

CONFIDENTIAL

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

To Chairman Eccles
Com Messrs. Thomas and Young

Date December 31, 1947

Subject: Preview of budget estimates
for fiscal years 1948 and 1949.

The attached memorandum gives a preview of revised budget estimates for fiscal 1948 and likely-official estimates for fiscal 1949.

At continued high levels of employment, income and taxes, the prospect for the current fiscal year is a final surplus of just under 9 billion dollars, and for fiscal 1949, a surplus of just over this sum.

If inflationary pressures relax during the coming year, but without downturn in total national product, a tax reduction of say 5 billion dollars could be made and still leave a budget margin of 4 billion dollars for further debt retirement. With a moderate decline in total national product and tax yield, and the threat of cumulative deflationary developments, tax reduction costing at least 5 billions would be essential. Depending on the timing, such reduction might only result in a small budget deficit for fiscal 1949.

The attached memorandum also indicates a desirable program of tax reduction, considering political feasibility, in the event of the appearance of deflationary tendencies during the next year and a half.

Mr. J.
Ray

Attachment

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date December 26, 1947

To Mr. Young

Subject: Revised Budget Estimates for

From Walter F. Stettner
WFS

Fiscal 1948 and the Budget for Fiscal 1949

The President will issue revised budget figures for fiscal 1948 and the budget for fiscal 1949 on or about January 12. Pending the release of the official figures some estimates may be ventured here, taking into account developments subsequent to the official estimates of last August. The most important development since then has been the continued increase in national income. In addition there have been requests for additional expenditures in the field of international affairs, principally for the Marshall plan.

Additional Expenditures Fiscal 1948

Increased expenditure estimates for fiscal 1948, primarily in the field of foreign affairs include (1) a request for 597 million dollars for short-term relief aid to France, Italy and Austria; (2) a request of 6.8 billion dollars to finance the first 15 months of the Marshall Plan (European Recovery Program), beginning April 1, 1948, and (3) a request for a supplemental appropriation of 490 million dollars to finance increased occupation cost of Germany, Japan, and Korea during the balance of the fiscal year.

Of these three requests, the special session of Congress which adjourned last Friday granted (1) and (3), although not in the full amount. Congress authorized the full 597 million dollars requested by the President for interim aid but appropriated only 540 million dollars of which 18 million dollars were earmarked for aid to China. It also reduced the additional appropriation for Army occupation costs from 490 million dollars to 340 million dollars. It is possible, however, that if these appropriations should prove inadequate, the full amounts may be restored later.

The 6.8 billion dollars requested by the President for financing the first fifteen months of the Marshall Plan are 700 million below the 7.5 billion mentioned earlier by Secretary Marshall for the same period. Although no detailed breakdown was given by the President, it may be assumed that around one billion dollars would be spent during the first three months and would be included in this year's budget. Thus, the total additional outlay for international affairs for the current fiscal year would be around 2 billion dollars.

Confidential Budget Bureau Estimates Fiscal 1948

Despite this increase in foreign affairs expenditures a recent confidential Budget Bureau estimate leaves total expenditures for fiscal 1948 at the August level of 37 billion dollars. It assumes an increase in international affairs expenditures of only 1.3 billion dollars, primarily because only 500 million dollars are included for expenditures

under the Marshall Plan during the current fiscal year. Offsetting a large part of the increase is a decline in expenditures for veterans. The confidential Budget Bureau estimate puts the expenditure for veterans at 6.9 billion dollars as against 7.5 billion dollars in the August budget. The main reasons for this assumed decline are considerably smaller expenditures for readjustment and educational benefits and the exhaustion of unemployment benefits. Other small declines below earlier estimates are now expected in expenditures for housing, education, and agriculture, but no exact breakdown is available. Outside the international field the only other upward revision is in the field of transportation, primarily for highways, rivers and harbors. The revised Budget Bureau estimates are shown in Table I.

Since some of the confidential Budget Bureau estimates seemed to be rather on the low side and involve a considerable change from earlier estimates, it would appear that a more realistic estimate of expenditures for fiscal 1948 should probably be about one billion higher than the August figure. An estimate of 38.0 billion dollars was therefore taken as the basis for the "Financing Outlook" memo of December 4, 1947.^{1/} The areas where we think the Budget Bureau estimates are probably too low are indicated in brackets on Table I.

