

The Graduated Gadinkus Tax

F. A. Harper

IT WAS New Year's Day and Alonzo Brown had a headache. Not because he had imbibed too much, for he was a teetotaler. His head ached because he was making out his federal income tax return. The further he figured, the more he fumed.

Alonzo's final calculations showed:

Adjusted gross income	\$300,000
Tax bill	194,804

Left for himself	\$105,196
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Belinda, his wife, tried to console him by pointing out that \$105,196 was no mean income, even if he had worked long and arduous hours. He agreed with this, but his ire was generated by the fact that he was going to have to pay the government \$194,804 — “for doing *nothing*,” as he expressed it.

Belinda tried to console him further by observing that he did get something for the \$194,804. “You got all those services people get from their government,” she said.

“True enough,” Alonzo replied. “We do get services from the gov-

ernment, even though we differ in what services we want and how much we are willing to pay for each of them. But aside from that, one gets these services whether his tax is \$194,804 or \$1,000 or nothing. In fact, some persons who pay no tax at all get food and other things that the rest of us have to buy for ourselves.”

Alonzo's business is the making and selling of gadinkuses. A gadinkus is a hypothetical gadget Alonzo discovered after ten years of intensive study and experimentation. Nobody else knows how to make it.

The raw materials Alonzo uses to make the gadinkus are air, water from the brook that runs through his property, and heat from the sun's rays. He does all the work himself.

In the first year of operation Alonzo had sold gadinkuses at \$10.00 each. Let us say that you had been his first customer.

“How can you in good conscience charge me \$10.00 for something made from materials that are God-given and free?” you had asked.



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"I'm not charging you anything for the materials," Alonzo had replied. "If all you want is some of these materials, just step outside and take all you want for free. What I'm charging for is my time in making the gadinkus, plus some return for the ten years of work discovering how to make something consumers want. Plumbers, you know, are now getting nearly \$4.00 an hour around here."

"I am setting my price by guess," Alonzo had continued. "I want to work steadily all year producing gadinkuses. If I have any left unsold at the end of the year, I'll know my price was too high and that consumers wouldn't pay this price for as many as I could produce. If, on the other hand, buyers queue up at my shop, I'll know the price was set too low."

By THE STRANGEST chance, Alonzo happened to have hit exactly the free-market price for gadinkuses. In that year he produced 30,000 of them. Everybody wanting one for \$10.00 or more was able to buy one. The last gadinkus was sold just before Alonzo closed his shop on December 31 to go home for his New Year's Eve dinner with his wife and two children.

It was the next day that he

made out his income tax return and had his headache.

The more he thought about it, the more the meaning of this tax system began to form in his mind. He began to see clearly a new picture of how it affected him and his business.

Beginning on January 2 of the new year, he sold gadinkuses at \$10.00 as before. Then at about 10:00 a.m. on January 5 he raised the price to \$12.50 each. A lady buyer protested the new price, saying: "I just saw you sell one at \$10.00 to the lady who bought one before I did!"

"But it cost me more to produce yours than it did hers," Alonzo replied. "And I'm going to try to price gadinkuses so that my customers throughout the year will each pay the same price after taking account of changing costs. What consumers will pay, rather than precisely the cost, finally rules the market, of course. But unless a producer covers his costs, he can't stay in business long. And anyhow, it seems to me that the fair thing for me to do is to price them to my various customers equally in proportion to the costs. That sort of 'equality' seems just, and I'm willing to help put it into practice in economic affairs."

"But," the lady replied, "your costs haven't gone up at all. Your

materials are still free, and it didn't take you a bit longer to make the gadinkus I want to buy than it did the one you sold to the other lady. Why, then, the jump in price?"

"But my time costs more now than it did then," he countered.

"Why?" she persisted. "In both instances it was all your own time. You can't just suddenly say your time is worth that much more."

"It's not me saying it," Alonzo replied. "The government says so."

"How? You work for yourself and not for the government. They don't set your wage."

"I worked fully for myself from the beginning of the year till now," he replied. "But I am not allowed to do so any more. Beginning now I am forced to work one-fifth of my time for the government. You see, from the first of the year till now my income was not taxed. Now it has reached a point where the government begins to take 20 cents out of every additional dollar I get. That is why I must charge you \$12.50 in order to continue to have \$10.00 left after the 20 per cent tax. If I were to charge you only \$10.00, I would be selling it to you cheaper than to those who had bought earlier — much cheaper relative to costs of producing them."

Being unable to refute the fact, and being a willing buyer even at that price, the lady took it. She would have liked, of course, to have been able to get it for \$10.00, just as the lady who had gotten one earlier for \$10.00 would have liked to have gotten it as low as possible.

Then on January 15 at about 11:00 a.m. the price took another jump. This time it went up to \$13.51, as required to cover the new tax rate of 26 per cent applying to additional dollars of income, leaving him his \$10.00 net after the tax. And he had to go through an explanation of taxes and prices all over again.

