
CHAPTER XI

THE ECONOMIC EFFECTS OF THE DISBURSEMENT AND COLLECTION OF PUBLIC-AID FUNDS

By 1940 public-aid expenditures had come to occupy an important place in the national economy, amounting to approximately 5.8 percent of the national income and accounting for 24.5 percent of all governmental expenditures. Such large-scale financial operations could not have failed to exert both direct and indirect economic influences. The present chapter will inquire into the nature of their influence on the course of economic recovery and into the appropriateness of the specific taxes used, in relation to the major objectives of public-aid policy.

Forces Affecting Recovery

Evaluation of the broad effects of the disbursement and collection of public-aid funds upon the operation of the economy as a whole necessarily depends upon the diagnosis of the causes of the depressed conditions which characterized the last decade. Unfortunately there is no unanimity among economists in explaining the depression.

According to one interpretation, the depression can be accounted for in terms similar to those by which earlier depressions were explained; *i. e.*, by reference to the "cycles" or "regular" ups and downs in business development believed to be an inevitable concomitant of economic growth. The course of economic activity, according to this view, runs somewhat as follows. In prosperity periods credit expands; purchasing power is channeled into the creation of new productive facilities; and consumers' purchasing power increases because more labor is employed at higher wages. But sooner or later this increase in production must press against the limits of available productive resources. Increasing interest rates and costs of labor and materials limit further expansion.

Economic growth, according to this analysis, is not merely slowed down to the bounds of available resources. This deceleration of expansion inevitably develops into a temporary set-back, because during prosperity many enterprises have been overdeveloped and prices of labor or materials have increased more than a long-run equilibrium would justify. A general economic housecleaning is needed from time to time to correct disproportions which have crept into the price system and to eliminate those business ventures which are not efficient or were established through a miscalculation of the market. Unfortunately a cessa-

tion of economic growth in one area extends in widening circles to the whole economic sphere until some new sort of balance is reached, at which time a contrary trend can ensue.

It is thus argued that the process of decline in activity continues until an oversupply of capital and labor so reduces interest and wage rates that low costs of production provide a stimulus, initiating a new period of expansion. Thus the stage is again set for an upswing. In these patterns of development, depression has the positive function of a periodic readjustment of prices and costs. It is not agreeable, but is nevertheless necessary. Such a periodic housecleaning is regarded as the price which society must pay for economic progress in a system of free enterprise.

This interpretation of the nature of the recent depression is based upon certain assumptions. Two of these assumptions are of vital importance: (1) That there is never an excess of any good unless its price is too high; and (2) that low prices can be expected to make this unlimited demand effective, regardless of the economic and social climate. It would follow from these assumptions that an ample capital supply expressing itself in low interest costs, coupled with low wage rates, would necessarily stimulate an amount of private investment sufficient to employ all productive forces, labor as well as plant. The presence of idle resources, and specifically unemployment, would thus be merely an indication that the prices of capital and labor are too high.

The application of this analysis to a consideration of the economic effects of the spending and collection of public-aid funds is clear. If the root cause of the continued depression is an undue rigidity of wage and interest rates, then public-aid policy may have to bear some share of the responsibility, if it can be shown that public-aid payments have contributed to the maintenance of wage rates. From this point of view, it would follow that public-aid policy helped to prevent the housecleaning process from following its course. In the humanitarian desire to protect people from this disagreeable but wholesome process, government unwittingly paralyzed the economic forces of recovery.

It must be admitted that public-aid payments have helped to put a floor under the general wage level, in the sense that in their absence the wage level might

have sunk even more sharply.¹ Yet there are serious grounds for questioning whether the social structure could have withstood so drastic a cure. For signs of unrest and social disturbance were already evident (and in some areas were a cause of grave concern) in the years prior to the development of extensive public-aid measures in 1933. Indeed, it is not too much to say that fear of the disruptive influences caused by discontent with privation and long-continued idleness was one of the spurs to the development of more nearly adequate public-aid programs.

The years between 1929 and 1933 were characterized by sharp wage reductions. Their failure to stimulate revival had already led to speculation whether larger reductions would not have reduced purchasing power further and accelerated the downward spiral of the depression long before they would have stimulated business through lower costs, lower prices, and enhanced real purchasing power. Quite apart from the experience of these years, however, there are more fundamental reasons for questioning the assumption basic to the view that public aid hindered recovery by maintaining the general wage level—that low prices stimulate demand regardless of the prevailing social and economic climate.

The influence of the prevailing economic and psychological environment is indeed often conceded even by those who adhere most persistently to the cyclical interpretation of the recent depression. Thus the failure of the economy to expand, despite sharp declines in interest and wage rates and other cost factors, has not infrequently been attributed to the undermining of business confidence by government controls and regulations and by the prospects of increased taxation.

Once it is admitted that psychological factors influencing producers' expectations play a role in determining the extent of business activity, the relationship between low costs and economic revival calls for reconsideration. For insofar as the assumption of the speedy responsiveness of producers to low costs is based upon observation of past behavior, the question arises whether this behavior was not conditioned at least in part by other factors as well, such as expectations of demand. It is as if a rower who has attributed the performance of his boat to his own prowess with the oars as he sped downstream gradually discovers that there are hindrances when his course takes him upstream. If demand expectations have played a prominent role in earlier periods, it is necessary to determine

the character of the influences to which they were responsive and their persistence into the present. If these influences no longer operate in full force, the preceding diagnosis of the nature of depressions may be misleading when applied to the present era. A broad survey of economic developments during and since the nineteenth century does indeed suggest that there may be justification for this point of view. More specifically, *the evidence suggests that expectations as to the extent of demand play as great a role in determining the degree of business activity as the level of costs. Indeed, during the last 10 years the influence of demand expectations appears to have been predominant.* Furthermore, it seems likely that the economic environment of recent decades was one less conducive than that of the nineteenth century to a sense of optimism on the part of producers and investors.

The change in the underlying trend of economic development has been described in many different ways. The theories of "oversaving," of the "mature" economy, of "secular stagnation" are all more or less successful attempts to grasp a fundamental alteration which has been going on in recent decades. This change in the whole economic climate of the world can neither be dated at a specific day or year nor related to a single set of factors, despite frequent attempts to do so. Nor can it be assumed that this new phase of economic development is a definitive phase and that no further vicissitudes need be expected. On the contrary, many facts seem to indicate that the economy may be in a transitional period which may lead to a new era of expansion, if the market mechanism is supported by appropriate government policies.^{1a}

The theory of the "maturing" of the economy has often been misinterpreted as attributing the stagnation of the thirties to a saturation of consumer demand or an exhaustion of the potentialities of development. Maturity should not be confused with senility. With one-third of the nation ill-housed, ill-nourished, and ill-clad, the talk about saturation does not make sense. The real problem is of a different nature. *The specific historical combination of factors which facilitated the spectacular economic expansion of over a century has changed. There still are wide opportunities to increase productivity and raise the standard of living. But the patterns of development must be revised in line with a different historical combination.* It is not possible to describe and analyze here all the changes that have taken place in the world economy as well as in the domestic scene. Only a few of the most significant developments can be mentioned.

¹ See ch. XII for a discussion of the specific instances in which the nonavailability of public aid might have stimulated acceptance of employment at low wage rates. But it should also be noted, as shown in that chapter, that in other cases the availability of supplementary public aid served to depress wage levels by making it possible for workers to accept employment yielding wages less than enough for maintenance.

^{1a} See chs. XVII and XVIII below for further discussion of these policies and of their relationship to policies and programs in the field of public aid.

The nineteenth century was characterized by a rapid economic expansion facilitated by the interplay of many factors, all of which operated to create in the minds of producers an expectation of expanding demand. It was a period in which the development of new areas for the production of food and industrial raw materials coincided with the development of industrial centers in Europe, which absorbed the product of the new raw-material areas and in turn supplied the growing demand of these areas with an ever-increasing volume of manufactured goods. This coincidence between the spectacular development of new resources and a similarly spectacular development of demand from a rapidly increasing population was paralleled by a further coincidence between increasing savings and a swelling need for capital. Capital was required not only for the building of industrial centers but also for the development of new areas, especially for constructing means of communication in these regions.

The growth of the new regions resulted in increasing land values, part of which were monetized by credit and transformed into consumption. This was one of the processes which resulted in the absorption of savings over and above the savings absorbed by physical investments. The limit of expansion was set only by the limits of capital supply.

With a slowing down in the growth of population and a rising level of the standard of living, the demand for staple foods decreases in proportionate importance. In addition, with progressive techniques, the demand for industrial raw materials does not expand in proportion to the production of finished goods. An electric dynamo, for instance, requires for its production much less coal, iron, and steel today than did a dynamo of the same power two generations ago. The development of new areas started mostly with the production of staple products of fields and mines. With the relatively declining demand for these products, one of the main stimuli to economic expansion was cut off. This altered demand situation, rather than any alleged exhaustion of available land, is responsible for the phenomenon called the "closing of the frontier."

Technical developments are going on at a rate never experienced before. But their effects on the total capital supply are declining. The invention of the railroad brought in its wake the creation of several new industries and absorbed a high proportion of the capital supply during several decades. The perfecting of commercial airplane transportation, at least as spectacular as that of the railroad from a technical point of view, has had only limited direct and indirect effects on the demand for capital.

Modern developments not only affected the composition of demand and modified the force of technical

developments but also changed business organization and even the incentives to which business enterprise responded. Under the pressure of competitive investment in many lines of production, investment in new facilities had formerly often preceded demand. Sometimes demand grew so quickly following investments that all facilities could be operated at a profit; in other cases old investments were rendered obsolete by the new; sometimes even the new investments were proved failures. Competitive investments frequently implied a waste of capital that helped keep it relatively scarce. This "waste," however, contributed to the vigor of expansion. In the present period, part of the competitive struggle has been eliminated or mitigated by industrial integration and concentration. New investments are made only after careful study of the existing and potential market for the whole industry, including surveys of the possible expansion of competing corporations. "Administered investments" avoid much waste of capital but also curb the vigor of economic expansion. *In general it can be said that today private investment increasingly follows an already visible demand, while in the earlier period it was significant that investments often anticipated and thereby created a future demand.*

As average incomes rise, the demand for capital at most increases in proportion to the increase in incomes. Total savings available, however, tend to grow faster than does the income itself because the ratio of savings to income rises with the level of income. Thus it follows that, as total and average incomes go up, savings tend to increase faster than the investment demand for savings. This explains the basically "deflationary" trend in the modern economy which makes it difficult to attain or to sustain full operation of all resources by the automatic working of the market forces alone.

The changes in the supply-demand situation with respect to investment and savings took place very gradually over a period of many decades. But the force of this development cumulated and struck all at once. Economic difficulty probably would have occurred earlier if the World War of 1914-18 had not created an enormous investment demand during the war period. In the postwar period European reconstruction, the backlog demand for housing, public utilities, public improvements, and modernization of plant postponed during the war, all created an extraordinary demand. In the "New Era" period the speculative boom resulted in increasing stock values, part of which were monetized in the same fashion as the increasing land values of an earlier period and resulted in a high level of luxury consumption and an extraordinary absorption of savings. The expansion of consumer credit had a similar influence. But all these

developments could offset the fundamental disproportion in the economy only temporarily. Once they petered out, the boom collapsed.

