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ROUND TABLE ON THE INCIDENCE OF TAXATION

HARRY GUNNISON BROWN, *Chairman*

The following summary of the proceedings of this round table includes papers by James K. Hall, on "The Incidence of Death Duties," and by Henry C. Simons, on "Incidence Theory and Fiscal Policy"; and discussion by Harold M. Groves, M. Slade Kendrick, and Tipton R. Snavely. Except for the summary of Professor Hall's paper, the abstracts were submitted by the participants.

JAMES K. HALL:[1] Discussions of the incidence of death duties in economic literature have been, on the whole, scattered and fragmentary. The *Report* of the Committee on National Debt and Taxation (1927), the *Economics of Taxation* (1924), by Harry Gunnison Brown, and *First Principles of Public Finance* (1936 translation), by de Viti de Marco, are among the noteworthy exceptions. American writers in public finance generally have emphasized the descriptive aspects of particular death duties.

No less than four different conclusions of death duty incidence may be distinguished. These vary from the view that death duties are without burden, provided that substantially the whole of the estate is taken by such taxation, to conclusions that the incidence of death taxes is on the predecessor, the successor, or jointly, and in indeterminate proportions upon both the predecessor and the successor.

Jeremy Bentham, in his advocacy of burdenless death duties, contended that, for burden to be involved, there must be expectation of benefit. In the absence of expectation there can be no disappointment and, therefore, no hardship. He suggests that the measure of burden is to be found in disappointed expectation. Should the state take all, or the major part, of estates through death taxation, no one would expect to receive anything of consequence; hence there would be no disappointment and no burden.

In general, those who support the conclusion that death duties establish their incidence on the predecessor regard this taxation as a capitalized income tax, or an occasional compound property tax. Successors, it is said, generally are indifferent to the amount of death taxes. Further, the whole of the levy will be paid by the transfer of an appropriate amount of estate value. Also, the successor's power to consume is not burdened except in a negative sense, because whatever he may inherit constitutes an addition to his consumption power. Among the leading exponents of this view of incidence are A. C. Pigou, de Viti de Marco, and, in regard to estate taxes, the Committee on National Debt and Taxation.

The view of incidence which apparently has received quite general endorsement by American economists is that the incidence of death duties is upon the successor. It is argued in support of this conclusion that the predecessor is dead before the taxes are imposed and dead men cannot pay taxes (Hugh Dalton), that predecessors generally make no advance financial provision for the duties (Sir Felix Schuster), and that successors would be richer by the exact amount of such taxation if it were not imposed (Henry Sidgwick). Professor Harry

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Gunnison Brown, while concluding, apparently, that the burden is upon the successors, visualizes possible shifting of these taxes. He reasons that if personal motives to save are affected adversely by death duties the total accumulation of wealth will be decreased and, in consequence, interest rates in the long run will rise. In this event the incidence of death taxes will be upon laborers or landowners, or both.

Lastly, death duty incidence is viewed in terms of a divided burden between predecessor and the successor, with the proportions incapable of determination. This theory of mutuality of incidence rests upon the assumption of the jointness and solidarity of the pecuniary interests of the predecessor and successor. An analogy is found in the income tax, the burden of which, it is contended, affects the taxpayer's son as well as the taxpayer himself, and perhaps as severely.

The view of incidence which it is believed may be most strongly supported is that the burden of death duties, including taxes directed to the estate as a whole as well as the distributive shares, is upon the predecessors. Incidence from this point of view is interpreted with reference to the immediate burden of such taxation, and is distinguished from the subsequent economic and other effects which result therefrom. Admittedly in certain cases the motives to save or accumulate may be weakened in consequence of the psychological reactions of predecessors to death taxation with the supply of capital relatively diminished. This seems, however, more appropriately to be regarded as an effect of incidence rather than a part of the process of incidence establishment at a point apart from the predecessor. An analogy may be drawn between personal net income taxes and death duties in terms of the absence of subsequent price transactions, and the indirect and indecisive manner in which personal industry or activity may be affected in the former case and personal saving in the latter. To successors generally it appears that sharing in estates is a net gain with their standards of living thereby increased over and above their individual exertions. The successor's power to consume will not be burdened except in a negative sense. On the other hand, the predecessor has exercised during life less than his full power of consumption, even though voluntarily. The burden of death duties, as well as such other costs attaching to estate creation, appears to rest fully and finally upon the predecessor.

HENRY C. SIMONS: Most of you are doubtless sensible of the awful state of economic theory as it appears in the literature of our special field, in the public finance textbooks, and presumably in college courses generally. One is tempted to say that there are more analytical "howlers" in chapters on incidence than anywhere else in the literature of economics. The accessible literature of incidence, at all events, is largely the product, first, of writers not well-qualified for economic analysis and, second, of pure theorists who, with no sense of significant practical issues, have constructed analytical curiosa in the form of incidence problems.

