

October 31, 1941

Chairman Eccles

Treasury Discussions on

Martin Krost

Amount of Revenue Needed to
Prevent Inflation

Since the latter part of last week there has been a series of internal staff meetings at the Treasury on the topic of the amount of additional revenue needed to prevent inflation. Besides the permanent members of the Treasury staff Professor Carl Shoup of Columbia, Mr. Roswell Magill, Mr. Randolph Paul, and Mr. Chester Barnard, President of the New Jersey Bell Telephone Company, have participated in these discussions. I understand that Mr. Barnard has been brought into the Treasury as a special adviser on the inflation problem. This group has had as a basis for discussion a report prepared by Professor Shoup on the prospect for growth in physical output and in money income during the next few months and the magnitude of the gap which was likely to develop between money expenditures and the volume of goods and services offered for sale. Representatives of several government agencies were asked to consult with Professor Shoup concerning the reasonableness of the methods used and the results obtained in his report, and I was present at these discussions. These talks have thus far covered only a part of the report and it was expected that they would continue although this now seems uncertain.

Uncertainties as to the more important magnitudes involved in this problem, particularly with respect to the course of defense expenditures and the possible increase in physical output make it impossible to give estimates as to the magnitude of the inflationary gap except in the form of a very wide range. The Shoup report estimates the amount of additional revenue needed to close this gap at between \$5 and \$9 billion in the year 1942. This is over and above the \$3 1/2 billion of additional revenue attributable to the Revenue Act of 1941. The estimate is based upon a comparison of the conditions in June, 1941, and June, 1942, and it is recognized that the amount of revenue needed in the earlier months of 1942 might be somewhat less and in the latter months somewhat greater than the magnitudes given.

The general nature of the approach may be shown by citing the figures given as the basis for the minimum estimate of \$5 billion. The maximum increase in the output of goods and services which is thought to be possible in the twelve months period under consideration is estimated at \$12 billion. This is a measure of the increased physical volume of goods and services valued at the prices of June, 1941. The increase in defense expenditures is estimated at \$14 billion. Thus the volume of goods available for civilian consumption (both consumer goods and capital goods) must decline by \$2 billion. In order to determine the effect on total civilian expenditure of the increase of \$14 billion in defense expenditures there must be deducted (a) increased Federal taxes under the

tax structure as affected by the Revenue Act of 1941 of \$6 billion; (b) an increase in undistributed corporate profits of \$1 billion; (c) decreases in private and business spending, due to the operations of priorities and allocations and to other factors, of about \$2 billion. After deducting these offsets from the \$14 billion of increased defense expenditures \$5 billion is left. It is estimated that the multiplied effects of imposing taxation of this amount will do more than keep consumer expenditure constant; it will decrease it by an amount sufficient to match the \$2 billion reduction in the volume of goods available for sale.

It is apparent that very slight variations in the estimates of the basic figures as to the volume of government expenditures, the increase in physical output, and the probable volume of personal and business spending will produce very large differences in the final results; on the assumption that the possible increase in physical output amounts to only \$9 billion, the conclusion is reached that additional revenues of \$9 billion instead of \$4 billion are needed. The general trend of the discussion was to raise the estimated figures for declines in private expenditure attributable to the operation of priorities but at the same time to raise the figure for defense expenditures by more than a corresponding amount. The meetings did not reach the point of assessing the effect of these changes upon the final figure of revenue needed.

The Shoup report suggests a specific device for raising the additional revenue. This device is a supplementary income tax to be deducted at the source on wages, salaries, and corporate dividend and interest payments. Other forms of property income and the earnings of the self-employed would be reached by requiring the taxpayers whose incomes were not taxed at source to file quarterly returns. Personal exemptions of \$1,000 for married persons, \$500 for single person, and \$300 for each dependent would be allowed as deductions from taxable income. These exemptions could be pro-rated over the year in the case of wages and salaries. For other types of income an adjustment in tax would be made on the basis of an annual return. Allowances for deductions from gross income such as State and local taxes and interest paid could also be made on the basis of an annual return. It is proposed that with respect to taxpayers already subject to the regular rates of income tax that the supplementary tax be imposed on income after deduction of regular income taxes paid.

It is estimated that on the tax base defined in this way a rate of 17 per cent would be necessary to raise the \$5 billion of additional revenue regarded as the minimum required. A rate of 31 per cent would be required to raise the maximum amount of \$9 billion.

Any additional revenue secured through increasing the Social Security taxes would of course reduce the amount of revenue required from the supplementary income tax or any similar device. The Secretary's recent announcement indicates that the Treasury will seek to obtain some part of the additional revenue from the social security taxes. The Shoup report also fails to explore the possibilities of increased corporate taxation and increased excise taxes.

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The Shoup report also takes up the issue of whether increased Treasury receipts ought not to take the form of compulsory saving instead of taxes but its conclusion on this issue is that it is desirable to keep the increase in the national debt as small as possible and that the time for increased taxes is now, when incomes are rising rapidly.

I should stress the fact that there is nothing to indicate that the supplementary income tax proposal will be officially adopted by the Treasury. The figures and the other facts touched on in this memorandum were discussed with the understanding that they would not be referred to outside governmental circles.

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