The above interpretation of the present phase of economic development leads to an explanation of the depression of the thirties fundamentally different from the purely cyclical explanation. Recovery was not hampered by any lack of capital nor were investments made unprofitable by excessive costs of production. Most of the conditions which are requisite for recovery, according to the cyclical explanation, were then present. Yet recovery, in the sense of sustained employment of all resources, did not come. *It seems difficult not to conclude that recovery failed to materialize because the necessary stimulus to resumption of productive activity required in the changed environment and economic climate—evidence of renewed demand—was not present and in its absence low costs alone were an insufficient incentive.* This diagnosis of the depression gives an entirely different background for the analysis of public-aid programs than did the cyclical explanation. An inquiry into the effects of public-aid policy upon recovery becomes a problem of determining the extent to which the combined programs led to a net increase in effective demand through expansion of mass purchasing power.

Influence of Public-Aid Disbursements and Collections on Purchasing Power

All the various elements in the public-aid programs have a common quality in that they put money into the hands of individuals in the low-income brackets. (The only exceptions are relief grants in kind and services to the underprivileged.) This holds true for the most part in general relief, in the various assistance programs, in work relief, and in social-insurance disbursements. It seems a fair assumption that most public-aid money is spent by recipients more or less promptly on consumer needs, although there are certainly cases in which the public-aid recipient uses some of his money to pay off a debt, so that the money may be withdrawn from circulation before it can affect active purchasing power and employment.

In this respect public aid differs from other parts of the Federal emergency program. Some parts of the aid to agriculture and even more of the aid to home owners and business enterprises were used more largely to pay off or convert debts. These forms of aid strengthened the capital and credit structure of the country but contributed less directly to sustaining active purchasing power during the depression.

On the whole, *the magnitude of public-aid spending in the depression years was such that it may have*

substantially contributed to the consumers' expenditures of these years. In the 8 years 1933-40, public-aid expenditures of all kinds, Federal, State, and local, totaled nearly \$25.7 billion, or 5.2 percent of the total national income of this period.² These imposing figures might well lead to the conclusion that public-aid expenditures were a very forceful recovery factor and might create surprise that, in spite of them, no greater degree of recovery was achieved.

Before such a conclusion is drawn, a more careful analysis must be made. It is true that the \$25.7 billion disbursed by public-aid programs in the 8-year period were received mainly by people in the lower income brackets, and most of this sum was spent for consumer goods. Not all of this money, however, represented the creation of "additional" incomes, for much depends upon the manner in which these expenditures were financed.

Three methods of financing public aid can be distinguished, each of which has a markedly different effect upon the extent to which consumer demand is enhanced by public-aid policies. Public-aid expenditures may be financed by taxes, such as taxes on consumption or wages, which predominantly cause a curtailment of consumption. They may be financed by progressive income and profit taxation, the net effect of which may be to transfer income from savers to spenders. Or they may be financed by borrowings, which may increase purchasing power by practically their full amount in a depression period. It will be shown below that the first and third of these types of financing were extensively resorted to for public-aid financing during the last decade, as instanced by the financing of State programs by sales taxes, by the financing of the unemployment insurance and old-age and survivors' insurance by wage and pay-roll taxes, and the partial financing of other Federal aid programs by borrowing.

When incomes of taxpayers are curtailed and the money collected by Government is spent for public aid, no additional income is directly created, income being merely transferred from the taxpayer to the aid recipient. If the taxpayer cuts down his consumption by the full amount of the tax, the total demand for consumers' goods is not increased merely because the public-aid recipient consumes what the taxpayer has ceased to consume. If, however, the taxpayer cuts down on his savings, even partially, and does not fully decrease his consumption, a mere transfer of income may lead to an increase in consumption and indirectly to a creation of additional incomes. When the public-

² Computed from table 63, ch. X above. For types of public-aid expenditures included, see footnote 1 of that chapter.

aid program is financed by borrowing funds which otherwise would remain idle, the spending of public-aid money adds to the income flow.

The increase in the flow of incomes creates consumers' demand and may induce private investments, thus leading to at least temporary recovery.

In the course of recovery, incomes increase and net savings grow even more. The stimulating effect of government spending therefore diminishes with an increasing income level unless private investments manage to absorb an increasing portion of private savings. Yet, even if public-aid spending financed by borrowing does not result in a *net* increase in purchasing power, it may prevent the drop in purchasing power that would otherwise occur.

The initial spending by the public-aid recipient creates income in the hands of his grocer, landlord, or department store, each of whom spends the money to replenish stock or pay wages. This is the so-called secondary effect of government spending. But to have a tertiary effect, these secondary expenditures themselves must in turn inspire further investment. If they do not stimulate it, the effect of spending fades away. For example, if inventories of certain goods have been overexpanded and the public-aid recipients buy such goods, new production will not be encouraged by the reduction of inventories, unless there is promise of continued purchasing power on an increased scale.

It follows from this analysis that evaluation of the effects of public-aid measures on purchasing power involves two lines of inquiry. It is necessary first of all to determine how far public-aid expenditures were financed by borrowing, and secondly, to the extent that taxation was employed, to discover whether the taxes were of a type which might be expected to lead through transference between income classes to an increase in purchasing power.

In making this analysis it has been necessary for technical reasons to treat the social-insurance wage and pay-roll taxes separately because they involve the principle of reserve financing. A relatively small portion of the sums collected have been disbursed during the period under study and their financing was in fact separated from that of other public-aid measures. Yet, these taxes must be regarded as public-aid taxes, for their total yield was earmarked for present or future public aid. They are part and parcel of the larger public-aid program as developed in recent years.

Extent of Taxation and Borrowing in Financing Public Aid

Public-aid expenditures are only one element in the total of Federal, State, and local expenditures; and,

except for the social insurances, only a small portion of all taxes is earmarked for public-aid purposes.³ An attempt must therefore be made to attribute specific methods of financing to public aid on the basis of general considerations in the years 1933 to 1940.

The attribution of specific revenues to specific types of expenditures is a very hazardous undertaking. However, in the case of government expenditures for public aid such an attempt is not unfeasible. Government expenditures for public aid are a new phenomenon in Federal budgets, and even on the State and local level they had never previously been made on such a large scale. Such expenditures were initiated at a time of depression when the customary sources of revenue hardly sufficed to meet the customary expenses of government functions. For financing public aid, therefore, new sources of revenue and borrowing had to be used. This historical fact makes it possible to relate new types of financing to these new types of expenditures.

In certain cases new taxes were legally allocated to public-aid expenditures. In the Federal budget, for instance, wage and pay-roll taxes are specified for appropriation to the old-age insurance and other trust accounts. State taxes are more frequently earmarked for public-aid expenditures, although the practice is diminishing. When no legal tax allocation exists, an allocation of various sources of taxation and borrowing to different types of expenditures must be made on the basis of specific assumptions. This is essentially the procedure followed in constructing Table 80, which shows the estimated distribution of taxes and borrowing for public aid on the Federal and the combined State and local levels of government.⁴ It is important to note that these estimates are highly tentative, especially in the case of State and local financing where data are scanty, and must be regarded as suggestive rather than definitive.

Table 80 suggests that the relative shares of borrowing and taxation in the current financing of total public-aid expenditures were roughly equal, with taxation slightly preponderating. There is, however, a sharp contrast between the Federal and the State and local fiscal policies. The latter utilized taxation to a far greater extent than the former. Even so, the amounts financed by the creation of Federal debt decreased both in absolute terms and in relation to total public aid from the fiscal year 1934 until the fiscal year 1939, when the previous year's recession led to a sharp

³ All Federal receipts are merged in the General Fund of the Treasury before disbursement, and the practice of earmarking funds is losing ground in the more advanced State and local fiscal systems, too.

⁴ The details of the method of computation are presented in Appendix 21.

TABLE 80.—Estimated taxation and borrowing for public-aid expenditures,¹ exclusive of social insurances, 1933-39

Fiscal year	Tax-financed expenditures (millions of dollars)			Debt-financed expenditures (millions of dollars)			Percentage of expenditures financed by debt		
	Federal	State and local	Total	Federal	State and local	Total	Federal	State and local	Total
1933.....	0	184	184	384	173	557	100.0	48.5	75.2
1934.....	153	297	450	1,692	241	1,933	91.7	44.8	81.1
1935.....	660	394	1,054	1,607	242	1,849	70.9	38.1	63.7
1936.....	930	592	1,522	1,410	190	1,600	60.3	24.3	51.2
1937.....	1,504	827	2,331	1,079	154	1,233	41.8	15.7	34.6
1938.....	1,783	1,027	2,810	386	175	561	17.8	14.6	16.6
1939.....	1,160	1,168	2,328	1,792	242	2,034	60.7	17.2	46.6
Total.....	6,190	4,489	10,679	8,350	1,417	9,767	57.4	24.0	47.8

Sources: All data on Federal expenditures, both tax-financed and debt-financed, are from Appendix 21, table 1, below, based on *Annual Report of the Secretary of the Treasury on the State of the Finances for Fiscal Year Ended June 30, 1940*, Washington 1941, pp. 650-653.

Data on State and local financing are based on Ecker-R., L. László, "Sources of State Emergency Relief Funds, July 1, 1930, through June 30, 1935," in *Monthly Report of the Federal Emergency Relief Administration, July 1 through July 31, 1935*, Washington, 1935, p. 64; and Ecker-R., L. László, "Sources of Local Emergency Relief Funds" in *Monthly Report of the Federal Emergency Relief Administration, December 1 through December 31, 1935*, Washington, 1936, p. 46; Sternberg, Wesley J., *Indebtedness in the United States*, a forthcoming publication, a condensed version of which is available in Bangs, Robert B., "Public and Private Debt in the United States, 1929-40," *Survey of Current Business*, XXI (November 1941), 18-21; and Moody's Investors' Service, *Moody's Manual of Investments—Government Securities*, New York, 1941.

¹ The figures of expenditures used in this chapter are not in all cases comparable with those given in ch. X and appendix 19 because of differences in the sources from which they were derived. In order to secure comparability with other financial and tax data, Federal expenditures in this chapter and appendix 21 were derived from annual reports of the Secretary of the Treasury, whereas in ch. X and appendix 19 figures were secured in many cases from the agencies concerned, in order to make possible distribution between administrative and other costs. State and local expenditures are in agreement with those shown in appendix 19 when allowance is made for the exclusion of unemployment compensation benefits.

rise in deficit financing. However, recourse to borrowing was much less significant in regard to State and local public-aid expenditures, with an especially sharp decline in deficit financing after 1936.

It should be noted that the figures presented in Table 80 relate to the financing of public-aid expenditures, exclusive of the social insurances. The financing of the latter programs differs from those hitherto discussed, in that taxes were levied to provide funds for meeting both current and future disbursements. From 1936 onwards, the heavy tax collections made in connection with the financing of this type of public aid greatly exceeded disbursements. Therefore, properly to appraise the role of the public-aid programs in contributing to the course of recovery, these annual surpluses (accumulations to the reserves) must be deducted from the total Federal public-aid deficit as shown in Table 80. The resulting figures, specified as the net Federal public-aid deficit, are shown in column 7 of Table 81. It will be noted that the levying of wage and pay-roll taxes significantly changed the balance of taxing and borrowing attributable to public-aid financing.

Economic Effects of Deficit-financed Public Aid

Although the estimates in the preceding section suggest that a significant proportion of total public-aid

expenditures was financed by borrowing, it does not follow that the purchasing power of the Nation was increased to a corresponding degree. For, as already indicated, public-aid expenditures form only a part of total public disbursements, and their potential stimulating effects may have been nullified by contrary financial policies in regard to these other items.

