

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

# Office Correspondence

Date September 7, 1943.

To Board Members (individually)

Subject: \_\_\_\_\_

From Chairman Eccles

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For your personal and confidential  
information I am attaching a copy of a memo-  
randum submitted to Mr. Paul with my covering  
letter.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

September 7, 1943

Miss Egbert:

Enclosed I am sending the requested copies of the Chairman's letter and memorandum to Mr. Paul for distribution to the Board members.

R. A. Musgrave.

*R.A.M.*

September 7, 1943

Dear Randolph:

I am enclosing a brief statement which will explain why I think it undesirable to advance the proposal for an expansion of Social Security as a part of the Administration's current revenue program.

My main concern is that a linking of these issues would weaken the prospects for obtaining a satisfactory revenue bill and would cause considerable delay in providing for increased taxes. The major task before Congress is to provide promptly for a substantial amount of additional revenue needed to assure the success of the stabilization program. If the Social Security proposal were introduced as a part of the revenue program, this basic issue would be lost sight of. The public, which has come to understand the need for increased taxes as a means of inflation control, would find it more difficult to see how an expansion of the Social Security program at this time would serve the same purpose. Congress has shown no eagerness to tackle the Social Security issue now, as evidenced by the reception given the President's recent statements on the subject. Introduction of the Social Security issue would raise highly controversial problems which have no relation to the immediate needs of the situation. Opposition to specific Social Security provisions would be turned into opposition to any substantial increase in taxes. For all of these reasons it would appear a serious tactical error to link the Social Security program with the current revenue proposal.

At the same time an increase in payroll taxes earmarked for Social Security benefits would offer no advantages, for purposes of current policy, which could not be obtained as well by other methods. An increase in income taxes, if combined with a provision for tax refunds after the war would provide an equally effective means of relieving the burden upon taxpayers in the lower income groups. The reduction in voluntary purchases of savings bonds, resulting from a sharp increase in payroll taxes, would be no less, and perhaps more severe than that resulting from an increase in income taxes, combined with a refund provision. In some other respects the economic effects of increased income taxes combined with post-war refunds would be preferable to those of increased payroll taxes.

These considerations, which speak against a combination of the Social Security proposal with the current revenue program, raise no objection against an expansion of the Social Security program at a later time. On the contrary, I believe that every effort should be made to obtain Congressional action on an enlarged Social Security program after a substantial revenue measure has been passed. If such action is obtained in the course of 1944, increased benefits will become available in time to meet the needs which may arise in the period of transition to a peacetime economy. An increase in taxes now should not jeopardize the case for an expansion of the Social Security program next year. Additional taxes now imposed can be reduced later when the higher payroll taxes become effective.

Sincerely yours,

M. S. Eccles.

Enclosure

Honorable Randolph E. Paul,  
General Counsel,  
Treasury Department,  
Washington, D. C.

Place of Social Security in the Administration's Revenue Program

Expansion of the Social Security program is highly desirable, but it would be a mistake to link the drive for a broadened program with the Administration's current revenue proposal.

If a broadened Social Security Program were made the central part of the Administration's revenue proposal, the basic issue of inflation control would be lost sight of in the discussion of social insurance. As a result the adoption of a revenue bill would be delayed. More important, the chances of obtaining the revenue objective would be greatly reduced. The public, which has been brought to understand the need for increased taxes as a means of inflation control, would find it more difficult to see how an expansion of the Social Security program would serve the same purpose. Congress, on the whole, has shown no eagerness to tackle the Social Security issue at this time, as evidenced by the reception given to the President's recent statements on the subject. If the Social Security issue is introduced, highly controversial matters such as medical insurance or the shifting of State unemployment insurance to a Federal basis would have to be considered. Issues would be debated which are entirely unrelated to the immediate needs of the situation. Groups which are opposed to specific Social Security provisions would be placed into opposition against any substantial increase in taxes. For all of these reasons, it would appear a serious tactical error to link the Social Security program with the current revenue proposal.

