



TREASURY DEPARTMENT

WASHINGTON

July 22, 1942

Dear Marriner:

At the Secretary's suggestion, I am enclosing herewith a draft of his statement to be given tomorrow before the Senate Finance Committee. If you would like to make any suggestions I should like to hear from you as soon as possible, as the statement will be mimeographed this afternoon.

You will understand, of course, that this statement is highly confidential, prior to its release tomorrow when the Committee meets.

Sincerely yours,

A handwritten signature in cursive script that reads "Randolph E. Paul".

Randolph E. Paul  
Assistant to the Secretary

Honorable Marriner Eccles,  
Chairman, Federal Reserve Board,  
Washington, D. C.

Enclosure

FOR DEFENSE



STATEMENT OF SECRETARY MORGENTHAU  
BEFORE THE  
SENATE FINANCE COMMITTEE  
JULY 23, 1942

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12:30 Pm

CONFIDENTIAL

You will recall that in his Budget Message of January 5th, President Roosevelt asked for additional taxes for the fiscal year 1943, exclusive of Social Security taxes, of \$7 billion. On March 3rd, I appeared before the Committee on Ways and Means of the House and presented recommendations for a tax program to produce \$7,600 million in additional annual revenue from taxes. On May 6th I wrote a letter to the Chairman of the Committee on Ways and Means recommending a reduction in personal income tax exemptions to produce approximately \$1,100 million more revenue. These two recommendations together involved a tax program of \$8,700 million of additional revenue. These amounts represented what I believed, and still believe, was the very least that the American people could afford to provide.

It is only against the background of our war expenditures that we can tell whether the revenue bill before you will fulfill its purpose. We are now spending

\$150 million a day, or almost \$5 billion a month. In the fiscal year that is beginning we expect to spend the almost inconceivable sum of \$77 billion to win this war for human freedom.

There can be no compromise with these war expenditures. We would not reduce them if we could. Our whole effort must be to spend as fast and as effectively as possible in the production and use of our war materials. If our expenditures this year reach \$77 billion, our receipts in revenue from the people must bear some reasonable relationship to that colossal figure. If the House Bill were to become law it would be necessary to borrow from the public during this fiscal year about \$53 billion. To the extent that we enlist our current income in taxes to cut down this borrowing, we shall be protecting the future economic soundness of our country and our free institutions. To the extent that we fail, we shall be endangering the survival of all that we are fighting to preserve.

It is interesting to compare the fiscal situation here with the situation in Great Britain and Canada,

remembering, of course, that they have been at war longer than we. In its first full year of war, namely, the fiscal year 1941, Canada devoted not quite one-fifth of its national income to the war effort; in the fiscal year 1943 it expects to devote more than two-fifths of its national income to the war. In the fiscal year 1941 Great Britain devoted almost half of its national income to the war effort, and in the fiscal year 1943 it expects to put just about half of its national income into the war. In the fiscal year 1943, which will be our first full year of war, it is estimated that the United States will devote at least half of its national income to the war effort. Thus, thanks to the foresight of President Roosevelt and the splendid cooperation of Congress, we shall in our first full year of war have devoted to the war effort a proportion of our national income comparable to the proportions similarly devoted by Great Britain and Canada today.

We get a different picture, however, if we look at the percent of expenditures financed through taxes in the three countries, as shown in the following table:

Percent of Expenditures Financed  
through Taxes

*Being revised*

<u>Fiscal:</u> <u>Year :</u>	<u>Great Britain :</u>	<u>Canada :</u>	<u>United</u> <u>States</u>
1941	44	61	(Not at War)
1943	52	57	37

In the fiscal year 1941 Canada financed 61 percent of its expenditures by taxation, and in the fiscal year 1943 it expects to raise 57 percent from taxes. Great Britain, in the fiscal year 1941, financed 44 percent of its expenditures by taxation, and in the fiscal year 1943 it expects to raise 52 percent from taxes. In the United States, however, including Federal, State, and local governments, only 37 percent of total fiscal 1943 Government expenditures would be financed by taxation on the basis of the Revenue Bill now before you. It is clear that we are substantially behind Great Britain and Canada in the proportion of our expenditures which we are raising from taxes. Quite frankly, I do not see why we should not do at least as well as Great Britain and Canada.

