,500 applicable to the service of the third year. The loan required the third, is therefore £2,779,500, and the amount of the three loans £8,369,500, exactly the same as the unredeemed debt when a sinking fund is continued; and it is obvious that the same equality will hold for any number of years.

When Dr. Price says that a debt of 258 millions might be discharged in eighty-six years, at no greater expense than an annual saving of £200,000, he overlooks the taxes imposed, year after year, for the payment of interest; a great part of which would not have been needed, if that annual sum had not been separated from the public revenue. The reasoning used

above is equally applicable to any other supposition of war expenditure, whatever be the annual deficiency, whether uniform or varying, — whether continued for three or thirty, or an hundred years, still the taxation and expenditure of each year being the same, the finances of the nation will be found in the same condition at the end of the period, whether the sinking fund be preserved inviolate, or entirely laid aside.

If no sinking fund be kept up for thirty years, a little alteration on the arrangement of public accounts would bring them exactly to the same state as if it had been uniformly adhered to; and conversely, the present form of our financial accounts, arising from a sinking fund, may be brought by a like alteration of arrangement, to the form in which they would have stood, if no sinking fund had ever been thought of. It is impossible that a mere change of order in the public accounts, capable of being reversed at any time, can be attended with advantage to the public.

At the termination of a war, the nation remains charged with a certain debt, and it possesses or ought to possess, a certain surplus revenue. The efficacy of this surplus to discharge the debt depends upon its proportion to the debt, and the length of time during which it is applied to that purpose, and upon these alone. It operates by compound interest. But the manner in which the debt was contracted, or the surplus obtained, have no relation to the progress and period of its discharge. It is of no avail that a sinking fund had been operating by compound interest during a former peace. When war breaks out again, the operation of compound interest is at an end. In place of continuing to discharge debt, an additional debt is contracted. When peace returns, the operation of discharge recommences from a new basis, according to the state of finance at the time. The public debt is certainly increased — the proportion of surplus revenue to that debt, and therefore the time requisite for its complete discharge, may be greater or less than at the former peace; but the two periods of peace cannot be united to obtain a powerful effect from the long continuance of compound interest.

The Doctor's plan for discharging the national debt by borrowing money at simple interest, in order to improve it at com-

pound interest, is, we apprehend, completely delusive. He admits the absurdity of such a measure in private life, — and its absurdity in national finance is exactly the same. The cases differ only in extent of sum, and duration of time, which no ways alter the general tendency of the measure. Suppose a million borrowed for this purpose, and assigned to commissioners for the redemption of the national debt, in whose hands it operates by compound interest. The interest of this loan is £50,000, which must either be provided for by some additional tax, or saved by some measure of public economy; or if neither of these be adopted, an additional loan must be made next year to pay the interest. In the former case, it is the tax or the economy, and not the operation described, that benefits the revenue; and they would have produced the same effect by affording an additional surplus improved at compound interest, without any loan. In the latter case, an additional sum of £50,000 is borrowed the second year; and a sum equal to the interest of both loans, or £102,500, the third year; and thus the debt accumulates by compound interest against the public, exactly to the same extent that the money vested in the hands of the commissioners accumulates in its favor.[1]

96. Sinking-Fund Legislation in the United States. — The early sinking-fund acts of 1792 and 1795 were constructed, in general, upon the British model. They placed certain revenues in the hands of commissioners who were to redeem United States stock, and then draw from the treasury the interest on the purchased stock and apply it to making further purchases. The act of 1802, passed in accordance with recommendations of Gallatin, enlarged and simplified the sinking fund, but did not disturb the provisions of Hamilton's sinking-fund law of 1795.

[1] A further point is brought out by Hamilton in his criticism of Pitt's sinking-fund policy, which was shaped according to the theories of Dr. Price. Hamilton shows that the money borrowed in war time in order to keep up payment on the principal of the old debt was secured on terms which really imposed a heavier rate of interest than the old debt bore. The result was that England lost heavily by borrowing at a higher rate in order to redeem a debt that bore a lower rate. He estimated the loss occasioned in this manner between 1793 and 1812 at something less than £20,000,000. *Inquiry*, pp. 149–160. — Ed.

In 1817, however, the whole complicated apparatus of previous acts was swept away, and a permanent appropriation of $10,000,000 was made for the payment of interest and reduction of principal of the debt. Moreover, it was distinctly provided that, in case war should occur with any foreign power, the United States should be free to discontinue the redemption of the principal of all debts not included in the provisions of earlier sinking-fund laws.

The following account of the operation of the sinking-fund law of 1862 is presented by Professor E. A. Ross, in his monograph upon Sinking Funds:[1]

With the outbreak of the Civil War begins the final period of sinking-fund history. In the earlier part of this period we find a return to Hamiltonian principles. Secretary Chase in his report of July 4, 1861, advocated the immediate establishment of a sinking fund for the expungement of the war loans. The fruit of his policy was the clause in the act of Feb. 25, 1862.

This act, after authorizing a serious appeal to credit, undertook to establish the debt on a secure basis. The coin paid for duties on imports was to be applied, first, to the payment of interest on the bonds and notes of the United States. It was then to be applied "to the purchase or payment of one per centum of the entire debt . . . to be made within each fiscal year, which is to be set apart as a sinking fund, and the interest of which shall in like manner be applied." . . . The residue of customs receipts was to be paid into the treasury. The language of this act is plain. The provision was made part of a loan act and was to apply to future as well as to existing debt. In view of this, the words of a writer in the *Bankers' Magazine* seem warranted.

> It was a formal notice to all persons, who should loan to the government, of its future intention, and constitutes a contract as binding as any can be made between it and the persons who have loaned to the government since that date.

[1] In Publications of the American Economic Association, Vol. VII (1892). Reprinted with consent of the author and the Association.

Notwithstanding the law of 1862, there was no compliance with its sinking-fund provision during the war. At the close Secretary McCulloch, who resembled Gallatin as Chase resembled Hamilton, ignored the law of 1862 and proposed a sinking fund similar to that of 1817. He estimated that a yearly appropriation to the debt of $200,000,000 would discharge the whole in about thirty years. The proposal was not accepted, and during his administration the treasury applied to the debt whatever funds were available, without reference to the sinking fund. As the actual reduction was far greater than that required by law, nobody complained.

The sinking-fund provision of 1862 seems to have been discovered by Secretary Boutwell. In his first report he announced that he had purchased twenty millions of bonds for the sinking fund. He had made further purchases, which he held as a special fund subject to the action of Congress. He recommended that such extra purchases be added to the sinking fund until it equaled what it would have been, if the law had been complied with from the first.

In the great funding act of July 14, 1870, reorganizing the public debt, it was provided that all bonds applied to the sinking fund be recorded, canceled, and destroyed, and that a sum equal to the interest on all bonds belonging to the sinking fund, be included in the yearly amortization. Heretofore the heads of the treasury had bought bonds, even beyond the requirement of the sinking fund. This action was legalized by a clause authorizing the secretary to redeem the five-twenties with any coin which he might lawfully apply to that purpose.

In 1873 the great crisis dried up the sources of revenue seriously and made it impossible to meet all claims upon the receipts. It is possible that, if Secretary Boutwell had been in office, there would have been a rigid adherence to the strict letter of the law of 1862. Under Secretary Bristow the law was practically construed to suit the emergency. It was announced that for 1874–75 there would be a surplus revenue of nine millions to be applied to the sinking fund. As under the law over thirty-one millions was required for the fund, there would be a deficiency for the year of over twenty-two millions. This was making the sinking fund the residuary legatee of the revenues.

In his report for 1875 Secretary Bristow acknowledged that the sinking-fund payment was secondary only to the interest on the public debt, and took precedence of all other appropriations. As some had asserted that the excess payments of former years excused the lapse of the sinking-fund payment when need arose, the secretary took occasion to declare that the statute imposed a duty to be performed annually, and that purchases must be made within each fiscal year. The secretary explained the cessation of bond purchases by the fact that bonds could not be bought at par, while he was forbidden by law to pay more. This deadlock, however, had been broken by the law of March 3, 1875, which authorized the secretary to obtain bonds for the sinking fund by calling in and redeeming the five-twenties.

As the deficiency in the revenues continued, the next secretary, Morrill, thought fit to present a view of the operations of the debt *in toto*. From his calculations he concluded that the public creditor had no ground for complaint.

> The terms of the law of Feb. 25, 1862, required that by the operations of the sinking-fund account, the public debt should be reduced in the sum of $433,848,215.37 between July 1, 1862, and the close of the last fiscal year. A reduction has been effected during that period of $656,992,226.44, or $223,144,011.07 more than was absolutely required.
>
> It can therefore be said, as a matter of fact, that all of the pledges and obligations of the government to make provision for the sinking fund and the cancellation of the public debt have been fully met and carried out.