What we might expect as a minimum, given the present state of general economic theory, is skillful and penetrating discussion of highly differential taxes, in their effects upon relative prices and, assuming full employment, on the allocation of resources. The influence of such taxes under pure competition is an

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elementary problem in partial equilibrium analysis; the analysis yields results which are simple enough for easy application in practical questions of policy.

I believe that what can usefully be said about the incidence of taxes under very imperfect competition can best be said without recourse to much formal, geometric, or algebraic analysis. The important question here, as I see it, is one of the effect of taxes on the price strategy of precarious collusion, formal or tacit and informal, i.e., a question of the politics of price strategy, not of marginal revenues and expenses in any simple meaning of those terms.

A few suggestions for raising the level of incidence discussion are as follows:

1. Discussions of incidence under competitive conditions must be purged completely of propositions appropriate only to the case of monopoly or highly monopolistic competition.

2. Almost everything commonly said about the incidence of taxes under conditions of decreasing cost must be discarded; and propagation of the notion that industries are commonly operated under such conditions must be stopped.

3. The sophistical Cambridge speculations on the welfare advantages of taxing industries of markedly increasing cost should not be retailed to elementary students or treated as sources of significant insights anywhere.

4. The lag of incidence theory behind general theory should be reduced from more than a century to less than fifty years. General equilibrium analysis and alternative-cost conceptions should inform the treatment throughout.

5. That pathetic, appealing figure, the marginal producer, with all the misconception and confusion which accompany his appearance in analytical argument, must go.

6. The methods and propositions of partial equilibrium analysis, invaluable in their proper place, must not be carried over, as they commonly are, into areas of inquiry where they are grossly and patently inappropriate.

I am increasingly persuaded that useful instruction must give attention mainly, and not incidentally, to nondifferential levies or, better said, to those effects of actual taxes which are not allocational. Some reasons are:

1. Taxes like our sales taxes and pay roll taxes have acquired a major place in our revenue system and—perish the thought!—are likely to retain it.

2. There is little difference, as to important effects, between general excise levies and vast collections of particular excises.

3. The important commodity taxes, even when studied separately, are seen to have effects which have much in common with the effects of general excises. Our important particular excises have much in common economically with sales taxes and pay roll taxes. One urgent reason for stressing these similarities, incidentally, may be found in the curious practice, even among academic writers, of condemning the one kind of levy and commending or condoning the other.

4. Systematic discussion of nondifferential excises is invaluable as preliminary to the discussion of property tax incidence.

An increasingly popular solution of the methods problem is to study the joint effects of a new tax and particular new government expenditures equal to the new revenues. With other proper assumptions it yields meaningful conclusions. However, I wish to argue and protest against its use in general incidence discussion.

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Our discussions of incidence problems should be focussed upon the significant relative effects of different revenue devices for obtaining the same revenues. So the proper procedure in studying the effects of a particular tax is that of assuming its imposition to be accompanied by a total-revenue-balancing reduction in some other specified levy. The most useful analyses are probably those which indicate how various taxes would work out relative to a flat proportional income tax as the common norm. It is for us to weigh new or questionable spending schemes against the worst taxes which must be imposed or retained to provide the necessary aggregate revenue.

No straightforward analysis is possible without definite monetary assumptions. Analysis of the effects of nondifferential excises, relative to the income tax norm, should start with the assumption of deliberate fiscal stabilization of some particular price index, preferably in most cases an index of wholesale prices. We must go on to study the implications of our monetary assumptions—to see, in each case, what kinds of monetary action would be necessary to maintain the assumed index stability. It will then be easy to indicate—much less systematically, of necessity—how the relative effects of taxes might be different in the actual world.

Tentatively I suggest that incidence discussion should now be designed mainly to reveal the relative effects of different taxes (1) on the degree of economic inequality in the long run, (2) on the legitimate vested interests of particular groups, and (3) on the volume of unemployment. Of these the third strikes me as the most important and, because it plunges us headlong into monetary problems, much the most difficult.

Harold M. Groves: Professor Hall's exhaustive exposition of the incidence of death taxes gives small attention to the definition of terms. It may be thought that we should not worry too much about mere matters of definition but I think that they are rather significant in this discussion because they are the basis of many important exclusions. The distinctions between incidence and effects, in the discussant's opinion, are nowhere so sharp and clear that a line can be drawn between the two and one can be properly treated apart from the other.

Does an inheritance tax reduce saving? If so, do interest rates respond by rising? If the answer is again affirmative, do profits tend to behave in a similar manner? Does this mean that rich men tend to accumulate faster and more during their lifetimes to compensate for the taxes they must pay at death?

