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## Chapter 14

# TAXATION

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### INTRODUCTION

*Taxation without representation is tyranny.*

JAMES OTIS

*Of all debts, public and private, men are least willing to pay taxes. What a satire is this on government!*

RALPH WALDO EMERSON

*Taxes are what we pay for civilized society.*

OLIVER WENDELL HOLMES, JR.

AMERICANS not only grumble about paying taxes; they also dispute about what kinds of taxes are best (or least onerous), about what level of government they should be paid to, and about the purposes to which tax revenues should be put. American history shows at least six great controversies about taxation. All are perennial, but each has been a major issue in different epochs of our past.

The first is the colonial controversy surrounding the question of whether men can properly be taxed without their consent. The second involves the conflict between federal and state jurisdictions — the great question of states' rights. The third revolves around the tariff. The fourth concerns the suggested substitutes for this tax — notably the personal income tax. The fifth has to do with the question of the relations of church and state, and with the use of public taxes to support private schools. The sixth

touches on the general subject of philanthropy, both public and private, and involves questions about the role of nonprofit and tax-free institutions in the context of the modern welfare state. At the same time, this last controversy raises important questions about the purposes of taxation in general.

Before treating these great controversies, it is desirable to discuss the kinds of taxes that Americans pay, and the criteria, largely from an American point of view, for determining what is a fair or just tax.

#### 1. THE KINDS OF TAXATION

MODERN GOVERNMENTS impose many different kinds of taxes — so many, indeed, that economists have found it necessary to classify them, not by one or two but literally



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"He should pay the taxes"; cartoon by Homer Davenport, "New York Journal"

dozens of criteria. Taking only the ten or so most familiar, we find that they are classified according to the *tax base*, as taxes on real estate, on general property, on income, on inheritance, and so forth; according to the *regularity of the levy*, as ordinary and extraordinary taxes or assessments; according to the *purpose*, as general and special taxes (road and school taxes, for example, are special taxes, while the personal income tax is a general tax); according to the *manner of applying the charge*, as assessed and nonassessed taxes; according to the *basis of liability*, as taxes on things and taxes on persons; according to the *source*, as taxes on wages, profits, and rents; according to the *economic process particularly affected*, as taxes on production, acquisition, possession, exchange, and consumption; according to the *nature of the rate structure*, as proportional, progressive, and regressive taxes; according to the *method of fixing the rate*, as percentage and apportioned taxes; and according to the *assumption regarding "shifting,"* as direct and indirect taxes.

Many of these criteria are obvious

enough, but one or two require comment. A proportional tax is one in which all persons pay the same percentage, no matter how much or how little they may own of what is taxed; such a tax is described in Genesis 47:26, where it is said that "Joseph made it a law over the land of Egypt unto this day, that Pharaoh should have the fifth part." Real estate taxes in most U.S. communities are proportional taxes, although the rate of assessments on which the fixed percentage is paid sometimes differs according to the amount of real estate owned. A progressive tax is one in which the percentage of the tax base increases as the tax base itself increases. The federal income tax is such a tax. A regressive tax is the opposite of a progressive tax; an example is the sales tax on food. Since persons with low incomes spend more, in proportion to their income, for food than do persons with high incomes, they pay, relatively, a greater proportion of their income in the form of sales taxes. Thus the percentage of the tax base actually decreases as the tax base increases.

Tax shifting involves the distinction be-

tween the tax payer and the tax bearer, as well as the notion of incidence of taxation. Excise and consumption taxes, such as those on automobiles, cosmetics, liquor, tobacco, and "luxury" items, are actually paid to the government by the producers or distributors of these commodities, but they are passed on, or shifted, to the consumer in the form of higher prices. In like manner, the real estate tax, paid by the landlord, is passed on to the tenant in the form of higher rents, unless rent control hinders the landlord from so doing.

Nonshiftable taxes, or relatively nonshiftable taxes, include the general property tax, the general personal income tax, business taxes based on net rather than gross income, and the tax on inheritances. But all of these, even the personal income tax, may, in certain circumstances, be shifted. For example, a doctor or lawyer may pass on his tax bill to his clients in the form of higher fees — if, in fact, he does not lose clients by this practice or raise his income to a level at which the increased percentage of income tax due defeats the purpose of the original rise in fees. Modern economists tend to view the distinction between direct, or nonshiftable, and indirect, or shiftable, taxes as of dubious clarity and value. However, the distinction is of importance in American history.

All taxes are ultimately borne by the individual, but there is nonetheless a difference between the modern federal income tax, in which the federal government directly assesses individual U.S. citizens, and the general property or real estate tax that used to be assessed on individuals by the states and demanded by the federal government from the states on the basis of their relative populations. The latter taxes were at least jurisdictionally indirect; for the individual paid the state tax collector, who in turn paid the federal tax collector, with whom the individual, theoretically, had nothing to do. The distinction between direct and indirect taxes in this sense of the terms is not important

now, but in the nineteenth and early twentieth centuries it was the source of one of the most heated disputes in the history of American taxation.

Whatever system for classifying taxes is used, there is no question that the average American pays many taxes. They can be divided according to how they are paid — to the federal, to the state, or to the local government.

*Federal taxes.* The personal income tax is the most familiar federal tax, and also the one that produces the most revenue for the national government.

The federal government taxes businesses as well as individuals. Corporations receive their charters from the states instead of the federal government, so there is no federal "cost of doing business" tax. Instead, the federal government, treating corporations as persons, assesses their incomes. During World Wars I and II an additional tax was imposed on corporations, the so-called excess-profits tax, to keep companies from making undue profits out of war.

The Constitution gives the federal government the right to impose duties on goods imported from foreign countries. The schedule of duties imposed on particular imported articles, and on all articles imported from particular parts of the world, is called the tariff.

The Social Security tax is a degressive tax; that is, below a certain level of income the rate structure of the tax is regressive, and above this level the rate is fixed. The rate structure itself changes from time to time.

Inheritance taxes are assessed by the federal government in either or both of two ways, depending on particular circumstances. A general estate tax is levied on the entire estate of the deceased; and the various shares received by the heirs and assigns are also taxed. (If one of the heirs is a non-profit organization, such as a university, it may not have to pay inheritance tax on its share.) The federal laws regarding inheri-

tance are complex and experts are paid high fees — on which they of course pay taxes — to “minimize” taxes of this sort.

This might be the place to point out that minimization of taxes is recognized by all American tax courts as a basic right of taxpayers. However, evading taxes is not the same as avoiding them. The citizen has the right, indeed perhaps a civic obligation, to avoid taxes that he is not legally required to pay. But he may not evade taxes by concealing income or assets, claiming unjustified deductions, and so forth.

Use or consumption taxes are imposed by the federal government on commodities like gasoline, liquor, and tobacco. Gasoline taxes support the federal highway program but are also used for other purposes. Taxes on liquor and tobacco are used for general purposes. They were originally imposed to limit the consumption of these “luxuries” and have been retained partly for that reason, perhaps, and partly because consumers do not seem to complain publicly about the severe taxes they pay on these items. (Approximately four-fifths of the domestic price of a bottle of whiskey goes to pay taxes of one kind or another, imposed at all levels of jurisdiction.)

