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War finance

By GRETCHEN WELLS, C. P. A.

What methods of financing are available to a country at war? Indirect methods include the process of failing to repair or replace capital goods which wear out or are destroyed. Money metals can be used to purchase goods from other nations. Foreign investments can be liquidated as was done by England in 1941. Borrowing from foreign countries can take place. Still a further indirect method of financing war is to loot conquered countries, the most recent example being Germany.

Among the direct methods of financing a war, some are predominantly expansionary while other methods can by their natures partly offset inflationary tendencies. Issuing paper money or government bank borrowing are the easiest but most dangerously expensive means of war finance. Paper money was issued during the Revolutionary War, the War of 1812, and the Civil War. As a method, it is no worse than other inflationary methods, but is more readily distrusted by the populace. Borrowing from banks increases the government's bank account and places it in a position of competing with civilians for a shrinking supply of goods, thereby causing rising prices and inflationary spirals. Inasmuch as the entire funds necessary to prosecute the war cannot be raised through taxation and bonds purchased by the public, bank borrowing needs to be indulged in, with inflation checked by other means at the government's disposal, as will be pointed out later.

Borrowing from the public would appear to be noninflationary, as the first reaction is that consumer purchasing power is being drained off. However, unless the amounts which consumers would normally spend are taken away from the demand for goods side of the picture, expansionary forces remain. For instance, many in-

dividuals ordinarily have a program of placing a part of their earnings in savings banks, increasing life insurance coverage, or investing in securities, in other words, a savings program in their personal budget. If those individuals now invest those normal savings in government bonds, there will be little or no check on inflation for the reason that their normal expenditures will be competing for articles on a market in which the supply of consumer goods has been curtailed due to war requirements. If individuals' incomes available for spending have been augmented due to wage or price increases, the situation becomes more acute, as there is even more money on the demand side bidding up the price of goods.

The investment of idle funds (held by individuals or corporations) in government bonds provides revenues to the government but nullifies inflationary checks. Similarly, if individuals borrow money in order to buy war bonds, or buy bonds and use them as collateral to borrow funds, the bonds might just as well have been sold to the banks in the first place, as all three methods are forms of expansionary financing; the banks have been required to create credit. Likewise, attention needs to be given to the redemption provisions of government bonds. If it were possible to control the time when the public liquidates its bond-holdings, inflationary as well as deflationary forces could be controlled. However, the government can only discourage the unloading of public bond-holdings by providing that for the immediate future, bonds are redeemable below par.

The knowledge that, in order to check inflation, bond purchases should replace consumer-good purchases is one thing but to effect such purchases is another. United States has never openly forced its citizens to buy bonds. If campaigns to encourage individuals to purchase bonds up to a certain per cent of income do not produce effective results, a compulsory wage deferment plan could be instituted. Such a plan might involve pay deductions made in the same manner as employee contributions to the social-security fund and, indeed, carried on through the same channels. Such funds might then be invested in gov-

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ernment bonds and later used for unemployment benefits in case of a post-war depression. In addition, such a plan would offset the very real danger to be found in a widespread practice of liquidating these bonds during a post-war inflationary spree. In other words, bond redemption would better take place during a deflationary period.

There is another form of war finance that offers greater possibilities in checking inflation. Such a form is taxation. Taxation appears on the face to be the hardest and most severe method. Actually, in the long run it can prove more beneficial to the populace. It is a pay-as-you-go basis and for just that reason makes war costs apparent. The portion of the war financed by bonds is too often overlooked in a mental computation of the war burden. As will be seen, some forms of taxation are not entirely innocent of inflationary tendencies. In addition, some forms of taxation are inequitable. Types of taxes to be considered are additional corporation income and excess-profits taxes, additional income, estate, and gift taxes on individuals, and various types of excise taxes including sales taxes.

