Statement of Edward A. O'Neal, President of the American Farm Bureau Federation, before the House Ways and Means Committee, May 2, 1941.

Mr. Chairman, Members of the Committee, we have asked for an opportunity to appear before you today in order that we may present the views of the American Farm Bureau Federation on defense taxation. We recognize that increased taxes are vitally necessary to insure the success of the defense program. In developing this new tax program we believe that it is vitally important that as many citizens as possible shall have a direct part in the financing of the national defense effort. I believe that the vast majority of American people are anxious to do their part. Taxes should be distributed equitably throughout our entire population on the basis of ability to pay, and they should be levied so that people will know what taxes they are paying. Direct taxes which make people "tax-conscious" will do far more to stimulate greater patriotic support for the defense program and the interest in government, which our democracy needs, than will hidden levies. We also believe it is vitally important that all non-essential government expenditures be curtailed during the present emergency.

The general policy of the American Farm Bureau Federation on this subject is set forth in the following resolution adopted at our 22nd annual convention held at Baltimore in December, 1940:

Federal Taxation

> "The national defense program is placing new and greatly increased burdens upon the Federal budget. In affirmation of the policies set forward by the Board of Directors, we support higher taxes to meet a proper share of this added expenditure. We will oppose efforts to raise this revenue from excise or consumption taxes. The corporate and personal income tax must be the main source of revenue and the excess profits tax should be tightened and maximum rates of profit established above which all revenues will be considered as excess profits and be taxable as such. Only by such tax policies can profiteering be forestalled and the defense program financed on the basis of ability to pay."

In order to obtain the technical data needed to make constructive recommendations for the development of a sound tax program we have had a comprehensive study of the entire Federal tax problem made by the Economics Staff of Iowa State College.

On the basis of this study we are convinced that the real problem is not simply to raise enough money, but also to choose the right ways of raising money. Over and above paying for defense our financing policy must help toward the following important goals of public policy:

(1) Attaining maximum production of goods and services.

(2) Preventing runaway inflation.

(3) Sharing defense burdens fairly.

(4) Giving all citizens a sense of participating in defense.

(5) Releasing resources needed for defense from non-essential industries.

(6) Promoting a healthy financial structure for the post-war period.

Farmers are particularly vulnerable if we bungle our defense financing. No other group is likely to be so hard hit by the eventual collapse if we make mistakes and let excessive inflation take place. Agriculture is a $38 billion industry. The equity of operating farmers is probably $15 billion or less. The rest is represented by mortgage debt of $7 billion plus landlords' equities. Six to 8 percent of the farms change hands annually and more would be bought and sold if prices rose substantially. A farm purchase by an operator is the investment of a life time's earnings; all he has earned to date and hopes to earn in the future. No other large group with comparable incomes has as high long-term investments as farmers. Partly because of this and for other reasons, farmers bear the brunt of falling price levels, mortgage foreclosures, and agricultural adjustments are painful and long drawn out.

Farmers' vital interests are not fully protected simply by preventing runaway inflation, however. Only the unemployed are as interested as farmers in seeing our economy move into full production. With the exception of cotton, tobacco and wheat growers, the income of farmers is almost directly related to national income. Farmers are demanding a defense financing system which will encourage full employment at the earliest possible time as well as provide safeguards against inflation.

The farmers are also interested in the fairness of the additional taxes levied to finance defense. Farmers have a special stake in improving the equity of the tax system for they are predominantly in the lower income brackets. They realize that sales taxes would increase farm costs and lower consumer buying power for farm products which make up such a large part of the total expenditures of low income families.

An income study made a few years ago shows that 18 percent of our farmers, or a million farm families foll in the "less than $500 income" bracket in 1935-36, while 53 percent had an income less than $1000.

| Incomes | Percent of all non-relief families in group | |
|---|---|---|
| | Farm | Non-farm |
| Under $500 | 18 | 8 |
| $500 to $999 | 35 | 14 |
| $1000 to $1500 | 23 | 24 |
| Over $1500 | 24 | 54 |

Families in the "less than $500 income" bracket are already paying more than 22 percent of their income for taxes when allowance is made for State and local, as well as Federal levies. This is a heavier tax burden than is borne by any other group making less than $10,000 per year. The following table shows the percentages of income now being taken from various groups by present taxes:

| Income Class | % of Income Taken by Present Taxes (1) |
|---|---|
| Under 500 | 22.5 |
| 500 - 1000 | 18.7 |
| 1000 - 1500 | 18.1 |
| 1500 - 2000 | 18.7 |
| 2000 - 3000 | 18.5 |
| 3000 - 5000 | 19.0 |
| 5000 - 10000 | 19.3 |
| 10000 - 15000 | 28.3 |
| 15000 - 20000 | 35.7 |
| 20000 and over | 43.2 |

(1) G. Colm & H. Tarasov, "Who Pays The Taxes?" These estimates include the defense taxes of 1940.

