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FINANCING THE WAR

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I. THE WAR-FINANCING PROBLEM

“**W**HERE will the money come from?” This question in one form of phrasing or another is on the tongue of most persons who talk about financing the war, and at the pen-tip of most who write about it. The unusual but absolutely true answer is that very little money will come from anywhere, and that not much would be needed if it came.

The war cannot be financed with money. This is not a dogmatic pronouncement, but a statement of fact which needs only to be considered thoughtfully in order to be recognized as true. No wars are financed with money. It is not money that is borrowed when war bonds are issued, nor money that is confiscated when war taxes are levied. Labor products, not money, are the things needed and used in war.

The few pieces of money that are paid for bonds or taxes are taken by the government only as tokens to be passed on for the consumable and destructible things it really needs. What it borrows with the bonds which it issues, or confiscates by the taxes which it levies, is not the money even

when it takes money in payment. Money can neither be eaten nor worn, nor yet loaded into guns and shot at the enemy. The subjects of governmental borrowing or confiscating for war purposes are the food, the clothing, the munitions and the like which come to the government as the pieces of money it happens to take pass on and round-about—mere counters in the flow of exchanges.

In fact, however, the great majority of all the multitudinous and intricate transactions necessary for financing the war will be neither dependent upon nor effected by any borrowing on war bonds, nor by any confiscation by war taxes, of anything that can be called money. They will be effected by means of checks, drafts and other orders upon banks. Nor can it be said that these are substitutes for money, or are money by another name. They are nothing but instructions to bank bookkeepers to make debit and credit entries in bank ledgers. The transactions by which the government borrows its war necessities with bonds or confiscates them by taxes, are consummated (by means of those instructions to bookkeepers) through the ledgers of banks and clearing houses. The whole war-financing process is a bookkeeping process. And the bookkeeping, though the entries are expressed in terms of money, bears witness not to transfers of money, except in minute degree, but to receipts of consumable commodities in exchange for gov-

ernment bonds and tax levies. The transactions culminate in deliveries by the government of war bonds and tax receipts for food, clothing, munitions and the like which it needs for prosecuting the war.

No one who is at all familiar with the mechanism of financial transactions will be misled by the use of money terms. He may speak with awe of the vast volume of "money" necessary to prosecute the war, but the word is to him only a bit of business "patter" connoting anything and everything that can be measured in terms of money. He knows that it is not money that is needed, but industrial output. A vast majority of folks, however, do not distinguish money symbols from money itself. So they fall into the error of supposing that money in fabulous abundance will be indispensable to a successful prosecution of the war. It is this misapprehension that evokes the frequent question regarding war financeering — "Where will the money come from?" When one realizes, though, that financing the war consists not in getting money, either by borrowing it on bonds or by confiscating it by taxation, but in getting currently produced labor products, and that this is not achieved by getting money in exchange for bonds or tax receipts, but is effected by bookkeeping transfers of individual credits in bank ledgers, the question, "Where will the money come from?" loses its embarrassing significance. For it is then clearly enough seen

that the whole problem of financing the war, so far from being a problem of finding money and taking it over, is a problem of marshalling labor and taking over its products for war supplies.

That war supplies must be produced continuously as the war goes on, we have already seen. They must be produced, that is, by continuous labor—mostly wage-earning labor. "The man behind the plow keeps the man behind the gun," as some one has phrased the thought in its elemental phases. And this productive labor must support not only the fighting forces of the country but itself as well. It must also renew its machinery as it works. Moreover, in order to be thus continuously productive, those of our fellow citizens who produce must have continuous access to appropriate natural opportunities for production.

As the products of this continuous labor upon continuously accessible land are continuously exchanged in the market places—not for money in any great degree, for money cuts a small figure in industrial exchanges; but product for product by measurements in money-terms evidenced by checks, drafts and other commercial paper—individual credits in bank ledgers are continuously created by deposits of evidences of credit certifying to the value in exchange of what the depositor has sold. Against those credits the respective depositors continuously draw checks and other bank orders. With some of these, war-

bonds are purchased. Others are used for payments of war taxes. Upon receiving them in due banking course, the government delivers its bonds and tax receipts. Also in due banking course, the credit balances of the check-drawers are to that extent reduced in the ledgers of their respective banks by debit entries. Thereby the depositors exchange particular portions of their credit balances in the ledgers of their respective banks for value-equivalents in war bonds or war taxes. Whatever they themselves might have got out of the market in exchange for what they had put into the market, the government may now get; and the transfer has been effected not by money but through bookkeeping.

When the government offsets its own credits thus created in bank ledgers, by drawing drafts or checks in payment for what it needs to prosecute the war, it has to that extent, and without any appreciable use of money, either borrowed on war bonds or confiscated by war taxation (or else in part by one and in part by the other) food, clothing, munitions, ships and other necessities of warfare. It has done in effect what it might have done more crudely and with clumsier results, if it had borrowed or confiscated those identical necessities directly, instead of doing so indirectly through the financial facilities which the mechanism of modern banking affords. It has in effect done precisely what it would have done had it conscripted men to produce food,

clothing, munitions, etc., paying no wages for part of the work and giving interest-bearing scrip for the rest. The process is dependent hardly even if at all upon money. It is a process, by means of ledger entries, of exchanging bonds and tax receipts for currently produced labor products.

Reduced to its essentials, then, financing the war has consisted and will continue to consist, not in getting for the government vast sums of money from somewhere, but in causing continuous production of vast volumes of war supplies for the government through voluntary or coercive transfers of bank-ledger credits. Voluntary transfers of those credits may be effected through issues of war bonds; coercive transfers can be effected by levies of war taxes.

Irrespective, however, of method—whether by issues of war bonds or by levies of war taxes—the processes of financing the war must consist essentially in the taking of consumable things for war purposes. Unless these things are borrowed, subject to future repayment in consumable things produced in the future, they must be confiscated outright. And they can neither be borrowed nor confiscated from accumulations; for consumable things cannot be accumulated. It is from products of labor as produced, that the borrowing or the taking by taxation must be made. In other words, whatsoever the government takes must be either borrowed or confiscated or both, from

the contemporaneous labor that produces it or from persons who derive it from that labor.