Revenue Estimates and Surplus Fiscal 1948.

An even more important change in estimates since the August figures were published has taken place on the revenue side of the budget. Recent estimates indicate that receipts will probably be around 46.7 billion dollars as against 41.7 billion dollars shown in the August revision. The main reason for this increase is, of course, a much higher level of prices and incomes than apparently was assumed in August. The largest increase over earlier estimates is shown in the anticipated yield of the personal income tax which is now estimated at 23.7 billion dollars or 3 billion higher than in August. Corporate income tax receipts are now estimated at 9.6 billion, 1.1 billion dollars higher. The remaining 600 million dollar increase is accounted for by higher excise revenues. Our budget surplus of December 4 amounting to 8.7 billion dollars is 4 billion dollars higher than the President's August estimate. The cash surplus would be nearly 5 billion dollars higher.

The Budget Outlook for Fiscal 1949

Recent Budget Bureau estimates indicate that budget expenditures for 1949 will be in the neighborhood of 40 billion dollars. This corresponds to the higher estimate for 1949 which we gave to Chairman Eccles on

^{1/} The figure of 38.3 billion shown there includes a 300 million dollar net expenditure of trust accounts for the current fiscal year which is not included in the budget figure.

STRICTLY CONFIDENTIAL

December 24, 1947

Table I

THE BUDGET OUTLOOK FOR FISCAL 1948 and 1949 1/
(In billions of dollars)

	1948 Budget		1949
	August Estimate	Revised Estimate	Budget Estimate
1. National Defense	10.4	10.2	10.9
2. Veterans' Services and Benefits	7.5	6.9 (7.2)	6.1 (6.5)
3. International Affairs and Finance	4.3	5.6 (6.0)	6.7 (7.5)
4. Interest on the Public Debt	5.1	5.2	5.2
Subtotal 1 - 4	27.3	27.9 (28.6)	28.9 (30.1)
5. Social Welfare, Health, Security	2.0	1.9	2.0
6. Natural Resources	1.2	1.2	1.4
7. Transportation and Communication	1.4	1.6	2.0
8. Other	3.0	2.3 (2.6)	2.9 (3.0)
9. Refunds	2.1	2.1	2.0
10. Fund for Contingencies	--	--	0.5
Subtotal 5 - 10	9.7	9.1 (9.4)	10.8 (10.9)
Total	37.0	37.0 (38.0)	39.7 (41.0)

1/ Column 1 shows the revised budget estimates made public by the President last August. The second column presents recent confidential revisions by the Budget Bureau of the budget for the current year. Both the estimated total and the estimates of major items are Budget Bureau figures; the others are approximations. Column 3 contains confidential Budget Bureau estimates for fiscal 1949. Where Budget Bureau estimates appeared very low and likely to be revised upwards, a somewhat higher figure was included in parenthesis.

September 17, and which we considered more likely than the low estimate of 35 billion dollars. Although the total is the same, the composition of our budget differed somewhat from the Budget Bureau estimates. The Budget Bureau estimates are shown in the last column of Table I. Again some of the estimates appeared to be on the low side and somewhat higher estimates have been included in brackets. A budget estimate of 41 billion dollars was taken as the basis for the financing outlook.

As shown in Table I, four items, namely national defense, veterans' benefits and services, international affairs, and interest on the public debt are likely to amount to almost 30 billion dollars or 75 per cent of the total budget. Of these four items, all but veterans' expenditures are now estimated to be higher than in the current fiscal year. National defense expenditures are estimated about 500 million dollars higher in view of requests of the Armed Forces for an expansion of the Air Force and additions to the Navy.

Despite inclusion of the Marshall Plan, outlays for international affairs in fiscal 1949 are estimated by the Budget Bureau at only slightly over a billion dollars higher than the estimates for the current year. Although the administration is requesting about 6 billion dollars for the full year, actual expenditures are estimated by the Budget Bureau at only 4 billion dollars. In addition, there will be an increase in Army occupation costs by 200 million dollars and an additional expenditure of about 400 million dollars for taking over the British share of the occupation costs of Germany. The remainder of the total of 6.7 billion dollars for foreign affairs is made up of the expenditures of the State Department, various relief expenditures and contributions to international organizations. The small increase in the total for the next year despite the inclusion of the Marshall Plan is due to the fact that a number of items which are included under foreign affairs in the current budget are of a non-recurrent nature, primarily the British loan, relief to Greece and Turkey, and the current stopgap aid to Europe.

