

Are We Going Broke?

A Debate on National Finances

I—Up to Our Neck in Debt

by H. PARKER WILLIS

THE OPENING of a new fiscal year on July 1, with a public debt which had reached an all-time peak with an aggregate near \$34,000,000,000, has naturally attracted the attention of the public to the question of Treasury conditions. Secretary Morgenthau, in his annual statement, is inclined to treat the great growth in debt rather lightly, pointing out that a very substantial percentage of the increase in new debt since the opening of the present administration has been the result of loans for which the various governmental agencies have claims upon those who have borrowed the funds, the result being a corresponding lessening of the true total of obligations.

Indeed, in Secretary Morgenthau's annual statement, while he places the aggregate debt at \$33,750,000,000, an increase of about \$18,000,000,000 since President Roosevelt took office, he is disposed to claim an offset of about \$8,750,000,000, composed of \$2,750,000,000 balance in the Treasury fund, the stabilization fund amounting to \$2,000,000,000, and at least \$4,000,000,000 loans which it is assumed will eventually be collected. There is another side to this offset question, due to the fact that the government itself has guaranteed outstanding bonds which are reported in the Federal Reserve Bulletin each month and now aggregate a total upwards of \$5,000,000,000, which, of course, must be added to the total for which the government is eventually liable.

Its actual debt, then, would seem to be in the neighborhood of \$34,000,000,000, with a contingent liability of \$5,000,000,000 additional, making nearly \$39,000,000,000; while the government has on hand in the "general fund" \$2,700,000,000 plus the stabilization fund of \$2,000,000,000. Making these deductions of \$4,700,000,000, we should have left an outstanding debt of about \$34,300,000,000.

The miscellaneous assets which are counted by Mr. Morgenthau as possible or probable reductions in liability, resulting from collections, will eventually produce something. Judging from the experience thus far had with the government's claims against borrowers in the way of necessary renewals, it would seem that the actual collections eventually realized would be a comparatively small percentage of the total. However this may be, it is admitted by all that most of whatever is collected will come in only after a great while; the same considerations which led to the lending of it in the first place proving influential in bringing about renewals or extensions. On the other hand, the meeting of the principal and interest upon guaranteed obligations, when these fall due and are not otherwise met, is unavoidable, as a matter of the sustaining of public credit. The obligations which have thus been incurred on a contingent basis present a kind of liability which is constantly developing into some draft upon the ability of the government to pay; while the stabilization fund and the general fund of the Treasury are, of course, unproductive and merely represent working funds that are theoretically available. From all practical standpoints, therefore, the actual burden of the existing debt at the present time must be regarded as equivalent to an amount substantially more than the \$33,750,000,000 definitely recognized. If we say that at the present moment the government is actually carrying a load of about \$35,000,000,000 of indebtedness, we shall be putting the matter conservatively.

II

AS WE HAVE just seen, Mr. Morgenthau's annual statement places the increase of public debt during the Roosevelt Administration at about \$13,000,000,000, minus, according to

him, the offset of some \$8,750,000,000 more or less representing cash in hand and recoverable assets: an indicated increase of debt then of about \$13,000,000,000 and, according to Mr. Morgenthau's estimate, a real increase of only about \$4,250,000,000. The Secretary of the Treasury, moreover, points out that, owing to constant reductions in the rate of interest, which he estimates at about one quarter of the original amount, the annual cost of carrying the debt has been reduced by \$260,000,000 and is not much more than it was at the opening of the new administration.

After making all allowances and offsets and after allowing for the reduction in the rate of interest which has taken place and above all after assuming that the present reduction in the rate of interest will continue indefinitely, we still have an outstanding and undisputed debt which is very much higher than it has ever been before and which today is far above the total that had been expected or estimated in advance by our Treasury authorities. The situation naturally raises in a good many minds two questions: (1) How far will this increase in debt be likely to continue, and (2) how far is the nation likely to be able to continue to carry further increments of debt? These two questions are of very vital significance, particularly in view of the fact that our present system of taxation by no means provides the income necessary to cover present expenses, so that the country, as things stand, must expect to face a continuing indebtedness as time goes on.