In fact this appears to have been the case with State and local deficits attributable to public aid. Despite the sizable State and local public-aid borrowing, there was probably no net contribution to the national income, since old debt was being simultaneously retired⁵ and other expenditures were curtailed.⁶

For this reason, and because State and local public-aid expenditures were so largely financed by taxation, the following discussion will be concerned solely with the influence of deficit-financed public aid at the Federal level. For, over the period 1933-40 as a whole, there was an excess of Federal cash outlays adding to the community's income over cash receipts neutralizing such outlays. The extent of the Government net contribution, as this figure (with some modification of both the outlay and the offset sides) is called, is shown in column 3 of Table 81.

It is not easy to attribute the increase in activities and national income which took place after the depth of the depression in 1932 to any one specific recovery factor. However, as Table 81 shows, four periods can be distinguished. It has been estimated that a substantial proportion of the increase in national income from 1933 through calendar year 1935 was attributable to the primary and secondary effects of Federal deficit spending.⁷

Public-aid expenditures accounted for about one-half of the "stimulating" expenditures of this period and consisted largely of Federal Emergency Relief Administration and Civil Works Administration spending. Public construction, even including work

⁵ A study made by Wesley Sternberg for the Department of Commerce has shown that rather more than a sixth of the issues of States and municipalities between 1929 and 1940 were for refunding purposes. The results of the study have been summarized by Robert B. Bangs in "Public and Private Debt in the United States, 1929-40," *Survey of Current Business*, XXI (November 1941), 18-21.

⁶ In 1934, for example, expenditures on public elementary and secondary schools were about \$1.7 billion against some \$2.2 billion in 1932, and over \$2.3 billion in 1930. (Bureau of the Census, *Statistical Abstract of the United States: 1939*, Washington, 1940, p. 107.) State and local spending on highways fell from over \$1.3 billion in 1930 to less than \$0.5 billion in 1933 and never recovered. (U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, *Construction Activity in the United States, 1915-37*, Washington, 1938, pp. 78-79; and Dennis, Samuel J., "Recent Developments in Construction Activity," *Survey of Current Business*, XIX (August 1939), 12, tables 4 and 5.)

⁷ See Colm, Gerhard and Lehmann, Fritz, "Public Spending and Recovery in the United States," *Social Research*, III (May 1936), 129-166. The authors estimate this proportion at between two-thirds and four-fifths. Cf. also Angell, James W., *Investment and Business Cycles*. New York, McGraw-Hill Book Company, 1941, pp. 225-229.

TABLE 81.—Role of public-aid expenditures in Federal Government net contribution, 1933-40

(Millions of dollars)

Fiscal year ending June 30—	National income payments ¹	Government net contribution ²	Federal public-aid expenditures ³	Federal public-aid deficit ⁴	Social security and railroad insurance tax accumulations ⁵	Net Federal public-aid deficit (5)-(6)	Net public-aid deficit as percentage of Government net contribution (7)÷(3)
1	2	3	4	5	6	7	8
1933.....	45,452	1,921	384	384	-----	384	20.0
1934.....	50,806	2,377	1,845	1,692	-----	1,692	71.2
1935.....	56,007	3,571	2,267	1,607	-----	1,607	45.0
1936.....	62,619	3,976	2,340	1,410	66	1,344	33.8
1937.....	71,262	2,966	2,583	1,079	557	522	17.6
1938.....	69,245	1,103	2,169	386	1,107	-721	(⁶)
1939.....	68,366	3,328	2,952	1,792	814	978	29.4
1940.....	73,135	3,389	2,305	1,593	1,018	575	17.0

¹ From *Survey of Current Business*, XXI (June 1941), 16, and (July 1941), 18.² This figure, which is based on preliminary studies of the Federal Reserve Board, indicates the net addition to disposable cash income of the community attributable to the excess of expenditures that go into income, made by the Federal Government over tax collections. For discussion of the meaning and composition of this figure see testimony of Lauchlin B. Currie before the Temporary National Economic Committee, in *Investigation of Concentration of Economic Power*, Hearings before the Temporary National Economic Committee, 76th Cong., 1st sess., Washington, 1940, pt. 9, pp. 3528-3538.³ See table 80 and footnotes.⁴ Represents the increase in assets of the Old Age and Survivors Insurance Trust Fund, the Railroad Retirement Account, and the Unemployment Trust Fund (including increases attributable to interest). (*Annual Report of the Secretary of the Treasury on the State of the Finances for the Fiscal Year Ended June 30, 1941*, Washington, 1942, pp. 520-522.)⁵ Since there was no net Federal public deficit in this year, no percentage can be calculated.

relief, was well below the predepression level during the first phase of the recovery period. Increased Federal construction was more than offset by a drastic decline in State and local building.⁸ Such recovery as took place would seem to be largely due to Federal public-aid expenditures. State and local relief expenditures could have no stimulating effect in view of the simultaneous sharp decrease in public construction activities, the trend to net debt retirement, and their reliance on taxes on sales and real property, which tended to neutralize the effects of spending. *The experience of this period certainly seems to indicate that public-aid expenditures can bring about a substantial degree of recovery even in the absence of other stimulating factors.*

The second period, which was of a quite different nature, included the calendar year 1936 and the first half year of calendar year 1937. The veterans' bonus brought a great increase in the "government net contribution" and gave a great stimulus to business activity at the same time that more effective work relief under the Works Progress Administration was getting under way, while public works were also increasing substantially. Public construction in 1936 and 1937 was considerably above the predepression level, al-

though the increase did not offset the decreased private construction.⁹ In this period the primary and secondary effects of public deficit expenditures were reinforced by tertiary factors, by long-delayed replacements and expansion in business, and by an extension of consumer investments. A substantial rise in prices in some fields occurred in early 1937 (*i. e.*, the end of this second period) and in turn encouraged another investment factor, an accumulation of inventories. Symptoms of near-boom conditions appeared although millions of workers were still idle.

The third period practically coincided with the fiscal year 1938. It is marked by two concurrent factors. An attempt was made to curtail expenditures, especially for work relief, public works, and aid to agriculture. At the same time revenues increased not only because taxes based on the high income of the calendar year 1937 were collected in 1938, but also because the pay-roll taxes were yielding high revenues for the first time. The net cash outgo of the Federal Government (*i. e.*, the budget deficit minus the accumulation in Federal funds) fell from \$2,591 million in 1937 to \$277 million in 1938.¹⁰ This came very close to a balanced cash budget. The public-aid program in this fiscal year actually constituted a negative item, for the accumulation of taxes for social-insurance programs exceeded the deficit due to public-aid expenditures by \$721 million. (See Table 81.)

Other depressing factors existed, but this sudden shift from a large deficit to an almost balanced budget was probably one of the main factors.¹¹ The prosperity of the years 1936-37 was not self-sustaining. It had been supported by Government spending, and it broke down upon sudden withdrawal of that support. Undoubtedly, the movement was accentuated by rapid inventory accumulation in 1936 and 1937 and by inventory liquidation once the recession became apparent.

The next fiscal year, 1939, again brought a turn in the tide, with deficit spending consciously adopted as a recovery policy. Public-aid expenditures reached a record height. Public works and aid to agriculture were also increased. National income again responded promptly.

Late in 1939, with the beginning of the second World War, a new factor began to dominate business development; namely, the speculative demand in anticipation of price increases and scarcities, which swelled national income in the same months in which the government

⁸ *Ibid.*, p. 17, table 1; and ch. XII, below.⁹ Calculated on the basis of *Annual Report of the Secretary of the Treasury on the State of the Finances for Fiscal Year Ended June 30, 1940*, Washington, 1941, pp. 650-653.¹¹ See Angell, *op. cit.*, pp. 229-232.⁸ See National Resources Planning Board, *The Economic Effects of the Federal Public Works Expenditures: 1933-1938*, Washington, 1940, p. 18, table 2, and p. 19, fig. 2.

net contribution fell off. When the expected increase in war demand did not occur, inventory accumulation stopped, with an ensuing drop in production and income in the early months of 1940. From the summer of 1940 a new upturn became evident, dominated first by British purchases and later by the domestic defense program. Expenditures for public aid began to decline, and the economic lead was assumed by the defense program. The role of public-aid expenditures in transferring purchasing power continued; but the stimulus to production was being furnished by direct injection into the economy of defense spending. Defense spending lifted national income, production, and employment to record heights. Total cash spending on national defense in the calendar year 1941 rose \$8.4 billion over the calendar year 1940. In the same period, national income increased by \$17.4 billion.¹² Even after elimination of the price rise, production for civilian use grew more than did production for war.

The experience of the years since 1933, and especially of the defense period, suggests the effectiveness of a spending policy in increasing national income, production, and employment. This experience alone, of course, does not permit conclusions as to the feasibility of a permanent policy of deficit spending. It is, however, indisputable that public-aid expenditures and methods of financing materially influenced the size of the net government contribution and thereby of national income and employment.

Two conclusions can be drawn from the experience of these years. First, *neither the magnitude of the public-aid expenditures nor the belief of business in their duration was such as to stimulate any substantial amount of new investments in consumer-goods industries.* With the exception of the fiscal year 1938, the public-aid program undoubtedly added to the active purchasing power and was thereby effective in mitigating the depression, but it did not succeed in inducing prosperity based on new investments of an amount sufficient to absorb the increasing savings of the community.

Second, *policies in connection with the financing of the social-insurance programs after 1936 materially reduced the net deficit attributable to public aid.* Until the end of the fiscal year 1936 public aid formed a substantial percentage of the government net contribution. (See Table 81.) Thereafter, however, its relative and absolute significance declined. In 1938 public aid was financed out of a surplus. After 1938 the net public-aid deficit formed a smaller proportion of the government net contribution than in the years

1934-36. While some part of the smaller contribution in the fiscal year 1938 is attributable to reduced expenditures, the greater part of the decline in that and subsequent years was due to the collection of the social-security and railroad-insurance taxes which greatly exceeded disbursements under these programs.

Thus the experience of the thirties demonstrates that the use of debt-financed public-aid payments did stimulate the economy, but that this effect was limited in extent because of conflicting financial policies and limited in duration because deficit spending alone was not able to induce a sufficient amount of private investments.

Economic Effects of Tax-Financed Public-Aid

Public aid financed by government deficits adds to the purchasing power of the lowest income brackets since the deficit is a net addition to national income, directed to a particular income level. It has been shown in the preceding section that in the years 1933 to 1939 between 16.6 percent and 81.1 percent of expenditures for public aid exclusive of the social insurances were thus financed. (See Table 80.) The remainder was financed out of taxes which merely transferred purchasing power from the taxpayer to the recipient. Therefore, before the total effect upon recovery of the expenditure and financing of public-aid funds can be determined, it is necessary to discover who paid these taxes and specifically whether they were paid to any significant degree by recipients of public aid and other low-income groups. For even a transfer of funds may increase mass purchasing power if it involves taking money from persons who will curtail consumption by less than the amount of the tax and distributing this money to those who will spend it; or if the recipients spend money more quickly than the taxpayers reduce their consumption.

On the other hand, if taxes to finance public aid are collected primarily or in large measure from persons whose margin of savings is small, and in particular from the recipients of public aid, there may be no net increase in disposable income, *i. e.*, total income received (including public aid) minus taxes paid. So long as the transfer is within the same income level, the total demand can scarcely change; many families may have to cut their spending somewhat, while others may be enabled to raise consumption correspondingly.

