



# the LEDGER

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JUL 1979

## economic education newsletter

The purpose of the following article, which describes the economic principles of taxation, is to provide students with an objective framework for analyzing and discussing an issue which figures frequently in today's news. Follow-up activities are suggested at the close of the article.

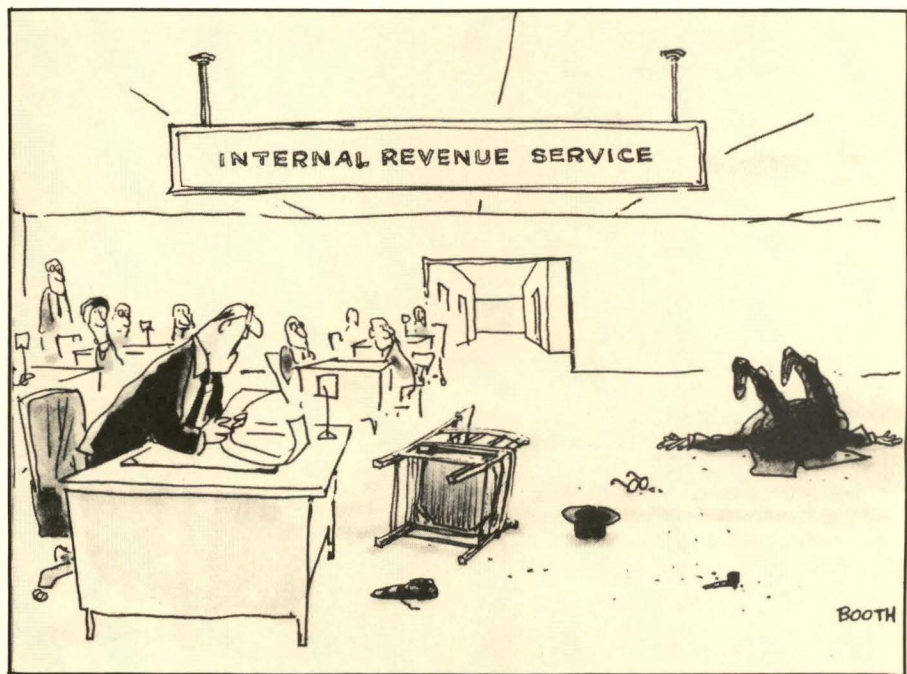
Since colonial times, when the issue of "no taxation without representation" sparked the American Revolution, taxation has always aroused controversy in our nation. In recent months, for example, we have heard much about a "taxpayers' revolt," which was exemplified by the overwhelming passage of Proposition 13 by California voters.

Proposition 13 is an amendment to the California constitution which drastically limits the property tax in that state. Since its passage last June, other states have considered or passed similar measures, and the movement for tax relief has extended to include other taxes as well as the levy on property.

American citizens do pay a great number of taxes. Federal and state governments tax personal and corporate incomes as well as inheritances. State and local governments levy sales taxes; the federal government also taxes the sale of certain products, like tobacco and liquor. State governments collect licensing and user fees, such as a tax on those who use highways. Local governments tax property.

In all, Americans paid about \$600 billion in taxes in 1977. Some people feel that taxes are too high while others disagree. One's view of what constitutes a fair tax system is ultimately a question of one's social values; decisions about taxation are thus made through the political process. Economics, how-

## The Economics of Taxation



*"Other folks have to pay taxes, too, Mr. Herndon, so would you please spare us the dramatics!"*

Drawing by Booth; ©1972  
The New Yorker Magazine, Inc.

ever, provides concepts which enable one to analyze the issue more clearly and logically.

### PURPOSES OF TAXATION

What is the economic nature of taxation? Most simply, taxes are the price we pay for goods and services purchased collectively through the government. When individuals and businesses pay taxes, they lose the opportunity to spend the money on their private wants, such as buying a car or investing in a new plant. Instead, tax revenues are used to

finance the public goods and services provided by federal, state and local governments. Taxation is thus the means by which economic resources are transferred from the private to the public sector.