And whether the taking be by borrowing or by confiscating, no financial return by the government is possible. The only way in which the government can repay what it borrows, is by resorting to future confiscations from future production. The same thing is true of its war taxes. What the government confiscates by war taxation from present day producers, it cannot make any financial return for—except by confiscating from future producers.

There is, it is true, one way in which the government could make financial compensation to both bondholders and taxpayers. In so far as land is increased in value by governmental expenditures, its enhanced values might be devoted to repaying war loans and returning war taxes. But consideration of this possibility may be deferred for the present. Another apparent exception to the general rule that the government can make no financial compensation for what it takes in taxes, is indirect taxation—taxation, that is, upon the processes of business; for when a tax is thus indirect, the taxpayer can usually recover it from consumers of the taxed commodity by adding it to prices. Since it increases the cost of doing business, how can it be prevented from increasing the prices of business products? But the supposed taxpayer in this case is in reality not a taxpayer at all; he is a tax collector. The true

taxpayers are his customers. Nevertheless, although the government cannot itself financially compensate either lenders or taxpayers, it *can* compel future taxpayers to compensate both—them or their heirs or assigns.

In this war, however, it is not expected that future taxpayers will be compelled to compensate war-taxpayers. But it is expected that future taxpayers will be compelled to compensate war-bondholders. The choice of method, therefore, for taking consumable things for war purposes, is of high importance with reference to the simplest principles of human justice and the plainest perceptions of social fairness.

Shall the war be financed by long-time war bonds or by taxation? That is, shall we place the financial burdens of this war upon the labor of future generations of producers, as long-time war-bonds would? or shall we pay as we go? And if we pay as we go, confiscating products of labor for war purposes as they are produced, by what fiscal method shall the confiscation be made? Shall it be by taxes upon production, which producers who first pay them will collect of consumers in augmented prices? or shall it be by taxes directly upon profits, which the first payers cannot collect of others but must bear altogether themselves? And if by direct taxes upon profits, shall the taxes confiscate earned profits or only the profits of privilege?

II. BONDS

When President Wilson called upon the country to meet the German Kaiser's war against the government and people of the United States with their acceptance of the status of belligerency thus thrust upon them, he indicated the magnitude and character of the financial obligation that would be involved. Saying that it would involve "the granting of adequate credits to the government," he added an expression of his hope that these would be sustained, "so far as they can equitably be sustained by the present generation, by well conceived taxation."

It was a judicious admonition against the creation of vast public loans having long periods of time to run. To have proposed at the beginning of the war that it should be financially supported altogether by the present generation would have discredited any statesman making the utterance. Habits of generations have established a child-like confidence in the notion that the wars of one generation can be equitably paid for by later generations. It was a huge mistake, and we are rapidly finding it out.

To realize that nations live from hand to mouth, that production and consumption necessarily coincide, is to understand that wars cannot be equitably paid for except as they are being fought. Not only is this the only equitable way of paying for them; it is essentially the only way

in which they can be paid for at all. We do not fight wars on after-the-war products. Public loans payable by future generations can no more enable any previous generation to escape the cost of its wars, or any part of their cost, than next year's rains can revive the harvests that were withered by last year's drought. As a distinguished professor of political economy has said, "it is a manifest truth that each generation must subsist upon the product of its own industry," that "no father can eat the potatoes to be hoed by an unborn son, nor can an army live on bread to be delivered, at the option of the baker, between ten and forty years from the date of the contract."* All that public loans can do in this respect is to furnish an alchemy of legislative law whereby some persons in future generations may idly draw tribute from their industrious contemporaries.

This self-evident truth was convincingly put by one of America's greatest publicists nearly forty years ago. A single quotation is conclusive on the point: "If it were possible for the Present to borrow of the Future, for those now living to draw upon wealth to be created by those who are yet to come, there could be no more dangerous power, none more certain to be abused; and none that would involve in its exercise a more flagrant

*Prof. Henry C. Adams of the University of Michigan. "War Finance Primer," issued by the National Bank of Commerce in New York, May, 1917. Page 52.

contempt for the natural and unalienable rights of man. But we have no such power, and there is no possible invention by which we can obtain it. When we talk about calling upon future generations to bear their part in the costs and burdens of the present, about imposing upon them a share in expenditures we take the liberty of assuming they will consider to have been made for their benefit as well as for ours, we are carrying metaphor into absurdity. Public debts are not a device for borrowing from the future, for compelling those yet to be to bear a share in expenses which a present generation may choose to incur. That is, of course, a physical impossibility. They are merely a device for obtaining control of wealth in the present by promising that a certain distribution of wealth in the future shall be made—a device by which the owners of existing wealth are induced to give it up under promise, not merely that other people shall be taxed to pay them, but that other people's children shall be taxed for the benefit of their children or the children of their assigns.”*

In this view of the matter the only equitable basis for financing the war in which we are now involved, will be that which requires the present generation of American citizens to sustain all its cost. They will have to sustain it in terms of human life destroyed. They will have to sustain

*Henry George. "Social Problems," Ch. XVI.

it in terms of production for war consumption. Why ought they not to sustain it also in terms of legal obligation with reference to the distribution of future products of labor? Equitably considered, there should be no long-time bond issues based upon any part of the cost of the war; no financial pretense of postponement to future generations of any part of the labor cost which the war imposes. To resort to the hoary device of permanent debts for relieving the propertied classes of the present of war burdens, enriching an unborn few at the expense of the unborn many, would tend to turn this righteous war for the defense and extension of democracy into another "rich man's war and poor man's fight."