Analysis of the economic effects of the types of taxes used in public-aid financing is peculiarly difficult. In the first place, the mere determination of the types of taxes utilized presents difficult problems not only because only a small portion of total taxes is specifically earmarked for public-aid purposes (except in the case

¹² Gilbert, Milton and Bangs, R. B., "Preliminary Estimates of Gross National Product, 1929-41," *Survey of Current Business*, XXII (May 1942), 12, tables 1 and 2.

of the social insurances), but also because many of the data on which estimates have to be based are of a fragmentary or incomplete character. In the second place, even when the tax sources are determined, there remains the problem of distributing their incidence among the various income groups, a task rendered the more precarious because of the uncertain character of much of the modern theory of tax incidence. Finally, to discover the net effect of the disbursement and collection of public-aid funds, it is essential to determine the distribution of payments among these same income groups.

All three steps in the analysis call for the adoption of certain hypotheses, the exercise of judgment, and the utilization of various estimating techniques. Inevitably therefore the results must be regarded as tentative and suggestive only. Nevertheless it is believed that the broad conclusions that result have sufficient validity to warrant presentation.

Taxes used for financing public aid.—No difficulty arises in regard to the determination of the types of taxes utilized in financing old-age and survivors insurance, the railroad old-age and unemployment insurances, and unemployment compensation, since all of these programs levy pay-roll taxes and, to a somewhat lesser extent, wage taxes to provide the funds needed for present and future disbursements. But the determination of the taxes utilized for all other forms of public aid can only be the result of estimating techniques.

It was assumed for the purposes of the estimates given below that the primary source of all Federal revenue used for public aid exclusive of the social insurances, was in the yield of depression-induced taxes first levied (or sharply increased as to rate) in 1933 and 1934 to meet the increased fiscal need.¹⁵ Certain revenues were treated as not used at all for public-aid purposes because they were an established source for covering traditional government expenditures (*e. g.*, customs and levies on tobacco and playing cards) or because they were levied for other specific purposes, often regulatory (*e. g.*, stamp taxes, and taxes on bituminous coal, oleomargarine, and narcotics).

State and local data on public-aid financing are far less adequate than are Federal.¹⁴ To discover which

taxes were used by States to finance public aid, a procedure similar to that applied for the Federal tax distribution was followed, with one modification.¹⁵ Some of the States, particularly in the South and Midwest, specifically assign the yields of certain levies or fixed proportions of some receipts to public aid. This fact reduces the residue to which estimating procedures must be applied. The theoretical assumptions adopted for this residual estimating are similar to those found appropriate for attributing Federal taxes to public aid, but they are adapted to State revenues on the basis of known earmarking practices and legal provisions. As with Federal taxes, it was extremely likely that taxes levied at a time of fiscal stress due to public-aid needs were used to alleviate such stress. Therefore most automotive taxes, general property levies, "death" taxes, and nonbusiness permits, but only a portion of general sales taxes were regarded as used for general purposes of government exclusively.¹⁶ The greater part of sales taxes were regarded as major sources of State public-aid financing. Other taxes were apportioned to public aid in direct ratio to their importance in total revenues. For the fiscal year 1939,¹⁷ tax allocations were made for each individual State on the basis of its actual system of earmarking, assignments, and practices in public-aid financing. For 1937 and 1938, proportions deduced from the 1939 analysis were applied to total revenues of the 48 States. For earlier years only a rough estimate was made, with crude assumptions as to the public-aid use of total yields of newly imposed taxes.¹⁸

Besides the State public-aid expenditures, State revenues supplied the funds for certain types of locally administered public aid. The State financing of local public-aid expenditures was in the form of specific tax yields returned to local governments or of grants out of general funds. Grants to localities from States for public-aid purposes are treated here as State expenditures, but shared taxes are regarded as local revenues, since the State acts merely as agent for the subordinate unit. Thus the procedure involves the inclusion of shared taxes (which are often assigned to specific

¹⁵ For a fuller account of the procedures applied and sources used see Appendix 21.

¹⁶ The use and yield of State general-property taxes have declined markedly since 1930 and disappeared in many States. Death-tax yields have likewise been falling steadily in the depression years. While general sales taxes have largely been imposed coincidentally with rising relief needs, they have also been used as a substitute for property tax yields decreased by legal exemptions or limitations in favor of property.

¹⁷ Receipt figures were classified as shown in Tax Policy League, *Tax Yields: 1939* (New York, 1940), especially pp. 100-116; rather than in accordance with Census data, because the Tax Policy League's figures are given for the 4 years 1936-39 on a directly comparable basis. Census data are comparable from 1938; the 1937 figures are rather sketchy; and 1934-36 figures are not available.

¹⁸ For a more specific account of the methods adopted and the limitations to the use of available data, see appendix 21.

¹⁴ These included, in various years, levies on soft drinks, admissions, communications, transportation, leased safe deposit boxes, and dividends; manufacturers' excises; excess profits, capital stock, estate and gift taxes, and portions of alcoholic beverage taxes. The revival of liquor-tax revenues with the repeal of prohibition coincided in point of time with the growth of public-aid expenditures and may be considered as used in part to finance some such expenditures. In 1939, a year of heavy tax financing, a part of income-tax collections was also included. For a fuller account of the methods adopted, see appendix 21.

¹⁵ The materials have improved in recent years, although their use is subject to many limitations. A fairly satisfactory analysis of taxes used for State public aid is possible for 1933, and from the fiscal year 1937 on.

purposes, such as school funds, road improvements, and welfare) among local revenues available for the financing of public aid and other functions.

Local financing accounted for rather more than a tenth of all public-aid costs during the years 1933-39.¹⁹ For 1933 through 1935, determination of local taxes used for public aid was possible on the basis of a special study.²⁰ For later years, fairly precise data are available for cities over 100,000, which have all had large expenditures. An analysis of their tax systems shows that, with the exception of New York City and 15 other large industrial cities, most of them relied largely on the traditional source of local revenue—property taxation.²¹ Once the few exceptions were found, the residue of local tax-financed aid was distributed in proportion to the usual local tax pattern. Since 90 percent and more of local tax revenues comes from general property taxes, it can be assumed that about 90 percent of the local public-aid expenditures which were not covered by special relief taxes were also financed out of general property tax yields.²²

The taxes presumed to be used for public aid were estimated in detail by these methods for each level of government in the fiscal years 1933-39 and are shown in Table 82.

Imputation of taxes to specific income groups.—The next stage in the analysis requires the imputation of the taxes shown in this table to specific income groups. It was pointed out above that this procedure calls for certain assumptions as to the theoretical incidence of particular taxes. In addition it is necessary to secure data regarding the relative size of different income groups and the expenditure patterns of each of these groups.

No problem of incidence is presented by income and other personal taxes which can be presumed to be paid directly out of the incomes of the taxpayers concerned. Sales taxes on specific products, such as tobacco, liquor, or gasoline, are usually added to the sales price. This follows from the fact that the major excises are usually levied on merchandise with a relatively inelastic demand.²³

¹⁹ See ch. X.

²⁰ Ecker-R. L. Lászió, "Sources of Local Emergency Relief Funds," in *Monthly Report of the Federal Emergency Relief Administration, December 1 through December 31, 1935*, Washington, 1936, pp. 34-58.

²¹ See Criz, Maurice, "Emergency Taxes in New York City Since 1933," *Taxes*, XVIII (March 1940).

Thus New York, which accounted for perhaps a fifth of local tax-financed aid spending in 1939, has been levying a variety of special relief taxes since 1933.

²² The State aid allocations for 1939 excluded taxes collected by States and distributed to localities. Study of them showed that a large portion of shared taxes (such as gasoline taxes) were allocated to non-public-aid purposes, e. g., school funds and highway funds, or were assumed to be so allocated. For many localities, any shared taxes may be regarded as miscellaneous.

²³ The statement in the text is a simplification of a very complex problem. In the case of tobacco taxes, for instance, it is highly probable that a part of the tax is shifted, not forward to the consumer, but back

TABLE 82.—Taxes estimated to be used for the financing of public aid, by type and by governmental level, fiscal years 1933-39, and social-insurance taxes*

		(Millions of dollars)						
Type of tax and Governmental level	1933-39	1933	1934	1935	1936	1937	1938	1939
Tax-financed public-aid expenditures, excluding social insurance	10,679	184	450	1,054	1,522	2,331	2,810	2,328
Personal taxes:								
Federal ¹	2,505		50	245	488	469	738	515
State ²	183	9		6	32	34	43	59
Local ³	123	12	13	14	17	21	26	20
Consumption taxes:								
Federal ⁴	3,491		103	360	411	999	1,008	610
State ⁵	693	4		9	58	173	209	240
Local ⁶	443	38	43	47	56	72	88	99
Business taxes:								
Federal ⁷	194			55	31	36	37	35
State ⁸	1,837	25	134	192	264	325	418	479
Local ⁹	1,210	96	107	126	165	202	243	271
Social-insurance measures:								
Wage and pay-roll taxes ⁷	3,616					19	544	1,502
								1,551

*For sources and methods adopted, see appendix 21. At the time the study was made, 1940 figures were not available for States and localities.

¹ Estate and gift taxes and individual and (imputed) corporate income, excess profits and capital stock taxes, and (imputed) dividend tax in 1934.

² Income, personal property (nonbusiness), and poll taxes.

³ Taxes on admissions, manufacturers excises, pleasure boats (1934), safe deposit boxes, soft drinks (before 1937).

⁴ Special sales and portion of automobile taxes, 40 percent of general property taxes (imputed to residential real estate).

⁵ Taxes on transportation, communications, and checks.

⁶ Taxes on all business, general sales and miscellaneous taxes.

⁷ Includes old-age and survivors insurance, railroad retirement, and unemployment compensation taxes. (*Annual Report of the Secretary of the Treasury* * * * 1940, pp. 424, 426-427.)

But the impact of general sales taxes falling on transactions and therefore more or less on all merchandise is not always predictable. For example, if taxes (or indeed other costs) raise the price of liquor, consumers may spend more money on it and a fraction less on all their other needs. If taxes on all goods add to their sales price—i. e., raise the general consumer-goods price level—the total quantity consumed must be correspondingly curtailed if the total purchasing power does not increase at the same time. It is quite conceivable that business may find its advantage to lie in absorbing at least part of the tax out of its profit margin, or in bringing pressure on employees either to accept lower wage rates or not to insist on an otherwise possible wage rise, in preference to increasing prices. Particularly is this true in lines of business serving a low-paid mass market.

In general, it can be said that the actual effect of a general sales tax on prices, costs, and profits depends mainly on the business conditions prevailing at the time the tax is enacted.²⁴ In fact, half the State sales taxes were enacted during the depth of the depression

to the tobacco grower; in other words the elimination of the tax ought to result in lower prices for finished tobacco products and higher prices for raw tobacco. The actual extent of such shifting and its precise direction are highly controversial matters. Nevertheless, most excise taxes must be predominantly shifted to the consumer, if for no other reason than their magnitude, which would make full shifting backward an almost impossible procedure.

²⁴ For a more detailed analysis of the incidence of cost taxes see Colm, Gerbard, "Public Revenue and Public Expenditure in National Income," in *Studies in Income and Wealth*, New York, National Bureau of Economic Research, 1937, vol. I, pt. V, pp. 175-222.

and the rest in the early recovery stages. Profit margins, especially in retail trade, were generally low and could scarcely absorb the new tax. Prices and wages had been declining under the impact of the depression.