Taxation and the Cost of Living

Taxation does more than supply money to finance the war. It does more than apportion the war burden now, once and for all, instead of leaving it for further distribution through taxes after the war. Wartime taxation also plays an important part in preventing rapid and continued increases in the cost of living. The President has announced a seven-point program for holding down the cost of living. Ceilings have been placed on prices. This fact may have caused many people to be unduly optimistic about the future of the cost of living. It cannot be too strongly emphasized that if the price ceilings are to be maintained and rapid and continuous price rises avoided, the pressure of the large and expanding volume of consumer purchasing power on the diminishing supply of goods must be reduced.

To reach a much larger volume of consumer purchasing power, the Bill now before you includes such a broad reduction of personal exemptions that it will affect almost seven million individuals who have never paid direct taxes to the Federal Government before. If this section of the Bill is passed as it stands, some thirty

million income tax returns will be filed in the new fiscal year as against only 7,600,000 in 1940. Moreover, these thirty million individuals represent the bulk of consumer demand today. The income tax has, in fact, become a people's tax for the first time in our history.

Taxes cannot, by themselves, win the battle against inflation. The battle must be fought with determined and coordinated effort on many fronts. Taxation can be fully effective in this battle only if it is accompanied by restraint and self-denial in other fields. Nevertheless, taxation by itself can make the price situation more controllable and less dangerous than it otherwise would be, and it is an essential anti-inflationary weapon that must be used to the utmost. Inflation has been well described as "the ruthless process whereby sacrifice is imposed inequitably upon a people who have lacked the unity, the courage and intelligence to impose that sacrifice equitably upon themselves." It is for us to show that we have the unity, the courage, and the intelligence to check inflation now.

#### Treasury Program a Minimum Program

The Administration's revenue program was presented last Spring as a minimum. On March 3rd, when I first

came before the Ways and Means Committee, our total contemplated expenditures for the fiscal year 1943 were \$63 billion. Since then they have risen by \$14 billion, and the total war appropriations, authorizations and requests for this and succeeding fiscal years have risen by \$75 billion. It is true that the Bill before you would produce by far the greatest revenues in our history, and I would not wish for one moment to minimize the task performed by the Ways and Means Committee. Yet this Bill would provide only \$6.3 billion additional revenue in place of the \$8.7 billion we recommended in the Spring. It would fail by about \$2.4 billion to reach that minimum of last Spring, which is even more emphatically the very least we can afford to provide today.

In presenting its revenue program to the Committee on Ways and Means, the Treasury outlined methods of taxation which it considered most desirable and appropriate to raise the required amounts. I still believe that these proposals are sound and present the best sources for a revenue program of this size. They are based upon the principle of ability to pay, and they avoid such devices as a general sales tax, which would fall with the



greatest impact upon those least able to bear the burden. The various provisions of the Administration program are well known and it is not necessary to repeat them here. I should like, however, to emphasize certain points which I hope will be most carefully considered by the Committee.

### 1. Special Privileges

The Revenue Bill as it stands violates the basic principle of equity which is so important to an all-out war finance program. It does this by leaving certain highly privileged groups free from tax on large portions of their income.

The first of these especially favored groups are the recipients of tax-free interest from State and municipal securities. Exemption of interest on State and local securities is a serious breach in our system of taxing according to ability to pay. For example, in the case of one individual, out of a total reported income of approximately \$975,000, over \$668,000 came from State and local securities. If the Bill as it passed the House should become law, this individual would pay only \$243,000; if, on the other hand, your Committee would adopt my suggestion and remove this pre-Pearl Harbor exemption, he would pay \$832,000

The glaring unfairness of this exemption may be seen in another way. Under the tax rates in the House Bill, a person with a surtax income of \$100,000 from other sources who holds a 3 percent tax exempt security receives as much net return after taxes as from a taxable security yielding 20 percent. The existence of this special privilege for all holders of tax-free securities costs the Government and the people of the United States, under the House rates of tax, about \$200 million a year; and it will cost still more as our wartime taxes tempt more and more wealthy individuals to shift their investments into the hide-out of tax exempt securities.

