

May 29, 1940

THE NATIONAL DEFENSE TAX PROGRAM

The newspapers of yesterday afternoon and this morning carry reports of an agreement between the Administration and Congressional leaders to raise the debt limit by \$3 billion and to impose additional taxes of about \$700 million to pay interest and amortization charges on this amount. Agreement on the type of taxes to be raised is apparently to be reached this morning.

The details of this agreement show signs of extreme haste and a complete neglect of the economic effects which may be expected to follow from the suggested tax increases.

The rate of expansion of our national defense program over the next few years is still uncertain, and it seems likely that it will be limited by the necessity for organizing the production of the specific items needed rather than by the size of the appropriations. There is every reason to believe that with the most strenuous efforts to accelerate defense activity, the increase in output over the next twelve months will be small in relation to the idle capacity of our industrial structure as a whole.

The increase in defense expenditures, therefore, cannot be relied on to bring about anything like full employment in that period. Meanwhile, domestic business may be subjected to two serious shocks. One

of these is the possible termination of hostilities in Europe with all that it will mean in terms of cancellation of Allied orders and dislocation of our export trade. The second is the catastrophic decline in stock prices which is certain to be the stock market's reaction to peace or rumors of peace.

In the light of these possibilities it would be extremely unwise to tighten consumers' belts now. This would be precisely the effect of the suggested 10 per cent increases in manufacturers' excises, and in the tobacco, gasoline, beer and liquor taxes. These tax increases will strike directly at the market for the products of industry, not merely the products on which the taxes are levied but the whole range of articles included in consumers' budgets. Taxes on consumption already make up a disproportionate part of our Federal tax structure and a true program of financial preparedness would include reductions rather than increases in such taxes.

The size of the immediate increase in defense expenditures will not be such as to require hasty enactment of a superficial and ill-considered tax measure. Financial preparedness for a defense program of the scale which can already be foreseen makes it essential, however, to plan a comprehensive revision of our whole tax structure adapted to our total economic situation as it develops under the gradually mounting impetus of our defense outlays. If Congressional sentiment makes it necessary to enact additional taxes at once, it would be far better to impose an excess profits tax, the details of which have already been fully drawn up, than to make the suggested horizontal increase in tax rates generally.