Federal excise taxes correspond to state and local sales taxes, except that they are imposed on particular items, such as automobiles, cosmetics, and jewelry, rather than on general sales. Excise taxes are often levied in order to discourage the purchase of certain commodities, as during World War II. Many other federal taxes are imposed on specific transactions and services, among them the tax on long distance telephone calls, on amusements, on stocks and bonds, and so forth.

*State taxes.* In recent years state taxes have increased numerically as well as in dollar revenues, although they have decreased in revenue relative to federal taxes. More than thirty states have some form of personal income tax, but most states are de-

barred from gaining large amounts of revenue from taxes of this sort by provisions in their constitutions against progressive taxes. Many states impose corporate taxes of one kind or another, although some states, in order to attract large corporations, keep the rate of such taxes low or fail to impose them at all. All of the fifty states plus the District of Columbia have some kind of payroll tax, which, since it supports their unemployment insurance programs, corresponds to federal Social Security. All of the states impose taxes on inheritances, on alcoholic beverages, and on motor fuels, and most of them impose them on tobacco. In addition, a portion of state revenues is provided by automobile license fees. Indeed the automobile — counting excise and sales taxes payable on purchase, corporate taxes payable by manufacturers (and shifted to buyers), fuel and road taxes, license and registration, excise taxes on replacement items such as tires, service taxes on repairs, and taxes on liability insurance — accounts for a large part (about 15 percent) of the total U.S. tax bill.

In addition to the above taxes, a prime source of revenue for many states is general sales taxes, most of which were introduced in the 1930s. These are regressive, as was pointed out above, which means that their burden falls most heavily on persons of low income. Nevertheless — or perhaps because of this — politicians seem to feel that they are among the “safest” taxes, and their use is increasing.

*Local taxes.* Some cities, notably Philadelphia and New York, impose a personal income tax, and this kind of tax has been suggested as a means of overcoming the pressing financial problems of other great urban centers such as Chicago and Los Angeles. Most cities, however, are forbidden by their state constitutions from using progressive income taxes. Cities and other local communities sometimes impose general sales taxes, but these tend to conflict with state



sales taxes and their use is not widespread. (In 1967, New York City had a 3 percent sales tax on most commodities, except food, and on selected services. This, combined with a state sales tax of 2 percent, meant a total sales tax of 5 percent. This heavy tax was not, however, even in combination with the city income tax, adequate to support city government functions, and still other sources of revenue were being sought.)

The main sources of revenue for local communities are, first, the real estate or general property tax, and second, grants-in-aid from the state and federal governments. Such grants reflect increasing recognition of the fact that local government, though it retains expensive obligations, primarily that of public education, can less and less provide for them out of purely local tax revenues.

The general real estate or property tax is the characteristic American tax. In 1902, such taxes accounted for 80 percent of all state and local taxation and for more than 50 percent of all taxation. By 1955, this kind of tax, owing to the relatively great difficulty of collecting it, to unequal assessments in different areas, and to the fact that it is a proportional tax and therefore seems to satisfy less than adequately the criterion of social equitableness, had been largely abandoned to local governments — villages, towns, and counties. It remained, however, as any homeowner knows, a producer of large amounts of revenue — some \$10.7 billion in 1955.

A final kind of local tax is the poll tax. The word “poll” means head; a poll tax is therefore a kind of capitation tax. On the face of it, it is a fair tax, if any fixed tax is fair, but it had been notoriously used to keep Negroes from voting in Southern and Western states. In these states no one could vote who had not paid the poll tax; the Negroes, on the whole an underprivileged class, were allowed to evade the tax; but as a result they could not vote. The Twenty-

fourth Amendment to the Constitution, ratified in 1964, made this use of poll taxes illegal.

## 2. FAIR AND UNFAIR TAXES: THE CRITERIA OF A JUST TAX

MODERN NOTIONS regarding the justice or injustice of a particular tax usually go back to the four “maxims” laid down by Adam Smith in *The Wealth of Nations*.

1. The subjects of every state ought to contribute toward the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state. . . .

2. The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. . . .

3. Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it. . . .

4. Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state. . . .

It is now widely held that the last three of Smith's famous criteria provide no more than three commonsense rules of tax administration. The federal income tax, for example, must be paid by everyone at the same time, and the rates that apply to every level of income are public knowledge. Tax withholding makes the payment of taxes more convenient for most persons; for those relatively few persons who would be inconvenienced by regular withholding, other ar-



**"REMINDS ME OF THAT CRAZY  
IDEA OF HENRY FORD'S THAT YOU  
CAN MAKE MORE SELLING  
AT LOWER PRICES."**

Courtesy, Herblock, "The Washington Post"

rangements can be made. And the use of automatic machinery, such as computers, by the Internal Revenue Service is, among other things, an attempt to meet Smith's last demand. Computers not only help to insure that everyone pays the tax he owes but also that the cost of collecting the total tax is as low as possible.

Whatever Smith meant by his first maxim — he probably had in mind a proportional and not a progressive tax — there is no question that the notion that individuals ought to support the cost of government according to their abilities is of great social and political importance in the modern world. Indeed, Smith's rather simple statement has been extended so that its overall interpretation is comprised under four heads.

*Consistency with economic goals.* A given tax might be desirable in many ways, but it would be impolitic if, for example, it produced widespread unemployment; and it

would also be injudicious if it had the effect of lessening the overall productive capacity of the nation. Hence the importance, recognized since the time of J. M. Keynes, of harmonizing tax policy with the ultimate economic goals of the community. Taxation is now seen to be a powerful instrument of social and economic control. The problem is twofold: first, the ultimate economic goals must be carefully and realistically defined; and second, the theory of taxation must be developed to the point where the economic overtones of a given tax can be accurately assessed.

*Ease of administration and compliance.* A tax might be consistent with economic goals and still be uncollectible owing to prejudice against it of one kind or another on the part of those who must pay it; or particular circumstances may make one tax harder than another to collect at a given time.

Thus sales taxes, for example, would be impractical in a frontier community, where many exchanges are made in kind and there is little money. A general property tax is difficult to collect owing to the ease with which personal assets are concealed: a herd of cows can be driven into the woods on the day the assessor is due to arrive, and rugs can be taken up off the floors and the best furniture hidden in the hay mow in the barn. A tax on savings bank interest requires some means of checking the records of the bank if not of the individual depositors. In practice, the ease of collection and administration of one tax as opposed to another is a leading consideration in tax policy.

*Revenue adequacy.* Even the best tax, by the foregoing criteria, is not good enough if it fails to supply the funds required to support those government activities that are desired by the people or their legislative representatives. The proliferation of kinds of taxes in modern times is partly a result of this fundamental principle. Particularly in the United States, with its highly developed notion of economic welfare supported by

taxation, and also with its conflicting tax jurisdictions, no one tax or even kind of tax is able to pay for the many different functions and services of government.