The sinking fund first rose into prominence during the preparations for specie resumption. The act of 1875 permitted the sale of bonds, to procure the stock of gold necessary for resumption. A compliance with the letter of the statutes would lead to the practice of redeeming and borrowing at the same time. Sound finance required that, in such a case, the government should cease buying bonds for the sinking fund, and let the cash destined for that purpose accumulate in the treasury, awaiting the day of resumption. It was accordingly urged, and with reason, that the claims of the sinking fund should be suspended.

This was not done, but something similar was done. The

debt to which a yearly one per cent payment was pledged included notes as well as bonds. It might, therefore, be held lawful to redeem greenbacks, or even "shinplasters," for the sinking fund, in place of bonds, and thereby lessen the mass of paper to be confronted on Jan. 1, 1879. Accordingly under the law of April 17, 1876, $7,000,000 of fractional currency were credited to the sinking fund at five per cent interest. Similarly $8,000,000 of greenbacks were added under a clause in the resumption act.

Since the accession of Senator Sherman to the treasury portfolio a construction of the law of 1862 has prevailed which, however consonant with common sense and sound finance, is irreconcilable with the theory that the sinking fund then established is part of the contract with the public creditors. In his report for 1879 the secretary said: "These acts (of 1862 and 1870) are regarded as imposing upon the secretary the duty of providing for the sinking fund out of the surplus revenues of the government." The new construction was very apparent in a Senate debate, in 1884, over a proposition to reduce the sinking fund. Senator Plumb regarded the sinking fund as merely a matter of bookkeeping. . . . "The sinking fund has simply been something represented by certain entries on the books of the treasury, but nothing in the vaults of the treasury."

Senator Sherman stated that, in 1873 and thereafter, the government did not pay one fourth or one fifth of the sinking fund. In 1877 and the following years, surpluses appeared and much more was paid than the sinking fund required. The question, then, is, Has the United States, which has pledged its faith to pay a certain sum annually, a right to apply the excess payment of one year to make up the deficiency of another year? The senator regarded it as a compliance with the law when the government does substantially what it agreed to do. No man could question the faith of the United States because it was for three or four years unable from its current revenues to pay the sinking fund, provided it has, on the whole, more than made good its promise. But while the senator regarded the sinking-fund payment as justly amenable to the financial demands of the country, he deemed it inconsistent with honor and public faith to alter or invade the sinking fund by law. Temporary

exigency might suspend amortization without dishonor, but conscious policy never.

Our conclusion, then, is that the debt has been reduced, but not with the steadiness and automatic regularity contemplated by the terms of the law of 1862. Though the total reduction has exceeded the requirements of the law, yet so sensitive have the yearly appropriations been to the condition of the treasury, that it is doubtful if they could have conformed more closely to the varying financial situation, had there been no law at all.

What the secretaries have done — and they could do no more — was simply to amortize with the annual surplus, be it large or small. It is hard to see, therefore, wherein our sinking-fund law, thus administered, differs in effect from a law directing the secretary to use surplus funds to pay the debt. If Congress had ordered the law to be administered so that the sinking-fund appropriation should enjoy a priority over other appropriations, not permanent, or regular, the law would have meant something. In that case a shrinkage in the revenues would have meant a deficiency in the funds for public works, and not in the funds for the public debt. We should not then be placed in the anomalous position of granting to gratuitous appropriations like those of the river and harbor bill, the preference at the counters of the treasury over a matter of contract like the sinking-fund appropriation.

It seems, then, from our last experience, that, however solemnly a sovereign state may confer upon the principal of the public debt the first lien upon the revenues, considerations of practical policy will lead that state to relegate the principal of the debt to the frontier of public obligation, there to be abandoned, should the national income for a time retreat within narrower bounds.

CHAPTER XXVI

NATIONAL AND LOCAL DEBTS COMPARED

97. Differences in the Nature of National and Local Debts. — In addition to important legal differences, national and local debts differ in respect of the purposes for which they are contracted. This is discussed by Professor Henry C. Adams[1] as follows:

The rule according to which public functions are allotted to the various centers of power in the United States is quite simple for one who understands the political philosophy of democratic governments. The safety of democratic institutions lies in the realization of local self-government, and the principle that controls in matters of organization is that the administration of all powers should lie as closely as possible to those interested in their exercise. This theory of allotment would grant to the federal government all duties touching purely national and sovereign questions; it would press upon the local centers of administration such functions as are of peculiar local interest; while the states, standing between the two, would gather up into themselves all the remaining powers that the people have chosen to place out of their own immediate control.

From this it seems natural to expect that local financiering should differ from that of the federal government chiefly in the variety of purposes for which money is borrowed, and a glance at the history of local administration shows this expectation to have been met. The commonwealths have frequently borrowed money for purposes regarded as lying outside the appropriate duties of Congress, and, when we come to consider the course of municipal financiering since 1860, it will be seen that the activity of the minor civil divisions has also greatly extended.

[1] Public Debts, 299–306. Reprinted with the consent of the author and the publishers, Messrs. D. Appleton and Company.

The first occasion upon which the states employed their credit as a source of revenue brings to view the financial operations of the Revolutionary War. There was, at this time, much confusion, both of thought and of action, and the line of distinction between the local duties of the states and the comprehensive duties of the central government had not yet been drawn. The states had not yet surrendered any part of their sovereignty, and in consequence the administration of their treasury departments was largely shaped by national ideas. It is for this reason that the first period of local indebtedness records nothing of interest to the present comparison.[1] The states did not again come forward as borrowers of money until about 1830. The development of the railroad system, which has since revolutionized all industrial methods, had at this time just begun, and it was not then believed that private enterprise was adequate to the extensive demands of the public for highways of inland commerce. The wildest expectations were entertained respecting the efficacy of public improvements, and, under the pressure of speculative excitement thus engendered, the states were forced to undertake business enterprises upon the basis of borrowed money.

This period of excitement will receive detailed attention in the following chapter;[2] for the present is it adequate to notice that public banking and public improvements left upon the states a burden of debt from which many of them only escaped through financial disgrace. The amount of this debt in 1842, as also its character and residence, is shown by the figures in the following table:

[1] It may, however, be well to add the following details. In order to aid in the prosecution of the War for Independence, the states contracted various debts, largely, although not wholly, in the form of issues of paper money. After the war many of the states did little or nothing toward extinguishing such obligations, and were deeply in debt when the new government was formed under the Constitution. In 1790, when the federal debt was funded, Congress, upon the advice of Hamilton, decided to assume the outstanding state debts incurred for the prosecution of the war. The funding act authorized the assumption of $21,500,000 of state debts; but, after a through sifting of the indebtedness, only $18,271,000 was finally assumed. From this time onward until the period of which Professor Adams is to treat, the states made little use of their credit. — ED.

[2] Besides Professor Adams's chapter, it may be well to refer the student to a contemporary account of the financial situation of the states in 1837, by Alexander Trotter, entitled, Observations on the Financial Position of the States of the North American Union (London, 1839). — ED.

TABLE SHOWING THE AMOUNT OF DEBT RESTING UPON THE STATES IN 1842, AND THE PURPOSES FOR WHICH IT WAS INCURRED.

States and Territories	Public and Internal Improvements	Banking	Miscellaneous	Total
Maine	—	—	—	$1,734,861
Massachusetts	$4,105,000	—	$1,319,137	5,424,137
New York	21,727,267	—	70,000	21,797,267
Pennsylvania	31,186,130	—	5,149,914	36,336,044
Maryland	14,098,854	—	1,115,907	15,214,761
Virginia	6,193,161	$458,107	343,039	6,994,307
South Carolina	3,350,000	137,704	2,203,530	5,691,234
Georgia	1,309,750	—	—	1,309,750
Alabama	—	15,400,000	—	15,400,000
Louisiana	1,200,000	20,200,000	2,585,000	23,985,500
Mississippi	—	7,000,000	—	7,000,000
Arkansas	—	2,676,000	—	2,676,000
Kentucky	3,085,000	—	—	3,085,000
Tennessee	1,198,166	2,000,000	—	3,198,166
Michigan	5,420,000	—	191,000	5,611,000
Ohio	10,924,123	—	—	10,924,123
Indiana	11,751,000	1,000,000	—	12,751,000
Illinois	10,371,294	3,034,998	121,000	13,527,292
Missouri	20,000	389,261	433,000	842,261
Territory of Florida	—	3,900,000	100,000	4,000,000
District of Columbia	—	—	—	1,316,030

From the facts which this table displays, it appears that the cotton and tobacco-growing states expressed a decided preference for public banking, while the grain and metal-bearing states favored the building of canals and railroads. One may not, however, on this account, conclude that public sentiment in the North respecting banking questions was more highly educated than in the South, for the fact is that during this period the people of the North were provided with all the paper money they could desire. The Southern states did not so strongly feel the need of railroads and canals, for the nature of their produce, and the character of their industrial society, did not suggest the necessity of rapid inland communication. They regarded it as much more desirable to furnish the planter with "capital" for

the adoption of better methods in the culture of cotton, and to this end they established banks, or guaranteed the payment of notes issued by private associations. On the other hand, the great majority of the Northern states seem to have been completely mastered by the enthusiasm for public improvements. New York led the way by building the Erie Canal, and Pennsylvania and Maryland quickly followed, in order to protect their local interests. The lake states also, desiring to avail themselves of the benefits arising from direct communication with the Atlantic seaboard, and to open all parts of their territory to rapid settlement, adopted a similar policy. Other states, as, for example, Kentucky and Tennessee, having no need for either cotton-banks or canals, but being influenced by the general enthusiasm for public improvements, set about building turnpikes and toll roads.

