Form F.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 22, 1940

To Chairman Eccles

Subject:

From Emile Despres

ED

There are attached hereto (1) a memorandum by Mr. Krost setting forth a number of proposed tax changes, with yield estimates, as well as estimates of the yield of existing taxes, at various levels of national income; (2) a memorandum by Professor Hansen stating his views regarding tax increases; and (3) a copy of a letter received this morning from Mr. Randolph Paul. Mr. Solomon is preparing a summary of the proposals referred to by number in Mr. Paul's letter.

The proposals described in Mr. Krost's memorandum were selected because (1) they will raise additional revenue without causing an equivalent reduction in consumer outlays, and (2) if put forward by the Administration, they are believed to have a reasonable chance of enactment at this time. A tax program of this sort runs the danger that it may lead taxpayers to make more intensive use of the loopholes left unclosed. Of the tax avoidance devices not covered by these proposals, the most important is the practice of leaving corporate earnings undistributed in order to avoid high surtaxes on individual incomes.

Even nonconsumption taxes of the type put forward by Mr. Krost are bound to be somewhat deflationary. One-third of all dividends reported for individual income tax purposes were received by those having incomes below $10,000 a year.

In my judgment an adequate and practicable tax program at this time would consist of (1) an excess profits tax, (2) elimination of the privilege of filing separate returns for husband and wife, and (3) removal of tax exemption for future issues of Federal, State, and local securities. At present levels of income the first two measures would yield about $800 million of revenue, and at least double this amount at a $100 billion national income. We estimate that our existing tax structure, including both budgetary receipts and net social security funds, will provide $7.4 billion of revenue at the present national income and $17.1 billion at a $100 billion national income. A tax program which goes much beyond the three measures listed above runs the danger of seriously retarding the general expansion of income and employment which the arms program is expected to produce.

Defense expenditure in the present fiscal year is being tentatively placed at $3.5 to $4 billion. By using material presented before Congressional committees we have estimated that the nonrecurrent costs of expanding our national defenses as provided in legislation passed or now pending will be about $15 billion, to be spread over a number of years. This figure includes a tripling of our present naval tonnage, an air force of 35,000 planes with facilities for annual production of 50,000, and full equipment for an army of 2,000,000 men. The recurrent cost of maintaining our armed strength at this level would be about $5 1/2 billion. In the light of these figures, it seems improbable, leaving aside the possibility of our becoming a belligerent, that defense outlays will exceed $7 or $8 billion a year even during the period of armament expansion. Under these circumstances, it seems appropriate to postpone drastic increases even in nonconsumption taxes until a substantial amount of general economic expansion has been achieved.

Attachments 3