From a family income standpoint farmers are about in the same class as wage earners and, as consumers, will be similarly affected by sales or excise taxes, with the exception that they do not have to spend as high a portion of their income for food.

Already agriculture as an industry pays 24 percent of the income it produces as business (mostly property taxes) taxes.2/ This is more than the amount paid by any other industry except public utilities. A general sales tax would increase this disparity. It is estimated that around 25 percent of the cash farm income is spent for new machinery, lumber, fertilizer, commercial feeds, machinery repairs and similar items used in farm production which would be subject to a general sales tax.

Sales taxes would also depress farm prices and thus farm incomes from the sale of products. Food, clothing and tobacco represent over half the expenditures of families receiving less than $1500 income.

Food, Clothing and Tobacco as a percentage of all Expenditures of American Families, 1935-36

| Income level | Percentage of Income Spent | | |
|---|---|---|---|
| | For Food | For Clothing | For Tobacco |
| Over $1500 | 21.5 | 13.2 | 1.0 |
| $1000 to $1500 | 37.7 | 9.1 | 2.0 |
| $500 to $999 | 42.6 | 8.3 | 2.0 |
| Under $500 | 43.6 | 7.5 | 1.9 |

If a sales tax of 8 to 10 percent is added to the prices of things purchased by these groups, they will find it necessary to reduce the quantity of all goods purchased. Any tendency to reduce the quantity taken because of the tax, will have a depressing effect on farm prices.

These low-income families consume over half the total value of all food, clothing and tobacco consumed. For example, in 1935-36, 63 percent of the money spent by American families for food, was spent by families with incomes of less than $1500. These same low-income families accounted for 45 percent of the expenditures made for tobacco that year and 35 percent of the expenditures for clothing. A sales tax of 8 to 10 percent transferring that much of the spending power from the low-income groups

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2/ Tarasov and Colm in TNEC Monograph No. 3.

to defense spending would seriously affect the ability of around half the population to buy farm products as compared with raising the same amount of taxes from the higher income groups. From a general welfare standpoint (health of the affected families) and also from the farm income standpoint, this is far more serious than the increase in farm costs occasioned by the sales tax. We estimate, on the basis of the study made by Iowa State College, that a sales tax of 8 to 10 percent might easily reduce the income from a normal volume of farm marketings by 10 percent or more. This 10 percent drop is likely to occur because marketing charges are relatively fixed. You, Mr. Chairman, and every member of your committee are well aware of the fact that on the average the farmer only gets about 40 cents out of each consumer's dollar spent for food. A five percent drop in cash payments for goods at the retail counter often means a 10 to 15 percent drop in cash income at the farm.

If the low-income farmers happened to be producing products, the cash income from which was lowered by 15 percent as a result of sales taxes, and their costs increased by 2 to 3 percent, they would have 17 to 18 percent less income to spend than otherwise. When they went to buy consumer goods with this 17 to 18 percent smaller income, their purchases would be restricted by another 8 to 10 percent because of the sales taxes on the goods they buy. Mr. Chairman, a policy of financing defense by sales taxes would reduce the effective income of many farm families by as much as 25 percent.

The farmers of America, Mr. Chairman, have a tremendous stake in the type of defense financing program you and your committee recommend. Their interests demand that it be a flexible program based on ability to pay.

Too much borrowing, resulting in inflation, will certainly get the whole economic machinery out of gear as it did in the first world war. If it does, it is highly unlikely that the most effective farm program we can devise will be able to keep agriculture from bearing the brunt of the shock in making post-war adjustments. Fully as important as achieving a proper balance between borrowing and taxing is the method of raising the taxes. In order to raise sufficient taxes on the basis of ability to pay, the method of income tax collection must be overhauled. The tax base must be enlarged. Gaps and loopholes must be closed.