That anything of this kind will be done is extremely improbable. It is urged, to be sure, by parasitical financial interests whose demands are phrased and statisticized for them by hired advocates and echoed by unconscious dupes; but they are evidently losing ground rather than making headway. Although bonds have been issued, they are not long-time bonds;* and although additional bonds will be issued, these are likely, too, to be short-time bonds.† So short are the time-terms of the issued bonds that the bonds are hardly more than due-bills for bridging over the emergency until an equitable system of taxation can be adopted. The tendency is clearly away

*They are redeemable at any time between 15 and 30 years after issue.
†Since the text was written the second issue of bonds has been offered. They run from 10 to 25 years.

from the policy of putting a huge war-debt over upon the disinherited of future generations.

One may reasonably regret, therefore, that so many of our democratic people who are sensitive to the evils of permanent public debts, have not been quicker to recognize the manifestly democratic meaning of the recently placed "Liberty Loan." It is to be hoped that the meaning of the next one will be more quickly apprehended. Only by general sympathy with officials responsible for financing the war, in their efforts to do so without fastening a permanent debt upon the nation, can such a debt and its brood of social evils be avoided. Public officials are not omnipotent. They must have public sympathy and support in their endeavor to stem the profiteering tides that war inevitably sets in motion, or they will be swallowed up helplessly in the flood—not because they wish or are willing to be thus submerged, but because they cannot help it if public opinion misjudges their purposes and ignores their difficulties. To a high degree the administration had this support in placing the "Liberty Loan," but not in sufficient volume to overwhelm profiteering interests.

Consider the situation. A vast purchasing power for war materials was needed by the government at once. There was not enough time to design and adopt legislation for equitably confiscating this power by means of war taxation.

The power had to be borrowed. This could have been done without difficulty in the old way of issuing long-time bonds in large denominations, selling them in bulk to bankers' syndicates at less than par, and leaving the syndicates to make a profit by retailing the bonds to rich investors at par or more. The government would then have got less war supplies than the value of its bonds, and workers of future generations would have had to struggle with a gigantic permanent debt, upon the so-called "interest" of which (annual taxation) their more or less idle fellow citizens of those future generations would have lived in the sweat of their neighbors' faces. It could have been done, and it would have been the easier way. But rightly and wisely the Administration chose another way. By issuing short-time bonds it reserved to the present generation the right to call these bonds in and substitute equitable taxation for them. By making them of small denominations—not as small as the denominations ought to be, yet within the financial reach of most citizens—it afforded an opportunity to the people to spread this temporary debt so widely among themselves that no powerful special interest desiring to perpetuate the debt could spring up. By giving small purchasers the preference, it strengthened the spreading-out tendency. Thus, on the one hand, the least possible opportunity for profiteering was afforded, while on the other the utmost opportunity for bringing the temporary

loan to an early end by substituting taxation for it was offered.

Fortunately, the Administration has been, as it still is, in a strong position to pursue that financial policy for prosecuting the war. For this advantage the public interests are deeply indebted to a great financial reform which the same administration had already made without reference to war necessities. But for the Federal Reserve banking law of 1914, and its faithful and efficient administration, there would have been little opportunity for choice on the question of a permanent war-debt. Prior to that law, the monopolization of control over bank deposits by the financial "combines" commonly known as "Wall street," was so nearly absolute that, if it had continued, no policy for financing the war could have been adopted in the face of "Wall street" opposition without imminent risk of a tremendous financial panic. This syndicalistic power was swept away by the Federal Reserve law of the Wilson administration. Consequently, in financing the war, the Administration is not bound hand and foot by financial syndicalism. All it needs for war-financing in order to serve the people with singleness of purpose and directness of aim, is the quick understanding and steady support of the masses of the people. If in large numbers they buy war-bonds of small denominations and in small amounts, directly from the government and at par, these bonds will be distributed so generally

as to minimize almost to the vanishing point all profiteering interest in our temporary war loans. They will also thereby enable the administration, whatever financial syndicalists may wish or say, to keep the bonds within such reasonable time-limits for redemption as to give the people full opportunity, if they so desire, to redeem all war bonds within this generation, by effective and equitable methods of taxation.

The extent, then, to which temporary bonds of small denominations are generally purchased by the common people of the United States, may largely influence the fate of American democracy in so far as this can be affected by the creation of permanent public debts. It may be widespread, and thereby determine that our war bonds shall be what they now are, mere temporary loans pending the enactment of a just system of tax-levies for war purposes; or it may be disappointing, and thereby determine that our war-bonds must be of large denominations and for long time-terms and be "brokered" by "Wall street" syndicates. In the latter event these bonds would become the nucleus of a gigantic permanent debt by means of which generation after generation of industrious Americans would be compelled to work for their fellow citizens, and for aliens too, without other pay than tax receipts.

To discourage widespread investment in short-time war bonds of small denomination is, therefore, not only to obstruct the government in its

prosecution of this truly defensive war. It is also to help prepare the way for a permanent public debt in the interest of unborn generations of plutocrats, at the industrial expense of unborn generations of workers. On the other hand, to promote the sale of these bonds universally among the common people of the country is to contribute not only to the prosecution of the war, but also to the political possibilities of making an early and desirable substitution of an efficient and equitable system of war taxation for all war-bonds.

III. TAXATION—INDIRECT AND DIRECT

Except as a temporary makeshift until equitable and efficient tax legislation for war necessities can be formulated and adopted, bonds have no justifiable place in the prosecution of a war for democracy. By every democratic test, they at their best are worse than taxation at its worst.

And from worst to best, taxation itself has a wide range. It extends from the most predatory species of indirect taxation, which is hardly better than the best species of permanent bonds, to an ideal of direct taxation that would separate earned from unearned incomes and derive public revenues from the latter. Between those extremes the varieties of taxes are as heterogeneous as Polonius's varieties of the drama. Whole volumes and interminable shelves of volumes have been written about them, and the war-financing

literature of the hour is filled to overflowing with perplexing controversies over them. Considered as to their essentials, however, all varieties of taxation fall into three general classes which need but little elucidation and are easily understood.