It appears, then, that the debts contracted by the states between 1830 and 1850 differ somewhat from those considered in the former part of this essay. Not only were the bonds issued for a different purpose, but it was supposed that they would rest for their extinction upon a different fund; and from this it must follow that the rules appropriate to the management of the federal treasury do not apply in all strictness to local financiering.

Since 1850, the history of the treasury operations of the states presents little of importance to the student of finance. The amount of their indebtedness, less sinking-fund accumulations, was, in 1880, as follows:

Eastern states	$35,207,482
Middle states	37,575,110
Southern states	123,803,235
Western states	37,671,256
Pacific states	179,178

Taking into consideration what we know of the relative wealth of the sections here represented, it appears that the only considerable sum of debt lies upon the Southern states, nor is this so large but that the entire amount might be wiped out by a moderate taxing-policy vigorously applied. This debt was created for the most part during a period of bad government.

The general fact with regard to the states seems to be that, at the present time, they possess no financial standing. They never appear upon the market as borrowers of large amounts of capital, for their administrative activity has been so restricted as to render this unnecessary.[1] Duties which they once performed have passed either to the federal government, as in the case of banking, or to private corporations, as in the case of railroads. The questions of organization and administration suggested by this state of affairs are certainly of importance, and all that follows bearing upon the history of local indebtedness may be regarded as leading to their solution.

If now our attention be turned to the cities and minor civil divisions, the same necessity for special and detailed study will present itself. The purposes for which municipalities have employed their public credit are peculiar to the position which they hold in the general structure of government, and the rules by which their treasuries should be managed are shaped by the peculiar duties imposed. The totals of local indebtedness for certain significant years are given in the table below. The states, which began to assume obligations in 1830, found themselves most heavily burdened, wealth and population being taken into the account, in 1842; but at this date the cities were comparatively free from debt, while the minor civil divisions had not yet made such use of their public credit as to attract general attention. For the year 1880, the amounts presented in the tables are net indebtedness; for the previous dates no such careful estimate has been made to secure accuracy of statement. It is further necessary to notice that for the years 1870 and 1880 the debt of townships and school districts is included under the heading of city obligations.

[1] The unfortunate experiences of certain commonwealths between 1830 and 1840 led to the incorporation into state constitutions of many provisions designed to check the further growth of state debts. Some constitutions prohibit the state governments from entering upon schemes for internal improvements. Others, and these are the most numerous class, prohibit the states from incurring debts beyond certain small amounts, which range from $50,000, the minimum, to $1,000,000, as a maximum. Very frequently, also, the constitutions provide that every debt contracted shall be accompanied by the levy of a tax sufficient to sink it within a somewhat short period, as from five to ten years. See the Reports upon Public Debt, of the Tenth and Eleventh Censuses. These constitutional limitations date back to the period following 1840; they are found in the more recent state constitutions also. — Ed.

TABLE SHOWING THE RELATIVE GROWTH OF STATE AND MUNICIPAL DEBTS[1]

	1842	1870	1880
State debts	$198,800,000	$352,800,000	$234,430,000
City debts	27,500,000	328,250,000	698,270,000
County debts	—	187,500,000	123,870,000

The important feature of this table is the change in the balance of indebtedness which its figures portray. While the states have in large measure retired from the market as borrowers of money, the municipalities have increased the frequency and extent of their demands. It is true that the total per capita debt of both together was not as large in 1880 as in 1870, being $23 in the earlier period, and $21 in the latter, but the proportion of this sum for which the cities are responsible is greatly increased.

But for what purposes did the municipal corporations incur their obligations? For an answer to this inquiry we are obliged to rely upon data furnished by the Census Report of 1880. The facts desired are not there given, but it is possible to arrive at substantially accurate results by means of a simple calculation from the figures furnished. The figures, upon which this calculation proceeds, as well as the results derived, are presented in the following table:

[1] For 1890, the last year for which data are available at the time of writing, the state and local debts were as follows:

State debts	$228,997,000
County debts	145,048,000
Municipal debts	724,463,000
School-district debts	36,701,000

Great differences appear in the per capita state and local indebtedness of different parts of the country. In West Virginia, in 1890, the per capita indebtedness was but $3.32; in Maryland it was $40.46. In general, the per capita debts were smallest in the South and West. Heaviest of all was the per capita debt of the District of Columbia, which was not less than $85.86. Nearly half of the states and territories had state and local debts amounting to more than $20 per capita. — ED.

TABLE SHOWING AMOUNT OF BONDED DEBT IN 1880, FOR STATES, CITIES, AND MINOR CIVIL DIVISIONS AND PURPOSES FOR WHICH BONDS WERE ISSUED.

Purpose for which Local Debts were Contracted	State and Local Indebtedness, as given in the Census of 1880	Indebtedness of Cities with Population of 7500 and upward, as given in Census of 1880	Indebtedness of States as computed from Balance Sheets of States	Indebtedness of Towns and Minor Civil Divisions, computed from the Foregoing
Bridges	$24,853,388	$20,809,431	—	$4,043,957
Cemeteries	283,816	272,912	—	10,904
Fire department	2,514,082	2,214,924	—	299,158
Public parks	40,612,536	40,490,636	—	121,900
Sewerage	21,370,536	21,335,434	—	35,102
Streets	86,674,860	81,502,817	—	5,172,043
Waterworks	146,423,565	141,797,828	—	4,625,737
Bounties, militia, war	75,154,400	28,722,787	$33,310,738	13,120,875
Funding of floating debts	153,949,095	122,864,804	2,978,048	28,106,243
Refunding old debt	138,743,730	71,071,140	57,057,862	10,614,728
Public buildings	48,493,952	25,516,829	6,327,780	16,649,343
Railroads	185,638,948	68,309,493	47,984,090	69,345,365
Canals, rivers, water power	36,224,548	16,726,064	8,655,780	10,842,704
Schools and libraries	26,509,457	13,889,915	—	12,619,542
Miscellaneous	130,374,758	26,571,446	90,000,000	13,803,312
Total	$1,117,821,671	$682,096,460	$246,314,298	$189,410,913

There are many significant items in the foregoing table. For example, the assistance granted to railroads suggests a line of study that demands a comprehensive investigation of the entire subject of internal improvements in the United States. Another point of interest is the excessive use made by municipalities of floating obligations. Cities have no business to create floating debts, and yet over $150,000,000 of their obligations are traceable to this source. Or, reverting again to the question of the balance of indebtedness, the foregoing table shows that the employment of credit by the larger cities is greatly in excess of its use by the minor civil divisions. There are in the United

States some three hundred first-class cities, containing about one fourth of the total population of the country; but their indebtedness is $682,000,000 as against $189,000,000 borne by the other municipal corporations. These are indeed startling figures and, when understood, disclose certain dangerous tendencies in the development of local administration; but since it is the purpose of the remainder of this treatise to interpret the facts thus disclosed, we need not dwell longer upon them at the present time.

98. Differences in the Principles of Financiering Applicable to National and to Local Debts. — Professor Adams continues :[1]

It remains to inquire how far the general principles of national financiering may be followed in the administration of local affairs. It is quite clear that these principles must be subject to some modification, for rules of deficit financiering spring in large measure from the conditions under which debts are contracted, and these conditions are shaped by the purposes for which appeal is had to credit. From a survey of the items mentioned in the foregoing table, it seems that the debts resting upon the cities and minor civil divisions are capable of a threefold classification. In the first class are included those debts incurred for the purpose of rendering a direct though a general service to the public. The building of highways; the maintenance of a fire department; the construction of sewers, and the like, are examples of such services. The second class includes those debts incurred for the purpose of rendering a direct service to the public, but of a particular rather than a general character. This division comprises such services as the supply of water, or gas, or heat, to the citizens of a municipal corporation. The purchase of cemetery grounds for resale to individuals would also be included in this class. The third kind of local indebtedness arises when the governing body employs its credit for granting assistance to private corporations, believing thereby to serve the public indirectly through the industries established.