At the same time, taxes are not levied for revenue alone. Even if one tax could supply all the needs of government, it might be advisable to obtain revenues from a variety of taxes to insure that they are spread more evenly over the population, and that the various jurisdictions receive their proper share.

*Social justice.* Involved here are the different notions that a just tax ought to be impartial in its application (that is, no one should be able to avoid paying taxes), and that it also ought in some sense and in some degree to redistribute the nation's wealth. In practice, these two ideas may conflict; for, if redistribution is the ultimate purpose of taxation, then is everyone actually being taxed impartially? Conversely, if everyone is being taxed impartially, can redistribution be effected? In other words, will not the extremely poor have to *receive* tax revenues instead of pay them? The whole complex theory of the incidence of taxation is relevant here, for the question of who actually bears a tax, rather than who actually pays it, must be answered before determinations of its justice can be made. Involved as well are fundamental notions of democracy and of the liberty of the subject or citizen. [For further treatment of these and allied matters, see Chs. 5: GENERAL WELFARE, 9: EQUALITY, and 15: FREEDOM OF ENTERPRISE.]

### 3. THE CONTROVERSY ABOUT TAXATION AND REPRESENTATION

THAT CITIZENS have a right to be represented in legislatures framing tax laws is a modern notion. In ancient times it was considered the duty of the lower classes — slaves, peasants, and conquered peoples —

to support their rulers, whether these were Pharaohs of Egypt or free citizens of Rome. The same was true of the Middle Ages, when kings, princes, and barons collected all the taxes they could, and spent them as they wished. The great bulk of the population had no voice whatever in determining the kind or rate of taxes they had to pay.

Two milestones in English political history — Magna Carta (1215) and the Bill of Rights (1689) — helped to establish the principle of consent and representation in taxation. The latter document declared that “levying money for or to the use of the Crown, by pretense of prerogative, without grant of Parliament, for longer time or in other manner than the same is or shall be granted, is illegal.” This statement expressed the expectations of the first colonists in America. William Penn, describing to potential colonists the virtues of Pennsylvania, pointed to the fact that the Crown charter, granted him in 1681, guaranteed that “the people and governor have a legislative power, so that no law can be made, nor money raised but by the people’s consent.”

In fact, however, the American colonies were not directly represented in Parliament, and as the eighteenth century wore on the colonists began to complain. The standard British reply to the colonial cry of “taxation without representation” was Burke’s doctrine of “virtual representation.” The exponents of this doctrine pointed out that many Englishmen lived in boroughs that were not represented in Parliament, and that these persons as well as colonists were virtually represented by members chosen by other constituents. In effect, by this argument, the representatives of some could represent all.

Many Americans vigorously opposed this idea. Daniel Dulany, a prominent Maryland lawyer, charged that “the notion of a virtual representation of the colonies . . . in truth is a mere cobweb, spread to catch the unwary and entangle the weak.” Indeed, a



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“Virtual Representation, 1775”; Protestant Boston’s reaction to Britain’s lenient taxation of Catholic Quebec

number of British politicians concurred, among them the elder Pitt, a leading opponent of the Stamp Act. As Lord Camden put it in a speech in the House of Lords in 1765, "Taxation and representation are inseparably united. God hath joined them; no British Parliament can put them asunder."

Colonial protests against the lack of direct representation grew with the levying of a high duty on sugar imported into America and with the imposition of other duties on wines, coffee, and textiles. These grievances were relatively minor, however, compared to the furor caused by the Stamp Act (1765), which required that all legal documents, licenses, contracts, newspapers, pamphlets, and playing cards must carry a tax stamp. Not only were the stamps expensive but they were sometimes withheld, with the result that an administrative censorship was exercised. The Massachusetts Assembly, along with many groups and individuals, instantly published a vehement protest. If

Parliament could tax trade, the document complained, it could tax land, houses, and other property, in direct violation of the chartered right of Massachusetts to tax and govern itself.

Though the Stamp Act was repealed (1766), the repressive British tax policy continued unchanged, coming to a head in the notorious Tea Act, passed in 1773. This law, intended to secure for the East India Company a monopoly on all tea imported into the colonies, met with open violation when a band of merchants disguised as Indians swarmed onto Company ships in Boston Harbor and dumped large quantities of tea overboard. Nor did the colonists' ire end there. Colonial complaints with regard to taxation were reiterated in the Declaration of Independence, which charged that "the history of the present King of Great Britain is a history of repeated injuries and usurpations," and which made clear that not the least of these was that the King,





**THE REPEAL, or the Funeral Procession, of Miss AMERICA-STAMP.**

Over the Walls are placed two golden Heads, their features on Poles and the date of the Revolution plain, expressly show what Party they represent, and in what cause they engaged in glorious battle.

Thenceforward Mr. St. John (who under that significant name is his person in support of the Stamp) leads the procession as preceding Priest, with the burial service and funeral sermon in his hands.

Next follow two eminent Pillars of the Law supporting two black flags, marked are depicted the stamps with the date, name and date of introduction agreed were designed to have been originally engraved on the 10th of June 1765, the complete date of the Stamp Act in force, but the face of the Stamp is changed with his friend and partner Mr. Foxton, Declaration of War.

Immediately after follows the chief Mourner St. James, then his Grace of Newcastle, and Lord Gower.

After these comes the chief mourner a child, by way of funeral anthem, Nephew his friend and partner Mr. Foxton, Declaration of War.

The war is brought up by two right reverend Fathers of the Church. These five mourners are preceded from the great scene which appears on the River Thames where their first meetings were held, viz. the Congress, Nottingham, and London, being the subjects above, about 1765, to London for the second round of petition, manufacturing towns from which letters are now addressed to America. Among these is a letter from containing the details of the Stamp Act, which is now on board a vessel at the time of the funeral, and is now the first funeral of the Stamp Act.

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Engraving depicting the repeal of the Stamp Act, 1766

through Parliament, had imposed "taxes on us without our consent." In the famous words of James Otis, the Massachusetts firebrand, "Taxation without representation is tyranny."

#### 4. THE CONTROVERSY ABOUT CONFLICT OF TAX JURISDICTIONS

COLONIAL OBJECTIONS to British taxation ended, of course, with the Revolutionary War, but the controversy over taxation itself continued. Feeling persisted in many of the states that the Continental Congress was, or at least could be, as dangerous as Parliament had ever been. Thus the states withheld from the Congress the power to lay and collect taxes; the Congress had to beg for funds to support the war effort, and these were always slow in coming and sometimes did not come at all.

The government established in 1781 by

the Articles of Confederation also lacked any legal taxing power. This radical weakness was recognized, and several amendments were proposed giving the government the power to levy a small duty on imports, but they were all defeated. The movement to provide the central government with legal taxing power was one of the main impetuses of the Constitutional Convention of 1787, but even then some states objected to the idea, often in terms reminiscent of their complaints to Parliament in the years before the war. Thus, for example, Virginia legislators had been instructed in 1783 by their constituents from Fairfax County to "oppose any attempts which may be made by Congress to obtain a perpetual revenue, or the appointment of revenue officers. Were these powers super-added to those they already possess, the Articles of Confederation and the constitutions of government in the different states would prove mere parchment bulwarks to Ameri-



can liberty." And even after a constitution had been framed, Massachusetts, in its ratifying convention (1787-1788), declared its desire to amend the new Constitution in such a way as to require an explicit statement to the effect that Congress should lay no "direct taxes, but [except] when the moneys arising from the impost and excise are insufficient for the public exigencies," and not even then unless the states should have refused or otherwise failed to meet the requests for funds of the federal government.