Not only may all the commodities obtainable for prosecuting our war be taken by means of any of those classes of taxation, without resorting to long-time bonds, but by the same means such temporary bonds as are necessary to bridge over emergencies pending desirable fiscal legislation may be promptly redeemed. In this connection let the economics of war supplies be remembered. Whether borrowed on bonds or taken by taxation, war supplies must be got from the labor of the present time. They cannot by any possibility be got from the labor of the future. Distributions of commodities to be produced in the future are indeed affected by bonds, but bonds cannot produce commodities in the present; and it is commodities produced now that we need for prosecuting the war. So far, therefore, as the mere getting of war supplies is concerned, bonding or taxation makes no difference; the supplies will be the same things and the producers the same persons either way. But the democratic way is by equitable taxation, which helps none to profit by the privations it imposes upon others.

If, now, in our war to preserve and promote democracy against Prussian conquest we decide to get our supplies wholly by taxation as we go,

using bonds only for emergent purposes and temporarily, we shall have to choose from the three general kinds of taxation alluded to above. One of them is indirect taxation; the other two are different kinds of direct taxation.

The chief characteristic of indirect taxes is their shiftiness. In the form of market prices they automatically transfer themselves, with accumulated profits, from original *taxpayers* to ultimate *taxbearers*. On the other hand, the chief characteristic of direct taxes is their stability. They cannot be shifted; they "stay put" where the law puts them. Consequently taxpayers and taxbearers, under direct taxation, are the same persons. A secondary but very important characteristic of this kind of taxation gives us our third classification: direct taxes can be so levied as to exempt the profits of work while taking the profits of privilege.

Within those three fiscal classifications, lies the whole field of our war taxation. Every variety of tax we adopt for war purposes, whether it be equitable or not, will fall into one or another of the three. Of course, there is more or less overlapping at the edges where they merge into one another. Fiscal students are not always able to discover just where the characteristics of one class leave off and those of another begin. But no less in actual experience than in intelligent theory, those three classes are fundamentally as different

as daylight and dark—which also have margins of twilight.

The first named of the three, *indirect taxation*, has long been a prime favorite with dull statesmen and acute conservators of privilege. Its shiftiness makes it so. Since taxpayers do not usually bear the burden of this tax, and tax bearers are unaware of the cause of the burden it lays upon them, it yields abundant government supplies and rich profits to special interests without seeming to confiscate anything from anybody. As a French statesman of the old regime is often quoted as saying in cynical praise of it as a revenue producer, this kind of taxation enables rulers to “pluck geese so as to get the most feathers with the fewest squawks.” He could have added, under his breath, that at the same time privileged interests profit by it inequitably at the expense of productive interests.

Indirect taxation may be illustrated with import taxes on sugar. Our total sugar consumption in 1914, for instance, is said to have been 7,500,000,000 pounds in round numbers. Of this a little more than half, about 4,000,000,000 pounds, came from foreign countries and was subject to import taxes; the rest, about 3,500,000,000 pounds, had been produced in the United States and was not subject to taxes of that kind. If, for simplicity of illustration, we calculate import taxes on sugar at the rate of one cent a pound, the importers of that 4,000,000,000 pounds

of foreign sugar must have invested \$40,000,000 in import taxes alone. In order to get their respective investments back, they had to add that amount to the market price of the sugar they sold. This is something which the "higgling" of the market ordinarily enables importers to do; the required supply of foreign sugar would fall off if importers could not get their import taxes back in added prices. They must also and in the same way get back the ordinary market profits on their tax; and if we estimate importers' profits at even so low a rate as 5 per cent., the importers' profits on the import taxes upon sugar consumed in 1914, would have aggregated about \$2,000,000. Added to the import taxes, this sum makes \$42,000,000 which the consumers of that sugar had to pay.

But that is not all. American wholesalers and retailers of sugar, each in turn, sell at prices calculated to yield not only what they themselves have respectively invested, but their own percentages of profits too. Averaging these intermediate profits at 10 per cent., we have as minimum accretions of import taxation borne by American consumers of imported sugar in 1914, over and above all the other costs and profits of foreign sugar production and delivery to and in the United States, the sum of \$46,200,000—about \$1.15½ a hundred pounds. An import tax, like a snow ball down a hill-side, gathers bulk as it rolls on.

The government, however, does not get any of

the accretion. At a tax rate of 1 cent a pound on the 1914 imports, it could have got not more than \$40,000,000. Sugar dealers got the rest—say, \$6,200,000, or 15½ cents a hundred. But the whole was paid by American sugar consumers. Though not the original taxpayers, they were in the end both the *tax* bearers and the *profit* bearers.

Nor is even that the whole of the story. In addition to the 4,000,000,000 pounds of foreign sugar on which American sugar consumers paid tariff taxes and profits on the taxes in 1914, amounting (if the import tax had been a cent a pound) to about \$46,200,000, we have to consider 3,500,000,000 pounds consumption in the United States that year of American sugar. On this there was no import tax. Inasmuch, however, as it sold in the American market at about the same price as imported sugar, quantity for quantity and quality for quality, its price (paralleling the above low estimate of profits on foreign sugar) would have included an extra \$1.15½ a hundred pounds. This extra price, due to import taxes on foreign sugar, makes an aggregate of \$40,425,000 for American sugar in excess of what it would have brought but for the import tax. Thus, all unknown to themselves, American consumers of sugar in 1914 had to pay about \$40,000,000 as indirect taxes to the government and \$46,625,000 as tax-profits and graft to American sugar interests.

Still the story is incomplete. The excessive prices at which untaxed American sugar sells in the American market in consequence of import taxes on foreign sugar, has a tendency to make American sugar production more profitable than the "higgling" of the market would otherwise allow it to be; and by economic action and reaction this tendency increases the acreage value of sugar plantations in the United States.