In the last half century, the American people have chosen to purchase more and more of the national economic output collectively through tax revenues. Before World War I, government purchasing of goods and services amounted to about eight percent of the gross national product (GNP), our total

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economic output. Today about 21 percent of GNP is purchased by federal, state and local governments.

It is important to note that although the share of GNP purchased by the government has risen, the amount of goods and services actually produced by the government has not increased appreciably. The majority of the goods and services bought by the government are still produced by private enterprise.

What type of goods and services does the government buy? In general, government goods and services are those which, for one reason or another, are not likely to be purchased by individual buyers in the quantities considered socially desirable. Examples are national defense, law enforcement, highways, space flights, conservation, fire protection and public education.

Consider the example of public education: the entire society benefits from better-informed citizens, yet if each family should decide independently whether or not to buy schooling, some would choose not to. As a result, public education is provided collectively by local governments.

While the primary function of taxation is to raise revenue to finance public goods and services, the tax system is also an instrument of social policy. For example, 46 percent of the federal government's tax receipts are spent on transfer payments, which are given to various individuals, such as the elderly and the poor, to spend on their private wants. Examples of transfer payments are the food stamp program, welfare payments and social security benefits. Transfer payments result in a redistribution of income among citizens: in essence, the government takes money from some and gives it to others.

Taxation is a tool of economic as well as social policy. By raising or lowering taxes, the government can influence the level of total spending and investment in the economy. If the economy is operating at less than full capacity, a tax cut will tend to stimulate economic activity by making more money available to consumers and businesses for spending and investment. If the economy is undergoing an inflationary boom, a tax increase will tend to decrease infla-

tion by reducing the amount of money available for private spending and investment. Variations of taxes and public expenditures make up the government's fiscal policy to regulate the economy.

## FAIRNESS IN TAXATION

Over the years, two major concepts of fairness in taxation have evolved: the benefit principle and the ability-to-pay principle. Both principles are evident in our tax system.

The benefit principle dictates that people should pay taxes according to the benefits they receive from government programs. The benefit principle is applied, for example, to highway building, which is financed by gasoline taxes and highway-user fees, such as tolls.

The other standard of fairness, the ability-to-pay principle, calls on the wealthy citizen to pay more in taxes than the poor citizen. The principle further provides that those who have the same income should pay the same amount in taxes. The federal income tax, which is lower for low-income groups than high-income groups, is an ability-to-pay tax.

## TYPES OF TAXES

Taxes can be classified as either regressive or progressive. A regressive tax takes a larger portion of total income from low-income taxpayers than it does from high-income taxpayers. A general sales tax is an example of a regressive tax: since an individual (or family) can eat only so much, spending (and therefore taxes) on necessities such as food does not vary as much as income does.

A progressive tax takes a smaller portion of total income from low-income than high-income groups. The personal income tax, through which the federal government collects nearly 45 percent of its total tax receipts, is a progressive tax. The existence of various legal means of tax avoidance, called tax shelters, diminishes to a degree the progressivity of the income tax. An example of a tax shelter is the treatment of a capital gain, which is the income resulting from selling an asset, such as stock, at a price above

its original cost. Capital gains are taxed less heavily than is ordinary income.

Whether a particular tax is regressive or progressive can be determined only if its final incidence, or who ultimately pays the tax, is known. The burden of a tax does not always remain with the person or business upon whom or which it is levied. The corporate income tax, for example, may be shifted either to consumers in the form of higher prices or to employees in the form of lower wages. Economists devote much effort to studying the final incidence of taxes, which is often no easy matter to determine.

**To sum up, the American tax system is a blend of the various types of taxes discussed above: some taxes, like the sales tax, are regressive; others, like the income tax, are progressive. Our tax system is also a compromise between the benefit and the ability-to-pay principles of fairness. Taxation not only pays the government's bills but also is a tool of economic and social policy. The tax structure is constantly evolving according to decisions made by the electorate and their legislative representatives.**

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## FOLLOW-UP ACTIVITIES

- Keep a file of newspaper and magazine articles that deal with taxation.
- Investigate the tax system of your local community. What are the sources of revenue? On what programs are revenues spent? Are residents satisfied with the tax system? If not, what reforms are proposed?
- Write to the Internal Revenue Service for copies of this year's tax forms and schedules. While waiting for the forms, investigate the current salary level for a job in which you are interested. (Contact local employment agencies or look through the help-wanted section of a newspaper.) Once you have received the tax forms, fill them out as if you held the job which you researched. Compare the amount of taxes you would pay if single, if married with no children and if married with two children.