All of these classes of debts have certain characteristics in

[1] Public Debts, 306–316.

common which distinguish them from debts contracted for national purposes. One important point of contrast pertains to the nature of the demands for which money is borrowed. When the federal government appears upon the market, the demand for increased revenue is usually sudden and extensive, and of such a sort that no safe estimate can be made of the amount needed. This is not true in the case of the minor civil divisions. Local financiering is entered upon with foresight, and not under the stress of any emergency. It follows from this, that common business maxims may be more closely observed, and general political and industrial considerations less strenuously regarded. A local council partakes more nearly of the character of the governing board of a corporation than is the case with the cabinet of the federal government. For similar reasons, also, the defense of local debts is different from that of national debts. A city or a town cannot possibly urge the plea of imperative necessity. It is true that some great disaster, as fire or flood, may incline the local authorities to render immediate assistance to those citizens who are subjects of misfortune. But this desire cannot be reflected in the record of indebtedness, since bonds issued for such purposes would be held invalid by the courts. The only defense of local borrowing rests upon the common-sense principle of payment by installments. A revenue law that makes sudden and rapid changes in the rates of taxation is the occasion of unnecessary inconvenience and vexation, and, notwithstanding the rise of extraordinary demands, the evils attending such arbitrary changes may be easily avoided by a resort to credit. If, for example, a courthouse or a city hall is to be erected, it is of common advantage that the people who are called upon to foot the bills should be permitted to distribute their contributions over several years.

A further distinction is suggested when it is noticed that the national financier is forbidden to calculate upon any income that may arise from the manner in which the proceeds of a loan may be expended, and that he is in consequence obliged to rely upon taxes for the support of the debt.[1] But in contrast with this, it frequently occurs that local authorities under-

[1] The query may arise if bonds issued for territorial purchases do not form an exception to this statement. Why may not land bonds be provided for out of the

take productive industries and derive a steady income from the investment of moneys borrowed. Thus, the proceeds of a loan are said to be spent for remunerative purposes when invested in such a manner as to render direct personal service to citizens. The furnishing of gas, or of water, or of heat, are illustrations of such services. In cases of this sort, the burden of debt is thrown upon the public industry which its proceeds establish, and its support and final payment are assumed to rest with those who are benefited by the service in proportion to the benefit received. For example, it is the common practice for waterworks to be supported by water rates; and it conforms fully to the requirements of finance that these rates should be so adjusted as to pay for the plant independently of taxation, except so far as the city is itself a consumer. Such a method of treasury management, which leads to the assignment of specific funds to specific services, is not common in national financiering. But in local affairs, the principle thus disclosed is one of wide application, and modifies in a marked degree the general rules for the administration of local debts.

Passing, however, from such general distinctions, one may easily observe certain technical differences in the administration of a local and a national debt, arising from the varying conditions under which credit is employed. The most important of these pertain to the use of sinking funds, tax loans, and floating

proceeds of the sale of land? This might be possible under some circumstances. If the land were already under cultivation, or if the government should purchase it with a view of going into the business of forestry, it might be desirable to pay the debt created out of the proceeds of the property; but according to the land policy adopted in the United States, the financier is forbidden such calculations. Indeed, a loan for the purpose of purchasing large tracts of wild, uncultivated land must primarily rest upon taxes, because such lands can only be sold as they are gradually absorbed by advancing population. The treasury figures show this to have been true in the case of the Louisiana Purchase. The total amount of six per cent stock which it was found necessary to create for payment to France was $11,250,000 (Bayley's National Loans, p. 120). This stock was issued in 1804. Payment upon it was begun in 1812, and, with the exception of about $8000, the entire debt was expunged in 1821. If now a date as late as 1825 be taken, it appears that the total gross revenue from sales of lands lying within the French cession was but $2,286,220 (Johnson's Report on the Relief of the States, p. 324). There seems to have been no difference, then, so far as taxes are concerned, between this financial operation and the borrowing of money for purposes of war.

debts, as well as to those measures which make provision for the future conversion of public funds. Those rules peculiar to local financiering thus suggested are as follows. The administrator of local finances is permitted to found a sinking fund at the time of issuing bonds, a permission, it will be remembered, contrary to sound rules of national financiering. The same may be said of the employment of tax loans, although the reasons against the use of such obligations by a federal financier are not so strong as in the case of sinking funds. Temporary debts, on the other hand, are regarded as necessary for governments imposed with the duty of carrying through a war, or of meeting sudden fiscal emergencies; but in local affairs there is nothing which testifies so unmistakably to fiscal incapacity as the existence of large floating debts. And, lastly, the thought of an ultimate conversion of the funds, which may properly influence the drawing of a federal contract, can modify but slightly the form of municipal bonds.

All these rules spring from the fact that the purposes for which local governments may properly contract debts do not demand obligations running for a long series of years. It is of even greater importance for the municipal than for the national administrators to remember that public credit is simply a means for anticipating clear revenue. The principles of perpetual indebtedness may properly give direction to a federal policy, because the extent of extraordinary federal demands is frequently uncertain, and the time of their occurrence is altogether beyond the control of the government; but in local concerns, the occasion for the resort to public credit is wholly a matter of choice, and reliance may be had upon calculations of expenditure and upon estimates of income. It is this fact that modifies the general rules of finance when credit is employed by the officials of minor civil divisions. Let us consider this more closely.

The attachment of a sinking fund, for example, to a loan bill, when the proceeds of the loan are to be expended for war purposes, is useless, to say the least, because the extent of the demand cannot, from the nature of the case, be known. Such a procedure involves the absurdity of borrowing money with which to pay an old debt, while yet under the necessity of employing credit to meet new expenditure. But in local affairs,

early provision for the payment of a debt is evidence of sound business principles. All the facts bearing upon the question are known to the authorities when they determine to borrow money, and there is consequently no reason why they should not make adequate provision for expunging a debt at the time it is created. This may be the more readily recognized if we call to mind the three conflicting interests which may be harmonized by the employment of local credit.

The first of these is the engineering interest, which demands that public works once begun should be carried on as rapidly as possible to their completion, and this can only be done by assured control over a large sum of money. The second is the financial interest, which regards it as essential that tax rates should not be subject to sudden fluctuations. The third is what may be called the general social interest, which stands opposed to the perpetuation of local debts. So far as the first two of these interests are concerned, the attachment of a sinking-fund clause to a debt contract is of no particular importance; but since quick and certain payment is demanded by considerations of general welfare, and since neither the engineer nor the tax assessor can object to an early provision for payment, such provision must be accepted as an essential requirement for the management of a local debt. The same line of argument might be used with regard to tax loans, a form of credit that cannot be employed in any marked degree when the extent of extraordinary demands may not be estimated with safety. Indeed, there is no difference in principle between a tax loan and a loan with a sinking-fund attachment.

There is also an additional reason why a law authorizing the issue of local bonds should contain a provision for the establishment of a sinking fund. It will be remembered that cities and minor civil divisions are inferior and dependent governments, and that their officers are subject to the jurisdiction of the courts to the extent that laws which exist must be executed. If now a sinking fund be created by the law that creates the debt, a public creditor has an assured and an easy method of securing payment upon valid obligations. It does not follow that the creditor would always enforce his rights should the sinking-fund payments be passed, but the fact that it lies within his power to

do so gives an additional value to the obligations, and consequently an additional advantage to the municipality in the placement of its bonds. This consideration does not apply to the federal government, nor at the present time to the state governments, because they are both sovereign for debt purposes, and the only security which it is possible for their bonds to offer is the good will of their legislative bodies.

The general evils attending an excessive use of floating obligations have been already pointed out, and it is only necessary to add, in this connection, that the alternatives which sometimes demand their employment by the national financier can never arise for local administrators. The only defense of a floating debt is the fact that an administration is surprised with sudden demands which cannot await the sale of ordinary obligations; but such a surprise cannot present itself to the local financier, who himself determines the occasion and extent of fiscal demands. As has been frequently remarked, local financiers have nothing to do with emergencies. Still, one cannot conclude from this that city and county warrants, certificates of indebtedness, and such temporary paper, should never be employed. Such instruments of credit may or may not constitute a floating debt, according as they are or are not assigned to some assured revenue. If a definite amount of clear income be appropriated to their payment, common warrants are properly classed as tax loans and not as floating debts, and their convenience in treasury administration commends their use. That which is here condemned is that looseness, so frequently to be observed in the management of city accounts, which leads to the settlement of claims by the issue of warrants and certificates. The funding of such paper must come sooner or later, and the city that thus postpones the liquidation of its accounts is sure to become embarrassed.