It needs no argument to show that this is a situation that is necessarily temporary, but the questions remain: What is its degree of permanence, and what factors are likely to bring it to a close? There has been a great deal of discussion within the past two or three years about the amount of debt that the nation "can" carry. Some persons high in the national service have gone so far as to estimate the amount that can be borne by the federal government as, perhaps, double its present amount — say, \$65,000,000,000 or \$70,000,000,000; and the vague statement has been made that such estimates have been sanctioned by well-informed bankers. To such assertions is added the further estimate that our present indebtedness, if computed either as a fraction of total national wealth or as a per-capita burden

resting upon the population, is very low as compared with the debt burdens of inhabitants of other countries and may be considerably increased.

Comparisons between the United States and other countries are usually made without taking into account all of the facts in the case. For instance, our States and municipalities have in nearly all cases large debts outstanding. In some States the actual burden of this debt is more severe than the proportionate share of the federal debt for which property owners are liable. Exact comparisons, therefore, between the amount of outstanding debt which must be borne by citizens of various countries are usually not reasonable, and are made without recognition of the fact that the whole question of the ability of the country to carry indebtedness depends upon the character of her taxation, quite as truly as upon the amount of wealth that she owns. A traveler hastening to a train may find himself very much embarrassed by a great number of packages or boxes of varying sizes but, if able to arrange what he has to carry in a single large traveling bag, may have comparatively little difficulty carrying his luggage. So with a citizen in a country where numerous ill-assorted and oppressive forms of taxation are in vogue. He might easily enough pay the total amount that is asked of him if the load were to be differently distributed and were to be put in a form more convenient to bear.

III

THIS IS the situation of the United States at the present time. The question of how heavy a burden of taxation and of indebtedness can be endured by the community is not susceptible of any absolute answer, nor is a conclusion with regard to it facilitated by ill-advised comparisons with conditions in other countries which are not on the same footing. Unquestionably, a very much larger burden of debt than is now resting on the United States could be endured — but only in the event of an entire readjustment of our tax system. In order to rival other countries, we should have to readjust our income-tax system in such a way as to have it reach the lower strata of incomes.

In the last analysis, of course, the capacity of the country to obtain wealth by taxation or by borrowing is dependent upon the amount which the community has and the proportion of its

total which it is willing to set aside for governmental purposes. The current estimates of the total amount of wealth and income available here are, of course, rough approximations at the best. If we assume, as some have in recent months, that the income of the country is now represented by about \$50,000,000,000 to \$55,000,000,000, while the total tax burden — federal, state, and municipal — is estimated at perhaps \$12,500,000,000, we have a situation in which about one fourth of our national income is being taken for public purposes. Roughly speaking, this means that of every dollar which the citizen receives about 25 cents is taken from him, either in direct or in indirect exactions (sometimes made through the medium of an increase in the price of necessities, due to our heightening of costs of production, through taxation).

Congress, for example, has just adopted a piece of legislation designed to change the basis of corporate taxation so as to bring the so-called surpluses of corporations within the scope of present income taxation. The eventual significance of this step is, of course, still further to confuse our conceptions of income and capital and to carry further the disposition

of Congress to levy its taxes upon capital accumulation when it is nominally attempting to enlarge income taxes. In this, as in other cases, the danger involved is not so much that of an overexaction of public wealth as it is the reduction of those portions of wealth which would otherwise be set aside for the purpose of rebuilding plants and giving employment to labor.

We have set forth, in brief terms, only a few of the serious questions which present themselves in connection with the tax and debt problem, but enough has been said to show that no simple answer can be given to the queries now raised as to the ability of the country to tax or borrow. What we may be sure of is that, as things stand, we have already gone beyond the limit, both of taxation and of borrowing, that is safe and wise for the nation as a whole; and that in order to enlarge it we must make up our minds to great changes, both in average consumption or in cost of living and in conditions of employment. It is possible for our nation or any other to do either or both of these things. The question is not one of possibility but of desirability and of public advantage.