How can we expect to obtain an all-out war effort from all our people if we go on permitting a group of individuals and corporations owning \$14 billion of State and local securities to go tax free on the income from these securities? We are asking our young men to give their lives for their country, and at the same time we are allowing many wealthy persons, safe behind the lines, to escape their fair share of the war's financial burden. At a time when we are straining our energies to the utmost to defeat a powerful and ruthless foe, common decency requires that we abolish

these special tax shelters, and do it now.

Another highly privileged group having large amounts of income exempt from income tax are the owners of oil wells and mines. I refer to those provisions of the law dealing with percentage depletion. Percentage depletion is a serious breach in our system of taxation according to ability to pay.

I cannot believe that the taxpayers of America would knowingly sanction a provision of the law which allows owners of oil and gas wells to deduct from their income 27-1/2 percent of their gross receipts from such wells--not for one year, two years, or the period necessary to return investment, but for an unlimited period. For example, a leading oil company owned a number of oil properties which had cost it \$3 million. At the time the case was examined percentage depletion of \$3.6 million had already been allowed and the properties still had three-fourths of the oil left.

Certainly we cannot justify this exemption on the ground that it encourages exploration and drilling for oil. There is grave doubt that it has a substantial effect on oil discovery. It would have cost the Federal Government less than one-third as much to have paid all the

cost of every wild-cat well that was drilled in 1941 than to have allowed percentage depletion and the associated intangible drilling expenses, at an annual cost of \$200 million to the Treasury and the taxpayers.

The privilege of filing separate income tax returns furnishes another example of special tax advantage to many married couples having larger than ordinary incomes. In families in which the income is earned partly by the husband and partly by the wife and in families in which income earning property can be divided between husband and wife, the tax on the family income is less than where the husband or wife receives the whole income. The family is the true economic unit, and it is unfair for the amount of tax on the family to vary depending upon who earns the income or upon who in the family has income producing property. Ability to pay taxes must be judged in terms of family incomes and not the incomes of members of the family. The failure to require joint income tax returns constitutes a violation of the fundamental principle upon which our tax system has been based.

The adoption of mandatory joint returns would also eliminate another discrimination prevailing under existing law. Married couples living in the eight or nine so-called community property States receive tax advantages which are in no way commensurate to any special relationship that may exist between husbands and wives in those States. For example, take a family in which the husband has a salary of \$10,000 after deductions. If the family has its residence in, say, California, the family tax would be \$2,138, while if the family lives in, say, Iowa, the tax would be \$2,549, or nearly 20 percent more. The discrimination is even more pronounced with larger incomes. In this national emergency, how can we complacently permit the citizens of these community property States a more favorable tax status than those of the rest of the country?

These examples of special privileges are intolerable at a time like this, when we are imposing heavy taxes on persons with small incomes and there is pressure for limiting wages and farm prices. The country is in greater danger today than ever before in its history. The war is now in its most critical phase, and only by pulling together as

a united people can we make the effort that will turn the tide toward victory. At such a time any special privilege for any group not only deprives the Treasury of revenue that is badly needed for the war effort, but it hinders the war effort by undermining the morale without which the war cannot be won.

## 2. Excess Profits Tax

Another similar hindrance to the prosecution of this "people's war" is the existence of excessive profits in wartime. There is no easier way to stir the righteous anger of the American people than to let them hear constantly of excessive wartime profits that are not being recovered by adequate taxation. I have said repeatedly that we are determined to take the profit out of war, and the Treasury's recommendations have been framed with this determination in mind.