Again and again during the year Alonzo had to raise the price for the same reason—to \$17.54 on February 6, to \$26.32 on March 24, to \$40.00 on June 8, and to \$90.90 by the end of the year. And there were many other intermediate increases.

Most buyers probably never did understand how taxes had caused the prices to advance. They just assumed it was a personal “mo-

nopoly” grab by Alonzo. But no matter how they looked at it, those who bought gadinkuses did so because they were willing to pay the price rather than to go without. Others went without, of course, because as the price rose it became too expensive for them — just as a price of \$10.00 or \$5.00 or even \$1.00 would be too high for some.

The demand for gadinkuses was such that — no matter what the price — about the same number of dollars would be spent on them by all people, or \$300,000 combined, during the year. So as the

price went up during the year, a corresponding number of buyers became discouraged from buying. Finally, at the end of the year, Alonzo was selling only about one-ninth as many gadinkuses in a day as he was at the begin-

ning of the year. As sales fell off, Alonzo had more and more leisure time—time to sit on the seashore, or to enjoy other pursuits of his choice.

Near the end of the year a lady asked him why he hadn't kept his

FEDERAL TAX RATES

Married Couple with Two Children, 1955

Income before tax (adjusted gross income)	Tax on another dollar of income
\$ 2,672	20c
12,000	26
30,000	43
70,000	62
132,000	75
300,000	89

price at \$10.00 throughout the year, whereby all the gadinkuses he could produce by working full time during the year would be bought. "Look at all the additional people who could then have gadinkuses to enjoy," she said, "but must now go without."

Alonzo replied that out of each \$10.00 received at the end of the year he would be allowed to keep only \$1.10 after taxes, as pay for his time. And he couldn't see why his time at the end of the year was worth any less than at the beginning of the year—still making the same product that people still wanted as much as ever.

"I look at it this way," said Alonzo. "If eight-ninths of the pay for my time is going to be taken from me, I prefer to sit on the seashore or do something else. Why should I work nine times as long to get a dollar at the end of

each year as at the beginning of the year? That doesn't make any sense to me, especially when the government takes some of these taxes to pay people not to produce things the rest of us want and are willing to pay for. I'll forego \$1.10 and have the leisure rather than to produce gadinkuses and provide \$8.90 in taxes to be used to induce someone else not to produce something I would like to buy."

"After all," Alonzo continued, "I don't see that it is my responsibility alone to solve this problem. Go speak to the others who want gadinkuses. I would gladly produce for them if we were allowed to do business directly with one another without this penalty. Have them help me solve it."

Well, they haven't solved it yet, and consumers are still going without gadinkuses they want and could have.

DAN THROOP SMITH, Assistant to the Secretary of the Treasury, told a House tax subcommittee the other day the Treasury Department opposes lifting the Federal excise tax from color TV sets "because this would be a 'concealed subsidy.'" He said, "if it were decided the Government should stimulate production of these sets, it should do it through a direct subsidy."

It seems to me that things have come to a pretty pass indeed when Government officials, with a straight face, speak of tax reduction as a "concealed subsidy."

Does Washington actually believe it has a vested right to all the taxes it can, by hook or crook, scrape into the Treasury? And that it is granting a subsidy when it condescends to reduce taxes?

JAMES C. INGEBRETSEN, *Pause for Reflection*

Executive Incentive

Crawford H. Greenewalt

AS OUR COUNTRY has developed and matured, we have become increasingly dependent on an active and dynamic industry for our economic growth and prosperity. Without minimizing in the slightest the important contributions to our national economy made by the farmers, the professions, the service trades, the fact is that our standard of living is firmly anchored to our industrial development.

Industry, if it is to keep abreast of its responsibilities to the nation, must have a great number of first-class minds at its disposal. It must compete for them with all other phases of our society, for there are never enough to go around. The fields of government, education, the military, the arts, the professions — all are seeking to persuade able young men to cast their lot with them. Each has its own type of incentive to offer, and the demand for talent always exceeds the supply.

The question of incentive is essential, whether we are speaking of business getting its share of the

talent crop or of encouraging the exercise of that talent once it is enlisted. It is perhaps unfortunate that human beings should require lures of any kind as the price of initiative, but I am afraid we have not yet reached that state of grace in which people will surely do their best without external motivation. People being people, they will for the most part respond with their highest abilities only when there is some stimulus or some satisfaction associated with success.

Adequate incentives, of course, differ with different people. Some are attracted most strongly by the promise of prestige. Some are more interested in leisure time, to follow scholarly pursuits or perhaps simply to meditate upon the ills of the world. To some people, public notice or outward signs of rank and importance are alluring goals. Some seek power. For most, however, the strongest and probably the most desirable incentive is financial reward. Furthermore, financial reward is not only an incentive in itself, it is the only fluid

Mr. Greenewalt is President of E. I. du Pont de Nemours & Company. This is an excerpt from his statement of November 9, 1955, to the Sub-Committee on Tax Policy of the Joint Committee on the Economic Report.