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## Innovative Classroom

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"Artful Toil: Artistic Innovation in an Age of Enterprise" is the title of the Brockton Art Center's current exhibition designed to enrich classroom units on the industrial revolution. The exhibition documents the transition from hand craftsmanship to machine production which transformed American craft industries during the 19th century.

The pieces on display, loaned by the Museum of Fine Arts, Boston, include prints, pottery, sculpture, glass, silver, textiles and furniture of 19th century America. The format of the display encourages students to explore the impact of industrialization: objects produced by machine are exhibited alongside similar items manufactured by hand.

Technological innovation made it possible to supply large quantities of artistic items that, for the first time, were within the price range of nearly everyone. As machines and assembly-line production methods



*Courtesy of Museum of Fine Arts, Boston  
This shelf clock, on exhibit at the Brockton Art Center, was manufactured by Aaron Willard of Boston in the early 1800s. The clock's movement was produced by machine; the ornamentation was painted by hand.*

were introduced in the various craft industries, the volume of goods produced soared while labor costs and manufacturing time decreased. The exhibition thus provides a good picture of the ornamentation and comforts brought to the average household by the industrial revolution.

The Brockton Art Center's Education Department provides a teacher's guide to the exhibition, which includes historical information about technological innovations in 19th century arts and crafts, suggested classroom projects, a glossary of pertinent terms and a bibliography. In addition, teachers may arrange to have a representative of the Education Department present a 30-minute orientation slide show to students before they visit the museum. During the museum visit, volunteer guides are available to accompany students while viewing the collection.

A visit to the exhibition is free for groups from the Brockton Public Schools and costs \$10.00 per class for other groups. Teachers may schedule a class trip by writing to Carol Heepke, Education Department, Brockton Art Center, Oak Street on Upper Porter's Pond, Brockton, MA 02401, or by calling (617) 588-6000.

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## New England Update

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### MAINE

From mid-January through mid-March, the **Maine Council on Economic Education** will conduct an in-service training program at the Dexter Primary School. The program will focus on teaching about the local economy.

### MASSACHUSETTS

Daniel W. Gibbs, previously business manager of the Silver Lake Regional School District, is the new director of the **Economic Education Council of Massachusetts**.

Courses on basic economic principles for elementary and secondary teachers will begin during January at the following economic

education centers: Stonehill College, Salem State College, South-eastern Massachusetts University, Worcester State College, American International College and Boston University. Consumer education courses will also be offered at the following centers: Stonehill College, Salem State College, American International College and Tufts University. For more information, call the council at (617) 628-5000, ext. 539.

### RHODE ISLAND

During the spring semester, the **Rhode Island Center for Economic Education** will offer five courses and in-service training programs on teaching economics for elementary and secondary

teachers. Times and locations have not yet been arranged; if you are interested, contact the center at (401) 456-8037.

### JOINT COUNCIL

The **Joint Council on Economic Education** has announced that entries are now being accepted for the 1978-79 International Paper Company Foundation National Awards for the Teaching of Economics. The competition is open to elementary, secondary and college teachers; the deadline for entering is July 15, 1979. To obtain an application, write to Economic Education Awards Program, Joint Council on Economic Education, 1212 Avenue of the Americas, New York, NY 10036.

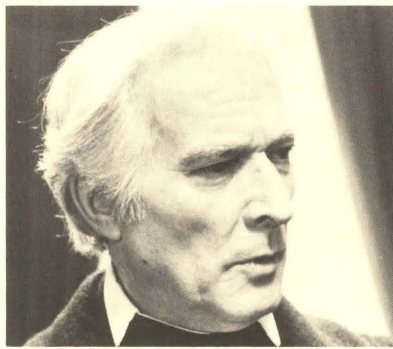


# Multi-media

**McCulloch v. Maryland**, produced by WQED of Pittsburgh. This 16mm color film highlights the political controversy surrounding the early history of central banking in the United States. The film dramatizes the landmark Supreme Court case, decided under Chief Justice John Marshall, which established the federal government's constitutional right to charter a central bank.