Why do some taxes not serve as an inflationary check? In the first place, any type of tax may actually be paid out of past savings or reduction of the current-year's savings program. Consumption is therefore not checked. Some types of excise taxes are added to the cost of consumer goods in the manufacturing processes and if such taxes are applied or increased, they come out in higher prices for commodities. To certain economic groups, higher prices are translated into higher living costs and demands are made by them for higher prices for their products or services, all of which in turn generates the inflationary spiral. A partial remedy is to have the tax separately stated, an accomplishment not easily brought about except for sales taxes and luxury taxes imposed, at the present, on consumers. Income taxes partially fail in their attempts to curtail consumer income for the reason that they are not collected until thirteen months (on the average) after the income is received. The immediate remedy is a withholding tax, by which employers de-

duct from pay checks a given percentage in anticipation of the employee's income-tax liability and disburse these withheld sums immediately to the government. The percentage must be established at a level which in normal cases will not collect more than the income-tax liability. If too much is collected, provision must be made for immediate refund.

The method of taxation also raises the question of equitableness. Income, inheritance, and gift taxes are said to be equitable for the reason that they are based upon an ability to pay. Excise taxes are said to be inequitable and regressive, as they bear heavier on the lower-income group. This situation comes about because this type of tax is levied chiefly on food and clothing, and more especially on the standardized type of commodity, easily reached by taxation. The lower-income groups spend more of their income proportionally on food and clothing. It is also in this group that large families are more likely to occur, thereby requiring disproportionate amounts of this type of goods. Therefore, a larger proportion of the income of lower-income groups is paid out in excise taxes. In peacetimes, this fact should be given very careful consideration. In an emergency, however, other factors come to the front. Large sums of money are needed and consumer income and purchasing power needs to be drained off. If a country has reached the limit in taxing the high-income groups, it must of necessity consider the possibility of taxing the lower-income groups. For example, the point has been reached in the United States where a substantial increase in the tax rate on high incomes raises an insignificant sum compared to a very low rate of tax on the low-income group. This is due to the fact that there are many, many more people in the low-income group, and their collective income is a considerable sum. Furthermore, it is into the hands of this group that enormous funds are being poured during the war activity. In fact, this group, in a great many instances, is receiving larger incomes per person. The argument may also be advanced during the present period that every individual, regardless of his income group, has a share in Democracy and its institutions; that the

low-income group have more to gain by the preservation of freedom.

Inasmuch as taxes are a source of war revenue and a greater or lesser extent check inflation, the various types deserve further consideration as to their possibilities of raising revenue. Corporation income and excess-profits taxes are already very high, but the advantage of this source of revenue is the ease of collection. There are relatively fewer corporate units than individual consumer units. On the average they are the depository of large sums of income, keep adequate records and are required to file detailed returns which are readily checked.

An inequity found in corporate income tax is the fact that such tax is levied before the distribution of corporate income to stockholders. Therefore a stockholder whose individual income-tax rate would be in the lowest brackets already has had his share of income in the corporation subjected to tax rates considerable above those he would have paid, had he received his share of corporate income, or, in the event of non-payment, been credited with his share.

Estate taxes have been mentioned as an equitable form of tax. They can become sharply progressive, but in so doing, discriminate against persons who become heirs during an emergency. Also, large collections are contingent upon the event of death of wealthy persons and do not occur until a period of time has elapsed (one year or longer).

Excise taxes already have been discussed as to their inflationary implications and inequities. If a program of withholding income tax is not adopted, a sales tax may be the necessary means of draining off consumer income. The additional problem involved is the rate to be imposed and the commodities to be included. In order to raise substantial funds, a comparatively high rate would need to be used. Sales taxes also present the additional problem of administration. If the tax is of a multiple stage or transaction-type of tax, the tax will pyramid with the number of times a commodity changes hands. If the multiple-stage type is modified as a value-added (each time the commodity changes hands) tax, computations become very

complex.

A single-stage tax may be imposed in the stage of manufacture. Since the number of industrial units are small compared to retailer units, and since they also maintain better records than retailer units, collection problems are minimized. As has been pointed out, however, adding the tax at the point of manufacture comes out in a higher sales price to consumers and gives the appearance of higher living costs (and the appearance of inflation). Taxing a commodity at the retailer stage presents problems of collecting from a greater number of units, encountering poor bookkeeping records, in addition to evasion and exemption. The one decided advantage lies in the fact that the tax can be added to the sales price as a separate item and therefore does not lose its identity as a tax.