Veterans' services and benefits in fiscal 1949 are estimated considerably lower primarily in continuation of the present trend of lower expenditures for educational and readjustment benefits and the exhaustion of unemployment benefits. On the other hand, no large increase in expenditures for hospital construction or veterans' pensions is anticipated. With regard to the remaining items, the Budget Bureau anticipates somewhat larger expenditures for natural resources, primarily for the Atomic Energy Commission, and an increase in expenditures for transportation (highways, airports, and rivers and harbors), as many projects which have been started during the last two years reach their full scale. These increased construction expenditures, however, are based upon legislation already passed by the Congress and

do not assume additional authorizations. The Budget Bureau estimate of the 1949 budget includes also an item of 500 million dollars for contingencies. This should make allowance for expenditures arising out of a possible Congressional enactment of a long-range housing program and of some type of health and welfare legislation either along the line of the President's recommendations or the program mentioned by Senator Taft.

Revenue Estimates, Surplus and Tax Reduction

Assuming a continued high level of income and employment in fiscal 1949, and an increase in personal income and corporate profits shown in a footnote to Table I of the financing outlook of December 4, total revenues are estimated at around 50 billion dollars, or 3.5 billion higher than in the current year. Since the economy has never before experienced such a high level of income and of profits it is appropriate to exercise caution in the use of these estimates of revenue. Any slackening in activity or fall in prices would obviously be reflected in lower tax yields and the magnitudes may be quite considerable. However, under the assumptions noted, the budget surplus in 1949 would be around 9 billion dollars.

Table II
THE BUDGET FOR 1948 AND 1949 1/
(In billions of dollars)

	Budget for President's August estimate	Budget for Fiscal 1948 December estimate	Budget for Fiscal 1949
Revenues	41.7	46.7	50.2
Expenditures	37.0	38.0	41.0
Surplus	4.7	8.7	9.2

1/ The first column represents the official Budget Bureau estimate of last August. Columns 2 and 3 show our own estimates which were contained in the financing outlook of December 4.

From the figures in Table II it is suggested that the surplus itself would leave room for tax reduction both in 1948 and 1949 and still allow some debt retirement of from 4 to 5 billion dollars. Such tax reduction, however, would be undesirable at the present time in view of the continuing inflationary pressures existing in the economy. However, it is conceivable that the inflationary pressures might not last through calendar 1948 and that it might actually be desirable to bolster consumer demand

through limited tax reduction in the latter part of the year or early in 1949. Any such tax reduction scheme would not affect the funds available for debt reduction in the current fiscal year. How much it would leave for debt reduction in fiscal 1949 would depend upon the extent of contemplated cuts in rates and upon the actual decline in income levels.

As a first step in counteracting deflationary developments through tax reduction, a tax reduction scheme costing about 5 billion dollars might be considered. Whether such a tax reduction would be sufficient would obviously depend upon the strength of the deflationary forces. However, at least a 5 billion dollar reduction would appear to be necessary in order to have any significant effect and still allow for debt reduction of the order mentioned. It should include a 100 dollar increase in exemptions (cost: about 1.7 billion), and a reduction in excises by about 1 to 1.5 billion. Since it seems politically unlikely that any tax reduction bill could leave out the income-splitting provision, this might also be included (cost: about 1 billion). This would leave about 1 billion dollars for a small percentage point reduction in the lower middle income brackets, say up to 8,000 dollars, since these persons do not benefit as much by the raising of exemptions and the reduction in excises as do the lower groups nor do they benefit by the income-splitting privilege as much as the higher income groups. It would be desirable that such a tax reduction scheme should include as many technical improvements as possible, to take advantage of the opportunity offered by a period of downward tax adjustments. Beside eliminating the tax exemption feature of State and local bonds it might also include some technical adjustments of the corporation tax even though rate reduction might have to be postponed.