At a time when the buyers' market is poor and labor supply plentiful, the primary reaction of business to such a tax would be to keep or press wages down. But wages had already been lowered, over a prolonged period, to a point where sociological resistance to further cuts was plainly felt. It is not likely that the imposition of sales taxes was regarded as sufficient justification by employees to overcome their previous resistance to further wage cuts even in the face of mass unemployment. It must therefore be assumed that sales taxes were passed on almost wholly to consumers, mainly in such fashion that an otherwise feasible price reduction was prevented. If prices of consumer goods increase (or are prevented from falling) at a time when consumers' purchasing power is depressed, the effect may be increased unemployment (or a slowing down of recovery and reemployment). This situation changes in a period of increasing consumers' incomes. The general business improvement, specifically reemployment and higher mass income, makes a continued absorption of sales taxes by consumers' income. The general business improvement, quite possible. The extent to which such absorption has occurred is a moot question; the actual incidence of such a tax is almost impossible to determine statistically, as changes in price levels may stem from a variety of other causes. Special local circumstances, legal exemptions of products, the presence of untaxed sources of supply, and price movements must all be disentangled before precise estimates are made or correctly interpreted.²⁵ But for the purposes of this study the assumption has been made that consumers paid the whole of special and general sales taxes in the period under discussion.

The incidence of employers' pay-roll taxes is fundamentally not greatly different from that of a sales tax, inasmuch as both are additions to business costs at somewhat different points of production. The incidence of pay-roll taxes likewise depends largely on the business conditions prevailing at the time of enactment or change. Both, if passed on, whether forward or backward, fall heavily on low-income groups, either wage earners or mass consumers. Both types of taxes are especially burdensome to certain kinds of industries. In the case of sales taxes this discriminatory

effect depends largely on the type of sales tax under discussion, as for instance, a retail sales tax, or a general turnover tax. As regards the pay-roll tax, the highly mechanized industries are affected only indirectly (for example, if the tax paid by mines is shifted to the price of coal or metals) while the industries employing relatively more labor than capital are affected to a considerably larger and more direct extent.²⁶

The pay-roll taxes came into effect in a period of accelerating recovery under conditions that differed considerably, especially when the taxes became effective, from those when most State sales taxes were enacted.²⁷ Prices, wages, and profits had entered upon a rising trend. The prices in that period followed increasing consumer demand and were determined more by what the traffic would bear than by costs of production. It can hardly be assumed that prices would have been lower by the full amount of the tax if the pay-roll taxes had not been imposed. Profits, although high in certain industries, were not favorable enough generally to make it plausible to assume that business had fully absorbed the employer's pay-roll taxes. Thus it appears probable that wages increased less than they would otherwise have done in a period of partial recovery because of the employers' pay-roll taxes. In this respect it might be assumed that the employers' tax was partly borne by the wage earners. It is nevertheless quite possible that besides this major effect, *some* price increase and *some* absorption of profits may be credited to pay-roll taxes. In view of the impossibility of tracing the relative extent to which each of these developments actually took place, it was believed advisable to adopt the extreme assumption of a full shift of taxes to the consumer. It is believed that this is not too arbitrary a procedure; for, whether shifting of pay-roll taxes backward to wage earners or forward through several middlemen to prices be assumed, the tax curtails or limits mass consumption.²⁸ It is so treated in the computations of the following

²⁵ Hynning, Clifford J., *Taxation of Corporate Enterprise*, Temporary National Economic Committee, Monograph No. 9, Washington, 1941, pp. 97-101, 119.

²⁷ It should be noted here that sales taxes must be considered with regard to the economic situation in the particular State, and not the Nation as a whole. Recovery lagged in many sales-tax States.

²⁸ See Colm, Gerhard, and Tarasov, Helen, *Who Pays the Taxes*, Temporary National Economic Committee, Monograph No. 3, Washington, 1940, pp. 25-26 and table VII, where this problem was discussed more fully and an estimate was made of the effect of a shifting of all indirect taxes to wages. Because of the concentration of both total wages and total consumption at low-income levels, it was found that *little* difference in final incidence would stem from the use of this second method. In fact, if all taxes were passed back to wage earners, the regression would be even steeper, as all consumption taxes would be assumed to fall on the producers of the taxed goods. In actuality, higher income groups buy a disproportionate part of taxed goods (such as liquors, new automobiles, etc.), so that if taxes are included in price these higher income groups would pay more than otherwise. The data for allocation to wages are even more scanty than for consumer expenditures, so the assumption of shifting forward is regarded as more reliable.

²⁶ Evidence is scattered and contradictory. See Shepard, E. F. and Ford, R. S., *The Michigan Sales and Use Taxes*, Ann Arbor, University of Michigan Press, 1941; Jacoby, Neil H., *Retail Sales Taxation*, Chicago, Commerce Clearing House, 1938; and Warhurst, H. P., "The Effect of General Sales Tax Levies on Retail Sales Increase, 1933-1935." *Domestic Commerce*, XIX (April 20, 1937), 222-224.

sections. The possibility that the pay-roll taxes were absorbed by profits is disregarded. It is not probable that this omission causes a very significant error in the result.

In brief, therefore, it may be said that the various taxes were allocated to the different income groups on the assumption that the burden of personal taxes, including the workers' share of social-insurance taxes, remains with the groups on whom they are levied, that consumer taxes can be distributed among income groups in proportion to their expenditures on the items taxed, while business taxes (including social insurance taxes other than those paid by workers) are assumed to be passed on eventually to consumers in the price and were allocated in proportion to total expenditures (after deducting savings and direct personal taxes) of each income group. General property taxes were broken down according to the best information available into residential property, business property (real and personal), and a small portion of personal nonbusiness property taxes, and were treated as consumer taxes, business taxes, and personal taxes respectively.²⁹

The income groups selected for the purpose of allocating public-aid taxes were those available from the Consumer Income Studies.³⁰ It should be noted that the units which compose the different groups are not individuals but family units (including 1-person families). Expenditure patterns, essential for determining the precise incidence of sales and business taxes, were similarly secured.³¹ Table 83 shows the resulting allocations of taxes for the fiscal year 1939 among income groups. That year was selected as being the period for which such an estimate could be made with the greatest approach to accuracy.³²

Distribution of public-aid payments among specific income groups.—Before the full economic effects of public-aid disbursements and tax collections can be assessed, it is necessary to take one further step; namely, to allocate the public-aid payments among the different income groups.

Available data do not allow income and public-aid receipts of various income groups to be compared directly. Public-aid data show payments made, both

total and per capita, and even a range of per capita amounts; but they give no indication either as to the total family income of the recipient or the importance of public aid in his income. On the other hand, the Consumer Income Studies data, which were utilized for the purposes of income distributions, and studies basic to them treat as a "relief" group all persons receiving any public aid during the year, a procedure which might conceivably include families in a normally comfortable income class who received special aid at some time in the year. The gap in information has become even more serious with the growth in social-insurance payments, which, being unrelated to need, may enlarge the income of fairly well-to-do families. A third problem is that of duplication of families receiving different types of aid; the extent of this duplication was indicated in Chapter V. Data relating to aid per recipient give no indication of the actual family income brackets of the recipient. As in the preceding sections, therefore, estimates must be made on the basis of general reasoning and scattered information concerning the groups which receive various types of public aid.³³

It was assumed that nearly all recipients of public aid were in families with total annual incomes of under \$1,000. The per capita and per family yearly public-aid figures indicate that the annual income of the recipients could scarcely exceed that level except in a few cases. However, there were some types of aid in which means-test requirements were less strict or entirely absent or where payments were higher. Accordingly, roughly 8 percent of WPA workers, 20 percent of the recipients of unemployment insurance, and about 50 percent of the recipients of the relatively high railroad-retirement payments, and of lump-sum payments under the old-age and survivors insurance program were regarded as falling in the \$1,000-\$2,000 family income level.³⁴ The resulting estimated distribution of public-aid payments is shown in Table 83.

Net effect of tax-financed public aid.—It is evident from Table 83 that *even that part of public-aid funds which was derived from taxes involved a considerable redistribution of income among classes.* For it is estimated that the group with incomes of \$5,000 and over paid in 1939, \$846 million in public-aid taxes and received no public-aid payments, while the group with incomes of \$2,000 and under \$5,000 contributed \$992 million and received no direct public-aid payment.

²⁹ For a detailed account of the procedures adopted, see appendix 21.
³⁰ National Resources Committee, *Consumer Incomes in the United States, Their Distribution in 1935-36*, Washington, 1938. See also appendix 21 below.

³¹ National Resources Committee, *Consumer Expenditures in the United States*, Washington, 1939; and Bureau of Labor Statistics, *Study of Consumer Purchases*. See also appendix 21.

³² In several of the years, the yield of taxes assumed primarily available for the financing of public aid exceeded total public-aid disbursements (other than the social insurances). Thus it would have been necessary to assume that only part of the receipts from each of these taxes was used to finance public aid. But such an apportionment would have required data which were not available for all years.

³³ For details of procedures applied see appendix 21. No figures on numbers of recipients in each group can be given because the analysis was made in such a way as to allocate only total payments to income groups.

³⁴ For the reasons for these allocations to the different income groups see appendix 21.

TABLE 83.—Allocation of taxes used for public-aid financing among income groups, fiscal year 1939

	Income groups				
	Total	Under \$1,000	\$1,000 and under \$2,000	\$2,000 and under \$5,000	\$5,000 and over
	Millions of dollars				
Public-aid taxes, other than social insurance:					
Computed proportion of personal taxes.....	430	3	4	5	418
Consumer and business taxes.....	1,898	402	659	541	296
Total.....	2,328	405	663	546	714
Social-insurance taxes.....	1,551	338	635	446	132
All public-aid taxes.....	3,879	743	1,298	992	846
Income received (includes imputed income and public-aid payments).....	60,108	12,397	22,452	19,810	14,449
Public-aid payments (included in above).....	4,707	4,369	338		
	Percentages				
Percentage of total public-aid taxes (other than social insurance) carried by each group.....	100.0	17.4	28.5	23.4	30.7
Percentage of social-insurance taxes carried by each group.....	100.0	21.8	40.9	28.8	8.5
Percentage of all public-aid taxes carried by each group.....	100.0	19.1	33.5	25.6	21.8
Public-aid taxes (other than social insurance) as a percentage of total income of groups.....	3.4	3.3	3.0	2.8	4.9
Social-insurance taxes as a percentage of total income of groups.....	2.2	2.7	2.8	2.2	0.9
All public-aid taxes as a percentage of total income of groups.....	5.6	6.0	5.8	5.0	5.8
All public-aid taxes as a percentage of total income of groups (excluding public-aid payments).....	6.0	9.3	5.9	5.0	5.8

¹ Imputed income raises this figure considerably over the income payments figure shown in table 81. The estimates in Colm, Gerhard and Tarasov, Helen, *Who Pays the Taxes?* Temporary National Economic Committee, Monograph No. 3, Washington, 1940, were used for this table with only minor modification. Recent restudy has led to a revision downward of all income and modification of its estimated distribution. The revisions in Tarasov, Helen, "Who Does Pay the Taxes?" *Social Research* (supplement October 1942), made too late to adopt here, do not materially alter basic patterns.

Source: See appendix 21.

To this extent, therefore, in addition to the stimulus to recovery received through deficit spending, there was a further stimulus attributable to some redistribution of incomes in favor of the lower income groups. This not only contributed to greater equity but also had important economic effects to the extent that it increased purchasing power of groups unable to save and cut down the saving of more heavily taxed higher income groups. It must be borne in mind, however, that while Federal public-aid taxes (except pay-roll taxes) were progressive, State and local taxes for public aid were mostly regressive, and that *only the preponderance of Federal public-aid payments out of progressive and high-income consumption taxes made possible this partial redistribution of income.*

It is also important to note that *the extent of this transference was considerably reduced by the regressive character of the methods of financing adopted.* The income group between \$1,000 and \$2,000 contributed 33.5 percent of the total taxes levied for these purposes (including social-insurance taxes), while the highest income group carried only 21.8 per cent. The

share of the lowest income group was 19.1 percent. *The major element accounting for this regressive distribution was clearly the social-insurance taxes.* When these are disregarded, the share of the costs of financing public aid carried by the wealthiest group rises to 30.7 percent, and that of the poorest group falls to 17.4 percent. In other words, had it not been for the social-insurance taxes, a much greater degree of economic stimulus on account of income redistribution would have resulted from the methods of financing public-aid expenditures.