The principle which the foregoing imperfect but substantially correct and exceedingly moderate example of the operation of import taxes illustrates, is active in all varieties of indirect taxation. Some instances seem to differ in principle because of temporarily disturbing circumstances, and most of them do differ in degree. Essentially, however, all indirect taxes operate to increase the cost of producing and delivering marketable commodities. Being imposed as a condition of such production and delivery, they enter into prices precisely as other costs of production and delivery do—wages and freight charges, for instance—and with the usual percentages of profit. They move through the market with the commodities to which they attach, accumulating profits as they go; and to the retail merchant of whom he buys, the consumer pays the accumulations in the prices of what he buys. Indirect taxes are taxes on consumers. They are, besides, enormously expensive of collection and extremely unfair in their distribution of tax burdens. Of

all kinds of taxation the indirect varieties are the least democratic.

They are bad in yet another respect. When consumers lessen their purchases, on account of what they regard as high prices but what in fact are indirect taxes, sales shrink and business staggers. When consumers in large numbers economize to an extreme degree, business collapses. If, then, Congress continues to trust too confidently to indirect taxation for war purposes, we are likely to face as great a menace to our country's cause as blundering military strategy would be.

There are better kinds of taxation than the indirect, and sooner or later Congress will have to consider them seriously. Business would yield abundant public revenues if its processes were free to operate without obstructive taxes—if taxation took only its profits after they were made. A business man of good sense as well as patriotic motive stated the problem roughly but right when he said: "I am willing to let the government take all my profits to help carry on the war, except barely enough for me to live upon decently while I make them. All I ask of Congress is that it will not disarrange and demoralize my business by indirect taxation so that I cannot carry it on at all. Let Congress stop throwing wooden shoes into the delicate and complex mechanism of my business, by indirect taxation upon the materials I have to buy, and it may in

welcome hang as big a pail as it wishes to under the spout from which my profits flow." It is as if a farmer were to say: "Don't allow my crops to be trampled down while they are growing, and you may have the whole harvest except enough to pay for raising and gathering it and to support my family until the next crop comes."

The standard objection to taxing profits is expressed succinctly in a recent bankers' pamphlet* in these words: "Excessive taxes on incomes will deplete the surplus available for investments and interfere with the placing of the enormous loans which will be necessary in any event." It is a sufficient answer that profits will not be necessary for loans to the extent that they are taken in taxes.

To tax profits of business after they are made, leaving the materials and processes of business unburdened with taxes, is *direct taxation*. Like the indirect kind, direct taxation has many varieties; but a sufficiently good illustration of the principle of all will be found in the income tax. This variety of direct taxation has within a few years become fairly familiar in the United States. As it operates here it distinguishes between corporations and individuals, doing so chiefly by taxing the net profits of corporations and the net incomes of individuals—a difference only in detail

*"A Constructive Criticism of the United States War Tax Bill." By Edwin R. A. Seligman, McVickar Professor of Political Economy, Columbia University. Published by the National Bank of Commerce in New York. June, 1917. Page 9.

and not at all in principle. There are several gradations of our income tax rates, but neither do these affect the principle of direct taxation which the income tax illustrates. The essential point is that income taxes do not clog the business processes necessary to produce the net profits which they take.

Income taxes amounting to about \$50,000,000 were paid on their net profits in 1916 by about 366,000 corporations. In the same way about 370,000 individuals paid on their net incomes, taxes amounting to about \$70,000,000. This total, say \$120,000,000 is doubtless much less than income taxation ought to have yielded in 1916. But it is three times the amount that could have been received as import taxes at a cent a pound on the sugar consumed in the United States in 1914, and its collection cost was comparatively negligible.

Not a penny of any one's income-tax entered into the prices of the materials which those 366,000 corporations had bought: the taxes fell upon incomes and profits *net*, and no one has yet learned how to turn a net result into part of the cost of producing itself. For the same reason, not a penny of their own income taxes could any of those corporations collect in higher prices from purchasers of their products. Nor could any of those 370,000 individuals charge a penny of their net income taxes to their employers in salaries or to their customers in higher prices. All the trans-

actions out of which the net profits and net incomes came, had been completed before the taxes were assessed. To shift those taxes to employers in salaries or to customers in prices would be like adding your doctor's bill for today's illness to your wages for yesterday's work. Might it be, however, that the income taxpayer could add this year's income tax to next year's prices? "It would be to laugh," and any thoughtful business man will tell you so. A grocer competing with other grocers for customers might as well try to get back his pew rent or club dues of this year by increasing the prices of sugar in his next year's sales. That sort of thing may be done within certain limits by monopolists, but in competitive transactions it is practically impossible.

Our income tax has been no wooden shoe thrown into the mechanism of business—increasing prices, be-deviling business processes, and slowing down business profits. It has been more like a public-revenue pail under business spouts to catch profits as they flowed into the tubs of profiteers. The only persons affected by these taxes are the persons who pay them. Income-tax payers are also income-tax bearers.

This is true also of all other varieties of direct taxation. Between direct taxation, therefore, and indirect—the "straight" and the "crooked" kind as they have been called—the only choice consistent with candor and democratic principles is the former. Over this proposition no two

honest statesmen who know the subject and understand each other will disagree.

But direct taxation itself, far and away more democratic though it be than indirect taxation, is not ideally democratic in all respects. There are two general kinds of direct taxation—the democratic and the plutocratic. The latter makes no discrimination between earnings and privilege; the former exempts earnings and taxes privileges. This difference gives us our third general class of taxation. The first, *indirect taxation*, falls upon business processes in such manner as to shift its burden automatically from original taxpayers to ultimate consumers, and incidentally to favor privileged classes at the expense of the earning masses. The second, *direct taxation*, is not shiftable; but it falls upon earners and the privileged indiscriminately. The third class, *taxation of privilege*, is a species of taxation which, while direct, as is the second class, limits tax burdens to economic privileges. The profits of these, no one earns. They are bestowed by government, and in their enjoyment some citizens are protected by law to the unfair exclusion of others.

Since democracy abhors privilege, a democratic financing of this democratic war demands that the incomes of privilege be wholly exhausted before the incomes of work are taxed at all.

