

REDISTRIBUTION OF  
INCOMES  
THROUGH PUBLIC FINANCE  
IN 1937

BY  
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## PREFACE

THIS study is primarily a quantitative investigation into the redistribution of incomes through public finance in this country before the war. It is not concerned with answering any of the wider questions involved, although it was impossible to avoid raising them. The two most important questions which remain unanswered concern the adequacy of the British system of public finance as a whole, and the choice between redistributive finance and other methods of social policy.

It has been found that, considering the total effect of taxation and public expenditure, the pre-war system of public finance was on the whole progressive throughout the entire range of incomes; that is, the greater the income the greater was the proportion of taxation paid, or the smaller the income the greater was the proportionate benefit derived from public expenditure. But attention is also drawn to the fact that the system of public finance was not adequate from a number of other viewpoints, which are outside the scope of this book; in particular, the distribution of taxation between large and small families was not equitable.

A study of redistributive finance as a method of social policy also leads us outside the scope of this book; but it is evident that Britain's social aims could have been attained by means more direct and more effective than redistributive finance. This study is designed as a factual analysis on which opinion, and future action, concerning the wider issues can be based.

But inevitably any study of this nature leads to the discovery of great economic inequality, both of income and of wealth; it can be inferred that most social evils, such as want, ignorance, disease, and even involuntary idleness, are to a large extent due to economic inequality. It can be said, therefore, that the fight against these social evils cannot succeed unless economic inequality in its extreme forms is also attacked.

This book is the result of research carried out at the London School of Economics. Among my teachers I am particularly indebted to Mr. Nicholas Kaldor, who first suggested to me the idea of this inquiry, and who greatly helped me by discussing with me most points of economic interest at each stage. Several of my arguments were

written under the influence of the works of Professor J. R. Hicks on the national income and allied subjects, for which it was impossible to give specific acknowledgement in every case.

My thanks are due to the University of London for the Gerstenberg and another studentship, and to the London School of Economics for the Leverhulme Research Studentship and a grant, which enabled me to undertake this inquiry.

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T. B.

CAMBRIDGE

*March, 1945*

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## INTRODUCTION

'It is their maxim that the weight of taxes must be calculated not by what is taken, but by what is left.' EMERSON, *English Traits*.

SINCE the middle of the nineteenth century the activities of the government have covered an ever-widening field.<sup>1</sup> In 1913 the revenue and expenditure of the government was 12 per cent. of the national income. After the war, in 1924, the revenue or expenditure of the government came to 24 per cent. of the national income and never since has it fallen below that proportion.

The liabilities of the Exchequer greatly increased as a consequence of the First World War. There was a great expansion in the national debt and interest was paid at high rates. A great number of war pensioners had also to be provided for. Yet, at the same time, the expansion of social expenditure (initiated by the Liberal governments) continued at a rate greater than the contraction of interest on the national debt and expenditure on war pensions. By 1937 social expenditure constituted about half of the total government expenditure, and its ratio to the national income was equal to the ratio of total public expenditure to the national income in 1913. 12%.

In the expanded system of taxation, direct taxation expanded not only in its amount but also as a proportion of total revenue.<sup>2</sup> Social expenditure as a means of redistributing income from the rich to the poor was successful because it was financed by taxation falling mainly on the rich. The rate of indirect taxes on necessities (for instance on sugar) was lowered after the First World War and other duties (such as the duty on tea or on petrol) were abolished for a time. The 'thirties, however, saw the return of these duties and also of protective tariff duties. The importance of indirect taxation has grown during these years, and its complexity, because of preferential rates and hidden duties, became formidable.)

The incidence of taxation was known to be regressive in the lower ranges of income affected by indirect taxes only; but it was progressive in the higher ranges of income where the incidence of income tax and surtax fell. The tax curve was known to be U-shaped with the lower middle classes getting off rather lightly.<sup>2</sup> Each increase in taxation,

<sup>1</sup> Government, as explained in Ch. II, is meant to include all public authorities.

<sup>2</sup> Cf. diagram in U. K. Hicks, *The Finance of British Government, 1920-1936*, p. 270.

aimed at (probably for political reasons) increasing the yields of both direct and indirect taxation almost proportionately, raised both arms of the U-shaped tax curve but left the dip unaffected. An attempt to eliminate the dip was made for the first time during the war when, since the budget of 1940, the income-tax exemption limit was lowered and the proportion of direct taxation in total revenue raised.<sup>1</sup>

After the First World War the obligations of the government and its expenditure were regarded as being more or less given; attention was concentrated on the means of raising the revenue necessary to finance the given amount of expenditure and, especially, on the distribution of taxation between the various classes. In 1919 Lord Samuel read his presidential address to the Royal Statistical Society on 'The Taxation of the Various Classes of the People', comparing the distribution of most taxes at various levels of income before and after the war.<sup>2</sup> The calculation was repeated in great detail by the Colwyn Committee and the figures were brought up to 1925.<sup>3</sup> Finally, in 1942 the National Institute of Economic and Social Research published an inquiry into the incidence of taxation in 1937-8 and during the war.<sup>4</sup>

None of these inquiries discussed all taxes, and the expenditure side of the government accounts was completely ignored.<sup>5</sup> There was no attempt to answer the question how far were incomes redistributed by the government and how much was transferred from the rich to the poor.

