

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

## Office Correspondence

Date July 29, 1938To Chairman Eccles

Subject: \_\_\_\_\_

From Ronald RansomC O N F I D E N T I A L

At my request, the Federal Reserve Bank of Atlanta permitted Mr. Malcolm H. Bryan to come to Washington to make an informal and factual study of taxes and national income in Great Britain and the United States. There having been much public discussion of the relative tax burdens of the two countries in relation to national income, and the effect of their respective tax systems on the national economy of the two countries, I considered that it would be helpful to have some facts on the subject available for consideration. A copy of his study is attached hereto. Mr. Bryan explained that within the limit of time available to him he could not give the matter the thorough exploration which the subject justifies, and that the first part of the study is a discussion of his concept of "tax burdens".

While here, I called his attention to a press report to the effect that plans were being considered for a tax subsidy for new investment and asked him to give me his views on this proposal. A copy of this is also attached.



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COPY

Board of Governors  
of the  
Federal Reserve System

July 6, 1938.

To: Mr. Ransom  
From: Malcolm H. Bryan

Subject: Taxes and national  
income in Great Britain and  
the United States.

This paper presents in an informal way certain available figures relating to the proportion of national income represented by all federal, state, and local taxes in the United States in comparison with the proportion of national income represented by national and local taxes in Great Britain. Some figures relating to expenditures, as contrasted with taxes, are also presented.

Such a comparison does not yield a conclusion about the tax burden, and the phrase "tax burden" is avoided. There are so many meanings and half-meanings, and so many points of view involved in the term, including moral connotations that are not always helpful in a rational approach to economic problems, that its use is almost inevitably confusing unless defined carefully. Because the words are in such constant popular usage, however, it is worth while to set forth a list of considerations that seem to become entangled, implicitly or explicitly, in almost every tax burden discussion.

1. The simplest aspect of the tax burden relates to the (a) actual amount of money taken from private hands, either in direct or indirect levies on individuals or on businesses, and diverted to governmental use, in comparison with the (b) total amount of wealth or income from which taxpayers can meet their tax bills.

2. Among additional complications, however, is the distribution of the tax load in relation to the distribution of wealth and income among the individuals upon whom the taxes are levied or finally come to rest. A total tax assessment that is small with respect to the sources available for its payment can be distributed so inequitably among various taxpayers that its impact on those who are actually caught in the revenue net may be severe and, in a way, a greater burden than an equal or larger tax load more equitably distributed.<sup>1/</sup> Yet the existence of direct or indirect tax levies makes an attempt to determine the distribution of total taxes among taxpaying classes and individuals so complicated, efforts in that direction have been so unsatisfactory, and judgments concerning equity in taxation differ so widely, that this phase of the question is entirely omitted in what follows.

As a general consideration, it may be noticed that any tax is a deduction from income and thus a burden for certain taxpaying individuals and groups. The generality of Government services, unlike private business, do not result from a particular payment for a particular service, and this characteristic of most Government activity means that Government

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<sup>1/</sup> While there is nowadays a great deal of discussion concerning general aspects of the tax load, it is often true that the individual who discusses comparative tax burdens thinks of it in the form of the question: "What taxes does a person of my sort pay in the United States as compared to Great Britain?" An effort to solve that problem is avoided because, though there have been attempts to distribute the presumptive payment of indirect taxes by income class in the United States, the writer has not had time in which to investigate the possible existence of comparable material for Great Britain. A question that logically needs asking in connection with the previous question is this: "What chance should I have in Great Britain of being in an income class as high as in the United States?"

production of goods and services adds more to the incomes of certain individuals and less to others than taxes take away, and the tax contribution in payment for the service is not measured by the amount of the service. It follows necessarily, then, that in any tax contribution whatever, regardless of its absolute amount or percentage relation to national income, there are some who are burdened, net, and some who are benefited, net.