IV. TAXATION OF PRIVILEGE

That in financing our war for democracy democratic principles demand, besides rejection of long-time bonds and of direct taxes, the adoption of *taxation of privilege* in preference to every other variety of direct taxes, is a conclusion the correctness of which will be confirmed upon reasonable reflection.

Let it be understood in passing that the last dollar of every fortune and of every income, little as well as big and earned as well as unearned, saving only enough for a meager living, must be given up if necessary to sustain our men at the front while their lives are in the balance for our country's cause. But let us not wholly ignore the equities. We must no longer cling to the undemocratic custom of needlessly making no discrimination between parasitical profits and earned incomes—or of professing to make none while in fact favoring the former.

What though profits of privilege be sanctioned by custom and law, are not earnings of industry nevertheless worthy of vastly more respect, when sources of war revenue are to be tapped? Shall monopolists of natural coal deposits, for instance, be taxed no more *pro rata* for war purposes on the unearned profits of their monopoly than industrious producers are taxed on their earnings from useful work? Shall owners of iron-ore deposits be taxed no more on the value of these

natural resources than useful producers are taxed on the profits of their own industry? Shall laborious producers of necessities of life and munitions of warfare be taxed as much on the value of the useful labor they perform, as luxurious monopolists of natural resources are taxed on the value of their privilege of being allowed by law to say of those gifts of Nature, "These are ours"?

It is not just, it is not democratic, to tax the earnings of useful labor on a parity with the profits of law-created privilege. It is the same in principle as total exemption of profits of privilege would be. It does in fact exempt them to the extent that the earnings of the unprivileged are taken, for to that extent the privileged retain what in equity belongs to all. By all means let the last penny of everybody be taken in war taxation if the necessity arises; but before falling back upon conscription of earnings, let us conscript the profits that spring unearned out of mere conventional privileges of monopolizing the resources with which Nature has so richly endowed our country. This would be just, and it would be democratic. It is the best method, too, of applying to the wealth of the country that principle of selective conscription for war purposes which is rightly applied to its manhood.

No question of abolishing private ownership of natural resources is thereby raised. To maintain privileges of owning natural resources is not in-

consistent with taxing their unearned profits proportionately higher than taxes on industrial earnings. It would be consistent though that class of profits were wholly absorbed by taxation. Enabling idleness to profit by selling permission to utilize natural resources is no part of the object of creating private ownership in them. If that were its object this kind of property would be unrighteous and indefensible. Private ownership of natural resources is justified only for the purpose of enabling owners to secure fair compensation for actually utilizing the resources. In so far, then, as such resources incidentally yield or are capable of yielding unearned profits, equitable considerations demand the transfer of those profits to the common purse for common uses. With even this complete absorption by taxation of the unearned profits of those privileges in natural resources the privilege of ownership for use is quite consistent.

The principle applies, of course, to all natural resources. Natural deposits of coal and iron ore are but examples. Oil deposits are in the same category. So are all privately owned public highways. So also are railway terminals, oil-way terminals and ocean-way and lake-way terminals. Another example is the building lot. Privileges of owning building lots are not at all justified as a means of enabling their owners to profit by exacting tribute for natural places to build upon. They are justified only as a means of enabling

owners to utilize sites for buildings secure from interferences which might make building operations and uses abortive.

Still another example is farming-land. The privilege of owning the natural soil has no justification as a means of giving unearned profits to the owners by enabling them to sell to others permission to make farms and to work them. The only justifiable object in creating private ownership of farm-sites is in principle the same that alone justifies private ownership of building lots, of coal and ore deposits, and of all other natural resources. It is to enable the farmer to protect his earnings while making farms out of farming land and keeping them up. If the rich farm-owners of our cities do not appreciate this, the hard working farm tenants and farm hands and mortgaged farmers of the country-side ought to. The same principle applies, of course, to forest lands. Forest lands are natural resources like farming lands, and forestry is only a kind of farming; the fact that many years instead of a few months intervene between harvests, makes no difference in principle.

Privileges of ownership in all natural resources may be justly and wisely continued and protected; but the profits of the privilege, in contradistinction to earnings of production under protection of the privilege, are neither justly nor wisely the property of the privileged. No custom, no law, no decree can make them so. These

profits are in justice and upon democratic principle the common property of the whole community. They are therefore peculiarly appropriate for public expenses. They should, at any rate, be conscripted for war expenses before we take any one's current earnings.

Although the profits of such privileges are not the only kind that should be conscripted in preference to earnings, they are so vast in the aggregate, the public equities regarding them are so obvious, and they are so easily distinguished for assessment, that they may best serve to illustrate the subject of taxes on privilege. Recurring for illustrative purposes, then, to privileges of ownership of natural coal and iron deposits, let us consider the possibilities of raising war revenues by taxing the values of such privileges before putting the burdens of war-finance upon the earnings of industry.

Natural deposits of iron, coal and oil are necessary for the production of steel, which is among the most important of products for war purposes. Its price in billets for July, 1914, just before the outbreak of the European war, averaged \$19 a ton. The average price for July, 1915, had risen to \$21, for July, 1916, to \$41, and for July, 1917, the fourth month of our war with Germany, to \$100.* Why this enormous jump in the price of steel?

*It is a curious fact that the price of steel rails, a manufactured product, which averaged \$28 a ton in July, 1914, when billets, a raw material averaged \$19, had risen only to \$38 in July, 1917, when billets were \$100. The figures are from U. S. Bureau of Labor Statistics reports of the Pittsburgh market.

Higher wages do not account for it. Were one trailing the profits of steel production he would hardly turn his steps toward the homes of wage-earners, even though "they *are* getting better wages than they ever dreamed of before." Wouldn't the intelligent trailer be more likely to go where owners of steel-producing opportunities flaunt their dazzling but unearned incomes? Wages have not more than doubled since August, 1914, either in turning pig-iron into steel, or in turning ore into pig-iron, or in producing the ore, the coal or the oil, or any of the other natural materials for the making of steel. Those high prices are certainly not due to high wages—not altogether.