It is necessary to regard the whole process of redistribution as something integral. Marshall stressed the point that all taxes should be considered together;<sup>6</sup> since that time government expenditure

<sup>1</sup> Cf. *Economic Journal*, June-Sept. 1943, p. 261.

<sup>2</sup> *Journal of the Royal Statistical Society*, 1919. Previous to that the rate of income tax and death duties was estimated officially in 1906, 1914, and 1918. Cf. pp. 109 et seq., below.

<sup>3</sup> *Report of the Committee on National Debt and Taxation* (1926). Papers in the *Journal of the Royal Statistical Society* by D. Caradog Jones (1927) and M. Sandral (1931) are based on the calculations of the Colwyn Committee.

<sup>4</sup> G. Findlay Shirras and L. Rostas, *The Burden of British Taxation* (1942).

<sup>5</sup> This is not to suggest that the authors of these inquiries were not aware of the limitations of their method, since it was made clear that certain taxes (notably rates) were omitted and the effect of public expenditure ignored. But, as argued below, it might be better to make an hypothetical allowance for any tax or expenditure than to omit it if we want to gain a balanced view.

<sup>6</sup> 'Onerous taxes, imperial and local, must be treated as a whole. Almost every onerous tax taken by itself presses with undue weight on some class or other; but this is of no moment if the inequalities of each are compensated by those of others, and variations in the several parts synchronise. If that difficult condition is satisfied, the system may be equitable, though any one part of it regarded alone would be

conferring divisible benefits has expanded so much that it is necessary to consider the whole system of taxation and expenditure together.) (The term 'burden of taxation' should be avoided as far as possible. We can only speak of the burden of taxation when comparing two alternative systems of taxation yielding the same revenue (given the pattern of public expenditure), or two different patterns of expenditure spending the proceeds of a given system of taxation. It is misleading to use this expression to imply that the nation's welfare is less than what it would be with a less expanded system of government finance (and lighter taxation), unless this proposition is explicitly stated and proved. It is not possible to speak of the 'burden of taxation' without considering, at the same time, the benefits of expenditure made out of this taxation.) Inquiries into the distribution of taxation alone cannot serve practical purposes or be used in political arguments. It is not so much a matter of explicitly stating the omission of government expenditure, when inquiring into the distribution of taxation, but a matter of correcting that omission.<sup>1</sup>

The question which the present inquiry seeks to answer has so far been asked by Mr. Colin Clark only.<sup>2</sup> Though his chapter does not aim at any very precise formulation of the question, or the attainment of exact results, its conclusions seem to be broadly true. 'In 1913 it appears that the working classes contributed more than the cost of the services from which they were direct beneficiaries, leaving a surplus contribution to general revenue. In 1925 working-class taxation contributed 85 per cent. of the cost of these specified beneficial expenditures; in 1935, 79 per cent.'<sup>3</sup>

inequitable' (*Memorandum on Imperial and Local Taxes*, C. 9528, p. 113). We should substitute for 'onerous tax', 'the redistributive effect of any kind of tax or expenditure'.

<sup>1</sup> A conspicuous case occurs when luxury goods are taxed and, at the same time, necessities subsidized. In that case it would be misleading to talk of the 'burden of taxation' on low incomes without taking into account the subsidies. In *The Burden of British Taxation*, for instance, the duty on sugar in 1941-2 is elaborately distributed while the subsidy on sugar, off-setting most of the duty, was ignored. The 'burden' of sugar duty on a standard family with low income was given as 4 per cent. of the income, whereas the correct figure should have been less than 2 per cent.

<sup>2</sup> *National Income and Outlay*, ch. vi.

<sup>3</sup> *Ibid.*, pp. 147-8. 'The net effect of taxation and local rates in 1935 can be described as a redistribution of £91 millions from the rich to the poor in the form of services, other than those provided for from the proceeds of working-class taxation. The £685 millions paid by the rich in indirect and direct taxation provides £263 millions of services beneficial to themselves, £91 millions for transfer as above, and the whole cost (£331 millions) of general administration and of public saving not covered by miscellaneous revenue.' (The dividing-line between rich and poor is taken as an income of £250.)

This book is divided into two parts. Part I deals with problems of general interest, mainly in the field of public finance and the national income. The central problem here is the exact definition of the scope and nature of this inquiry which is discussed in Ch. I. The government accounts are analysed in Ch. II and the national accounts in Ch. III. To conclude Part I, the initial distribution of incomes is obtained in Ch. IV.

The questions discussed in Chs. II-IV are closely relevant to the central theme but deal with subjects which would be, strictly speaking, outside the scope of this book. Their discussion was necessary partly for lack of published information and partly to adapt published information for our purpose. All appendixes at the end of the book refer to Chs. II-IV and are of a similar nature.

Part II deals with the actual measurement of redistribution of incomes in 1937. Chapters V-XVI follow a logical order, dealing with transfer expenditure, direct taxes, indirect taxes specifically on consumption, subsidies, indirect taxes on production in general, and, finally, public expenditure on goods and services. The length of the chapters is not at all proportional to the importance of the various taxes or expenditures but is related rather to the possibility—both theoretical and practical—of obtaining accurate measurements. The results are summarized and the conclusions given in Ch. XVII.

It is necessary to warn the reader that most of the conclusions are drawn after certain arbitrary assumptions have been made and that these assumptions are conditional to some, though not all, of the conclusions. The interpretation of the results, at the end of Ch. XVII, is of course largely a matter of opinion, and the results obtained might yield different interpretations in the hands of others.