3. Discussions of the tax burden often have in them a psychological element--an observation at least as old as Adam Smith. A tax load or an especial tax to which citizens are unaccustomed will always appear more rigorous and more burdensome than a tax to which psychological adjustment has been made through long acquaintance.

4. More fundamentally by far, statements regarding the tax burden must be made to rest upon the disposal that Government makes of the money it collects.

(a) For instance, a distinction must be made between taxes levied for the purpose of "transfer" expenditures and "exhaustive"<sup>1/</sup> expenditures. That is, there exists a substantial fraction of all Government expenditures--as in debt, interest, relief or bonus payments--in which the tax collections result merely in the transfer of income, with a small expense deduction, from some individuals to others. As was indicated in a foregoing paragraph, some persons are obviously

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<sup>1/</sup> This word was apparently coined some years ago by Mr. A. C. Pigou of Cambridge University. It is not from many aspects a desirable or very expressive word, but it has gained a certain usage and is continued here for lack of a wholly desirable substitute.

burdened and others are obviously benefited by the process, but in most cases it is not clear that the amounts representing transfers are to be thought of as a burden on the total economy, and in some cases it is clear that they are not a burden.

(b) "Exhaustive" expenditures are those in which the Government itself makes use of men, materials, and equipment for the production of goods and services. In short, exhaustive expenditures are those in which the Government occupies the field of economic and social endeavor and makes use of a portion of the total resources of the economy; and in that circumstance they differ from transfer expenditures.

Even in the case of taxes collected for so-called exhaustive expenditures, however, it is by no means certain that they are properly and ordinarily to be spoken of as a burden. So far as the total economy is concerned, the exhaustive expenditures of Government, and thus the taxes levied to finance them, represent the cost of goods and services, plus those produced by private industry for governmental use. In comparing tax revenues with national income, therefore, it is necessary to remember that the costs must be offset by the economy as a whole, as would be done in any private business, by the value of the goods and services produced. In other words, in thinking of taxes as a deduction from national income, it is necessary to keep in mind the offsetting contributions that Government makes to the national income and to

remember that in our estimates of national income there is a large element representing these contributions.

Still another way of looking at the matter is by comparison with private business, in which the expenses of the business would not be thought of as constituting a burden. The expense could be eliminated of course, but the elimination of the expense would involve the sacrifice of the goods and services that would have been produced. Were it true, then, that any individual business--call it A--failed to operate, businesses that purchase A's products would have funds available for the purchase of alternative goods or services or for the purchase of the same goods and services from some other firm, but there would be no net saving to society unless products and services other than A's were more desirable to society or A's products or services could be produced more cheaply.

So it is with Government. If Government (a) produces no income in the form of goods or services there is a saving, but the cost is saved by relinquishing the production, and the only net advantage would occur if privately produced goods or services could be acquired more cheaply or were more desirable.

If Government (b) in obtaining income by taxes or other devices, then, uses its receipts for the production of national income that is of lesser amount or of lesser utility than would have been produced by the use of the same amount of money in private hands, there has been a real tax burden,

regardless of the absolute or percentage level of the taxes the Government collects. If the Government (c) collects taxes or other receipts and produces national income of greater amount or greater utility than would have been produced by the same money left in private hands, then it is very difficult if not impossible to speak of a tax burden to the whole economy, regardless of the absolute or percentage level of tax receipts. The crucial problem in connection with this aspect of the tax burden is the relative efficiency of Government in producing goods and services in comparison with their private production and the relative usefulness of the kinds of goods and services generally produced by Government in contrast with the kinds that would have been produced by private enterprise. Ultimately this is a question of personal judgment as to the relative value of goods and services produced under Government auspices as contrasted with those produced under private auspices; it is not a problem that can be solved by mere statistical measurement.

5. Enough has been said to indicate the extreme complexity of talking about taxes in terms of burdens. Unfortunately, it is also necessary to keep in mind the phase of the business cycle in discussing the problem, and that brings on another widely ramified series of considerations.