It follows, likewise, from the reasons already given, that the policy of local indebtedness need not be shaped with a view to ultimate conversion. Conversion of a public debt means such a modification of the contract as to secure, before its final payment, more favorable terms than those originally entered into. In the case of national financiering this is of great importance, because the conditions under which money is borrowed are com-

monly such that the government is obliged to accede to severe terms. A state of war, for example, is unfortunate for the borrowing of money, and without any change whatever in the industrial relations, the return of peace will give a government control over capital at cheaper rates than it was obliged to pay during the continuance of hostilities. But this cannot apply to local financiering, for a local government is at liberty to select the most opportune times for the sale of its bonds, and consequently it need never suffer the expense of high rates of interest to overcome the risk of investment. So far as the rate of interest is dependent upon risk, a municipal council may censure itself if that rate be not as low when a debt is created as after several years shall have elapsed.

Again, in the administration of national affairs, it may be necessary to contract a debt of such magnitude that it cannot be expunged before the natural development of commercial relations shall have reduced the rate for which money may be secured; and from this it follows that the thought of ultimate conversion should be always kept prominently in view. But this reasoning cannot apply to local borrowing, for local debts should never cover periods so extended that industrial changes can materially modify the value of money while specific obligations continue to run. The purposes for which municipalities borrow do not require that their obligations should long remain in the hands of creditors. It may be that those conditions justifying an appeal to credit will constantly recur in the course of local administration, so that the local government will not be freed from debt for a long series of years; but it will be a debt constantly in course of expungement, and in this manner whatever advantage arises from a gradual fall in the rate of interest can be secured to municipalities. In local financiering, new borrowing secures money for new purposes, while existing taxes expunge old debts; in national financiering, conversion implies the employment of fresh credit in order to pay off existing debt for the purpose of obtaining better terms — but in either case the governing bodies reap an advantage from constantly falling interest.

The accuracy of what has been said may, perhaps, be more clearly discerned in the reflected light of another distinction.

Those considerations that determine the time at which the payment of debts should begin, as also the rate at which it should proceed, are quite different for national and local financiering. The point at which the two policies diverge is, that in the one case money is borrowed for general and in the other for particular purposes. When a debt is contracted for a general purpose, as is the case in time of war, it is conceived to rest upon the combined industries of the country, and questions pertaining to payment are determined by the state of trade. This subject has been already discussed in a foregoing chapter. Most local debts, on the other hand, are contracted for some definite purpose, and their proceeds are employed in such a manner as to establish in the community some particular form of public service; it is natural, therefore, that the expungement of a local debt should conform to the manner in which its funds were invested. As an illustration, suppose capital to be borrowed for the purpose of paving streets or providing sewerage, the service thus rendered is common to all members of the community, but of such a nature that the debt must rest upon taxes. But what is of yet more importance, the local council cannot proceed as though the city would never be called upon to repeat its expenditure, for pavements and sewerage are subject to wear, and must sooner or later be replaced by new systems. From this it must appear that the payment of a local debt is not to be determined by the general industrial conditions of the country, but that sound policy demands the expungement of existing obligations before the public authorities find it necessary to borrow fresh capital for new improvements. It seems, then, that the rapidity with which such payments should be made depends upon the probable life of the pavement or the sewerage, and this is a question that must be determined by the city engineer.

Similar reasoning applies, only in a more marked degree, if the proceeds of a debt are employed to establish remunerative public works, for in such a case the income from the public industry established is supposed to support the debt. With regard to gasworks and waterworks, for example, general business rules may be appropriately applied for the reimbursement of capital sunk. Such debts should be paid as

rapidly as the interests of consumers will bear, so that the property may become an unincumbered property to the community. There are other conditions, however, in which these rules of payment may be somewhat modified. In the case of purchasing real estate for public parks, or of lending assistance to railroads or other private enterprises, the policy that should direct a local treasury is more nearly akin to that followed by the national financier. The reason is that these measures are conceived to be exceptional rather than constantly recurring. The real estate of a park, which at first may cost a large sum of money, is an investment the value of which is not depreciated by time and use; the benefits supposed to arise from large commercial facilities are also of a permanent nature. It follows that the payment of such debts may properly extend over a longer period, and for two reasons. The fact that the investment is permanent obviates the necessity of clearing accounts before a similar expenditure of fresh money is required. But of more importance is the demand that the rate of taxation shall not be changed with unnecessary rapidity. If, for example, it were undertaken to pay for a park purchased in four or five years, there would be an unnecessary burden entailed upon the community, first, by the rapid rise in tax rates, and second, by the rapid fall in tax rates after the payment had been accomplished. It is true that this is not of so much importance in local taxation, where impositions are for the most part direct, as in the case of federal taxes, where reliance is had upon indirect contributions; but it yet applies, and from it one may conclude that a two or three per cent sinking fund provides for the extinction of such debts with sufficient rapidity.

CHAPTER XXVII

FINANCIAL LEGISLATION IN THE UNITED STATES

99. Problems of Budgetary Reform.—Concerning proposed reforms of methods of budgetary legislation in the United States, Professor Henry C. Adams has written:[1]

The paper here presented, which deals with technical questions that arise in framing budgetary laws and budgetary procedure, is written from the point of view of American conditions. This is done primarily because the problem of budgetary reform, as it presents itself to governments of the American type, is a peculiar and, in some of its phases, a local problem. It would be an error to answer technical questions of financial procedure in the United States as they are answered in England, in France, or in Germany. For another reason, also, are American conditions of peculiar significance in the discussion of budgetary reform. During the past ten years the federal, the state, and the municipal governments in the United States have shown great interest in the betterment of financial machinery, and the discussions that have taken place, the programs that have been proposed, and the laws that have been enacted supply new and pertinent material for the study of budgetary problems. Just at present more can be learned from the analysis of American than of foreign conditions.

General Defects of American Financial Practice

The chief evils in American practice may be traced to a diffusion of responsibility for money bills. The several steps to be followed in financial procedure are not clearly defined, nor can there anywhere be found a definite expression of the authority which the various officials are at liberty to exercise in dealing

[1] Reprinted with the consent of the author and publisher from the *Journal of Political Economy*, October, 1919. Published by The University of Chicago Press. The article is to be incorporated in the revised edition of the author's Science of Finance, published by Henry Holt and Company.

with budgetary matters. "Congress habitually disclaims responsibility for the methods it employs. Responsibility is shifted from the House to the Senate, or from Congress to the Executive, or even to the mass of the people."[1] The states and municipalities are, in this matter, no more fortunate than the federal government. Every student of financial procedure in these grades of government must conclude, as did the commission appointed by the Commonwealth of Massachusetts, to compile information for the use of the Constitutional Convention, that, "in most of the states . . . the function of making up the budget has been assumed by appropriation committees with the result that our government has on the whole been run without careful financial planning. The adoption of a budget system would greatly improve the conditions in this country by substituting business-like financial methods for the present unscientific, haphazard practices which are followed by both the Legislature and the appropriation committees."

This diffusion of responsibility for financial methods may be traced to the eighteenth-century doctrine of Montesquieu relative to the separation of governmental powers. Definite expression of this doctrine is found in the constitutions of six of the states that were parties to the framing of the federal Constitution, and although no specific mention of that doctrine is to be found in the federal instrument, its influence in the organization of the new government is everywhere apparent. This fact is of prime importance at the present time in the study of budgetary reform inasmuch as it sets limits to pertinent suggestions for overcoming the evils incident to American practice. Budgetary reform must render effective the principle of responsibility under the conditions imposed by the American type of constitutional government.

The diffusion of responsibility for finance bills, which seems to have reached its limit in the practice of the American Congress, shows itself in three ways:

In the first place, the House and Senate are so organized as to distribute authority for the appropriation of public moneys between twenty-nine independent committees, of which fourteen are committees of the House and fifteen committees of the Senate. Ten of these House committees and eight Senate committees report out all the bills carrying appropriations, while the other

[1] Ford, The Cost of Our National Government.

eleven, four in the House and seven in the Senate, report out measures for pensions, public buildings, and other things carrying demands on the Treasury, which are met by bills from one of the other committees.[1]

In the second place, demands for appropriations may be presented from five sources. These are:[2]

The regular annual estimates transmitted by the Secretary of the Treasury, at the beginning of each session of Congress;

Supplementary estimates also transmitted by the Secretary of the Treasury;

Judgments of the Court of Claims;

Reports of engineers of the War Department;

Authorization of expenditures by enactments made during the session.