In comparing excise taxes with income taxes, the statement may also be made that while taxes curtail some savings in addition to curtailing spending, more is taken from spending and less from savings as taxes move down the income scale. Therefore, excise taxes (including sales taxes) are more effective in reducing the spending of current incomes. In order to cut into current spending to the same degree, income taxes need to raise larger sums of taxes, but in so doing produce more governmental revenue. In other words, income taxes are greater revenue raisers per purchasing power reduction, in addition to being more equitable, as has been previously pointed out. However, the fact remains that in the absence of withholding provisions under the income tax, excise taxes are an alternative for draining off income immediately. Further, income taxes, to play an effective part in curtailing the spending of incomes and thereby checking inflation, need a broader base in order to reach a greater number of consumer units. Withholding provisions, if adopted, might well be applied to interest and dividends, as well as salaries and wages.

While the method of bond-buying and the imposition of taxes are important as media for checking inflation, neither of these separately or collectively can bear the full responsibility of checking inflationary forces. In addition, governmental controls, such as priorities, rationing and price con-

trols, are needed for the reason that taxes and bond-buying, partly because of the methods used and partly because of physical impossibilities, will not drain off excess purchasing power.

Under normal conditions, the productive capacity of the United States is able to rise to the occasion and furnish an increased supply to meet an increased demand. In the present emergency, however, the government demanding goods on an extensive and intensive scale cuts off a considerable portion of the supply available to the consumer. The demand is so much greater than the supply in the case of the consumer, and it is this excess demand that should be drained off in bonds and taxes. To the extent that these two are not effective, the government must, under present circumstances, prohibit the use of that demand by rationing in one way or another the amount the consumer can spend.

Chapter News

Chicago

"Inflation" was the topic chosen for the February meeting by Dr. Mac Dougall of Northwestern University.

Attorney Ambrose Kelly discussed "The Prospects of Peace" at the March meeting held at the Central Y. M. C. A.

Detroit

The three C. P. A. sponsors of the chapter shared the speakers table at the February meeting in a discussion of tax problems, Grace Dimmer answering the corporation problems, Crystal Kilgour interpreting the law in regard to Estate Taxes, and Cecil Miner offering solutions to the individual taxpayers problems. The enthusiastic reception and a large attendance indicated that a round table discussion on taxes is preferred to tax lectures.

Miss Grace Glascott, Regional Director for the War Labor Board was scheduled to speak at the March meeting on Salary Stabilization.

Tsk! Tsk!

The yearbook editor wishes to apologize for the omission of the reason for including the pictures of Anna Grace Francis and Grace Keats in the current edition of the yearbook.

For the benefit of the newer members, it

was Miss Francis and Mrs. Keats who first conceived the idea of forming the AWSCPA.

Los Angeles

"Corporation and Miscellaneous Income Taxes" was the subject at the February meeting with Jane Goode presiding as chairman.

Mr. J. A. Stellern, branch manager, U. S. Department of Labor, spoke on "Wage Stabilization" at the March meeting:

Officers elected for the coming year are:
President Ruth Clark, C. P. A.
First Vice-President Elsie Waterman
Second Vice-President Eunice Moseley
Treasurer Velma Thompson
Recording Secretary Vera Jean Bobsene
Corresponding Secretary

..... Florence Pennington
Parliamentarian Antoinette Usselman
Directors-at-large Alberta Crary
Carmen Barlotti
La Verne Nettle
Peggy Crawford, Chairman
Amy Baldwin Werking

Spokane

Hazel Skog, C. P. A., Barbara Bateman, C. P. A., Betty Lucas and Dorothy Miller headed a round table discussion on tax problems at the January meeting. The secretary reports, "Our January meeting proved popular and was a very informative one. The membership really opened up, asked a lot of questions, and, I believe, got a lot of information out of it."

The Palm rooms at the Desert Hotel seemed to be an appropriate place to hold a discussion on nutrition and war time rationing. The speaker, Mrs. C. C. Dill dealt with such subjects as balanced noon lunches, etc., a timely subject and a refreshing change of subject matter at this time of year when minds are so crowded with taxes and financial statements.

Indianapolis

"Cost Accounting in the Meat Packing Industry" was the subject chosen by Mr. Howard C. Greer, Vice President of Kingan and Company, at the February meeting. The secretary reports that intellectually it was a treat but gastronomically—at least one member couldn't keep from wondering whether he had a stray lamb chop or a lowly wienie in his left vest pocket.