Prices of steel have doubtless stimulated wages in steel production, but high prices spring out of the enormous demand for steel which the war has made. This demand reacts upon the constituents of steel production. The steel doesn't exist: it has to be produced. Consequently demand for steel workers is increased and this increases wages. Steel-producing labor, however, is not the only constituent of steel production. Iron, coal, oil and so on being necessary, demand for these is augmented by the demand for steel; workers in those industries are therefore in greater demand and their wages also rise. But iron, coal and oil *deposits*—natural resources—

are needed by producers of iron, coal and oil. If these deposits could be created by labor, the wages of this labor too would be increased by the extraordinary demand for steel. But those deposits cannot be created by labor; they are gifts of Nature. And as they are monopolized by privileged owners, the owners control prices for permission to use them. The wages, therefore, that labor would get for creating coal, iron and oil deposits—if labor possibly could create them, as it can not—go to the owners of the natural deposits in the form of royalties, rentals, prices, dividends or the like. Whatever the form in which these profits are collected, and regardless of the extent to which they are confused with other profits, they are the unearned profits of conventional privileges of owning natural resources.

How much these unearned profits would yield for war purposes, it is impossible even to estimate without a systematic assessment. But an assessment could be easily made. The Census Bureau already possesses data that would assist the Treasury Department in appraising with reasonable fairness the value of coal and iron deposits privately owned, and in distinguishing the used from the unused. A tax of, say, 1 per cent. on the former and a surtax of, say, 1 per cent. on the latter, would promote rather than disturb mining activities. These taxes would take nothing for the government except what already belongs

in fairness to the people and not to the corporations that would otherwise keep it. And they would yield millions to our war chest; not enough, probably, to finance the war, but enough to make the heavy burden which industry must otherwise bear comparatively light.

Besides the values of natural mineral deposits, such a financial policy would subject to war taxation the values of vast domains of monopolized timber and farming lands, the values of railroad rights of way, the values of terminal locations, and the values of city building lots. It would be a kind of war taxation, too, that would yield abundantly without obstructing industry in any of its legitimate operations or taking from anybody any profit that he earns by his own industry or that rightly belongs to him.

Objection in behalf of farmers would of course be made. But such objections are not in the interest of real farmers. They originate with "farmers of farmers." An ad valorem war-tax on the land-values of farms, would touch no earnings of farm hands and none of farm tenants; and it would be a light tax on the owning farmers of farmed farms—not heavy enough to offset what they would save from the corresponding release from taxation on the cost of their market supplies. Being a *direct tax*, it could not be shifted to consumers in prices; and being a *tax on privilege* it would not take anything from earnings. The only farmers whom it would burden

are those who hold farm land out of use for higher acreage prices—our land-grant railroads, our bonanza owners of tracts the size of townships and counties, our city receivers of farm rents from the country, and the like. Not only would this tax make farm-land monopolists “do their bit” in paying for the war; but by its extra burden on unused farm lands it would bring much of those now neglected and wasted natural resources into use and thereby increase our supply of sorely needed food products.

As to the revenue-producing effect of a tax of 1 per cent. on farm land (valued irrespective of its improvements if improved) and a surtax of 1 per cent. on unused farm land, only a minimum guess may be ventured; but the guess may rest upon significant Census statistics.

According to the Census of 1910, the land area of the United States is 1,903,289,600 acres, of which 878,798,325 acres were then in farms. This leaves 1,025,491,275 for cities, deserts, bodies of water, mineral deposits, forests, “cut-over” areas, urban sites, and farming land not in farms; and of the 878,798,325 acres 478,451,750 (more than half) was at that time unimproved. The average value of land in farms, improved and unimproved but irrespective of improvements, was put at \$32.40 an acre, for 1909. It is reported as nearly 50 per cent. higher now. But a tax of 1 per cent. on the value of 1909 would average a little more than 30 cents an acre

for the entire area of land in farms; or, on that 878,798,325 acres of land in farms, a revenue yield for war purposes of \$265,000,000 in round figures. Add to this sum a surtax of 1 per cent. (30 cents an acre) on the unimproved parts of farms, 478,451,750 acres, which makes \$145,000,000 in round numbers, and we have a total annual war revenue from farm-land values of \$410,000,000 at the very lowest.

On building lots, such a tax would be as easy of fair assessment as on farm-land values. In advance of assessment the result can only be guessed at, as with farm-land values, but here also there are statistical bases for the guess.

The land values of Greater New York were reported in 1916 as \$4,611,804,833.* A tax of 1 per cent. on these values would produce \$46,000,000 in round numbers. Vacant lots in Greater New York that year were assessed at \$598,630,573. A surtax of 1 per cent. on this valuation would yield \$6,000,000 in round numbers. The entire tax, then, for Greater New York at those rates would be at least \$52,000,000 annually. This is at the rate of \$8 per capita of population. As population is not the only factor of urban land values, and may vary in importance in different cities, the land values war-tax in other cities cannot be even approximated by multiplying their

*Report of Commissioners of Taxes and Assessments of City of New York, 1916, pages 32-33.

population by the annual per capita average for New York. But this method is at least indicative. Pursuing it we have the following round number tabulation:

New York.....	\$52,000,000	Los Angeles.....	\$3,000,000
Philadelphia	15,000,000	Milwaukee	3,000,000
Boston	12,000,000	Providence	3,000,000
Chicago	19,000,000	Washington	2,500,000
San Francisco ...	5,000,000	New Orleans....	2,500,000
St. Louis	6,500,000	Kansas City	
Pittsburgh	8,000,000	(Mo. & Kan.)..	2,500,000
Baltimore	5,000,000	Louisville	2,000,000
Cleveland	4,500,000	Rochester	1,500,000
Minneapolis &		Indianapolis	1,500,000
St. Paul	4,000,000	Denver	1,500,000
Detroit	4,000,000	Portland, Ore....	1,500,000
Buffalo	4,000,000		
		Total.....	\$163,500,000

That these estimates are far below the least probable minimum is more than likely. The New York values are limited to the boroughs of the City, whereas the several populations* are for metropolitan districts. For New York this includes Yonkers, N. Y., in one direction and Newark, N. J., in another. The land values of the whole metropolitan district of New York, therefore, should be taken into account in order to get the per capita average. Were this done the average per capita would be larger than \$8 and the aggregate revenues consequently greater

*Abstract of U. S. Census of 1910, pages 61-62.

than \$163,500,000. So the above estimates for the cities named are doubtless low enough.