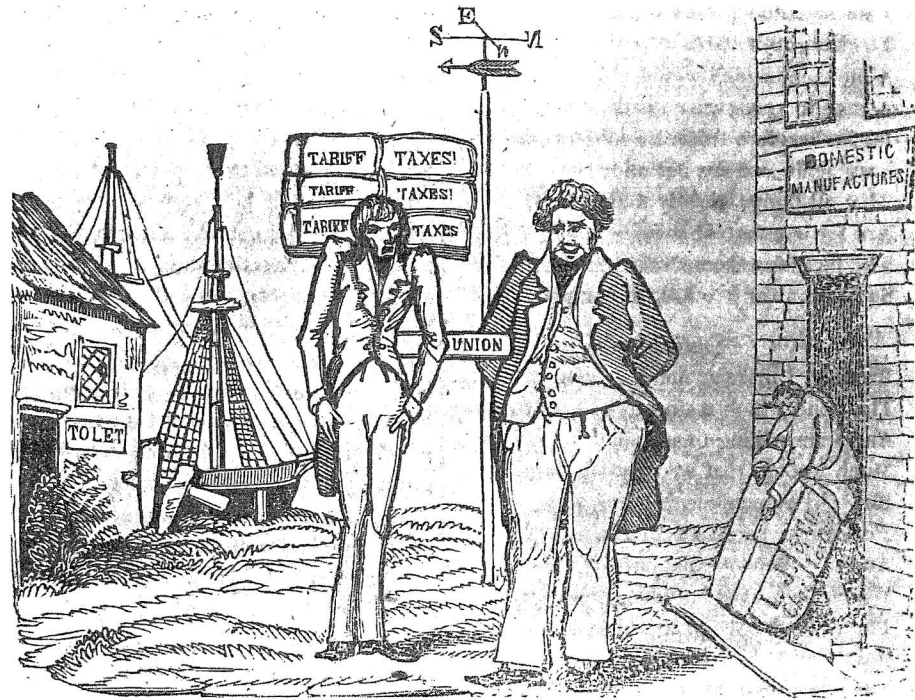
The authors of *The Federalist* opposed this view. One of them, Alexander Hamilton, warned that without the revenue raised by taxes, "one of two evils must ensue, either the people must be subjected to continual plunder, as a substitute for a more eligible mode of supplying the public wants, or the [federal] government must sink into a fatal atrophy, and, in a short course of time, perish." The Constitution itself, when it finally became law, represented a compromise on this issue. Article I, Section 8, declared that "the Congress shall have power to lay and collect taxes, duties, imposts, and excises, to pay the debts and provide for the common defense and general welfare of the United States"; but Section 9 of the same Article declared that no capitation or other direct tax should be laid and also forbade the federal government to collect customs duties on trade between the states. The problems involved in this seeming constitutional debarment of "direct" taxes were revived a hundred years later.

Conflict between state and federal rights to tax had come to a head long before that, however. A branch of the Second Bank of the United States opened in Maryland shortly after the bank's founding in 1816 and the Maryland legislature imposed a heavy state tax on it. The bank, which had been chartered by the federal government and was in part a federal institution, refused

to pay on the grounds that the legislature had exceeded its authority and that the tax, if paid, would destroy the bank. The case, the famous *M'Culloch v. Maryland*, reached the Supreme Court in 1819.

In the course of answering the question whether the state of Maryland could, without violating the Constitution, tax the branch of the bank, Chief Justice John Marshall conceded that "the power of taxation . . . is retained by the states; that it is not abridged by the grant of a similar power to the government of the Union; [and] that it is to be concurrently exercised by the two governments." But, he went on to say, "the power to tax involves the power to destroy . . . the power to destroy may defeat and render useless the power to create; [and] there is a plain repugnance in conferring on one government a power to control the constitutional measures of another, which other, with respect to those very measures, is declared to be supreme over that which exerts the control."

The main question, Marshall made clear, was whether the state constitution (in this case Maryland's) or the federal Constitution was the supreme law of the land. He pointed out that "if the states may tax one instrument, employed by the government in the execution of its powers, they may tax any and every other instrument." And, he concluded, "this is not all. If the controlling power of the states be established; if their supremacy as to taxation be acknowledged, what is to restrain their exercising this control in any shape they may please to give it? Their sovereignty is not confined to taxation. . . . The question is, in truth, a question of supremacy; and if the right of the states to tax the means employed by the general government be conceded, the declaration that the Constitution, and the laws made in pursuance thereof, shall be the supreme law of the land is empty and unmeaning declamation."



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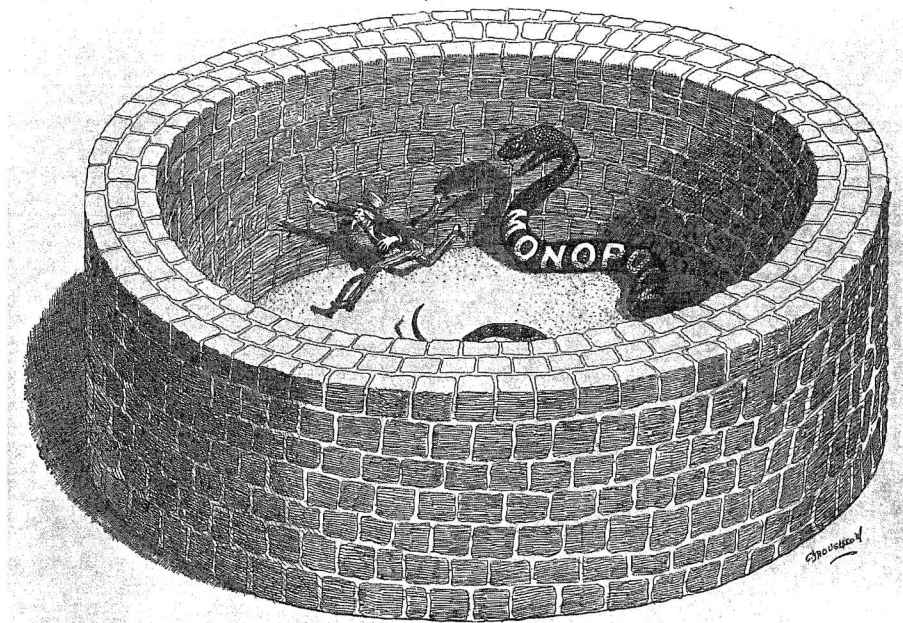
Southern view of the federal government's taxation policy, 1832

### 5. THE TARIFF AND THE NULLIFICATION CONTROVERSY

THE CONSTITUTION gives Congress the power to regulate commerce “among the several states.” It does not explicitly authorize Congress to tax interstate commerce, but Congress has assumed this power in certain circumstances from the power to regulate. More important, the Constitution declares that “no state shall, without the consent of the Congress, lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws; and the net produce of all duties and imposts laid by any state on imports or exports shall be for the use of the Treasury of the United States.” This meant, primarily, that the federal government could collect all customs duties on commodities imported into any state from abroad.

