Economics and Sociology
Iowa State College
Ames, Iowa

FOR YOUR INFORMATION:

This is the substance of a long letter which I sent to Time on July 12, 1942; in view of limitations of space I doubt very much that they can manage to print it.

A. G. H.

July 14, 1942

To the Editor of Time

When listing the alleged sins of the Congress of the United States the other day, you put a lot of stress on the failure of the Ways and Means Committee to come out for "effective taxation, which for all practical purposes means a sales tax." Now I can't be sure just what purposes you consider practical. But if you mean blocking inflation, you are over-rating the sales tax tremendously.

Consider the size of the inflation problem. As you mentioned on the same page of Time, Leon Henderson's office estimates the "inflationary gap"--that is, the excess of consumers' spending power over consumption goods supplies--at \$17 billion for the calendar year 1942. This may be high, but it is certainly not out of all proportion. Having just come to the end of a four-week bout with the statistics of national income, consumption goods supplies, taxes, savings, etc., I can assure you that the most optimistic assumptions that are anyway defensible cannot get the "gap" for the fiscal year 1942-43 (July-June) below \$11 billion. This allows for the effect of the 1942 revenue bill now in progress, the proposed additions to Social Security, the campaign to reduce installment debts, the normal effect of income increases in stimulating savings, and \$5 billion of savings in excess of normal. While the situation is very uncertain, the optimistic slant of those calculations is so strong that there is no chance they exaggerate the danger.

Now in the perspective of an inflationary gap of \$16 or even \$11 billion, what does a sales tax look like? According to official estimates made for the Ways and Means Committee, a 2% tax at retail would yield about \$1 billion, a 5% tax about \$2½ billion. Really to get inflation under control would take a minimum of \$10 billion of extra revenue--i.e., a 20% sales tax rate--and probably a good deal more. Gallup's poll shows that about a tenth of the people who favor a 2% sales tax balk at making it 3%. If you like far-fetched statistics, calculate how popular it would be at 20%!

In political terms, 5% at retail is the highest rate there is any prospect of getting. (The most drastic proposal with any support is for 4% at retail plus 4% of "manufacturers' excise"--equivalent roughly to 6% at retail.) But if you subtract the resulting \$2½ billion of revenue from the inflationary gap, the difference in the gap is scarcely noticeable. Even if we do adopt a sales tax, we have essentially the same problem that exists now.

Sales tax advocates are fond of trying to label their opponents as sentimentalists. In a sense this is true: one of the chief arguments against sales taxation is that it isn't fair to start the pinch on consumer spending with the poor man's bottom

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

dollar. But if all sentimental considerations were thrown out, the case against sales tax as an inflation remedy is still overwhelming on strictly "practical" grounds. The reasons:

(a) More than any other tax (except a tax on payrolls without any exemptions), sales tax favors wage increases.

(b) The war itself is undermining the base of the sales tax by shrinking the supply of consumption goods.

(c) A retail sales tax would call for an administrative effort big enough to carry out a much more effective income-tax reform.

(d) A sales tax levied above the retail level mixes badly with the enforcement of price ceilings. Retailers won't itemize to their customers a tax which is a percentage of wholesale price. To make separate adjustments in all retail ceilings would overburden the O. P. A. To make a blanket adjustment would breach the O. P. A.'s general policy, and would create windfalls for some retailers. If no adjustment at retail is made, the tax does not absorb consumer spending power, but falls largely on profits--that is, it turns into a messy way of collecting revenue the excess profits tax would otherwise get.

If the only objections to sales taxes are sentimental, why does Germany have much heavier war income taxes than we do, instead of boosting sales taxes to the skies? Are the Nazis just sentimentalists? Why does Canada coast along with her prewar sales tax rate while making increase after increase in income levies? Why is the English "Purchases Tax" so restricted in scope that in spite of its high rates it yields only about as much revenue as would a 2% general sales tax? There's only one answer to all these questions: The sales tax isn't what it's cracked up to be!

It is possible to block wartime inflation. Britain, Germany and Canada have done very well at it since 1939. Britain and Germany have much stronger price-control systems than we have, backed by a rationing system which covers almost everything consumers buy. Even so, both countries find it necessary to keep down inflationary pressure by collecting in taxes about half the money their governments spend. Canada has a price-control system more like ours, and like us has still no general rationing system. Till recently Canada has been covering about half her government expenditure from revenue and she laid plans in March to do so again for her 1942-43 (April to March) fiscal year. But in the last few weeks she has strengthened her budgetary position by a sharp tax increase, and into the bargain has introduced the world's most drastic compulsory savings program.

In contrast to these belligerent countries with a record of success in blocking inflation, the United States is trying to bluff its way through with a new and flimsy price-control system, next to no rationing machinery, and taxes raising only a quarter of government expenditures. When Britain and Germany need both rationing and drastic taxation, how can we expect to block inflation without either?

When the facts finally bite their way through our crust of wishful thinking, we shall have to set up both a lot of rationing machinery and a revenue machine which can absorb a large share of the excess spending power in taxes, compulsory savings, or a mixture of the two. On the revenue side, we could scarcely do better than to adapt the new Canadian system. This would increase the revenue yield $9 or $10 billion above the present proposal of the Ways and Means Committee--considerably more if we backed it up with a campaign to raise the proportion of tax liabilities reported.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Since the Treasury and the press are still pretending that wishes are horses--you're doing the same by dressing the sales tax up as a panacea--what we do in 1942 is sure to be inadequate. The best we can hope for at the moment, apparently, is a line of policy which will open up the possibility of solving our problems when we wake up. By this standard, the Ways and Means Committee has not done so badly. It has taken steps toward putting income tax collection on a current basis, which is a necessary preliminary to effective taxation; and in the face of the election it has made people realize that the war necessitates lower exemptions and higher rates. Blame the Committee if you like for leaving the exemptions too high, the rates of the first few hundred dollars of taxable income too low, and collections too slow and incomplete. But don't blame them for refusing to rush up the sales tax blind alley.

Yours for facing facts,

Albert Gailord Hart
Associate Professor of Economics

P. S. Here are the salient figures on the "gap," in billions.

	1941		1942-43, March, 1942 dollars	
	1941 dollars	March 1942 dollars	My estimate	Alarmist estimate
1. Income received by consumers	$94.5		$119	$125
2. Less personal taxes	6.2		11	10
3. Disposable income	$88.3	$95.9	$108	$115
4. Normal savings	10.4	11.3	14	16
5. Spending power	$77.9	$84.6	$94	$99
6. Consumer goods supplies:				
a) Durables	$10.3	$11.2	3	2
b) Non-durables (including services)	65.5	71.2	68	65
c) Total	$75.8	$82.4	$71	$67
7. Excess spending power	$ 2.1	$ 2.2	$23	$32
8. Offsets: Reduction of spending by:				
a) 1942 revenue bill	0.0	0.0	2½	2
b) Added Social Security	0.0	0.0	3/4	½
c) Reduced installment debt	0.0	0.0	4	2½
d) Abnormal savings	2.1	2.2	5	3
e) Total	$2.1	$2.2	$12	$8
9. Excess remaining	$0.0	$0.0	$11	$24

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis