March 17, 1939.

The President,
The White House.

Dear Mr. President:

In our capacity as members of the Fiscal and Monetary Advisory Board we have carefully considered the three main proposals made by the Social Security Board in connection with amendments to the old age insurance program, viz., commencing benefit payments in 1940, liberalizing benefit provisions, and permitting the scheduled tax increase in 1940 to go into effect. We support the proposals to commence benefit payments in 1940 and to liberalize, to the fullest extent feasible, benefit provisions. We are opposed to the scheduled increase in payroll taxes.

The collection of payroll taxes in excess of benefit payments imposes a serious drag on recovery. We are faced with a long term problem of deficient consumer buying power, -with an excess of savings over outlets for private capital expenditures. To continue a system which aggravates this deficiency intensifies our problem and postpones the day when it will be possible to balance the budget without interfering with business recovery.

The Social Security Board's recommendation envisages the further accumulation of a reserve fund, and the further net withdrawal of purchasing power. Approval of this recommendation would imply acceptance of a principle of financing old age insurance for which there is a rapidly decreasing expert and popular support. The accumulation of reserve funds is appropriate to <u>private</u> but not <u>social</u> insurance. This has long been recognized in other countries.

The contributory principle, in our judgment, would not be endangered by a failure to increase the tax in 1940, as this principle does not rest on any <u>particular</u> schedule of tax rates or tax increases, nor on the absence of a federal contribution. The greatest danger to the contributory system will arise from a failure to achieve a higher national income.

In 1937 the excess of payroll tax collections over benefits was a major contributory factor in the decline in consumption that preceded the downturn in business.

In 1938, about $1,000,000,000 had to be spent by the Government merely to offset the deflationary effects arising from the unemployment and old age insurance programs and in 1939 another $1,000,000,000 will have to be spent for the same purpose. This has the effect of increasing the deficit without securing a corresponding increase in buying power.

In 1940 and thereafter, the increase in payroll tax collections arising from (a) increasing payrolls, (b) an extension of coverage, and (c) a fifty percent higher tax rate, may entail a repetition of the 1937 experience or the necessity of incurring a much larger deficit than would otherwise be necessary, unless the benefits are increased sufficiently to offset tax collections.

Since it is likely that tax accruals on old age account will approach $900 million in 1940 if tax rates are advanced; since it is highly improbable in our judgment that liberalized benefit provisions will result in a sum in the next year exceeding $100 million; and since the reserve fund will amount to $1,700,000,000 at the beginning of 1940, we feel strongly that it would be dangerous from a fiscal and monetary point of view if the scheduled increase in the payoll tax rate should go into effect on January 1, 1940.

Although we are not at this time making any recommendations relating to unemployment insurance, we think it pertinent, in connection with the proposed increase in the payroll tax rate for old age insurance, to point out that the excess of payroll taxes over benefits on unemployment insurance account will, in our judgment, amount to around half a billion dollars, assuming a national income in 1940 no higher than in 1937.

If the tax rate increase is postponed at this time little difficulty in securing increases in payroll taxes in the future may be anticipated if such tax increases are actually necessary to finance current benefits and if, at the same time, a portion of the costs of such benefits is borne out of general taxation, as is the case in England and other countries.

In view of the foregoing considerations, it would not appear advisable to approve the scheduled increase in the tax rate.

Respectfully,