II—America Has Only Scratched Her Resources

by **ROBERT H. JACKSON**

THE CAMPAIGN opens with the cry of, "Wolf!" Candidate Knox talks of a "rendezvous with a receiver for the Treasury." Opposition leaders who promise a tight financial policy in loose language and seek to impress the country with their patriotism by slandering the nation's credit are trying to capitalize an honest anxiety which Mr. Willis expresses and many share.

Of course no thrifty-minded person views an increase of the public debt with satisfaction, and no sensible official favors spending public funds to a greater extent than conditions imperatively require. It is equally true that no

influential person should disregard or discount the factors in the present situation which give reason for confidence in our present national financial soundness and stability. Disregard of such factors gives a picture of the national economy as distorted and false as the picture in the mind of the person who believes in unrestricted spending. Neither can lead to any solution because each picture is distorted and unrealistic. Both result in a vague worry which obscures the problem instead of clarifying it. Thus Mr. Willis, after expressing his anxiety, can only ask the question: "How far will the increase in debt continue?" He can give no

hint of the answer. This means that he cannot frankly face the problem of the balance of necessary expenditures and available revenue which will be before any administration, whether Republican or Democratic, for the next few years.

The answer to the question proposed by Mr. Willis can be given only by events. The problem will continue until rising revenues and declining expenditures meet. The solution can be found only by taking an accurate account of the asset side as well as the debit side of the ledger. This is true of a private corporation when it is called on to meet a necessary expenditure. It is equally true of the government.

If we take a realistic view of the present situation, we find little to justify Mr. Willis' querulous anxiety. There is every reason to believe that the meeting between rising revenue and declining expenditure is not far away.

Since Mr. Willis' article was written, the Treasury report for July, 1936, has become available. The deficit incurred in July, 1936, is actually less than the July deficit for 1928 or any July since.

The favorable showing for a normally deficient month is due to repayment, by the Reconstruction Finance Corporation, the Commodity Credit Corporation, and three other agencies, of about \$241,000,000 in excess of debits. This month is not typical, and optimists are inclined to claim too much for it. It does, however, discredit the pessimistic assumptions of Mr. Willis and support Secretary Morgenthau's assurance that the New Deal deficit is in substantial part represented by prudent investment.

II

MR. WILLIS' second question is: "How far is the nation likely to be able to carry further increments of debt?"

No figure can fairly be assigned as a limit to a variable that responds to changes in economic and even psychological influences. The fairest answer must take the form of a condition or ratio, and a formula which seems to sum up all factors may be offered.

The limit is reached whenever an increase in tax rates or a new tax levy *fails to produce an increase in revenue*. When a tax increase meets with diminishing returns, then and not until

then can we say that a government is financially embarrassed.

By this test our government passed the low point of its credit in 1932 and 1933. By the revenue act of 1932 the government tried to increase its inadequate revenues by raising corporation and individual income taxes and by adding a gift tax and manufacturers' excise taxes.

But the revenue response was a further decline in total collections. From \$2,800,000,000 in 1931 they fell to \$1,886,000,000 in 1932 and again to \$1,871,000,000 in 1933. The Administration had lost control of its revenues. The tax structure seemed to rest on quicksand, and the heavier we made the load the faster the foundations crumbled. The reason for the failure of revenues to respond to tax increases is illustrated by the corporation income tax.

In 1929 the tax on corporate income yielded \$1,193,000,000 and in 1931 only \$398,993,000. This helped to unbalance the budget of the Hoover Administration and stirred the government. The revenue act of 1932 upped the corporation rate of 12 per cent to 13 $\frac{3}{4}$ per cent. But, while the 12-per-cent rate had produced about \$398,000,000 in 1931, the 13 $\frac{3}{4}$ -per-cent rate produced only \$286,000,000 in 1932. The reason was that the number of paying corporations in 1932 was only about one half of those paying in 1931, and their aggregate taxable income was a billion and a half less. The corporation tax had struck diminishing returns. Federal credit and spending power, in so far as it rested on that tax, was exhausted.

Failure of nominal tax increases actually to produce added revenues was a most discouraging indication, as the Hoover Administration came to its close. The very earnestness of Mr. Hoover's effort to balance his budget made his failure the more ominous. Even so, I do not believe we faced bankruptcy. The resources of our government and of our people were not exhausted even then. But that desperate hour affords a yardstick by which to measure opposition claims about this administration's financial position.