An effective excess profits tax does much more than produce badly needed revenue in time of war. It also reassures the masses of our farmers and factory workers that industry is not being rewarded unduly for its part in the winning of the war.

I do not believe that any patriotic American needs

the "incentive" of profits to produce for war at this time. Millions of our people are willing to pay new and genuinely burdensome taxes, to buy War Bonds without stint, and to do without many of the accustomed luxuries and even conveniences of daily life. Their only "incentive" is their firm resolve to win this war and build a better future.

Experience has shown, however, that when excess profits taxes are too high they may result in extravagance and waste in the conduct of business. It is vitally important that we stimulate business to produce for war purposes as economically and efficiently as possible, if for no other reason than to avoid a waste of war materials and labor and to hold down the cost of the war to the Government. Moreover, a post-war credit to industry will help toward the rebuilding of our economic life. For these reasons we have recommended a 90 percent excess profits tax coupled with a 10 percent credit for return to the corporation after the war. The credit should, of course, be restricted in such a manner that it would be used for the direct employment of labor, the conversion of plant to peacetime business or for other uses promoting economic adjustment and growth.

### 3. Tax on Freight and Express

One tax that would be imposed by the Bill before you directly threatens the stability of prices. This is the tax on freight and express which would add to the cost of producing and supplying practically every commodity and service. In great numbers of cases the added cost would make it impossible for businesses to continue to operate under the price ceilings which have been imposed and the breaches in the price ceilings which would thereby be caused would threaten the whole price structure.

### Conclusion

I shall not attempt today to discuss the more technical aspects of the long and complex Bill before you, nor to enlarge further upon the subjects I have mentioned already. The Treasury staff stands ready, as always, to assist you in every way possible in carrying out your difficult and responsible task. I should like, however, to make just one more appeal. Every day consumed in your Committee's work will lose us substantial amounts of revenue under the excise tax portions of the Bill. Every day that can be saved in enacting this will enable



it to produce just so much more in needed revenue. Every day saved will give our citizens additional time to adjust themselves to the impact of the most severe tax bill in all our history.

I am discussing our tax problem with you today on broader grounds than that of revenue alone. It is my conviction that the people of this country want a courageous tax bill, and want it with the least possible delay. They are ready for greater sacrifices than some of us imagine. The overwhelming majority of them, I am convinced, want us in Washington to show a determination that is worthy of their own. They will be critical of us only if we seem to palter or haggle, or if we pay too much attention to the demands of selfish groups, or if we seem half-hearted in asking self-denial of the people as a whole.

Our acceptance of sacrifice on the home front is a yardstick of our determination to win the war. For this reason it is unthinkable to me that we should be straining every effort on the fighting fronts abroad and on the production line at home, and at the same time be anything less than all-out in the financing of the war

effort. This war, above all others, can be won only by hard fighting, by the acceptance of risks and deprivations, and by the united effort of civilians and fighting men alike. In this kind of war a tax bill can be a decisive battle. It could be lost by narrow vision and faulty leadership. It can be won by boldness and courage. I am confident that this Committee will live up to its high responsibilities and keep faith with a united people.

REP:el

7/22/42 12:15 P.M.

I am in general agreement with the draft of the Secretary's statement before the Senate Finance Committee. There are, however, two changes that I would like to see.

The desirability of restoring the individual income surtax rates to at least the levels originally proposed by the Treasury is not one of the points singled out by the Secretary for special emphasis. I believe that this should be one of the points emphasized, and that it should be stated clearly that we must regard these lower bracket income tax rates as the part of the program which is of primary importance from the point of view of controlling inflation.

It also seems to me that a proposal for a 75 per cent limitation on the relationship of excess profits tax to total profits, coupled with a proposal to recover the loss in revenue by lowering the percentage of base period earnings allowed as an excess profits credit, would be preferable to the proposal for a 90 per cent rate with a 10 per cent post-war refund.