(a) For instance, taxes to support transfer expenditures have been mentioned. It was pointed out that the mere transfer of funds through the agency of Government as a clearing house may not constitute a burden on the total economy. It must now

be added that there are circumstances in which such a transfer may constitute a very real burden. If the Government, as an example, collects taxes for debt and interest payments at a stage of the business cycle in which the institutions or individuals are disinclined to reinvest and simply hold the funds transferred to them by Government, the transfer operation has constituted a burden on the economy because, if the Government has collected taxes from persons who would otherwise have expended the funds, there has in the process been withdrawn from the production of national income an amount held by investors. Such a situation may well occur on the down phase of the business cycle.

(b) "If the Government has collected taxes from persons who would otherwise have expended the funds. . ." On the contrary, if taxes can be so levied as to effect deductions from funds that would otherwise be saved and not invested, the burden to the economy is not clear, especially when so-called exhaustive expenditures by Government are involved. In such a situation, even the individual taxpayer is deprived only of a monetary "store of value" and his freedom in choosing to hold it. Since, by assumption, no private expenditure of the funds would exist, a comparison between what the Government produces and what private industry might have produced is not valid.

(c) In addition to considerations in any present phase of the business cycle, there are important factors in the burden



that may be thought of as arising from the possible compensating adjustment of expenditures to one phase of the cycle and of taxation to another phase. Expenditures of Government always exceed taxes by certain amounts represented by non-tax receipts, and often exceed taxes by a substantial amount represented by borrowing; and the creation of borrowed purchasing power when an economy has idle men, materials, and equipment may increase governmentally produced income and, at the same time, not lessen the flow of funds in the private production of income.

Thus the burden of Government operations on the economy may depend in part upon the proportion of Government tax receipts and Government borrowing in the various phases of the business cycle. It is at least possible, to state the point conservatively, that an increase in the proportion of Government expenditure financed by credits in the down phase and the liquidation of credits in the up phase of the business cycle may result in a lesser burden to the economy as a whole than the maintenance of the governmentally produced share of the national income through taxation alone.

This is, of course, the theory of deficit spending in connection with a compensating fiscal policy. Governmentally used credits when there are idle men, materials, and equipment in the economy may result in a net addition to national income when credits would not be used for the private production of national income; and the transfer repayments involved in the

liquidation of Government borrowing when the business cycle is in an upswing may not result in a diminution of national income if, by virtue of accelerating private business, the credits repaid are availed of by private enterprise.

The foregoing points reveal the reason why the discussion of tax burdens will go on forever. On the one hand, as was suggested, the contributions of Government to the national income are frequently made in the form of additions to the goods and service income of persons whose tax contribution to the expense of producing it is not proportioned to their direct or indirect receipt of governmentally produced income. That fact alone creates an inevitable and almost continuous dispute between those who in varying degrees contribute the expenses of Government and those who in varying degrees receive the income produced by Government. On the other hand, for most types of Government production, the only way of measuring its value is by the expense of producing it, i.e., its cost, which does not, of course, come to grips with the issue. In the private production of income there is generally the consumers' choice and specific payment to attest the value of the production, but in Government undertakings the factors of choice and payment are not generally coincident, choice is loosely expressed in the form of legislative appropriations, and most Government services are of a character that cannot be easily measured, even in quantitative terms quite aside from qualitative or value terms. There is thus always an argument regarding the value of Government production of goods and services as against the possible value of goods and service income that might have been produced with the same

fraction of the economy's men, materials, and equipment. Such factors in the tax burden are sufficient, of course, to create questions that can never be resolved, and when the adjustment of taxation and expenditure to the business cycle is related to the discussion of tax burdens, as must be the case in a careful examination of them, then the phrase "tax burden" becomes so complex in its manifold implications to be of doubtful usefulness. Even with the most precise definition, the failure of payment for Government income and the receipt of it to coincide, will almost certainly cause the argument about tax burdens to go on until the last economist, businessman, and civil servant is alike absorbed in the common denominator of an eternal and presumably uncomfortable destiny.