Sharp reversal of this trend toward financial disaster is illustrated in the corporation income-tax returns filed to December 31, 1935 (the last available), as contrasted with those of 1932. The rate of taxation on corporations was again increased, and the response was not a

decline but an increase in revenue from \$286,000,000 to \$586,000,000. The 82,000 taxpaying corporations had increased to 145,000. The corporation taxable net income of \$2,100,000,000 had grown to \$4,200,000,000.

The same upward trend was apparent in tax returns of individuals for 1935 (as filed August 31, 1935 — the last figures available). Net taxable income shown in 1932 of \$7,900,000,000 had become \$12,400,000,000, and the tax liability of \$329,900,000 increased to \$506,400,000.

There is no large debt or small debt, except as related to the resources available for payment. One man may owe a million dollars and be solvent, another owe a thousand and be bankrupt. The significant financial information is ratios and trends. The prophets of disaster publish only the liability side of the ledger.

The most significant measure of the debt of the Roosevelt Administration is this: The Roosevelt debt is *less*, per dollar of revenue, than the Hoover debt was.

June 30, 1932, showed revenues from taxes and customs of \$1,888,000,000 and a gross national debt of \$19,487,000,000. For each dollar of Hoover revenue there was owing \$10.32 of debt.

June 30, 1936, showed revenues from taxes and customs of \$3,890,000,000 and a gross debt of \$33,779,000,000. For each dollar of Roosevelt revenue there is only \$8.66 of debt. Our debt today is actually smaller in proportion to revenue backing than the debt in the closing days of the Hoover Administration.

While the average interest rate on the whole public debt in February, 1933, was 3.40 per cent, it had been reduced by June 30, 1936, to 2.56 per cent. The result is that it requires but a trifle more of the present revenues to carry the whole present debt than it was costing Mr. Hoover's administration to carry his debt. So, judged either by cost to carry or by revenues available, the present debt compares favorably with the debt of 1932. The last three years of the Hoover Administration, to March 3, 1933, produced a deficit of \$6,220,000,000, which piled up the public debt by \$5,060,000,000 net. This increased debt, not mentioned by Mr. Willis, was added at high interest cost and in the face of declining revenues. The Roosevelt deficits are supported by increasing revenues and subject to low interest costs.

III

HOW MUCH water can be taken out of a well? It depends on the rate of replenishment. So with the tax that can be taken out of the national income. Mr. Willis speaks of a present "income of the country" of \$50,000,000,000 to \$55,000,000,000 per year. For governmental fiscal policy, I prefer as a barometer only taxable income reported by individuals and corporations. They may be overmodest — the modesty of some men about their taxable income is shocking — but they are solid. One thing our financiers have never watered is their income-tax returns.

Taxable income reported was, in round figures, in 1929, \$32,000,000,000; 1932, \$10,000,000,000; 1935, \$16,000,000,000. While two thirds of our national taxable income disappeared during the administration of President Hoover, it increased 60 per cent during the first half of President Roosevelt's administration; and the increase continues.

In weighing the effect of a debt a vital consideration is whether its proceeds replenished national income and added to national resources. In that respect the debt Mr. Roosevelt incurred contrasts wholly in his favor with that which he inherited. A policy which raised a billion dollars to finance the banks of the country through the Reconstruction Finance Corporation does not have the exhausting effect of a policy which raised the same billion dollars to be shot to pieces on the battlefields of Europe. No one could compare a billion dollars spent in American public works with a billion dollars loaned to Europe. Repayment of debt that represents investment in added resources will be easier than payment for the proverbial dead horse.

Like Mr. Willis, I do not know the limit of taxation or the peak of our possible national debt. I strongly suspect that the limit is one which would recede as we approached it, if we approached it under real necessity. America has not begun to test her strength.

In addition to all tangible values, is not the government today entitled to a "going concern" value which had all but disappeared the day Mr. Roosevelt took the oath?

Who would go back to the days of 1932 and 1933, even if he could have them on a tax-free basis? There are things worse than taxes.