In the early years of the republic, this source of revenue yielded a sufficient amount to support most of the federal gov-

ernment's activities; the question, therefore, of where the government should derive additional revenues was not a pressing one. Nevertheless, a heated controversy developed over the specific duties, or tariffs, that were imposed on imported goods. Industrialists in the Northeast favored a high “protective” tariff on the import of *manufactured* goods, which would tend to raise the domestic price of such items and allow the same commodity when manufactured at home to sell at a higher price; Southern and Western farmers and plantation owners desired a low tariff on these items on the grounds that those regions had few mills and factories, and that the consumer, in effect, had to shoulder the burden of paying for a tariff that protected Northern manufacturers. The sugar growers of Louisiana and the hemp growers of Kentucky, in turn, asked for high tariffs on their products, as did the wool growers of Ohio and New England; but such tariffs harmed the Northern manufacturers, who, because of them,



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"Strenuous Sam and his tariff wall"; cartoon from "Life," 1902

had to buy raw materials dear and sell manufactured articles cheap.

In his Report on Manufactures (1791), Hamilton stated the classic argument for protective tariffs on "those foreign articles which are the rivals of the domestic ones to be encouraged." "Duties of this nature," he declared, "evidently amount to a virtual bounty on the domestic fabrics; since, by enhancing the charges on foreign articles, they enable the national manufacturers to undersell all their foreign competitors." The first protective tariff went into effect in 1816, and after that protective tariffs were in force until 1833, and from 1842 to 1846. Nevertheless, during most of the time before the Civil War, low revenue tariffs were in operation.

The passage of the notorious "Tariff of Abominations" of 1828 brought about the revival of the states' rights issue that had seemed to be ended — although everyone knew that it merely lay dormant — by the Missouri Compromise of 1820. Southerners and Westerners vigorously protested this

tariff, and when it became obvious that they did not have enough congressional votes to repeal it, some of them refused, for a while at least, to accept it as law. The so-called nullification issue in South Carolina, led by John C. Calhoun, revolved around this issue. In a statement accompanying the Ordinance of Nullification Calhoun declared that "we the people of South Carolina, assembled in convention in our sovereign capacity, as one of the parties to the compact which formed the Constitution of the United States, have declared the act of Congress [establishing the new tariff rates] . . . to be unconstitutional, and therefore null and void."

It was one thing for individuals to disobey the law; it was another for a "sovereign" state to declare a federal law "unconstitutional." In reply, President Andrew Jackson, in his Proclamation on Nullification, declared that "the Constitution has given, expressly, to Congress the right of raising revenue and of determining the sum the public exigencies will require. The states

have no control over the exercise of this right other than that which results from the power of changing the representatives who abuse it, and thus procure redress." In his proclamation, Jackson addressed himself directly to the proposed nullification of a federal law. "I consider . . . the power to annul a law of the United States, assumed by one state, incompatible with the existence of the Union, contradicted expressly by the letter of the Constitution, unauthorized by its spirit, inconsistent with every principle on which it was founded, and destructive of the great object for which it was formed."

The nullification controversy was resolved in 1833 by the passage of a compromise tariff and with the vindication of federal authority, so that both sides won something. But of course the states' rights question did not end there.

The tariff again became a major issue in the years after the Civil War, and may be said to have been *the* issue in domestic politics from the 1870s until the 1930s. During the first part of the period, farmers and Democrats tended to be against the tariff, while industrialists and Republicans tended to be for it. But an important shift in the alignment occurred in the 1920s. Some large manufacturers, seeking world markets, began to favor tariff reduction; and many farmers, fearing foreign competition, became protectionists. And this trend seems to be continuing to the present day. [For further discussion of some of the matters considered here and in the preceding section, see Ch. 10: PLURALISM.]

#### 6. THE CONTROVERSY ABOUT THE CONSTITUTIONALITY OF THE INCOME TAX

It was obvious to the North in 1861 that the expenses of the war could not be sup-

ported by the tariff alone, especially since it was debarred by the conflict from collecting customs duties in the Southern states. To defray the heavy expenditures, which reached \$2 million a day by 1864 and amounted to \$5 billion in all, Congress, in August 1861, passed the first federal income tax law — "a momentous legislative act in its consequences," according to economist Sidney Ratner, "approaching in importance such legislation as that of April 16 [1861] abolishing compensation slavery in the District of Columbia, and of June 19 abolishing slavery in the territories." An internal revenue act of 1862 also levied taxes on real estate, public utilities, and various commodities, but an important part of the revenue came from individual income taxes.

After the war, merchants, importers, and farmers wanted to retain the income tax as the primary source of federal revenue and at the same time wanted high protective tariffs abolished; the bankers and manufacturers, on the other hand, exerted pressure for repeal of the income tax and for retention of the tariff privileges established by the Revenue Act of 1864, the highest tariff up to that time in the history of American taxation. The income tax was allowed to expire in 1872, but the debate over its merits vis-à-vis those of the tariff continued. Between 1873 and 1879 no less than fourteen different tax bills were introduced by congressmen from the Middle West and the South, all of which were defeated by majorities drawn from the Eastern and Northern manufacturing states. And it was not until 1894, during the second administration of President Grover Cleveland (the only Democratic President between 1860 and 1912), that another federal income tax became law.

The new tax met with vigorous opposition. It was denounced as "socialistic" and "communistic" and was declared to be little more than a "tax on industry and thrift, an incitement to penury and fraud." The bill's

supporters praised the bill as a "means of correcting the great inequalities in wealth and of putting the burdens on those best able to pay the tax." Remarks of the latter sort merely added fuel to the fire, and in 1895 the Supreme Court, by a vote of 5 to 4, declared the law unconstitutional.

The decision in this case, *Pollock v. Farmers' Loan and Trust Co.*, is one of the most controversial in the history of the Supreme Court. The tone of the opposition to the income tax was struck by Joseph H. Choate, the brilliant attorney who represented the manufacturing and banking interests, and who appealed to the justices to halt the "communist march" that he implied would force wealthy men to support those who refused to work. Reformers of all kinds supported the law.

The constitutionality of a federal income tax had been upheld by the Court in *Springer v. United States* (1881). But circumstances were much changed from what they had been fifteen years before. An extraordinarily conservative Court was now faced with social ferment, stirred up by Populists and other reformers all over the country. In his majority opinion, Chief Justice Melville Fuller made no mention of these factors, but they were in the back of everyone's mind. Instead, he based his reasoning on a close reading of the Constitution. "The words 'direct taxes,' on the one hand, and 'duties, imposts, and excises,' on the other, were used in the Constitution," he declared, "in their natural and obvious sense. . . . The founders anticipated that the expenditures of the states, their counties, cities, and towns, would chiefly be met by direct taxation on accumulated property, while they expected that those of the federal government would be for the most part met by indirect taxes."