In the following tables data for tax collections in the United States and in Great Britain have been taken from compilations by the National Industrial Conference Board. The Conference Board in turn derived its figures from the Daily Treasury Statement, so far as Federal taxes are concerned, and from reports of state auditors, controllers, and other officials, so far as state taxes are concerned. Local taxes are estimated by a sampling process that is tied to exact figures from the census at various intervals, the last complete data being for the year 1932. There is thus a small margin of error possible with regard to the total tax collections. The Conference Board reports that the figures for taxes in Great Britain are computed from the Statistical Abstract of the United Kingdom.

Preceding paragraphs have indicated why the concept of tax burden is extremely elusive. It may now be added that there has been no attempt

in the following tables to make any adjustments for "transfer" as against "exhaustive" tax levies or in any way to go behind the reported figures. While it would be possible to exclude certain transfer items--as service of the funded debt--, some confusion regarding non-funded debt would occur, and the attempt to exclude interest and debt retirements would bring on a dispute regarding whether or not these payments, which are transfer items in the present, should not properly be included on the ground that a large portion of them represented exhaustive expenditures of the past. Still further, if all transfer items should be omitted, in order to develop an exhaustive expenditure basis, someone would be certain to contend that all or a considerable portion of the non-tax-supported activities of Government--supported by fees, fines, forfeits, earnings of Government departments, and borrowing--should be added, and sharp differences of opinion would develop in connection with activities supported by borrowing. Such a dispute would go on and on. Finally, and conclusively, there has not been time available in which to develop comparable adjustments in the British tax picture. So the figures for taxes represent simply the total amount of tax revenue levied by the governments of the two countries.

TABLE I  
TAX COLLECTIONS IN THE UNITED STATES  
(Amounts in millions)

Year	Total	Federal	State	Local
1922	\$7,502	\$3,487	\$ 858	\$3,157
1923	7,234	3,032	917	3,285
1924	7,812	3,193	1,017	3,602
1925	7,884	2,966	1,107	3,811
1926	8,605	3,207	1,264	4,134
1927	9,059	3,337	1,355	4,367
1928	9,342	3,194	1,507	4,641
1929	9,759	3,328	1,612	4,819
1930	10,266	3,468	1,780	5,018
1931	9,300	2,717	1,778	4,805
1932	8,147	1,789	1,642	4,716
1933	7,501	1,786	1,505	4,210
1934	8,773	2,892	1,721	4,160
1935	9,731	3,546	1,886	4,299
1936	10,498	3,847	2,296	4,355
1937	12,300*	5,029		7,271* <sup>1/</sup>

TABLE II  
TAX COLLECTIONS IN THE UNITED STATES  
(Percentage distribution)

Year	Total	Federal	State	Local
1922	100	46.5	11.4	42.1
1923	100	41.9	12.7	45.4
1924	100	40.9	13.0	46.1
1925	100	37.7	14.0	48.3
1926	100	37.3	14.7	48.0
1927	100	36.8	15.0	48.2
1928	100	34.2	16.1	49.7
1929	100	34.1	16.5	49.4
1930	100	33.8	17.3	48.9
1931	100	29.2	19.1	51.7
1932	100	22.0	20.2	57.8
1933	100	23.8	20.1	56.1
1934	100	33.0	19.6	47.4
1935	100	36.4	19.4	44.2
1936	100	36.6	21.9	41.5
1937	100	40.9		59.1 <sup>1/</sup>

\* Estimated

<sup>1/</sup>State and local

TABLE III  
TAX COLLECTIONS IN GREAT BRITAIN  
(Amounts in millions)