These issues are too involved to attempt a solution here. I suspect that few students would resolve them all affirmatively and conclude that death taxes are perfectly diffused. But the point to be emphasized, in the discussant's opinion, is that these questions are vital in death tax incidence.

I accept much of Professor Simons' criticism of incidence theory but I wish to dissent from his view that public expenditures should be ruled out in treating incidence. It is said that what the government does with its revenue may have important economic effects but they are no concern of incidence and fiscal policy. On the other hand Professor Simons himself argues that expenditures should be conservative because the gains therefrom are likely to be overbalanced by the unfortunate consequences of bad taxation. It is true that public finance students do not usually recommend earmarking of taxes for particular expenditures. On

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the other hand, legislators must balance the marginal dollar of outgo against the marginal dollar of intake and they are entitled to help from economists at this point. Public finance specialists cannot shirk this responsibility by saying it belongs to some other field. Public expenditure is a time-honored division of public finance. To include it in the discussion of incidence does add complications. But any analysis of the economic effects of taxes will surely be incomplete and one-sided if it ignores what the government does with the revenue. Particularly if, as Professor Simons advises (and properly), we are to give more thought to monetary effects of fiscal policy, public expenditures should receive due attention.

I agree with Professor Simons that incidence theory should give more attention to universal (nondifferential) taxes but I am not very hopeful of the results. We can assert of course that in the long run, prices tend to cover costs but whether the costs will accommodate themselves to the prices or vice versa is not likely to be convincingly demonstrated. It may be that resort to marginal productivity at this point is hardly more realistic than the resort to the marginal producer, recommended for discard. I am equally sceptical of the view that to draw a proper solution we must assume an inelastic quantity of money.

M. Slade Kendrick: Professor Hall has given an excellent discussion of the various theories of the incidence of death duties to which possibly one addition should be made. In refutation of Bentham's argument, it might have been pointed out that the expectation of the heir should take into account the inheritance tax as well as the inherited share.

Professor Hall's own position, that the incidence of death duties is on the predecessor, follows from an admittedly limited view of incidence. The usefulness of this view may, however, be questioned as leading to a conclusion of no economic consequence. This is not to accept usefulness as a test of truthfulness but is rather to say that of two interpretations of a term each of which can be justified, the more useful is to be preferred. A broader meaning of incidence would give results of economic importance.

Professor Simons would have the tax specialist limit his attention to the revenue effects of taxation, arguing that this limitation but recognizes his special and proper function.

This seems an artificial method of bounding the duties of the tax specialist. In practice, as Professor Simons admits, revenue problems are not always distinctive from expenditure problems. Moreover, the significant problems of fiscal policy that Professor Simons would have illuminated with the effects of different taxes are not to be examined adequately without reference to governmental expenditures. For example, why should a tax specialist interested in the effects of taxation on economic inequality stop with revenue. If the government may modify economic inequality by taking from the rich, may it not accomplish this purpose more effectively by spending the revenue so obtained for the poor. If the problem of economic inequality is worth the attention of the tax specialist, surely he should have the use of all tools needed for its solution.

Tipton R. Snavely: Given the premises which he assumes, Professor Hall has made a strong case for the establishment of death duties on the predecessor.

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Incidence is properly defined as the direct money burden of a tax, not its indirect economic effects. Hence, such factors as the psychological burden, the inability of the testator to make payment in person, moral and legal aspects, and the action of the predecessor in anticipation of the tax have no significance. Incidence, then, becomes a purely mechanistic process. A majority of economists have been unwilling to accept such an extreme conclusion. Is it not possible to find exceptions to the rule? Suppose that the beneficiaries of an estate have worked equally hard with the testator in its creation, have saved with equal effort, and have exercised similar restraint in consumption—all in the knowledge (though this is not important) that they would succeed to the property. Has the economic burden fallen exclusively on the predecessor? In this case, it is necessary not to confuse the economic burden with legal ownership.

Professor Simons is correct in his criticism of partial equilibrium analysis as applied to incidence. On the constructive side, he recommends the study of "significant relative effects of different revenue devices for obtaining the same revenues." We should look, as it were, at the opportunity cost involved. This method of analysis may yield highly fruitful results, but it is admittedly abstract, as is the suggestion that the analysis of incidence "should start with the assumption of deliberate fiscal stabilization of some particular price index. . . ." Is not this methodological approach quite as unreal as the partial equilibrium analysis of Marshall? We must know what will happen to the structure of "precarious collusion" in any likely set of circumstances—whether the price level is stable or unstable, whether the cycle is going up or down, and whether total-revenue-balancing reductions or additions are being made.

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