Appropriateness of Taxes Used To Finance Public Aid

In expenditures with such far-reaching economic and social effects as those for public-aid purposes, it is particularly pertinent to inquire whether means are compatible with ends. In other words, are the taxes which yield important parts of public-aid expenditures appropriate for furthering the general objectives of these expenditures?

Use of Consumption Taxes

In the preceding sections attention has been drawn to the fact that a substantial proportion of public-aid financing has involved the levying of taxes whose incidence falls heavily upon the consumption of the lower income groups. The estimates presented in Table 83 indicate that when all public-aid taxes are expressed as a percentage of the total income of each group *the heaviest burden fell upon the income group under \$1,000, which paid out 6.0 percent of its total income, including public-aid payments.* If the public-aid payments to this group are disregarded the burden of public aid financing is even more severe and disproportionate, rising to nearly 10 percent of the income of the group. On the other hand, taxes for public-aid purposes are estimated to account for only 5 percent of the incomes of the group with incomes of between \$2,000 and \$5,000 and less than 6 percent of the incomes of the group over \$5,000. The situation revealed by these estimates indicates that public-aid measures, effective as they were in relieving hardship in individual cases, nevertheless brought about only a limited general redistribution of the national income. These measures, intended to relieve distress, in fact drew for a large proportion of their cost on the incomes of low- and moderate-income groups, who paid out a greater percentage of their meager incomes for this purpose than did higher-income classes.

It should be emphasized again that these conclusions are highly tentative, being necessarily based on estimates and on the application of general reasoning. Nevertheless, it is believed that the general conclusion

to which they point is valid: namely, that *the burden of public-aid financing fell with greatest severity upon the lowest income groups*. The methods that have been adopted tend indeed to understate the proportion of taxes carried by these groups. For, in dealing with the financially important social-insurance taxes, the assumption that the tax levied on employers could be treated as a business tax resulted in the attribution to the groups under \$2,000 of a smaller proportion of these taxes than would have been allocated to them if it had been assumed that the entire tax levied on employers had been passed on to wages. Furthermore, the methods adopted in allocating the part of the tax paid by workers probably involved some underestimate of the amounts paid by the two lowest income groups. Finally, the principle applied to the distribution of public-aid payments among income groups may have resulted in some overestimate of the payments to the income group under \$1,000. Therefore, had more refined methods of analysis and allocation been possible, it is probable that the burden of taxes falling upon the lower-income groups would have appeared even heavier.

The paradoxical fact that a series of programs whose common objective is the welfare of the least secure sections of the population is financed in such a way as to require the lowest income groups not merely to contribute a substantial share of the total funds but also to sacrifice a greater proportion than the wealthier groups of their small incomes is due to the extensive use of regressive taxes in public-aid financing. Prior to 1936 this method of financing was in the main caused by the utilization by States and localities of sales and other consumption taxes. After 1936, the major influence was the imposition of wage and pay-roll taxes in connection with social-insurance programs.

In terms of social-insurance theory, strong arguments may no doubt be adduced for the utilization of taxes of this type for supplying at least a portion of the funds needed for these programs.³⁵ The fact remains that, as a method of cost distribution, they have the effect of requiring the poor to pay for a large share of their own security.

Use of the pay-roll tax to stabilize employment.—The heavy reliance upon pay-roll taxes in unemployment compensation is due in large measure to the desire to utilize the potentialities of variable tax rates for the purpose of stimulating employment stabilization. In fact, however, there are reasons for doubting the efficacy of existing experience-rating devices to accomplish this desirable objective, and there are some grounds for concern lest the retention of these finan-

cial devices conflict with the major public-aid functions of unemployment compensation.

As described in Chapter IV, unemployment compensation is financed by a tax on employers equivalent to 2.7 percent of their pay-rolls. In 39 States, however, an employer may have his tax rate lowered (or, in 26 of these States, raised), depending on his success in meeting the "reserve ratio" requirements of his particular State law. The experience-rating provisions and the methods devised for modifying employers' contribution rates vary among the States.³⁶ The most common type of experience rating provides that all or part of an employer's contributions should be credited to his account and that the ratio of the excess of his contributions over benefits paid to his employees, to his average annual pay roll should serve as the basis for modifying his contribution rate.

It is not intended here to examine the theoretical and controversial issues in experience rating.³⁷ This discussion is confined to the actual operation of variable tax rates in unemployment compensation in the United States. Through December 1940, adjustments of employers' tax rates had taken place in only four States—Indiana, Nebraska, South Dakota, and Wisconsin.³⁸ The experience in these States, although limited, suggests that *experience rating not only fails to induce any substantial degree of stabilization but also has serious implications for the financing of unemployment compensation and for the benefit phases of the system.*

The most significant feature of the experience in the four States where experience rating was in operation in 1940 is that, where tax reductions have oc-

³⁶ In most States these provisions have been amended in some particulars at every legislative session. Details of the experience rating provisions in the State laws as of March 1940 are described in Social Security Board, *Current Experience Rating Research*, Employment Security Memorandum No. 7, Washington, 1940, p. 67 ff. Cf. "Experience Rating Operations in 1941—A Preliminary Survey," *Social Security Bulletin* IV (October 1941), 25-28.

³⁷ For the pros and cons of experience rating, see the following: Pribram, Karl and Booth, Phillip, *Merit Rating and Unemployment Compensation*, Social Security Board, Washington, 1939; Feldman, Herman and Smith, Donald M., *The Case for Experience Rating in Unemployment Compensation and a Proposed Method*, New York, Industrial Relations Counselors, Inc., 1939; Lester, Richard A., and Kidd, Charles W., *The Case Against Experience Rating in Unemployment Compensation*, New York, Industrial Relations Counselors, Inc., 1939; *Report of the Committee on Employer Experience Rating of the Interstate Conference of Employment Security Agencies* (vol. I, Unanimous Report; vol. II, Majority Report; vol. III, Minority Report), Washington, 1940.

³⁸ The dates on which variable rates are to be effective among the 39 States with experience-rating provisions are as follows:

Effective date:	Number of States
January 1938	1
January 1940	3
January 1941	11
July 1941	2
January 1942	19
July 1942	2
January 1943	1

³⁵ See ch. XVIII for a fuller discussion of these arguments.

curred, there is little or no indication that they have been achieved through employers' successful efforts to stabilize employment. On the contrary, the findings indicate that tax rates have been reduced by the operation of a number of factors unrelated to the avowed purpose of experience rating. In Indiana, for example, where only 4 percent of all employers paid rates lower than 2.7 percent in 1940, "reductions were made possible largely by a decline in an employer's pay roll in 1939, or by his payment of voluntary contributions, rather than by employment stabilization."³⁹ A report by the Indiana employment security agency stated that "we can safely say that the reductions in contribution rates in 1940 cannot in any way be attributed to any successful attempts to stabilize employment."⁴⁰

In Nebraska, 31 percent of all employers obtained tax rate reductions in 1940. Of these, 86 percent were assigned the minimum rate of 1 percent. "Nevertheless, chance factors, such as credit for 1936 contributions and employers' voluntary contributions, which are not directly related to personnel practices intended to reduce employment fluctuations, have played a significant part in accounting for variations in employer contribution rates for 1940. Of the 172 employers who made voluntary contributions and also obtained rate reductions, only 19 would have obtained reduced rates without such contributions. No information is yet available which bears directly on the effect which experience rating may have on incentives for the stabilization of employment."⁴¹

In South Dakota, where 7 percent of the employers obtained reduced tax rates in 1940, "these reduced contribution rates are attributable to declines in employers' 1939 pay rolls, as compared to pay rolls in earlier years, rather than to stabilization achievements."⁴²

A special study of 247 Wisconsin firms of various sizes in different industries points out that "the results of an employer's efforts to avoid benefits are reflected in his reserve ratio in exactly the same way as efforts intended to stabilize employment."⁴³ In a certain number of cases employment stabilization was ef-

fectuated.⁴⁴ Yet despite the fact that only about 11 percent of the 247 firms had achieved "appreciable" stabilization, 43 percent received reduced rates in 1939 under the Wisconsin law.⁴⁵ Among the methods used by various firms to avoid benefit payments were workspreading (which may be equivalent to the stabilization of underemployment), hiring persons ineligible for benefits, contracting out certain work, moving some operations out of the State, laying off those workers with the fewest weeks of employment to their credit, and intimidating employees not to register for benefits when laid off.⁴⁶ The Wisconsin study concludes that, although the individual employer can do something to stabilize his employment, his ability is often limited, and that benefit avoidance is sometimes as significant as actual stabilization in the achievement of reduced tax rates.⁴⁷

*The great difficulty with this type of incentive taxation is that the inducement to reduce compensable unemployment is as great as that to reduce unemployment and may well be more feasible for many employers.*⁴⁸ It is significant that experience rating has given rise to the growth of stabilization consulting services which advise employers on methods of reducing their tax rates. The business press contains numerous articles which emphasize methods of avoiding benefit payments fully as much as methods of stabilizing employment.⁴⁹ Furthermore, to the extent that experience rating formulas in certain States determine the extent

no benefits had been charged from July 1934 would have had a reserve ratio of 12.4 percent at the close of 1939, while in most other States the corresponding ratio could not have exceeded 8.1 percent.

³⁹For a detailed account of successful stabilization by Wisconsin firms see Industrial Commission of Wisconsin, *The First Wisconsin Conference on Steadier Jobs, Milwaukee, June 21, 1940.*

⁴⁰Myers, *op. cit.*, p. 132.

⁴¹*Ibid.*, pp. 93-101.

⁴²The author also concludes that "against the stabilization accomplishments of the Wisconsin Act must be placed the fact that it has tended to stabilize underemployment and has added somewhat to the volume of total unemployment." (*Ibid.*, p. 144.)

⁴³Cf. Professor Edwin C. Witte's statement: "So long as this loophole exists experience rating is very defective and in actual operation will fall to secure the theoretical advantages of variable contribution rate." ("Whither Unemployment Compensation?" in *Proceedings of the Institute on Employment Security*, Minneapolis, University of Minnesota, 1940, p. 55.)

For an analysis of the extent to which the characteristics of different types of industries and businesses influence the feasibility of employing various stabilizing techniques, see New York State, Governor's Committee on Stabilization of Industry for the Prevention of Unemployment, *Less Unemployment Through Stabilization of Operations*, Albany, 1930.

⁴⁴See, for example, Councilor, J. A., "Social Security Taxation," *Journal of Accountancy* (October 1939), 244-252, which advises employers *inter alia* to lay off employees with the lowest accumulation of wage credits first, to hire as additional help, persons such as minors or "extra workers" employed for brief periods who are not subject to the law, to take advantage of special exemptions from merit rating provisions for temporary help, and to report to the commission all cases in which the reason for quitting work may result in loss or reduction of benefit rights. For a bibliography of this subject, see Huber, Franz, *Changes in Employment Practices Resulting from the Operation of the Social Security Program*, Committee on Social Security of the Social Science Research Council, Washington, 1940.