Year	Total	National	Local
1926	£846	£664	£182
1927	884	693	191
1928	876	685	191
1929	854	677	177
1930	875	704	171
1931	901	733	168
1932	895	728	167
1933	879	709	170
1934	886	710	176
1935	915	739	176
1936	959	783	176
1937	*1,017	*841	176
1938	--	*886	--

TABLE IV  
TAX COLLECTIONS IN GREAT BRITAIN  
(Percentage distribution)

Year	Total	National	Local
1926	100	78.5	21.5
1927	100	78.4	21.6
1928	100	78.2	21.8
1929	100	79.3	20.7
1930	100	80.5	19.5
1931	100	81.4	18.6
1932	100	81.3	18.7
1933	100	80.7	19.3
1934	100	80.1	19.9
1935	100	80.8	19.2
1936	100	81.6	18.4
1937	100	82.7	17.3

\* Estimated

The preceding tables speak for themselves within the limitations previously described. The following table translates the total American and British tax collections into per capita terms. The American figures are in dollars and the British figures in pounds sterling.

Total Taxes Per Capita

Year	United States	Great Britain
1926	\$73.84	£18.70
1927	76.64	19.48
1928	77.94	19.22
1929	80.30	18.69
1930	83.40	19.07
1931	74.93	19.55
1932	65.19	19.31
1933	59.64	18.89
1934	69.28	18.98
1935	76.31	19.52
1936	81.74	20.37
1937	95.16	21.51

Figures for national income vary, of course, with the concept of national income used, methods of calculation, and sources. Three series are presented here, two for the United States and one for Great Britain. The first series for the United States is the "realized" income calculations of the National Industrial Conference Board, and the second is the figure for "produced" income calculated by the Department of Commerce for the years since 1929. The British figure is that published by Colin Clark, and Mr. Nathan, who is in charge of the national income studies for the Department of Commerce says that, of the various concepts of national income in the United States, the produced income figures of the Department are most closely related in concept and method to Clark's British figures.

National Income: United States and  
Great Britain

Year	United States (N.I.C.R.) (In millions of dollars)	United States (Dept. of Com.) (In millions of dollars)	Great Britain (Clark) (£ million)
1926	73,473		4,173
1927	73,913		4,359
1928	75,847		4,339
1929	79,438	80,757	4,384
1930	72,340	67,969	4,318
1931	60,122	53,499	3,889
1932	46,546	39,545	3,844
1933	44,358	41,813	3,962
1934	51,052	49,575	4,250
1935	55,700	54,955	4,550
1936	63,790	63,799	4,876
1937	67,544	69,817	5,200

Percent of Total Taxes to National Income: United States  
and Great Britain

Year	United States		Great Britain
	<u>1/</u>	<u>2/</u>	<u>3/</u>
1926	11.7		20.3
1927	12.3		20.3
1928	12.3		20.2
1929	12.3	12.1	19.5
1930	14.2	15.1	20.3
1931	15.5	17.4	23.2
1932	17.5	20.6	23.3
1933	16.9	17.9	22.2
1934	17.2	17.7	20.9
1935	17.5	17.7	20.2
1936	16.5	16.5	19.8
1937	18.2	17.6	19.6

1/ On basis of National Industrial Conference Board's income realized.

2/ On basis of Department of Commerce income produced.

3/ On basis of Colin Clark's national income for Great Britain.



A point frequently made when comparing the American and British situation is that taxes in the United States have been increasing more rapidly than in Great Britain, and also that the proportion of national income represented by taxes in the United States has been increasing more rapidly than in Great Britain. The point is true enough, of course, but it may be remembered that the business cycle in the United States has for the past several years -- since about 1931, and the abandonment of the gold standard in England -- been pretty completely "out of phase" with the British business cycle. The result is that Great Britain, at least in the past two years, has been working under boom conditions, and as early as March 1937, the British authority who has currently done the most work in the field of British national income, Mr. Colin Clark, took the position in an article for the Economic Journal that British national income was at its "climax" and apparently beyond a level continuously sustainable. Indeed, it should be noted that in 1937 the British national income was approximately 118 percent of its pre-depression high in 1929, whereas the United States was at approximately 85 percent of its 1929 high. The fact seems to be that in the last two years Great Britain has been working at more than optimum capacity; the United States at considerably less than optimum capacity. Were the United States working on the basis of a similar relation of national income to capacity, it would be producing something like 88 billions of national income; and it is probable that the United States has or can shortly attain a sustainable capacity of 85 billions.