An increase in payroll taxes earmarked for Social Security benefits, moreover, would offer no advantages, with respect to current policy, which could not also be obtained by other methods. The granting of additional Social Security benefits would be one way of relieving the burden of additional taxes upon the lower income groups. The granting of post-war tax refunds would be an equally effective method. Under any approach a sharp increase in the tax liability of the lower to middle income groups will be inevitable if \$5 to \$10 billion of additional taxes are to be obtained from individuals. But the actual burden imposed on these taxpayers could be much reduced if a substantial part of their contribution were made in the form of refundable taxes. A simple percentage schedule could be provided by which the refundable part of the tax would be determined. If the additional tax revenue were obtained from a supplementary war tax rather than an increase in the rates of the existing surtax schedule, the refund schedule might be applied against the liability under the supplementary tax (otherwise it might be applied against the increased regular income tax). Of the first \$50 of supplementary war tax paid, 100 per cent might be refundable; of the next \$50 paid, 70 per cent, and so forth at a declining rate, with an upper limit for refunds of \$1,000. As a result the refundable portion of the taxpayer's liability would be the smaller the larger his income and the bulk of the refunds would go to the lower income groups. The schedule could be adjusted to provide for any desired breakdown of the additional liability between outright and refundable taxes. In this way taxpayers in the lower income groups would be given assets in return for their tax payments in much the same way as under an expanded Social Security program.

Any substantial increase in compulsory requirements on the lower to middle income groups would be reflected in reduced purchases of savings bonds on a voluntary basis. An increase in payroll taxes for Social Security purposes would have this effect no less than an increase in income taxes with a provision for refunds. Both methods would cut down the taxpayer's income out of which savings bonds could be purchased and would provide him with assets which he might substitute for the bonds heretofore bought on a voluntary basis. The fact that increased Social Security contributions would apply against total gross income (excluding the part of income in excess of \$3,000) and allow no exemptions to even the lowest income groups suggests that the resulting reduction in the payroll contribution program might be larger under a 12 per cent payroll tax than under a system of refundable income taxes which would provide for personal exemptions and credits.

Any substantial revenue program will tend to reduce voluntary purchases of savings bonds, but this is no decisive argument against it. It is of vital importance that the Government should retain some measure of control over the timing of redemption payments in the post-war period. Such control is retained under a compulsory program (be it in the form of refundable taxes or expanded Social Security benefits) but is absent under a voluntary savings program. Voluntary purchases of savings bonds, nevertheless, will retain a vital part in the financing program even though taxes are increased.

In certain respects an increase in payroll taxes would be less satisfactory in the current situation than an increase in income taxes, part of which would be refundable. The proposed payroll tax of 12 per cent would be shared in equal parts by employers and employees. Thus the contribution by employers would be increased from their present level of 4 per cent to 6 per cent and the contribution by employees would go up from 1 per cent to 6 per cent. A 2-point increase in the contribution by employers would, in fact, increase their labor cost by 2 per cent. In many instances this might require an adjustment of price ceilings. There would be no increase in production cost if the additional revenue were obtained in the form of income taxes, collected from the individual taxpayer. A 5-point increase in the contribution by employees would tend to create more hardship in the lowest income groups than would refundable income taxes which would allow for personal exemptions and credits. Therefore it would be more likely to result in a demand for wage adjustments. A broadening of Social Security coverage to agricultural workers and to self-employed, could hardly be accomplished on short notice, thereby lengthening the lag between enactment and administrative application.

In short, it would appear that the inclusion of the Social Security program in the present revenue proposal would lower the chances of obtaining a satisfactory bill without offering advantages which could not be obtained otherwise. But this conclusion in no way reduces the desirability of promoting an expansion of the Social Security program at an early date. If Congressional action on a broadened Social Security Program were obtained in 1944, the increased benefits would become available in time to meet the emergency needs arising in the post-war readjustment period. An increase in income taxes now would provide no obstacle to a broadening of the Social Security Program in 1944. Rather it would facilitate this step since existing taxes could be reduced later on, when the higher payroll taxes go into effect.

The development of the Social Security Program is of vital importance to the nation. It should be considered and adopted on its own merits. Study of the program would require more time, most likely, than would be available to Congress now if new taxes are to become effective by January 1, 1944. The relationship between the financing of Social Security and the requirements of general fiscal policy need be considered most carefully. It appears very doubtful whether the financing of the enlarged program should, even at the outset, rely exclusively upon payroll taxes and not be given some support from the general budget. Payroll taxes as high as 12 per cent might prove a severely depressing factor in the post-war economy, whether the burden were shifted to the employees in the form of lower wages or to the consumers in the form of higher prices. This point should be weighed carefully before adopting a 12 per cent payroll tax which would promise to become a rigid element in the post-war Federal tax structure.

September 6, 1943.

RAE:ed