Taking into account the whole urban territory of the United States, from towns of 2,500 to cities of a million and more, the Census* puts their aggregate population at 42,623,383. At the New York per capita average of \$8 this urban population would yield war revenues, at 1 per cent. tax on all building lots and 1 per cent. surtax on the vacant ones, amounting to the round sum of \$341,000,000.

On those extremely low estimates, then, a tax of 1 per cent. on land values irrespective of improvements and a surtax of 1 per cent. on vacant-land values, would yield an annual minimum of \$341,000,000 from city lots and \$410,000,000 from farming land—a total of \$751,000,000. And this estimate ignores the building-lot values of suburbs, the values of farming land held out of farms by speculative corporations, the values of timber tracts and the values of ore beds, coal beds and other mineral deposits. Were these ignored values also assessed, the revenue yield, at the same low rate, would probably amount to more than \$1,000,000,000 a year. From one coal deposit alone, a holding of the interlaced steel interests, the low rate of taxation suggested would produce an annual public revenue of not far from \$15,000,000.

*Abstract of U. S. Census for 1910, page 59.

If, then, the war were to last a year, and to cost \$20,000,000,000, it could be wholly paid for in twenty years, short-time bonds and all, by a special tax of only 1 per cent. on natural resource values and 1 per cent. surtax on the values of natural resources held out of use for speculation. (Of course this estimate leaves to other bases of direct taxation and to higher values of natural resources than the above low aggregate, the burden of meeting interest charges on bonds pending their redemption.) If the war lasted longer and cost more, the same result could be produced by a reasonable increase in the natural-resources tax rate. It could be so produced up to an aggregate war-cost of \$60,000,000,000—sufficient allowance, by the test of British experience,* for a four or five years' war—without exhausting the annual values of special privileges in our natural resources.

These taxes on natural resource values—let the fact be again emphasized—would “stay put.” The persons who paid them would be *taxbearers* as well as *taxpayers*. They would, therefore, not distract business, as indirect taxes do; and, unlike direct taxes on earnings, they would not take the legitimate earnings of any one's legitimate work. They would no more burden taxpayers unfairly than accounting to the public for tax collections

*War Finance Primer, issued by National Bank of Commerce, New York (May, 1907), pages 23, 26.

burdens tax collectors unfairly. In all those respects they would signify no more than this, that the owners of privileges in the natural resources of our country, who collect unearned profits therefrom, must turn those profits over to the government of the country for meeting the expenses of this war in defense of the country. In addition, they would promote beneficial uses of natural resources in place of a dog-in-the-manger monopolization.

But Constitutional questions arise. Has Congress the Constitutional power to get war revenues from direct taxation on monopolized natural-resource values, or must it continue to tax industrial earnings by both direct and indirect taxes and to embarrass and bankrupt legitimate industry by taxes that are indirect?

The Constitution requires direct taxes to be apportioned among the States according to population, and the Supreme Court has decided that taxes on real estate are direct. Inasmuch, then, as natural resources are in the category of real estate, they can be taxed by Congress only in proportion, in each State, to its population relatively to the whole population of the United States. To this method there are objections which may or may not be insuperable, but which need not concern us with reference to war taxes, because a Constitutional method, regardless of population,

of taxing the privileges of owning natural resources has been suggested.

This suggestion is by Jackson H. Ralston,* a distinguished member of the District of Columbia bar. Mr. Ralston makes a distinction between natural resources, which are real estate, and the privilege of owning them, which is a franchise. The former is, as noted above, subject to direct taxation by Congress only in proportion to the population of the several States; but the latter, the franchise, is subject to taxation by Congress like any other franchise.

Here is the legal argument in brief: "The holding of land by one individual to the exclusion of all others is entirely due to conventional arrangements. Without the convention, it does not exist. This has been recognized more than once by law writers. Blackstone maintains it in the first chapter of the second book of his Commentaries, wherein he says: 'There is no foundation in Nature or in natural law, why a set of words upon parchment should convey the dominion of land; why the son should have a right to exclude his fellow creatures from a determinate spot of ground, because his father had done so before him; or why the occupier of a particular field, or of a jewel, when lying on his deathbed and no longer able to maintain possession, should be en-

*See THE PUBLIC of September 14, 1917, page 889.

titled to tell the rest of the world which of them should enjoy it after him.' The right to hold land, therefore, being purely conventional, is to be treated as a privilege; and while the land itself may not be taxed, the privilege—the franchise to hold and use—is fairly subject to taxation. It differs in no wise from the franchise of a corporation, its property being taxed separately from the right to hold and control its property."

The tax, therefore, which Mr. Ralston's opinion sustains as a means of reaching the values of natural resources, is one imposed upon individuals who are privileged to own such resources, regardless of any use they may make of the privilege or of its location, but in virtue solely of the fact of its existence. The value of the privilege or franchise, as a basis for measuring the tax fairly, would be in proportion to the value of the natural resource.

"The reasoning," Mr. Ralston adds, "upon which the Constitutionality of such a tax would be based, since it would be levied regardless of proportions in population, is exactly parallel to that upon which inheritance taxes are sustained. The courts do not consider that inheritance taxes are upon the things inherited, but upon the privilege of inheritance, the value of which is measured by the value of the inherited property."

Mr. Ralston's opinion sustains the direct tax

and the direct surtax here proposed for war purposes, though they be levied regardless of differences in the population of the several States. It is a challenge to Congress, Constitutional as well as economic and patriotic, to finance this war for democracy by the supremely democratic method of taxing privileges of owning the earth in proportion to what each privilege is worth.