

CHAPTER IV

FISCAL EFFECTS OF TAX EXEMPTION

None of the reasons for and against the abolition of tax-exempt securities which were discussed in the preceding chapter is of real importance except as it may serve to bolster up an argument for a position which its adherents have reached chiefly for other reasons. The case against tax-exempt securities really hinges on three main contentions, as follows: first, that large amounts of revenue are lost to the Federal government on account of the exemption; second, that the competition of tax-exempt securities compels private enterprise to pay a higher price for capital; third, that the facility with which tax-exempt securities can be sold unduly stimulates state and municipal borrowing and thereby fosters public extravagance. We shall give our attention in this chapter to the fiscal argument.

Tax exemption is widely believed to have caused a great decline in the productivity of the surtax. Of all the arguments put forward in support of the demand for reduction of the surtaxes, this one has attracted the most widespread attention, and probably has been the most influential in creating a following for the "Mellon Plan" and for similar pro-