³⁹"Experience Rating in Indiana, 1940," *Social Security Bulletin*, IV (March 1941), 17.

⁴⁰*Ibid.*, p. 18. Quoted from Indiana Unemployment Compensation Division, *Savings to Employers Under the Operation of the 1940 Experience Rating Provisions of the Indiana Unemployment Compensation Law*, Memorandum No. 16, April 16, 1940.

⁴¹"Operation of Experience Rating in Nebraska, 1940," *Social Security Bulletin*, IV (January 1941) 201.

⁴²Social Security Board, *Experience Rating Operations in Delaware, Indiana, South Dakota, 1939-1940*, 1941 series, No. 3, Washington, 1941, p. 1.

⁴³Myers, Charles A., *Employment Stabilization and the Wisconsin Act*, Social Security Board, Employment Security Memorandum No. 10, Washington, 1940, p. 93. In Wisconsin the high proportion of accounts with reduced tax rates in 1940 (60 percent) is due to the longer period of operation of the State law. Tax collections commenced in July 1934, and a Wisconsin employer with a uniform pay roll against which

of tax reductions by reference to the size of the State's reserve,⁵⁰ an impetus will be given to employers' lobbies to oppose general liberalization of the benefit provisions. For if these are restricted, the total State reserve will remain high, and greater rate reductions will be possible.

In view of what has been said above concerning the relatively small extent to which experience rating has promoted stabilization of employment and thereby reduced the extent of unemployment, *the fact that many of the State laws fail to provide safeguards against undue reductions in the funds available for benefit payments may have serious repercussions upon the solvency of State systems.* Only 26 States provide for increases in taxes as against 39 permitting decreases. In none of the former, however, can the maximum rate rise above 4 percent although the reductions allowed are substantial. (In 6 of them an employer's contribution may cease altogether.) In only 3 of the States are there provisions designed to maintain a fixed average contribution rate necessary to support a given benefit scale.⁵¹ The danger that existing experience-rating provisions may lead to a reduction of the funds available for benefit payment greater than is justified by any reduction in the volume of unemployment has been an object of concern to the Social Security Board.⁵²

There is one final consequence of experience rating which calls for attention; namely, the danger that *the provisions as now operating may undermine the effectiveness of the Federal tax-offset device in preventing competitive tax reductions.* Prior to January 1940 practically all the State unemployment compensation systems collected a uniform pay-roll tax of 2.7 percent. When the experience-rating plans become effective, however, this uniformity will no longer prevail. Because of the differences in both the benefit

and the experience-rating formulas in State laws and State employment patterns, it is possible that establishments with identical employment experience will be taxed at rates varying from 0 to 2.7 percent under different State laws.⁵³ The Interstate Conference of Employment Security Agencies has drawn attention to the danger that, if this situation does not introduce the possibility of uneconomic shifts of industrial enterprises, it will in all likelihood result in interstate competition in pay-roll taxes.⁵⁴ In the competitive effort to reduce taxes through experience-rating devices, the adequacy of the benefit structure or the solvency of the State funds may be endangered. The dangers of experience rating unaccompanied by adequate Federal controls have been frankly recognized by some of the foremost exponents of experience rating.⁵⁵

Reliance on Earmarked Taxes

It was stated at the beginning of this chapter that an increasing reliance upon earmarked taxes was one of the characteristics of the financial developments of the last 10 years. This method of financing public aid has been especially marked in the special-assistance and social-insurance programs.

While the Federal share of special-assistance expenditures is appropriated from the general revenues of the Federal Government, a significant proportion of the States and localities, as Table 84 indicates, have relied upon earmarked taxes.⁵⁶ It should be noted that in all these cases the particular tax or taxes levied must be used for the purposes specified and for no others.

Prior to 1935 a number of the States had assessed special taxes for welfare purposes. The device of diverting specific tax yields, especially gasoline taxes, was increasingly resorted to as a method of financing relief expenditures in the early years of the depression. By 1940, however, most State and local governments

⁵⁰ In nine States experience-rating provisions aim to set contribution rates which will yield in any year the amount of the benefits paid on the average in the 3 preceding years: Alabama, Delaware, Florida, Illinois, Massachusetts, Michigan, Oklahoma, Texas, Virginia.

⁵¹ District of Columbia, Nevada, Wyoming; in addition Connecticut and Minnesota provide for an average contribution rate, which varies with the benefits paid. For a discussion of the effect of experience rating operations on the yield of pay-roll taxes see *Social Security Bulletin*, IV (October 1941), 25-28. It is estimated that in Wisconsin and Nebraska the yield will represent declines of 13 and 26 percent, respectively, from 1940 levies. In Texas, where rate reductions commenced in 1941, it is estimated that the present formulas will reduce the total tax yield by 44 percent.

⁵² "The Board does not want experience rating to be simply a vehicle for tax reduction and restriction of benefits. If we are to have tax reduction in this program, let us have it openly and above board. Let us decide what taxes and benefits we should have, apart from experience rating which, after all, is just a method of sharing the taxes. Above all, let us not pretend we are stabilizing, if all we are doing is legally restricting the benefits by various devices." (Clague, Ewan, "The Future of Unemployment Compensation," in *Proceedings of the Second American Retail Federation Forum*, Chicago, May 1940, p. 148.)

⁵³ Pribram and Booth, *op. cit.*: and appendix 6.

⁵⁴ "If experience rating is included in some State laws and not in others, States with uniform contribution rates may be impelled to allow rate reductions, and States that grant only moderate rate reductions may be forced by employers to grant reductions equivalent to those obtainable by competing employers in other States. Under the present Federal-State system the individual State has a right by legislative enactment to set up any benefit system which the State legislature determine upon. This makes it possible to effect substantial reductions in the contribution rates by placing restrictions upon eligibility, benefit rates, duration, and by increasing the penalties of the waiting period." (*Report of the Committee on Employer Experience Rating of the Interstate Conference of Employment Security Agencies*, vol. II, Majority Report, September 1940, p. 10.)

⁵⁵ "The revision of the American system of unemployment compensation on a national basis, or at least introducing strict national control, is essential to the most effective operation of experience rating. On many grounds the inadequacies of our disjointed Federal-State system are being criticized, and the consensus of expert opinion is that greater Federal control is necessary; this need in the case of experience rating supports the general tendency." (Feldman and Smith, *op. cit.*, p. 14.)

TABLE 84.—Methods of State and local financing of the special-assistance programs

Program	Number of States financing specified special-assistance programs			
	Total	From general revenues only	From earmarked revenues only	From earmarked and general revenues combined
State revenues:				
Old-age assistance.....	49	30	15	4
Aid to dependent children.....	41	28	10	3
Aid to the blind.....	41	26	12	3
Local revenues:¹				
Old-age assistance.....	23	13	9	1
Aid to dependent children.....	27	16	10	1
Aid to the blind.....	19	12	6	1

¹ No local financial participation provided in some States.

Source: Clague, Ewan, and Gordon, Joel, "Earmarking Tax Funds for Welfare Purposes," *Social Security Bulletin*, IV (January 1940), 12.

were financing relief from general, rather than earmarked, revenues. Nevertheless, even in that year, eight States relied wholly on earmarked funds for their share of general-relief expenditures, while four others utilized a combination of earmarked funds and general revenues. Reliance on earmarked revenues was more common among the localities. In six States, local expenditures were financed entirely from earmarked funds; in seven the majority of political subdivisions utilized earmarked taxes solely, while the remainder used them as a partial source of revenue. In six others, earmarked funds were used as the sole source of revenue in certain areas or in combination with general revenues in the majority of counties.

General sales taxes represented the revenues most commonly earmarked for relief purposes. Liquor and beverage taxes were only slightly less important.⁵⁶

Quite apart from questions of the incidence of the taxes thus earmarked, a matter which has been dealt with above, this method of financing public aid has raised several problems. It tends to foster an uneven development of governmental functions. Depending upon the yield and stability of the specific earmarked taxes some services will expand, perhaps to an excessive degree, while others will fail to secure adequate funds for minimum performance. The most noteworthy example of the influence exerted by earmarking is supplied by the State of Colorado, where the old-age assistance program has secured the lion's share of State welfare expenditures at the expense of other programs.⁵⁷

⁵⁶ Data in this and the preceding paragraph from *Social Security Bulletin*, V (March 1942), 21-24.

⁵⁷ In Colorado the State constitution allocates to old-age assistance 85 percent of all net revenues from any and all excise taxes now or hereafter levied upon sales at retail and other purchase transactions, on the storage, use, or consumption of any commodity product, and upon liquors, as well as 85 percent of the yield of inheritance taxes and incorporation fees. For a discussion of the disparities between old-age assistance and other programs in terms of numbers covered and payments made see above chs. VI and VII.

Officials of the Social Security Board have drawn attention to the harmful effects of the device of earmarking upon orderly budgeting for public services and upon the opportunity for continuous legislative review of the expenditures devoted to each governmental function in relation to others.⁵⁸

Unemployment compensation reserves.—Reliance upon earmarked taxes has peculiar disadvantages in regard to programs in which the volume of expenditures is likely to move inversely with the general state of business activity. This is especially the case with public-aid programs, the need for which is directly or indirectly occasioned by unemployment. For the conditions which cause unemployment are likely also to reduce the yield of most earmarked taxes.⁵⁹

The Social Security Act endeavored to offset this disadvantage of reliance upon earmarked taxes for financing unemployment compensation by providing for the levying of taxes which, apart from experience rating, would be uniform from year to year, and for the accumulation in a reserve of the surpluses arising in years in which tax collections exceed benefit payments. Furthermore, the act prohibited the States from making benefit payments until taxes had been collected for 2 years. The obvious purpose of these requirements was to sustain assured benefit payments whose volume would fluctuate inversely with the extent of employment, without the necessity of raising taxes in periods of depression.⁶⁰

Since the beginning of tax collections, the total of the State unemployment reserve funds, which are maintained in the Federal Unemployment Trust Fund, has steadily grown. By June 1940 it amounted to nearly \$1,700 million.⁶¹ As is evident from Table 85, the ratio of benefits paid to contributions currently collected for the country as a whole has been gradually declining, thus producing an increasingly larger reserve. In 1938 in the benefit-paying States, more than 81 cents were paid out for every \$1 currently collected. In 1940, approximately 61 cents in benefit payments was made for every \$1 of contributions currently collected. In the first 6 months of 1941, only 42 cents was paid out for every \$1 currently collected.⁶² By

1940), 48. This editorial states: "Indeed, with a \$370,000,000 annual fare Purposes," *Social Security Bulletin*, IV (January 1940), 14.

⁵⁹ For an account of the most usual types of earmarked taxes see *Ibid.*, pp. 15-20.

⁶⁰ Cf. the statement of the Committee on Social Security: "Unless reserves are accumulated during less adverse times to meet depression emergencies, drastic measures may be necessary to maintain the system on a solvent basis during prolonged and widespread unemployment." (Social Security Board, *Social Security in America*, Publication No. 20, Washington, 1937, pp. 116-117.)

⁶¹ Social Security Board, *Summary of Employment Security Activities, June 1940*, Washington, 1940, table A2. By June 1941, the balance was about \$2,105 million. (Social Security Board, *Summary of Employment Security Activities, June 1941*, Washington, 1941, table A-2.)

⁶² *Ibid.*, p. 8.

