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RESEARCH REPORTS

Coming Effects of Current Events

The President's message to Congress recommending higher taxes, and the passage of the Social Security Bill by the Senate were the important events in Washington during the past week. Business trends in general throughout the rest of the country were mildly favorable, indicating less responsiveness to developments at the capitol than might have been expected. However, the new tax proposals in particular are of sufficient importance to warrant detailed analysis in this bulletin.

Mr. Roosevelt's tax suggestions include three major features for which he has asked immediate consideration and two additional recommendations for later action. If the President expects adoption of his first three points at this session, he is looking forward to a much later adjournment than the general public hopes for. Even if the new taxes are not enacted at this session, it seems certain that as part of a general share-the-wealth program, they will be issues during the next election.

Larger Inheritance Taxes

It is probably true that certain taxes now levied have accelerated the accumulation of large fortunes. It is even more likely that the absence of taxes which perhaps should have been levied has made easier unearned gains at the public's expense. Unfortunately, Mr. Roosevelt's proposals do not seem well calculated to better the situation. It is a question whether an effort to redistribute wealth more equitably by action along the lines suggested by him would not create as many injustices as it cured. In any event, questions of vital importance are raised which seem to have been given little or no consideration.

In the first place, heavy inheritance taxes would force the sale of a closely held family corporation in order to meet death duties. In many instances, there would be no market for the stock except at sacrifice prices. No doubt, many business men would realize this possibility and take steps during their lifetimes with a view to changing the situation. It is possible that by setting up special trusts which could hold the common stock of such a company, gradually selling out to the principal executives thereof, much good might result. The public would benefit by preservation of the business as a going concern and especially by the continuation of control in the hands of the active management. Such an arrangement would probably be advantageous to the heirs of the founder of the business inasmuch as they could invest the proceeds from the sale of stock, thereby obtaining adequate diversification and a safer investment for the widow and other dependents involved.

On the other hand, it is conceivable that high income taxes might take control from the man best equipped to exercise it. The son, or brother, or other business associate of the decedent, if he happens to be the beneficiary involved, may be the most suitable individual to exercise control of the business. Of course, this assumes that it is in the general public interest to have businesses continue active and healthy if possible.

Mr. Roosevelt flatly asserted that "a tax upon inherited economic power is a tax upon static wealth, not upon that dynamic wealth which makes for the healthy diffusion of economic good." Although this is the kind of statement which such men as Senator Long and perhaps Father Coughlin welcome with delight, it is seriously erroneous in one important respect. Wealth which can be inherited may be either of two kinds: (1) a special privilege or monopoly right; or (2) ordinary capital such as the buildings and machinery which constitute the physical assets of most businesses. An example of the first would be title to coal deposits in Pennsylvania. The title of ownership would be a monopoly privilege entitling the holder thereof to demand a share of the community income in exchange for use of the natural resources inherited. Perhaps the most obvious example of the special privilege form of inheritable economic power is to be found in the land holdings of the Astor family in New York City. To the extent that the inherited wealth of these individuals consists of the site value of land alone, it is a monopoly privilege rather than capital in the ordinary sense. (We are here using the popular meaning of "wealth" obviously used by Mr. Roosevelt.)

Capital, in the economic sense (which includes that part of man-created wealth used for the production of more wealth) cannot rightfully be classified as "static wealth." Unless capital is carefully conserved, wisely maintained, prudently replaced (for example, as machines become obsolete), and efficiently co-ordinated with the other factors of production, it cannot result in the production of new wealth thereby producing income for the community and the owner of the capital. In other words, he who inherits capital (it is necessary to emphasize again the strict economic definition) has received dynamic wealth and can only hope to retain it by using it efficiently in production, a process which is

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ordinarily considered as making for "the healthy diffusion of economic good."

Those who inherit special privilege of one kind or another occupy a different position, however. They need only stand upon their rights, as the phrase goes, in order to collect a portion of the community income. Through the ownership of monopoly privileges essential to cooperative economic activity, they are in a position to force the general public to "stand and deliver." It will perhaps be admitted that inherited economic power of this class is static because it obviously involves no capacity for adding to the community income but only the power of taking from it, in effect levying a tax upon it.