Fuller conceded that the Constitution seems to grant to Congress in Article I, Section 8, an almost unlimited right to tax. But he emphasized strongly the qualification of this grant implied in Section 9, in

effect holding that for other than revenues derivable from duties on imports the federal government would have to apply to the states. And he concluded that the tax in question, "so far as it falls on the income of real estate and of personal property, being a direct tax within the meaning of the Constitution, and, therefore, unconstitutional and void because not apportioned according to representation . . . [is] necessarily invalid."

Justice John Marshall Harlan wrote the dissenting opinion in the case. In delivering it, according to the conservative *New York Sun*, Harlan "pounded the desk, shook his finger under the noses of the Chief Justice and Mr. Justice Field, turned more than once almost angrily upon his colleagues in the majority, and expressed his dissent from their conclusions in a tone and language more appropriate to a stump address at a Populist barbecue than to an opinion on a question of law before the Supreme Court of the United States." Whatever his manner, Harlan's dissent was a long and learned discussion of the issues involved in the "direct tax" question. Indeed, not only the Court's own precedents but also the records of the Federal Convention of 1787 supported his arguments, since the direct-tax clauses had originally been intended merely to debar the federal government from taxing Southern plantation lands by area and slaves by their numbers.

In addition, Harlan warned of some of the effects of the majority decision in terms reminiscent of Chief Justice Marshall's opinion in *M'Culloch v. Maryland*. "I cannot assent to an interpretation of the Constitution," he declared, "that impairs and cripples the just powers of the national government in the essential matter of taxation." And he pointed out as well that "the practical effect of the decision . . . is to give to certain kinds of property a position of favoritism and advantage inconsistent with the fundamental principles of our social organization, and to invest them with power and influence that may be perilous to that



portion of the American people upon whom rests the larger part of the burdens of the government."

Conservatives generally hailed the Court's decision. It was denounced by many, however, among them William Jennings Bryan, in his famous "Cross of Gold" speech of 1896. "The income tax is a just law," Bryan declared. "It simply intends to put the burdens of government justly upon the backs of the people." Theodore Roosevelt (but only after leaving the White House) was another supporter of the income tax, the arguments for which had first been persuasively put to him by Andrew Carnegie, one of the richest men of the time. "The really big fortune, the swollen fortune, by the mere fact of its size, acquires qualities which differentiate it in kind as well as in degree from what is possessed by men of relatively small means," Roosevelt said in 1910. "Therefore, I believe in a graduated income tax on big fortunes, and in another tax which is far more easily collected and far more effective — a graduated inheritance tax on big fortunes."

It was not until 1913, however, that the Sixteenth Amendment to the Constitution went into effect, declaring that "Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration." The last two phrases, of course, were required to circumvent the Court's 1894 decision. The Underwood Tariff of 1913 was the first general reduction of tariff rates since the Civil War. In anticipation of decreased federal revenues, the law included a provision for a graduated tax on personal incomes — a device and a fact of life that has been with us ever since.

Other substitutes for the tariff as a means of raising federal tax revenues were suggested in the years between the Civil War and World War I. Of these the most important, perhaps, was the so-called single tax, advocated by Henry George and his

followers. This form of taxation had few supporters in government circles, but the single-tax movement flourished in the last decades of the nineteenth century, and, indeed, persists to this day.

The idea of a single tax that would meet all of the expenses of government is centuries old, but the term itself and the movement to which it gave a name originated with the publication in 1879 of George's *Progress and Poverty*. His arguments were twofold. On the one hand, he declared, increase in the value of land, unlike other income, is a product of community, not of individual effort; society is therefore justified in taxing it to support government. On the other hand, the tax on land rental value could eliminate all other forms of taxation, particularly taxes on building, which hinder construction and general economic development. The single tax, George wrote, "falls only upon those who receive from society a peculiar and valuable benefit, and upon them in proportion to the benefit they receive. It is the taking by the community, for the use of the community, of that value which is the creation of the community. It is the application of common property to common uses. When all rent is taken by taxation for the needs of the community, then will the equality ordained by nature be attained."

Critics of George's single tax maintained that the tax would work contrary to usual standards of ability to pay; that there would be no correlation between land ownership and total wealth; that parts of other types of income could be regarded as "unearned" in much the same way as land rent; and that if the tax were applied, it would rest in large measure on the wrong persons — on those who had invested capital in land rather than on those who had actually benefited from the increase in land value. These arguments were in fact persuasive, and the single tax was never widely applied. (Henry George was, however, influential in Great Britain; and the famous Lloyd George bud-

gets, with their heavy taxes on the great estates, were one result.)

#### 7. THE CONTROVERSY ABOUT PUBLIC SUPPORT OF PRIVATE AND PAROCHIAL SCHOOLS

ONE OF THE PERENNIAL AMERICAN ISSUES regarding the uses to which tax moneys should be put revolves around the question of the support of private and parochial schools, and touches on the greater question of the relations of church and state. Charles W. Eliot, in 1874, voiced the classic arguments, extending back to colonial days, in favor of exempting religious foundations and schools from taxation. "To tax lands, buildings, or funds which have been devoted to religious or educational purposes would be to divert money from the highest public use — the promotion of learning and virtue — to some lower public use, like the maintenance of roads, prisons, or courts." Exemption from taxes is not, Eliot went on to say, a form of state aid. "It is an inducement or encouragement held out by the State to private persons, or private corporations, to establish or maintain institutions which are of benefit to the State."

Eliot emphasized that he was not calling for direct state support of churches and private schools. Others did. Archbishop John Ireland of St. Paul, Minnesota, for example, declared in 1890 that "it is no honor to America that 10 million of its people [*i.e.*, the Roman Catholic population] are forced by law to pay taxes for the support of schools to which their conscience does not give approval, and are, furthermore, compelled, by their zeal for the religious instruction of their children, to build school-houses of their own, and pay their own teachers. It is no honor for the 50 million to profit by the taxes paid by the 10 million." As far back as 1840 the Catholics of New York had attempted to obtain tax

money for the support of their schools on the grounds, as they declared to the Board of Aldermen of New York City, that Catholics "bear, and are willing to bear, their portion of every common burden; and feel themselves entitled to a participation in every common benefit." Similar arguments were expressed in 1949 by Bernard Iddings Bell, an Episcopalian. "If the public schools must 'leave religion out,'" Canon Bell declared, "then the only decent thing is to permit religious groups to run their own schools, which of course we now do, and to give them tax money to run them with, which we do not." And he added that such a step "would not in the least violate the principle, embodied in the Constitution, that there must be no established Church in the United States."

It is the last point, of course, that is the crux of the matter. Justice William O. Douglas, concurring in the majority decision in the highly controversial school prayer case of 1962, declared that "the most effective way to establish any institution is to finance it; and this truth is reflected in the appeals by church groups for public funds to finance their religious schools. Financing a church either in its strictly religious activities or in its other activities is equally unconstitutional, as I understand the Establishment Clause. Budgets for one activity may be technically separable from budgets for others. But the institution is an inseparable whole, a living organism, which is strengthened in proselytizing when it is strengthened in any department by contributions from other than its own members.