Judgments allowed by the Court of Claims call for neither executive nor legislative discussion and for that reason need not be included in either the annual or the supplementary Book of Estimates. But expenditures that follow the adoption of the reports of departmental experts or the passage of concurrent resolutions bear a different character. They should not receive legislative sanction without regard to the opinions of the Executive or to public policies approved at elections.

Congressional disorganization, when dealing with money matters, shows itself also in the unlimited right of amendment of regularly reported bills by individual members. As a result of the free exercise of this right, not only is legislative enactment removed yet another step from executive influence, but committee responsibility, as distinct from executive responsibility, is thereby greatly impaired.

Types of Budgets

There are four general types of budgetary adjustments, and the first of the technical questions of reform in financial procedure is to determine which of these types meets most perfectly the peculiar requirements of the government under consideration. These types may be described as (1) The Executive Budget which rests on Sovereign Authority; (2) The Executive Budget which rests on Conferred Authority; (3) The Legislative Budget; and

[1] Adapted from Collins, The National Budget System and American Finance.

[2] Ford, The Cost of Our National Government.

(4) The Joint Executive and Legislative Budget. Although current discussion makes use of these terms, the distinction between them does not seem to be entirely clear, and for that reason a word of explanation will be submitted respecting each.

1. *The Executive Budget which rests on Sovereign Authority*

By this phrase is to be understood a financial adjustment in which the executive branch of the government exercises a dominating influence over financial programs. The phrase "dominating influence" is used rather than "constitutional control" for the reason that there are many cases in which the reading of the Constitution seems to give the popular branch of the Legislature adequate control over finance bills when, in fact, the exercise of that control is so confined by the structure of the state, by established usage, or by other clauses in the Constitution, that the influence of the popular branch of the government on current policies through appropriations amounts to little or nothing. It is in this sense that the budget of the German Empire, as organized under the Constitution of 1870, was an executive budget.

The state of Maryland provides another illustration of an executive budget, or rather of an attempt to form an executive budget. In November, 1916, an amendment to the constitution was approved, which strengthened the hands of the Governor in dealing with financial legislation, if indeed it did not make him the dominant political factor in the state. This is a most significant revolution in public sentiment, inasmuch as the constitution of Maryland, adopted in 1776, contains the formal declaration that "the legislative, executive, and judicial powers of government ought to be forever separate and distinct from each other."

The new amendment provides that the Governor shall be responsible for all proposals for expenditures that can have any bearing on questions of public policy,[1] and that he shall transmit his budget to the presiding officers of each house, together with a "budget bill" which contains a detailed program of appropriations fully classified and itemized according to standard rules. Before final action is taken by the Legislature, the Governor may, with the consent of that body, submit amendments to correct

[1] The estimates for the judicial and legislative departments, and for public schools, although included in his budget, cannot be revised by the Governor.

oversights or to meet emergencies, but all such amendments are made a part of the original bill. The control of the Legislature over the executive program is limited to reducing or striking out items contained in the bill as received.

The formal domination of the Governor over financial matters, and through appropriations over general policies, seems to be fully established. In one respect only does the Legislature retain the right of financial initiative. That body is given the power to enact supplementary appropriation bills for purposes not included in the Governor's budget, provided the projects are supported by a majority vote of all members elected to each house.

Each such appropriation, however, must be embodied in a separate bill limited to a single object and purpose, and provision must be made in the bill itself for a levy of a tax sufficient in amount to defray the expenses thereof. Moreover, neither house of the Legislature may consider any supplementary appropriation until the general budgetary bill has been acted upon. Unlike the general appropriation act, all supplementary measures must be submitted to the Governor for his approval or veto.[1]

There can be no question of the purpose of the Maryland Amendment of 1916. Its aim is to impose on the Governor sole responsibility for ordinary financial legislation, to make it impossible for the Legislature to change radically the Governor's programs for such legislation, but at the same time to permit new constructive legislation to be enacted on the initiative of the Legislature with the approval of the Governor. How the plan will work time alone can tell. Were the Governor a member of the legislative body and the government a committee responsible to the Legislature, the plan would be logical and doubtless workable; as things are, the citizens of Maryland must be prepared for frequent interruptions of public business because of political deadlocks.

2. *The Executive Budget which rests upon Conferred Authority*

The English budget is an illustration of a budget of this type, and it is the only type possible under the English Constitution, which provides for party government through a committee re-

[1] State Budget Systems in the United States, a Report of a Commission to Compile Information, submitted to the Constitutional Convention of Massachusetts, p. 10.

sponsible to the House of Commons. This committee—the Prime Minister and cabinet members—is the government and as such controls all policies and programs so long as it retains the confidence of Parliament. As soon as it fails to command a majority in the House of Commons it ceases to be the accredited government, and another government is raised to carry on the King's business. The steps in budgetary procedure in England are well known. The cabinet makes the estimates, and the Chancellor of the Exchequer, who is the Second Lord of the Treasury, transmits these estimates to Parliament. These estimates are framed as a bill by the government; and the House limits its authority to approval or disapproval of the proposals of the cabinet. Members of the House deny themselves the right of amendment, with the single exception that they may reduce or strike out items.

The English budget, like the imperial German budget, is an executive budget. Both originate with the administration and in both cases the administration controls finance bills while before the legislative bodies. The political character, however, of the two systems is essentially different. The one was the expression of sovereign authority and stood for autocratic domination; the other is the expression of delegated authority and stands for the domination of the popular will. The English system cannot be understood until it is recognized that the object of the House of Commons in curtailing its own initiative on finance bills is to make effective its domination over general policies. We may admire this English system. It seems to fit perfectly the class organization of English society during the past two centuries. Nor is it for us to discuss in this connection whether the English plan of government by parties will continue to stand in the presence of a real democratization of the Kingdom. Our lesson is learned when it is observed that the personal and official connection between the executive and the legislative departments of the government is the key to the success of English financial procedure. The transfer of this English system to a country in which the executive is constitutionally responsible to the voters and not to the Legislature is impossible. The budgetary problem in countries that have adopted the essential principles of the Constitution of the United States is quite different from that which submits itself either to Germany or to England.

3. *The Legislative Budget*

Under this phrase is included any type of financial adjustment that gives the legislative department of government domination over financial programs, or through financial programs over general governmental policies. Two illustrations may be submitted, the one drawn from the financial practice of our federal government, and the other suggested by the New York Budget Law of 1916.

The leading facts respecting the financial procedure of the United States are commonly known. During the revolutionary period, and during the seven years covered by the Confederation, there was, strictly speaking, no executive department of government. Congress itself was a committee appointed by the states to secure co-operative action on the part of the states. It was clothed with no abiding authority, although, because of the pressing nature of the problems with which it was called upon to deal, it did assume to exercise certain administrative as well as legislative functions. The collapse of this experiment, when it came, was formal and final. In 1789 this pseudo-government gave place to a real government, and the financial difficulties experienced during the period of the Confederation were, perhaps, the strongest argument in support of the change.

Under the new government the popular branch of the Legislature was given the exclusive right to "originate" money bills, and this fact, taken in connection with the instinctive jealousy of executive authority, produced in the United States a budget of the legislative type. The interpretation placed on the prerogatives of the executive also contributed to the same result. The President has no official authority to give shape to finance measures. "The regular statement and account of the receipts and expenditures of public money" for which the Constitution provides is a duty imposed on Congress and not on the executive. The Secretary of the Treasury, although a cabinet member, has never been regarded as a finance minister responsible for the framing of finance bills. As an administrative servant of Congress, his hands have from time to time been somewhat strengthened, but this has always been at the expense of bureau chiefs and heads of departments, and not at the expense of what Congress has assumed to be its constitutional prerogatives. Such

changes as have taken place seem to encourage rather than to discourage executive disintegration in budgetary matters, and executive officials, knowing that they have no constitutional basis for constructive action, have quite generally acquiesced in the legislative assumption that the executive department has no responsibility for the framing or the meaning of finance bills. If to this be added the fact that members of the House and Senate exercise practically an unlimited right of initiative and amendment during the passage of money bills, while the veto of the President is limited to the approval or disapproval of appropriation bills *en bloc*, the essential weakness of the executive in matters of financial procedure becomes evident. It is therefore easy to understand why the legislative type of budgetary procedure has established itself as a feature of federal organization.

The New York Budget Law of 1916 is another illustration of a legislative budget. No change in the character of customary financial procedure was attempted, but it undertook to strengthen and render more effective the "legislative process dealing with appropriations."