TABLE 85.—Ratio of benefits to contributions, by States, for specified periods through June 1941

State	Date benefits first payable	1938 benefits to 1938 contributions ¹	1939 benefits to 1939 contributions ²	1940 benefits to 1940 contributions ³	Jan-June 1941 benefits to Jan-June 1941 contributions ⁴	Cumulative benefits to cumulative contributions since benefits first payable ⁴	Cumulative benefits to cumulative collections and interest since January 1936 ⁴
Total		81.8	54.4	60.8	42.0	59.3	41.0
Alabama	Jan. 1938	124.9	50.4	49.0	29.4	61.9	46.8
Alaska	Jan. 1939		64.0	77.5	76.2	77.2	46.2
Arizona	Jan. 1938	106.6	70.5	60.0	39.5	72.4	55.2
Arkansas	Jan. 1939		52.9	88.4	78.4	72.1	43.3
California	Jan. 1938	38.2	49.8	85.1	77.5	62.0	47.5
Colorado	Jan. 1939		68.8	89.5	64.9	76.0	42.4
Connecticut	Jan. 1938	95.1	30.7	27.1	11.4	39.4	30.5
Delaware	Jan. 1939		29.8	35.1	26.0	31.1	18.2
Dist. of Columbia	Jan. 1938	26.3	21.0	36.7	45.0	29.9	22.5
Florida	Jan. 1939		54.0	98.1	47.9	69.1	42.7
Georgia	Jan. 1939		40.4	50.5	29.6	42.1	23.7
Hawaii	Jan. 1939		15.5	14.5	9.2	13.7	7.9
Idaho	Sept. 1938	68.4	109.6	102.9	119.2	105.0	66.5
Illinois	July 1939		49.9	62.5	42.5	54.2	25.0
Indiana	Apr. 1938	140.5	48.9	44.1	22.0	58.4	40.3
Iowa	July 1938	65.7	63.8	52.1	47.2	57.6	39.4
Kansas	Jan. 1939		42.1	43.6	38.7	41.9	22.4
Kentucky	Jan. 1939		43.8	44.3	25.5	40.1	23.0
Louisiana	Jan. 1938	44.9	60.5	83.9	67.5	63.1	49.2
Maine	Jan. 1938	143.2	73.9	85.4	42.4	88.4	68.1
Maryland	Jan. 1938	99.9	47.5	62.8	32.7	59.0	47.4
Massachusetts	Jan. 1938	75.4	52.0	81.2	45.8	65.7	48.5
Michigan	July 1938	290.3	82.2	53.4	17.7	77.7	52.6
Minnesota	Jan. 1938	67.6	53.2	78.9	96.3	69.6	53.2
Mississippi	Apr. 1938	78.9	65.4	86.0	56.6	73.1	52.4
Missouri	Jan. 1939		27.9	36.9	23.0	30.3	17.4
Montana	July 1939		56.2	115.5	139.0	107.0	49.2
Nebraska	Jan. 1939		33.3	67.6	99.1	53.2	26.6
Nevada	Jan. 1939		86.1	119.0	123.9	106.9	63.7
New Hampshire	Jan. 1938	99.5	54.4	87.2	41.2	73.8	50.0
New Jersey	Jan. 1939		32.6	32.8	24.3	30.8	19.2
New Mexico	Dec. 1938	112.5	85.8	86.7	73.5	83.7	48.1
New York	Jan. 1938	69.7	68.8	77.8	56.2	69.7	55.4
North Carolina	Jan. 1938	84.0	39.4	40.4	22.5	47.8	37.4
North Dakota	Jan. 1939		55.2	71.7	143.2	73.7	37.8
Ohio	Jan. 1939		42.7	42.0	23.3	38.1	22.1
Oklahoma	Dec. 1938	12.7	75.9	59.8	48.8	61.7	32.8
Oregon	Jan. 1938	98.4	71.5	60.8	48.5	71.8	55.4
Pennsylvania	Jan. 1938	102.3	69.5	58.0	34.8	67.2	52.3
Rhode Island	Jan. 1938	113.8	70.3	80.0	33.7	77.5	61.0
South Carolina	July 1938	28.3	55.7	53.7	26.6	44.4	29.3
South Dakota	Jan. 1939		35.0	34.5	54.3	38.0	20.9
Tennessee	Jan. 1938	90.8	52.6	73.0	40.0	66.4	51.0
Texas	Jan. 1938	43.0	47.4	44.9	43.9	45.0	34.2
Utah	Jan. 1938	117.6	63.0	60.6	47.4	72.4	55.1
Vermont	Jan. 1938	58.1	37.6	68.1	45.3	52.6	39.9
Virginia	Jan. 1938	68.0	44.4	58.8	32.6	52.7	40.9
Washington	Jan. 1939		68.8	87.4	65.7	75.9	42.5
West Virginia	Jan. 1938	135.1	42.2	37.8	33.1	63.4	47.9
Wisconsin	July 1936	57.8	24.4	36.8	25.9	38.9	24.8
Wyoming	Jan. 1939		82.7	104.8	81.2	90.4	50.3

¹ Levine, Louis, *The Problem of Increasing Reserves in Unemployment Compensation*, Social Security Board, Employment Security Memorandum No. 5, Washington, 1940, p. 3.
² Social Security Board, *Social Security Yearbook 1939*, Washington, 1940, p. 121.
³ *Social Security Bulletin*, IV (February 1941), 51; Washington, 1940.
⁴ Computed from Social Security Board, *Summary of Employment Security Activities June 1941*, Washington, 1941, unpagged, table A3-11.

June 1941 total benefits paid amounted to 41 percent of all taxes collected (plus interest) since 1936.

The mounting size of the reserves which, as will be indicated below, are particularly high in certain States, has given rise to a conviction that the Federal reserves are excessive and to specific demands for their reduction through a lowering of tax rates or through liberalization of benefit provisions.⁶³ In fact,

⁶³ See, for example, "Reduction in Unemployment Insurance Tax Imperative," *Social Security*, XVI (June-July 1940), 1, 6-8; and "Unemployment Funds Need Employment," *Business Week*, (August 14,

however, there are serious reasons for doubting whether it is yet possible to assert that the reserve provisions are excessive or even adequate to fulfill their original purpose of ensuring continuous payment or the benefits provided for in the existing laws in periods of good and bad trade.

In the first place, it is noteworthy that, with the exception of the latter months of 1937 and the first 6 months of 1938, unemployment compensation experience in this country has been confined to a period of expanding pay rolls and employment. Thus, although benefit payments have increased as the laws have come into full operation,⁶⁴ the drain upon the funds has been relatively slight, because the percentage of covered workers who have been unemployed has been relatively low.⁶⁵ Not until the unemployment compensation laws have experienced a period of business recession following a period of relatively high employment will it be possible to determine whether the present reserves will be adequate or more than adequate to meet the drain upon the Fund. From this point of view, it is significant that when the accumulations of the first 2 years preceding the beginning of benefit payment are excluded, benefits constitute nearly 60 percent of taxes collected as against a little over 40 percent when these accumulations are taken into account.

In the second place *discussion of the adequacy of reserves that runs in terms of the mounting total of the funds in the Unemployment Trust Fund conceals a disturbing disparity in the experience of the different States.* For, although the reserves are held in the Federal fund, they remain the property of the individual States, and a surplus standing to the credit of one State cannot be used to meet the deficit of another. There is already evidence that the differing employment risks (and to a much lesser degree the differing legal provisions) of the States are resulting in very different financial experiences.⁶⁶ Thus during the first 6 months of 1938 (a year of relatively heavy unemployment) when only 23 States were paying benefits, 13 States paid out more in benefits than they

1940), 48. This editorial states: "Indeed, with a \$370,000,000 annual margin, it is possible both to reduce taxes and to liberalize benefits."

⁶⁴ In 1940, for example, disbursements to unemployed workers were 15 percent higher than in 1939 owing mainly to the following factors: (1) full 12 month operations by 18 States which began operations in January 1940, (2) higher base-period earnings in 1939 which resulted in larger benefit amounts and longer duration in 1940, (3) liberalization of State laws. (*Social Security Bulletin*, IV (February 1941), 51.)

⁶⁵ In certain States, such as New York, the small volume of general unemployment among covered workers has been masked by the heavy claims made by seasonal workers.

⁶⁶ The diversity in the incidence of unemployment among the States had been noted by the Committee on Economic Security in its studies prior to the passage of the Social Security Act. The Committee estimated, for example, that the percentage of unemployment in 1933 ranged from 15 in Georgia to 47 in Michigan. See Social Security Board, *Social Security in America*, pp. 58-59 and table 5.

currently collected in contributions. For every \$1 currently collected, for example, Rhode Island paid in benefits \$1.65; West Virginia, \$1.84; Utah, \$1.87; and Maine, \$2.07. During the second half of the year, drains on the State funds were somewhat reduced because many workers had exhausted their benefit rights and others became reemployed.⁶⁷

Although 6 of the 31 States paying benefits during part or all of 1938 paid out less than 50 percent of their collections, 10 paid out more than they currently collected. Michigan, in fact, paid out almost \$3 for every \$1 collected. (See Table 85.)

By the time benefits became payable in 18 additional States in January 1939, employment conditions throughout the country were gradually improving. With expanding employment and pay rolls, contributions increased more rapidly in relation to benefits charged.⁶⁸ Benefit payments in all States represented about 54 cents out of each dollar currently collected in 1939, as compared to 82 cents in 1938. Idaho was the only State in which benefits exceeded contributions. Michigan, Nevada, New Mexico, Oklahoma, and Wyoming, however, paid out 75 cents or more for every \$1 received. At the other extreme, Delaware, the District of Columbia, Hawaii, Missouri, and Wisconsin each paid less than 30 cents for each \$1 received.

As Table 85 shows, in 1940, a year of increasing

employment while benefit payments amounted to almost 61 percent of contributions collected in that year, they exceeded contributions in four States (Idaho, Montana, Nevada, and Wyoming) and were 80 percent or more of contributions in 12 others. The experience of the first half of the year 1941 is still more significant. For although, with expanding employment due to increased defense activity, benefits for the country as a whole amounted to only 42 percent of contributions collected, four States (Idaho, Montana, Nevada, and North Dakota) had to dip into their reserve, while in seven others benefits amounted to over 70 percent of contributions. At the other extreme, benefits amounted to less than 30 percent of contributions collected in 13 States.

It is evident that the objectives of reserve financing are unlikely to be attained so long as the reserves are maintained in 51 separate funds. This situation has led to a growing interest in proposals for some form of reinsurance, and during 1940 two bills were presented to Congress for the establishment of a Federal Unemployment Re-insurance Fund in the Treasury of the United States.⁶⁹ Neither bill emerged from Committee.

⁶⁷ The McCormack Bill (H. R. 7762, 76th Cong., 3d sess.) sponsored by the American Federation of Labor, proposed to deposit in the fund the difference between the 10 percent of the yield of the pay-roll tax retained by the Federal Government and the amount actually spent on costs of State administration, and an annual appropriation of an amount sufficient to maintain payment in accordance with Federal minimum standards set forth in the bill.

The Murray Bill (S. 3365, 76th Cong., 3d sess.), sponsored by the Congress of Industrial Organizations, proposed to establish a Federal equalization account which was to be credited with 33½ percent of all money deposited by each State together with the difference between the Federally retained 10 percent of the yield of the unemployment compensation pay-roll tax and actual expenditures for administration.

⁶⁸ Levine, Louis, *The Problem of Increasing Reserves in Unemployment Compensation*, Social Security Board, Employment Security Memorandum No. 5, Washington, 1940, p. 2.

⁶⁹ See Levine, Louis and Lerner, E. R., "Financial Aspects of Unemployment Compensation Experience," *Survey of Current Business*, XIX (September 1939), 12-18.