In 1816, five years after the charter of the first central bank had expired, Congress chartered the Second Bank of the United States to regulate the nation's money and credit. The film opens in 1818, when the state of Maryland sued James McCulloch, an officer of the Second Bank, for refusing to pay a state tax levied on the bank. The Supreme Court held that the states do not have the right to tax the operations of the federal government and further ruled that, in creating a central bank, Congress chose a "necessary and proper" means to meet its constitutional responsibility of promoting a healthy national economy.

A teacher's guide accompanies the 36-minute film, which is appro-



Chief Justice John Marshall (Ed Holmes) delivers the unanimous opinion of the Supreme Court regarding the constitutionality of central banking.

From "McCulloch v. Maryland," courtesy of WQED, Pittsburgh

priate for high school students. To order the film on a free-loan basis, write to Association Films, 410 Great Road, Littleton, MA 01460; to rent or purchase the film, write to National Audio - Visual Center, Washington, DC 20409.

**Neighbors: Conservation in a Changing Community**, produced by the National Endowment for the Arts. Urban renewal in Boston's South End is the subject of this 16mm color film. By exploring the concerns of 12 neighbors, the film illustrates the value of urban renewal strategies such as neighborhood preservation, renovation of existing housing and problem-

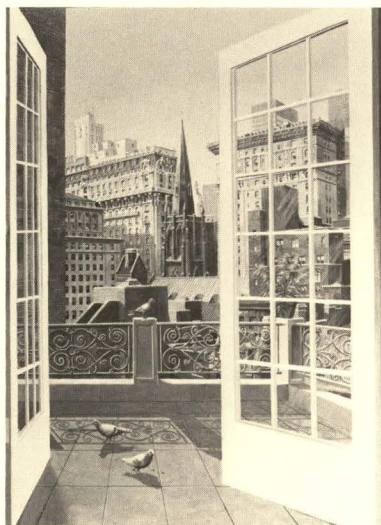
solving by local residents. The film is a useful resource in teaching about housing markets and urban economic problems. If it is shown to students who live in a suburban or rural community, the teacher might invite a person who has lived in a neighborhood like the South End to speak with the class after viewing the film.

The 28-minute movie is appropriate for high school students and may be ordered on a free-loan basis by writing to Association Films, 410 Great Road, Littleton, MA 01460.

**To Your Credit**, produced by Baker Productions, Inc. for the Federal Reserve Bank of Philadelphia. This 16mm color film provides an introduction to consumers' rights when applying for and using credit. The movie dramatizes a series of credit transactions to illustrate how regulations such as Equal Credit Opportunity and Truth-in-Lending protect the consumer when borrowing. The movie emphasizes the individual's responsibility to know his or her credit rights and to pursue a legitimate grievance.

The 15-minute film is appropriate for junior high and high school students and may be ordered on a free-loan basis by writing to Bank and Public Information Center, Federal Reserve Bank of Boston, Boston, MA 02106, or by calling (617) 973-3459.

## Fed Update



"View of 55th & Fifth," by Richard Haas

● "New England Connections," an exhibition of paintings and drawings by 35 contemporary

artists who have lived or worked in New England, is now on display at the Boston Fed. The exhibition is open to the public, at no charge, from 10:00 am to 4:00 pm, on each business day until January 31. If you would like to arrange a guided tour, contact Sally Fitzgerald at (617) 973-3454.

● A brochure is now available which lists the various educational programs offered by the Boston Fed on topics in money, banking and economics for elementary, secondary and college students. The brochure describes how to arrange for participation in these programs and/or a tour of the Boston Fed. To obtain a free copy write to Bank and Public Information Center, Federal Reserve Bank of Boston, Boston, MA 02106, or call (617) 973-3459.

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