This law represents three features that are of interest. In the first place, a conference between the finance committees of the Senate and the Assembly takes place before these bodies meet in legislative session, an adjustment which is a marked improvement over the common practice of meeting only to compromise the differences between Senate and Assembly bills. In the second place, a joint bill is submitted to both houses at the same time and the Senate and Assembly members of the joint committee appear on the floors of their respective houses to explain and define the bills submitted. In the third place, the right of amendment by members is considerably curtailed. The law provides that "while the bill is before the Committee of the Whole of the Senate, or on the order of second reading in the Assembly, it may be amended either by inserting additional items or by increasing, reducing or eliminating items, but on third reading no amendments are in order except to reduce or eliminate an item without unanimous consent. The purpose of these provisions is to give the appropriation measures ample consideration and publicity and to prevent the practice of 'tacking' on measures to the general appropriation bill."[1] The New York Law of

[1] State Budget Systems in the United States, p. 24.

1916 is of interest because it is a formal attempt to make a budget of the legislative type a successful governmental instrument. From these two illustrations one may learn the character and discern the political implications of a legislative budget.

4. *The Joint Budget*

The character of this type of budgetary procedure is suggested by the phrase used to describe it. It means the control of a nation's finance by the joint co-operative action of the executive and legislative departments of the government, such action being so organized as to make efficient use of the peculiar official responsibilities of each department. It is the type of budget that commended itself to President Taft when in his budget message of 1912 he urged on Congress the necessity of federal budgetary reform. At the close of this message he expressed himself as follows:

> The purpose of the report which is submitted is to suggest a method whereby the President, as the constitutional head of the administration, may lay before the Congress, and the Congress may consider and act on, a definite business and financial program; to have the expenditures, appropriations, and estimates so classified and summarized that their broad significance may be readily understood; to provide each Member of Congress, as well as each citizen who is interested, with such data pertaining to each subject of interest that it may be considered in relation to each question of policy which should be gone into before an appropriation for expenditures is made; to have these general summaries supported by such detail information as is necessary to consider the economy and efficiency with which business has been transacted; in short, to suggest a plan whereby the President and the Congress may co-operate —the one in laying before the Congress and the country a clearly expressed administrative program to be acted on; the other in laying before the President a definite enactment to be acted on by him.

Budgetary Reform in the United States

Budgetary reform did not become a political issue until the first decade of the twentieth century, when considerable attention was given to this subject by both the federal government and state governments. For convenience of treatment, these will be separately considered.

Federal Budgetary Reform

From the organization of the Treasury Department, including in that phrase those adjustments traceable to the influence of Albert Gallatin, down to 1909, when President Taft took up the task of formulating an administrative budget, the only congressional enactments which permanently affected financial procedure were the Acts of 1870 and 1874, according to which unexpended balances of general appropriations were to be covered back into the Treasury. Large sums had been accumulated by certain departments and bureaus as unused portions of past appropriations. In one case this unexpended balance was the accumulation of a quarter of a century and amounted to thirty millions of dollars. It is, of course, futile to expect Congress to control administrative policies by means of current appropriations as long as a department, a bureau, or a service has at its disposal revenues from past appropriations with which to expand old or establish new undertakings. A consolidated fund is an essential feature of any sound financial organization, and the effect of the Laws of 1870 and 1874 was to establish the integrity of such a fund.

To President Taft belongs the credit of having forced the problem of federal budgetary reform on the attention of the public. In 1910 an appropriation was made "to enable the President . . . to inquire more effectively into the methods of transacting public business . . . with a view to inaugurating new or changing old methods . . . so as to attain greater economy and efficiency therein." In 1911 a Commission on Economy and Efficiency was created which, after fifteen months' investigation, submitted a report on "The Need for a National Budget." This report was made the subject of a special message and was transmitted to Congress on July 27, 1912. The message itself is well worth the reading as expressing the embarrassments experienced by the executive in the exercise of his prerogative as the only official elected by the vote of all the people. Regarded as a program for constructive legislation, it is a statesmanlike document. It points out the evils of loose financial practice; it recognizes the restrictions under which both the executive and the Legislature are called upon to act; and it refrains from futile worship of political leadership in a country in which political

leadership finds no constitutional warrant. As already pointed out, it proposes a plan for co-operation between the executive and Congress. It advocates a joint budget as the type which meets most perfectly the American situation.

It must be conceded that the effort of President Taft to develop a sound budgetary practice has, up to the present time, produced but meager results. So far as this may be traced to what is called the jealousy of the Legislature of the executive, it cannot be regarded as a permanent obstruction to co-operative effort. The political situation under which the problem of budgetary reform now comes up is peculiar. The popular branch of the Legislature has maintained its so-called constitutional prerogative as against the executive, but in so doing the control over general policies has been transferred to the Senate. It was never intended by the founders of this government that the Senate should exert a dominating influence in public affairs, but such is the condition into which the jealousy entertained by the House of the influence of the executive has permitted the political organization of the federal government to drift. The situation is full of danger, a danger not to be overcome (indeed, the incongruity of the situation is emphasized) by the amendment to the Constitution which permits senators to be elected by popular vote. The only hope for the recovery by the House of its lost influence in the administration of public affairs is for it to accept the offer of the executive to co-operate in the formulation of a joint budget and to agree on the rules which the House and the executive will follow in the preparation of finance bills. In this situation is found the chief hope for federal budgetary reform. The argument for such reform will not be weakened when it is recognized that the restoration to the House of Representatives of its constitutional influence as the popular branch of the government is seen to be a by-product of such reform.

State Budgetary Reform

In 1910, when President Taft sent his special message to Congress on the need of a national budget, no state in the Union had provided either by statute or constitutional amendment for formal budgetary procedure. At the present writing twenty-six states have made such provision and others are taking steps in

this direction. Twenty-three of these states are listed in the summary that follows. The laws or constitutional provisions by which the states named have authorized budgetary rules are noted, as well as the kind of a budget which each state has adopted, so far as this may be indicated by the location of responsibility for initial estimates.

SUMMARY OF BUDGET PROVISIONS[1]

State	Method of Establishment	Responsibility for Initiation of Budget
Connecticut	Public Acts of 1915, Ch. 302	State Board of Finance
Illinois	Laws of 1917, Ch. 2	Governor and Department of Finance
Iowa	Acts and Joint Resolutions of 1915, Ch. 74	Governor
Kansas	Session Laws of 1917, Ch. 312	Governor
Louisiana	Acts of 1916, Act No. 140	Board of State Affairs
Maine	Laws of 1915, Ch. 299	Governor and Council
Maryland	Constitution, Art. III, Sec. 52	Governor
Massachusetts	General Acts of 1918, Ch. 244	Governor
Minnesota	Session Laws of 1915, Ch. 356	Governor
Nebraska	Laws of 1915, Ch. 229	Governor
New Jersey	Acts of 1916, Ch. 15	Governor
New Mexico	Laws of 1917, Chs. 81, 114	Governor
New York	Laws of 1916, Ch. 130	Committees on Finance and Ways and Means
North Carolina	Public Laws of 1917, Ch. 180	Legislative Reference Librarian
North Dakota	Laws of 1915, Ch. 61	Budget Board
Ohio	Legislative Acts of 1913, p. 658	Governor
Oregon	General Laws of 1913, Ch. 284	Secretary of State
South Dakota	Laws of 1916–17, Ch. 354	Budget Board
Tennessee	Public Laws of 1917, Ch. 139	Budget Commission
Utah	Laws of 1917, Ch. 15	Governor
Vermont	Acts and Resolves of 1915, No. 26	Budget Committee
Washington	Session Laws of 1915, Ch. 126	State Board of Finance
Wisconsin	Session Laws of 1911, Ch. 583; Laws of 1913, Ch. 728; Laws of 1915, Ch. 606	Board of Public Affairs

[1] Taken from *Report of Commission appointed to compile Information for the Constitutional Convention in Massachusetts.*

The impression gained from a cursory reading of the foregoing summary is that the present trend in the evolution of an American budget is in the direction of the "executive budget." In all of the states named, with the exception of the state of New York, the Governor or some officer or board attached to the executive, as distinct from the legislative department of the government, is made responsible for original estimates. The method of making estimates, the classification of estimates, and the centralization within the administration of authority over estimates, have greatly improved the situation as compared with the customary procedure prior to 1910; but it would be an error to assert, as many writers seem inclined to do, that the enactments referred to create executive budgets. In a few states only is there any provision that the classification of estimates furnished by the executive should give shape to the finance bills on which the Legislature is to vote. In a few states only has the Legislature consented to curtail the right of members to submit amendments to such bills while on their passage to enactment. Even in the case of Maryland, which confers on the Governor unusual powers in dealing with finance bills, the Legislature still has the right to authorize expenditures for purposes not included in the Governor's program, provided it has first disposed of the proposals submitted by the Governor and can raise the needed funds. The rejected New York constitution of 1915 contained a similar provision. Some adjustment of this sort is doubtless necessary to provide against suspension of public business because of a deadlock between the Governor and the Legislature, but it has no place in a true executive budget.

The most significant feature of the enactments cited in the foregoing summary is that which deals with executive procedure in the matter of estimates and, as such, marks an important step in the development of sound budgetary practice. Three tendencies are disclosed by the rules laid down.

First, these laws recognize that the authoritative estimates for future expenditures should be made by those who have charge of current expenditures and not by those who authorize services. The budget, in its initial stage, pertains to the executive. Nine of the twenty-five states that have enacted budgetary laws since 1900 impose the duty of original estimates on the Governor. In Massachusetts, for example, the law makes provision for a

"supervisor of administration," whose duty it is to "study and review all estimates" and to "prepare a budget for the Governor, setting forth such recommendations as the Governor shall determine upon." This makes the Governor responsible for the budget as submitted to the Legislature.

Eight of the states listed in the summary make use of some board or commission for the initial preparation of the budget, but these boards are composed either exclusively of administrative officers or other members appointed by the Governor, or, in case members of the Legislature are on such boards, the deciding vote lies with the Governor. The organization of these boards is instructive.

SUMMARY OF SPECIALLY ORGANIZED BODIES FOR DEALING WITH BUDGET SYSTEMS

Name of State	Name of Board or Other Organization	Total No. of Members	No. Ex Officio Members from the Legislature	No. Ex Officio Members from the Administration	No. of Members appointed by the Governor
Connecticut .	State Board of Finance	6	—	3	3
Louisiana . .	Board of State Affairs	3	—	—	3
North Dakota	State Board of Finance	7	3	4	—
South Dakota	Budget Board	3	—	3	—
Tennessee . .	State Budget Commission	5	—	5	—
Vermont . .	State Budget Committee	7	3	4	—
Washington .	State Board of Finance	3	—	3	—
Wisconsin . .	Board of Public Affairs	9	4	2	3

From the foregoing statement it appears that three states only provide for legislative representation on the body imposed with the duty of primary estimates, and that even in these cases the Governor holds the balance of influence. In the opinion of the writer, these three states, North Dakota, Vermont, and Wisconsin, are the only states that have taken the proper stand from which to develop sound budgetary procedure for governments of the American constitutional type. What they have done is consistent with the idea of a joint budget. They have at least started in the right direction.

Slightly different adjustments are made by the laws of other

states. In 1913 the general assembly of Illinois created a legislative reference bureau and assigned to that bureau the duty of preparing a detailed budget for the use of the Legislature. But in 1917 this adjustment gave place to greater centralization of authority. The administrative code of that date created a Department of Finance under the supervision of a director appointed by the Governor. According to this adjustment, the presumption is that the Governor controls the budget. Whether or not that presumption is tenable, experience alone can determine. In Oregon the Secretary of State initiates the budget estimates, while in North Carolina this duty is performed by the legislative reference librarian. Almost any kind of results can emerge from such arrangements. New York, alone of all the states, has provided for initiative and control over estimates by a committee of the Legislature.

Second, a second trend toward sound budgetary practice is found in those provisions of recent legislation which aim to keep the budget as a bill in harmony with the budget as an estimate. In Vermont, for example, the law undertakes to curtail the practice of direct and personal appeals to the Legislature. The general rule is that all claims against the state as well as all requests for appropriations by public officials of all classes will not be considered unless they have been filed with the secretary of the budgetary committee. In Maryland, not only may the Governor require itemized estimates from all departments and services and institute public hearings on all such estimates, but he may, at his discretion, revise these estimates, excepting only those that pertain to the Legislature, the courts, and the public schools. Similar provisions may be found in the enactments of other states, even in those of the states which make no mention of administrative centralization in the making of estimates.

The plain inference from recent enactments is that the Governor has, by virtue of the responsibilities imposed upon him, full authority to control administrative officers in matters of estimates and requests for appropriations. In this regard the trend of current legislation may be fully approved.

Third, a third significant feature suggested by a study of recent budgetary legislation pertains to the importance of a standard classification for estimates. In Massachusetts, for example, the Act of 1918 requires separate estimates and recommendations

under four general heads with appropriate subheadings. In Vermont the budget committee secures estimates from departments and services on blanks prepared and furnished by the committee, and the structure of such blanks is outlined in the law. For the most part, however, the budgetary enactments of the states are silent on this point, notwithstanding the fact that a proper classification of estimates is perhaps the most vital of the technical requirements of sound budgetary practice. Without a standard classification that can be followed from year to year no fruitful comparisons of the cost of government can be made. Only on the basis of a satisfactory classification of estimates would it be possible for the Legislature to accept budget estimates as the bases of appropriation bills. So important is this point that it should be made the subject of a special study.

Conclusions respecting American Budgetary Reform

Most of the underlying principles of sound budgetary procedure have been disclosed by the foregoing discussion. The difficulty lies in the application of these principles and in the formulation of definite rules for the control of financial practice. On one point there should be no difference of opinion. The type of budget adapted to the political organization of the American people is that of the joint legislative and executive budget. A budget of the German type is not wanted; a budget of the English type, even if it were wanted, could not be introduced; a budget of the congressional type, or of the type recently adopted by the state of New York, rests on a vicious political principle. As long as the Legislature seeks to control original estimates submitted by the administration, it is futile to look for efficiency and economy in government affairs. The constitutional situation in this country demands formal, conscious, direct, and continuous co-operation between those departments of government clothed with legislative and administrative authority. In order to realize sound financial practice, governments of the American type must work out reform along the lines of a joint budget.

This conclusion, simple in itself, means quite a number of things.

On its *administrative* side, it means the formulation within the executive department of specialized rules for making estimates

and an organization of executive departments and services of such a sort that the estimates submitted shall stand for a consistent political program. Those provisions in the recent enactments of certain of the states which impose on the Governor the task of framing the budget, and of framing it in such a way that it may be followed in the writing of finance bills, are defensible. Indeed, they are essential for the realization of the end sought. The federal situation is not quite so hopeful. The only congressional enactment which requires a consideration of estimates by the chief executive before their submission to Congress is found in the Law of March 4, 1909, which recites, in effect, that if estimated expenditures are in excess of estimated revenues, it becomes the duty of the President to advise Congress how, in his judgment, the balance should be restored. That is to say, when the treasury is empty, Congress wants the President to propose a plan of economies, but when the treasury is full, Congress wants no advice from the President. As long as this situation maintains, it is idle to expect reform in federal budgetary procedure.

On its *political* side, the establishment of a satisfactory budget involves the refusal of the Legislature as a voting body to assume responsibility for the details of finance bills. In no other way can the Legislature exercise efficiently its constitutional control over public policies. The man who guides the business policies of a business organization is not the man who concerns himself primarily with details. On the contrary, the strong man of a corporation is he who insists that those whose task it is to concern themselves with details should perform that task in a proper manner. This generalization is equally true for political bodies. It is not too much to say that the weak spot in the American organization for popular government is the diffusion of legislative energy, and nowhere does this appear more clearly than in connection with financial legislation. The finance committees do a vast amount of unnecessary work. They undertake original investigations to secure results which are, or should be, the by-product of an efficient administration, and which should be made available for a study by the Legislature of the broad interests involved in the voting of specific appropriations. Legislators in this country will increase their substantial influence by abandoning some of their cherished prerogatives.

On its *technical* side, budgetary reform in the United States

means a scientific classification of public services. This is no slight task. The classification required is one that will serve as the framework of a book of estimates, which, in turn, may be used as the basis of finance bills that carry legislative appropriations. The problem thus introduced is too exacting for cursory comment. It involves a detailed analysis of governmental functions and an exhaustive study of balance in appropriations. It calls for the same kind of expert treatment as is required for the formulation of a system of accounting records for a complex business enterprise.

The chief obstacle to satisfactory budgetary reform in the United States is not found in any of the technical requirements to which reference has been made. It lies rather in the misconception on the part of legislators as to the character of the influence they should exert in a popular representative government. Legislative bodies must be willing to surrender, or at least to curtail in a marked degree, the right of individual initiative and amendment so far as appropriation bills are concerned, and this they will do when they come to understand that their jealous retention of control over matters which are administrative in character weakens their influence as that department of government intrusted with the control of public policies.