"Such contributions may not be made by the state even in a minor degree," he continued, "without violating the Establishment Clause. It is not the amount of public funds expended, as this case illustrates, it is the use to which public funds are put that is controlling. For the First Amendment does not say that some forms of establishment are allowed; it says that 'no law re-

specting an establishment of religion' shall be made. What may not be done directly may not be done indirectly lest the Establishment Clause become a mockery."

The general import of these remarks has found expression many times, and in many circumstances, in American history. Not the least important of these expressions is that of the first Catholic President of the United States, John F. Kennedy, who declared in Houston, Texas, in 1960 that he believed in an America "where the separation of church and state is absolute," and where "no church or school is granted any public funds." Nevertheless, the \$1.3 billion Elementary and Secondary Education Act, signed into law by President Johnson on April 11, 1965, did seem to offer at least indirect aid to private and parochial schools. It provided \$100 million to buy textbooks and expand school libraries; the money went directly to state agencies but distribution of the materials was to be made equitably to private as well as public school students, including religious schools. And the act also provided funds to improve "shared-time" teaching programs, in which students from private schools take some of their instruction in public schools. [For further discussion of some of the questions treated in this section, see Chs. 21: EDUCATION and 22: RELIGION.]

#### 8. TAXATION AND PHILANTHROPY

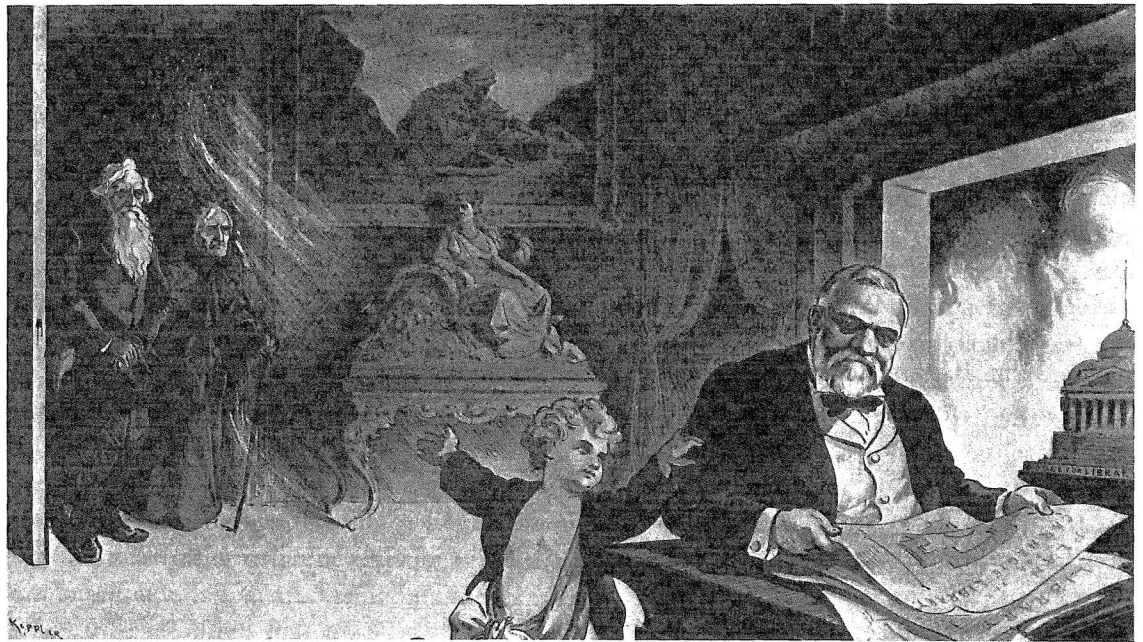
STILL ANOTHER perennial controversy regarding taxation concerns the question of who should administer aid and support to the indigent and the unemployed. In the 1830s, the Unitarian minister W. E. Channing voiced one of the traditional arguments against "public charities." These "weaken in men the motives to exertion," he declared, ". . . offer a bounty to idleness [and] make beggary as profitable as labor." They are "great calamities to society, and

peculiarly calamitous to those whom they relieve." The implication was that private charity can, and ought to, take care of those who really need help.

Other writers were opposed to private charity. Thoreau, for example, declared, in his characteristic vein, that "if I knew for a certainty that a man was coming to my house with the conscious design of doing me good, I should run for my life, as from that dry and parching wind of the African deserts called the simoom, which fills the mouth and nose and ears and eyes with dust till you are suffocated, for fear that I should get some of his good done to me — some of its virus mingled with my blood."

Channing's position may be summed up in the proposition that public charity has a corrupting effect on its recipients; Thoreau's, in the proposition that private charity has an ignobling effect. Both positions have been defended many times in many ways, but neither goes far, perhaps, to meet the actual problem. In fact, a certain proportion of Americans are in need of some kind of assistance, and always have been. The question is, whether public or private assistance is the more desirable means of alleviating their distress.

Until the Great Depression of the 1930s, the advocates of private philanthropy had the better of the argument. They emphasized the benefits not only to the recipient of private charity but to the giver of it. Thus Andrew Carnegie, while conceding that "indiscriminate charity" may foster "pauperism and crime," praised private, voluntary philanthropy because it "blesses equally him who gives and him who takes." John D. Rockefeller also emphasized the effect on the giver. "As I study wealthy men," he observed in 1909, "I can see but one way in which they can secure a real equivalent for money spent and that is to cultivate a taste for giving where the money may produce an effect which will be a lasting gratification."



Library of Congress

"A Christmas reminder"; cartoon by Keppler for "Puck"

As late as 1932, President Herbert Hoover was making the same point. "Our national resources are not only material supplies and material wealth," he declared, "but a spiritual and moral wealth in kindness, in compassion, in a sense of obligation of neighbor to neighbor and a realization of responsibility by industry, by business and the community for its social security and its social welfare. . . . We can take courage and pride in the effective work of thousands of voluntary organizations for the provision of employment, for the relief of distress, that have sprung up over the entire nation. Industry and business have recognized a social obligation to their employees as never before. . . . Never before in a great depression has there been so systematic a protection against distress. . . . Never before has there been such an outpouring of the spirit of self-sacrifice and service."

Actually, Hoover was making two points, rather than one. The first is that assistance to the needy is morally and spiritually beneficial to the giver, at the same time that it is beneficial in another sense to the recipient. The second is that private philanthropy, in

the early years of the Depression, had effectively relieved distress. It was the second point that was particularly attacked by men such as Abraham Epstein, "the father of the Social Security Act," and Ferdinand Lundberg. "The belief that in normal times private philanthropy takes care of all or most of the relief needs was never based on facts," Epstein declared in 1933. "At no time has private charity met even as much as one-third of the relief burdens of the nation." He went on to say that "it took the protracted depression to call the attention of all and sundry to the utter insufficiency of private philanthropy. But the myth of the unparalleled generosity of wealthy Americans *never* had any justification. It grew up as a result of the benevolence of a few rich persons who have distributed some part of their extraordinarily large fortunes. It is well known, however, that the great majority of the well-to-do give little or nothing to charity. A very small number of wealthy Americans support most of our charities. . . . The income tax reports strikingly reveal the parsimoniousness of our rich."

