

FINANCIAL POSITION OF CORPORATIONS IN POST-WAR PERIOD

I. The Facts.

Notwithstanding current arguments for tax relief, indications are that corporations will emerge from the war in a strong financial position. The following figures support this position:

(a) Corporate net income in 1943 is three times that of 1940, -- \$22 billion dollars as against \$7 billion dollars. After taxes corporate net income is still twice that of 1940, -- \$8.7 billion as against \$4.8 billion, -- and higher than it has ever been before. (See Table I.)

(b) Retained corporate income is similarly at a record level. Cumulative retained income since 1939 exceeds \$12 billion dollars and is now running about \$5 billion a year. (See Table II.)

(c) Depreciation reserves are now being accumulated at a rate much in excess of total investment (including plant and inventory). While investment exceeded depreciation allowances for 1940 and 1941, the excess of depreciation allowances over investment in 1942 was \$2.2 billion dollars and for the current year is estimated \$9 billion. If the war continues for several years, the current rate of reserve accumulation will grow into a very large total. (See Table III).

(d) Provisions under the present tax law will help corporations to strengthen their financial position in the post-war period.

(1) Under the Excess Profits Tax, corporations are accumulating reserves in the form of a 10 per cent refund of tax, amounting to about \$1 billion a year.

(2) Under the Corporation Income Tax, corporations are permitted a two-year carry-back and two year carry-forward of net operating losses and under the Excess Profits Tax, the same holds for unused excess profits credit. This relief will, of course, be available only to corporations which suffer a drop in income after the war and which pay taxes during the war, but the total refunds that may be obtained might be very substantial due to the enormous war-time income against which the carry-backs can be made.

On the whole, it appears that the combined effects of the very extensive retention of earnings, accumulation of reserves and possible refunds under present tax provisions will be adequate to provide a very substantial base for post-war expansion and growth.

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## II Policy Conclusions.

If war contracts are settled promptly, particularly if corporations receive liberal advance payments on outstanding contracts, corporations by and large will have sufficient funds to take care of reconversion to civilian production. While this applies to the bulk of corporations, there are likely to be some marginal concerns which did not have large profits during the war period and thus do not benefit from tax carrybacks. Special provisions might be necessary to help such businesses through reconversion loans.

Some corporations will have adequate reserves to take care of reconversion costs, but these reserves may not be in liquid form. Also, claims for tax refunds will not be immediately available. Steps may thus be needed to facilitate rapid liquidation of assets for reconversion purposes.

There is no good case for permitting corporations to accumulate large tax-free reserves for purposes of expansion after the war. Any such provision would simply mean a reduction in corporate tax rates. It would amount to a subsidy paid particularly to high-profit corporations which would be less in need of funds after the war. If corporations want to undertake large and new capital developments in the postwar period, and do not have sufficient funds, it is altogether desirable that they should go to the capital market to obtain funds. This is the more desirable, since investors will have plenty of liquid funds to invest.

A reasonable case can be made for permitting certain costs -- which are incurred in the postwar period but which are really a reflection of wartime production -- to be carried back against wartime income for purposes of computing the final tax burden upon wartime incomes. Costs of this type would be dismissal wages and a part of reconversion costs. It may be considered whether the tax law should be amended to provide for the carryback of such costs.

Financial Resources of Corporations <sup>1/</sup>

(All corporations; billion dollars)

## I. Corporate Net Income Before and After Taxes.

	<u>1940</u>	<u>1941</u>	<u>1942</u>	<u>1943</u>
Net income before taxes	7.3	14.3	20.1	22.2
Income and profits taxes	2.5	7.2	11.8	13.5
Net income after taxes	4.8	7.1	8.3	8.7

## II. Corporate Net Income Before and After Dividends.

	<u>1940</u>	<u>1941</u>	<u>1942</u>	<u>1943</u>
Net income after taxes	4.8	7.1	8.4	8.7
Net dividends paid	4.1	4.5	4.1	4.0
Retained income	.7	2.6	4.3	4.7
Cumulative since 1940	.7	3.3	7.6	12.3

## III. Estimates Business Investment and Depreciation.

	<u>1940</u>	<u>1941</u>	<u>1942</u>	<u>1943</u>
Net investment <sup>2/</sup>	11.1	18.1	8.1	1.4
Depreciation and related reserves	8.2	9.4	10.3	10.4
Excess of depreciation on investment	- 2.9	- 8.7	2.2	9.0

<sup>1/</sup> Source: U. S. Treasury Department.<sup>2/</sup> In plant and inventory.

## LIQUIDITY AND INFLATION IN THE POSTWAR PERIOD

I. Increase in liquidity -- the facts

Partly as an inevitable consequence of war finance, but also partly due to loose fiscal policy during the war, there will be an enormously high level of liquidity in the postwar period.