The present base for the income tax is entirely too small to raise sufficient revenue to meet defense needs. The Iowa State College study shows that under present tax laws only $16 billion or 18 percent of a national income of $88 billion would be taxable. If we should lower present exemptions from $2000 to $1000 for the head of a family, and from $800 to $500 for a single person and the credit for dependents from $400 to $200 we would increase the tax base to approximately $27.6 million or about 32 percent of an $88 billion income. By eliminating the present "earned income credit" we could add another $4.7 billion to this sum making the total tax base $32.3 billion or 37 percent of our total income. With this larger base a normal tax of 10 percent would raise over $3 billion, or five times as much as our present revenue from this tax. Of course, additional sums must also be obtained through higher excess profits and corporation taxes and from an extension of surtaxes. The following table, adapted from data supplied by Iowa State College, shows the relationship between national income and the income tax base (assuming a national income of $88 billion) with present exemptions, with the new exemptions suggested above, with one-half these exemptions, and with no exemptions.

| Group of Income Receivers | "Net Income" 1/ | "Earned Income Credit" | Taxable Income | Exemptions | Tax Base |
|---|---|---|---|---|---|
| | Billions of Dollars | | | | |
| | 1940 EXEMPTIONS 2/ | | | | |
| Persons taxable | 33.6 | 2.6 | 31.0 | 15.0 | 16.0 |
| | APPROXIMATELY ONE-HALF PRESENT EXEMPTIONS 3/ | | | | |
| New taxpayers | 21.5 | 2.1 | 19.4 | 14.7 | 4.7 |
| 1940 taxpayers | 33.6 | 2.6 | 31.0 | 8.1 | 22.9 |
| | APPROXIMATELY ONE-QUARTER PRESENT EXEMPTIONS 4/ | | | | |
| New taxpayers | 10.0 | 1.0 | 9.0 | 6.1 | 2.9 |
| Taxpayers under the higher exemptions | 55.1 | 4.8 | 50.3 | 11.4 | 38.9 |

| Group of Income Receivers | "Net Income" 1/ | "Earned Income Credit" | Taxable Income | Exemptions | Tax Base |
|---|---|---|---|---|---|
| | Billions of Dollars | | | | |
| NO EXEMPTIONS | | | | | |
| New taxpayers | 4.0 | 0.4 | 3.6 | 0.0 | 3.6 |
| Taxpayers under the higher exemptions | 65.2 | 5.8 | 59.4 | 0.0 | 59.4 |

1/ After allowable deductions, allowances for non-reporting, understatement and non-cash income.

2/ $2000 for the head of a family; $800 for a single person; $400 for each child.

3/ $1000 for the head of a family; $500 for a single person; $200 for each child.

4/ $500 for the head of a family; $250 for a single person; $100 for each child.

We do not believe that it is either necessary or desirable that all exemptions be eliminated, but we would like to point out that no matter how low exemptions are placed our farmers and low-income groups will fare better under an income tax system than under a sales tax designed to raise the same amount of money.

One section of the Iowa State College report deals specifically with the question of income taxes versus sales taxes. It contains a number of detailed tables showing the effect on various income groups of raising given amounts by sales and income taxes.

I would like to submit this particular memorandum for the committee's consideration, and for inclusion in the record as an extension of my remarks.

The study shows clearly that we can raise sufficient funds from the income tax if we lower exemptions and set the rates high enough.

For the record I should like to say that the American Farm Bureau Federation is opposed to the increases in excise taxes which has been proposed by both the Treasury and the Committee's staff. After carefully reviewing the study which Iowa State College made for us the American Farm Bureau Federation respectfully makes the following recommendations:

1. Financing by bond sales may safely be continued for the present; but we must prepare to break away from depending on it when production ceases to expand

with increasing spending.

2. The Treasury's campaign to sell savings bonds should be continued but should not be counted on to meet emergency revenue needs.

3. Defense taxes should be primarily personal net income taxes based on the ability to pay, principally to raise sufficient funds to finance defense costs on this basis, and to make the income tax machinery sufficiently flexible to check inflation. The following changes need to be made in the income tax:

(a) Lower the exemption to about one-half the present levels and take measures to reduce avoidance or evasion of income taxes.

(b) Be prepared to raise income tax rates whenever living costs rise by more than a normal amount since this will be a signal that spending is outrunning output of consumer goods.

4. General sales tax can and should be avoided as they would further increase the burdens on the low income consumers and directly increase prices.

5. Existing loopholes in tax collection regulations should be plugged, particularly those which enable individuals to escape surtaxes thru corporate organizations. In the meantime moderate increases in corporate income taxes and effective excess profits taxes are needed and fully justified.

6. Excise taxes should not be used to raise additional revenue.