Another point frequently made is that in the United States in the past few years there has been a heavy deficit in Governmental operations. The expenditures, in other words, have not been matched by taxes, so that there

is a deferred charge against public revenue in the form of debt service; and it is frequently assumed that the difference between tax revenues and expenditures represents the amount by which Government is, so to speak, "going in the hole".

To this point one or two observations should be made, one of which is that public expenses are by no means wholly financed out of taxes and borrowings. There is a whole series of receipts, as noted aforetime, from fines, penalties, rents, interest, earnings of general departments, earnings of public service enterprises, and special assessments, that represent non-tax revenues. These currently amount in the United States to something like 2 billions a year. Thus, if total Governmental expenditures in the United States are in the neighborhood of 17 billions for 1936 and total tax collections in the neighborhood of 10.4 billions, the gap between receipts and disbursements is not so large as might at first glance be supposed.

It is worth remembering, also, that the deficits of the past few years take on a somewhat different aspect when viewed in the light of the entire Governmental tax situation than when viewed in the light of Federal debt only. For instance, in the '20s, debts were increasing in the State and local category. From 1922 until 1933, indeed, State and local debts increased nearly 10 billions of dollars. In the succeeding years they have been stable, whereas the Federal debt has increased. The shift has naturally served to dramatize all issues connected with deficits, because the borrowing of State and local governments is hidden in the financial jungle that conceals their fiscal operations from close public attention. Had the Federal Government not incurred a deficit these past few years, moreover, it is almost certain that State and local debts would have had to increase

perforce. Such an observation does not, to be sure, prove that either the State and local governments were formerly or the Federal Government is now correct in borrowing; and it is true that total Government debts have in the years since 1929 increased about 20 billions of dollars to a level of approximately 53 billions, net. The total British debt is given for 1936 by the National Industrial Conference Board as £9,523 millions. In per capita terms the total debt in this country is \$430, and in Great Britain £202, which would be equivalent, let us say, to \$1,011.

No tabulation of figures for total expenditures in the United States and Great Britain, as contrasted with tax revenues, have been presented in this paper. Time has not been available to go behind the statistics in the United States and Great Britain to make certain that identical and comparable treatment is recorded in each country with respect to such items as retirement of funded and floating debt and inter-governmental transfer accounts of one sort and another. However, the National Industrial Conference Board gives the expenditure for all governments in the United States in the year 1937 as \$17 billions. Apparently this does not allow for net State and local debt retirements in the neighborhood of \$380 millions. An addition of expenditures for all of the governmental units comprising the United Kingdom -- the same governmental units that have heretofore been used in connection with tax collections -- seems to indicate a total expenditure of approximately £1,300 millions for 1936. This is about 28 percent of the national income. On the basis of income produced in the United States in 1936, our total expenditure was approximately 27 percent of the national income. These figures seem to check fairly closely with certain fragmentary data developed by the Twentieth Century Fund, which show (apparently for

1936) a per capita expenditure of \$133 in the United States and a per capita expenditure of \$123 in Great Britain. Measured against a per capita income in the United States of \$467, the per capita expenditure was 28.5 percent, and, in Great Britain, measured against a per capita income of \$406, the expenditure was 30.3 percent. To this should be added the point previously made, namely, that the United States in 1936 was working at a level of national income production far under its optimum capacity and far under 1929, whereas Great Britain was working its economy at a level even then well above 1929 and apparently approaching its optimum capacity.