Lundberg made many of the same points,

and added others. "The field of contemporary philanthropy, or noncommercial investment," he wrote in 1937, "is a labyrinth of mirrors, flashing lights, fitful shadows, and pervasive ballyhoo. . . . Very little money — a trivial amount, in fact — has been given away by the wealthy of fabulously rich America, and most of that has been given since the income tax took effect. . . . The word 'gift' might properly be discarded in this connection in favor of more precise words like 'allocation' and 'transfer.'"

The exigencies of the Depression, combined with the election of a Congress sympathetic to the ideas of men like Epstein and Lundberg, resulted in 1935 in the passage of the Social Security Act, which, by means of a compulsory levy on incomes, insures that most Americans will have some financial support in their later years. But even the passage and general acceptance of this act, which was extended over larger portions of the population after 1950, did not end the dispute on the basic questions at issue. All of these were raised again following Great Britain's passage, in 1946, of a law "socializing" medicine, the advocacy by President Harry S. Truman of a similar law here, and the support of Presidents Kennedy and Johnson for the program known as Medicare.

Opponents of this and like legislation argued that the freedom of the individual to choose his own doctor and method of care would be inhibited if the bill were passed, and that the program would decrease the effectiveness of private research foundations. Nevertheless, Medicare was passed by Congress in April 1965 and went into operation on July 1, 1966. It was financed primarily by a payroll tax; \$5 billion a year came from voluntary premiums and from higher Social Security taxes for everyone, and an additional \$1 billion a year came from the federal government's general revenue fund. Medicare provides medical services of various kinds mainly for older persons, who are given complete freedom to choose their



Courtesy, "The Wall Street Journal"

"Now that you mention it, I don't know what it's for either"; from "Sorry — No Budget"

own physician, but some of its benefits extend to younger persons — that is, those who pay the bulk of the taxes for it — as well.

The issues underlying the controversies over social welfare legislation such as Social Security and Medicare are general ones that crop up in most modern disputes about taxation. The most basic issue of all involves the perennial question of what are the purposes of taxation. And underlying this, in turn, are questions about the functions of government among men.

## 9. THE PURPOSES OF TAXATION

ACCORDING to classical economic theory, the primary purpose of taxation is to defray the expenses of government. Governments require funds in order to operate, and taxes, traditionally, are their sole or main source of revenue. It is not quite true to say, as Benjamin Franklin did, that "in this world nothing is certain but death and taxes"; if there were no governments, there would be no taxes, while death would remain. However, without governments, death would



probably come sooner to every man, so that taxes have what may be called a kind of social certainty, after all.

It is still true, of course, that taxes support the operation of government, but this is no longer held to be their only important function. Instead, the points referred to in Section 2 above have become the dominant ones. It is now widely maintained that the primary purpose of taxation is twofold: to regulate the national economy and foster its growth, and to promote the general welfare on the basis of canons of social justice.

Two meanings of distributive justice are involved in the latter notion. The idea that the burden of taxation should be distributed justly (which does not always, or necessarily, mean equally) over all citizens goes back to the eighteenth century — indeed, to Adam Smith's first maxim, quoted above. To that traditional meaning, however, has been added a modern one. During the present century, in the United States, as well as in certain other of the advanced industrial countries of the West, it has been recognized that the laissez faire or market system for the allocation of goods and services, if left to work itself out, simply will not put enough money into the sector of social capital investment — into welfare, slum clearance, schools, and all the other social dimensions of a healthy society. The political agency of the society must allocate such funds and use taxes to make that redistribution — not among classes *per se* but among sectors of the economy.

Involved here are other, even more important, ideas about the ends of government. Again according to the classical view, the proper function of government is to insure that citizens may peacefully pursue their own enlightened self-interest. In this conception, the functions of government are construed as primarily negative; that government is best that leaves people alone, while keeping individuals, as it were, from each other's throats. Thus the traditional governmental activities, for which tax reve-

nues are needed, include administrative activities such as those of the executive and the judiciary, on the one hand, and, on the other hand, activities for the maintenance of both internal and external security. Matters of this kind still require the bulk of the tax revenues of all modern states.

With the advent of the Industrial Revolution, and particularly of the twentieth-century affluence that has been its fruit in the United States and a few other Western nations, it began to be held that the reach of government should be extended into other realms. In our time the responsibilities of government have more and more been seen to be positive as well as negative. According to the Declaration of Independence, life, liberty, and the pursuit of happiness are inalienable natural rights of every man. But no longer is it sufficient to say that the end of government is to secure these rights — particularly that of the pursuit of happiness — merely by allowing every citizen to pursue his own happiness in his own way, and the devil take the hindmost. It is now almost universally held, although to different degrees and with emphasis on different aspects of the problem, that government has an even greater obligation. It must give aid to those citizens who are hindered in their own pursuit of happiness, not by giving them happiness, of course, for no government can do that, but by seeing that they share in the economic conditions of happiness. And this is conceived as a matter of justice and of right; it is not charity, in the traditional sense of the term, at all.

At the same time, it is also viewed as a fundamental responsibility of government — a responsibility that no other institution, public or private, can assume — to regulate the overall economy. Taxation is thus used not only to raise necessary revenues, and not only to allocate funds to the public sector that it would otherwise not receive, but also to control inflation and deflation, to maintain economic growth at a steady rate, and to avert the great economic depressions

that have seemed to be the specific disease of the capitalist system, otherwise so successful in providing the economic conditions of happiness.

These twentieth-century economic and political ideas have had a profound effect on tax policies. And they have also had a profound effect on the kinds and amounts of taxes that Americans pay. In 1954, studies showed that the individual with an income of \$7,500 a year paid nearly 30 percent of it in taxes of one kind or another, while the man with an income of over \$10,000 paid more than 40 percent of it in taxes. Thus taxes have become, for almost everyone, the largest single item of expenditure. Much of this taxation is more or less hidden, of course — in the high prices of liquor and tobacco, in sales taxes, in excise taxes of all kinds, and so forth — but it is paid nonetheless.

One result of this fact of modern life is

that the art of minimizing taxes has become of considerable legal importance. And although tax evasion (in contradistinction to tax avoidance) has been going on for centuries, we are perhaps more aware of it than we have ever been before. It is probable that most Americans nowadays cut a corner here and there — and feel guilty about it. (“We owe it to our country to pay our taxes without murmuring,” remarked “Bill” Nye a half century ago; “the time to get in our fine work is on the valuation.”)

Nevertheless, even though Emerson is probably still right — that of all debts, men are least willing to pay taxes — we do pay them, and not only because we have to. The ideas of social and political justice that underlie modern tax policy are great and persuasive ones. [For a more extensive discussion of the questions raised in the last two sections, see Ch. 5: GENERAL WELFARE.]