Although there is little in Mr. Roosevelt's proposals with which we can agree, his suggestion that the proceeds from inheritance taxes should be applied to a reduction of the national debt is eminently sound. In the first place, income received by the Government from such a source should not properly be considered as available for current expenditures because it would represent the liquidation of the nation's capital assets. In the second place, by turning such funds back into the capital market via redemption of Government bonds, there would be a tendency for funds seeking investment to balance the securities pressed for sale as a result of the liquidation of large assets.

Income Taxes

Mr. Roosevelt's arguments for higher income taxes likewise seem seriously defective in that they fail to differentiate between earned and unearned income. The case of Mr. Ford offers a striking example for purposes of discussion.

That Ford is one of the greatest inventive and organizing geniuses of all time will hardly be denied. Early in life, he demonstrated the possibility of future greatness by his ability to create a new form of wealth, and throughout the years he has continued to exhibit ability to use the income received primarily for satisfying the desires and needs of the public for cheap transportation. Many of his ideas seemed absurd when first tried. Certainly no socialistic and bureaucratic government would ever have embarked on the ventures which have been the stepping stones of his success. The net result of leaving in Mr. Ford's hands most of the income he obtained from year to year has been to bring measurably nearer the day when every man would have his own private means of transportation.

On the other hand, consider the case of the man who has inherited a gold mine. He is under no compulsion to exert any effort at all. The public will seek him out and offer to pay for the privilege of working the ore bequeathed by some ancestor. By merely standing in the path of those who must have natural resources whereon to apply their labor, he may take a toll of the community product. It cannot be argued that permitting him to keep this income results in general economic benefits and raises the standard of living. True, he may use part of the income thus received as capital but there is no assurance that he has capacity for using it wisely and it would be an extraordinary coincidence if he happened to have the business genius of a Ford.

It is seen, therefore, that incomes should not necessarily be taken for public uses merely because they are large. Their very magnitude may be the best possible proof that the recipient thereof is most capable of using them wisely in the general public interests, far more wisely than any politicians are likely to be. We conclude that Mr. Roosevelt's suggestions, so far as income taxes are concerned, are dangerously naive. If adopted, the result might be to handicap the small proportion of business geniuses upon whom the country must rely for large scale progress in raising the standard of living.

Corporation Taxes

In his discussion of corporation taxes, Mr. Roosevelt presents the new theory that corporations receive benefits from the community in proportion to the size of the corporation. If this is the case, how does it happen that the railroads are so heavily taxed in the various states? Why is not the United States Steel Corporation much more profitable than some of the smaller companies in that business (in proportion to invested capital)?

Presumably, when he says that the large corporations receive larger community benefits, Mr. Roosevelt means a larger portion per dollar of capital involved. Only this could justify discriminatory taxation such as he suggests. Just why he should believe this to be true is not apparent, and it would indeed be difficult to prove the opposite to be the case. However, from an intimate knowledge of the affairs of numerous corporations, we are inclined to doubt the President's premises. At least, he has not proved his point and it may be wise to investigate before acting.

Believing that the final form of the Social Security Bill may be known in the near future, we are postponing discussion of it until next week.

Supply, Demand, and Prices

The New York *Times* weekly index of business activity, which had been declining since February, has risen nearly 3% during the past three weeks. This does not mean that physical volume of production has increased, because the normal seasonal trend is downward. However, it does suggest that the summer recession this year is to be somewhat less than usual.

Supply

Electric power production increased its percentage gain over the corresponding period of last year to 4.6%.

A further slackening in steel production has occurred, in line with normal expectations for this time of year. Railroad freight carloadings continue to show increasingly favorable comparisons with 1934. This has been in part due to increased movements of bituminous coal in anticipation of labor disturbances.

Demand

The sustained demand for goods is not surprising in view of the rapid increase in the volume of demand deposits. Member banks of the Federal Reserve System, having over 80% of the country's checking accounts, report an increase of $1,647,000,000 from January 2nd to June 12th of this year.

Prices

Wholesale commodity price indexes, for which data have become available since the demise of the NRA, have shown few indications of serious declining tendencies.