(1) The interest bearing debt of the U. S. Government, \$55 billion in 1941, is close to \$170 billion now, and will be over \$200 billion at the end of this fiscal year. If the war continues for another fiscal year, it will be around \$270 billion by June 1945. (See Table I.)

(2) So far, much of the increase in the public debt has been taken by banks, -- from June 1941 to June 1943, commercial banks and Federal Reserve Banks took \$37 billion out of a total increase of \$85 billion. Recently, the record in this respect has been somewhat better. Nevertheless, bank purchases have resulted in a vast increase in the total money supply, and will result in substantial further increases. The total money supply in June 1941 was \$73 billion and now is \$102 billion; by the end of this fiscal year, it will exceed \$120 billion, and, if the war continues for another year, may exceed \$140 billion by June 1945. (See Table II.)

(3) The increase in liquidity is not only in the form of cash and deposits, but also in the form of security holdings. A substantial part of the securities held by the public are, in fact, demand obligations which may be redeemed at fixed prices at any time. Other obligations which are nominally not demand obligations actually come close to being so, since under present conditions the Federal Reserve System will probably have to maintain the security market should it threaten to break. Total liquid assets in the hands of the public (deposits, currency and U. S. securities) amounted to \$139 billion in June of this year as against \$60 billion in 1930. (Excluding commercial banks and life insurance companies). The total will be \$190 billion by the end of this fiscal year and may be close to \$250 billion by June 1945, should the war continue that long. Of the total, about one-third is held by business, two-thirds by individuals. (See Table III.)

(4) It is exceedingly difficult to estimate the distribution of liquid holdings by individuals between different income groups. Very roughly, it appears that about one-third to one-half of the total is held by people with incomes of under \$5,000, constituting about 80% of income receivers. If this ratio is correct, these people will hold about \$50 billion by June 1944 out of the estimated total of \$122 billion. (See Table IV.)

## II. Increase in liquidity -- the consequences

The consequences may be for the good or for the bad, but on balance, the increase in liquidity is more likely to prove a liability.

### Desirable consequences:

People will have sizeable funds with which to buy and to finance their backlog demand for semi-durables and durables after the war. Also, the fact that they have accumulated some savings may mean that future net savings out of current income may be less (however, the opposite may happen: people may have acquired a savings habit and continue to save more).

### Undesirable consequences:

(1) There is a danger that people will decide to liquidate their holdings at the wrong time, that is, when insufficient civilian supplies are available. Particularly, there is some danger in this respect in the transition period after the war. If this should happen, people will lose their savings in higher prices and considerable inflation might result.

(2) With a huge volume of public debt outstanding, public policy, most likely, will have to assure that the security market will be maintained. If public holders of securities decide to sell on the net, the Federal Reserve System will have to take up the slack, -- and this might happen at a time when a tightening of the money market would otherwise be desirable.

(3) On the whole, it appears that the large volume of liquid holdings by the public will make the whole economic mechanism more delicate and sensitive to fluctuations. It will be more difficult to maintain a high level of employment since we must be more careful not to risk an inflationary development. We shall be less able to afford making mistakes.

POST WAR LIQUIDITYI. Ownership of U. S. Government Securities <sup>1/</sup>

(In billions of dollars)

	June 30, 1941	June 30, 1943	Estimates	
			June 30, 1944	June 30, 1945
Total Interest-bearing Securities	54.8	139.5	206.1	270.6
U. S. Government Agencies	8.5	14.2	18.7	24.5
Federal Reserve Banks	2.2	7.2	11.2	15.2
Commercial Banks	20.1	52.1	68.1	84.1
Mutual Savings Banks	3.4	5.3	6.8	8.3
Insurance Companies	7.0	12.8	17.3	21.8
Other Investors				
Marketable Securities	9.4	19.4	34.2	47.5
Nonmarketable Securities	4.2	28.4	49.7	69.1

II. Total Money Supply <sup>2/</sup>

(In millions of dollars)

	June 30, 1941	June 30, 1943	June 30, 1944	June 30, 1945
<u>All Banks</u>				
<u>Deposits</u>				
Demand <sup>3/</sup>	37,317	55,952	( 68,000)	( 80,000)
Time	27,879	30,328	( 34,300)	( 38,300)
Total	65,196	86,280	(102,300)	(118,300)
Currency Outside Banks	8,204	15,800	( 19,800)	( 23,800)
Total Money Supply	73,400	102,080	(122,100)	(142,100)

<sup>1/</sup> Estimates by Mr. Piser. Purchases by the Federal Reserve Banks are estimated at \$4 billion dollars each for the fiscal years 1944 and 1945.

<sup>2/</sup> Purchases of U. S. securities by the commercial banks and the Federal Reserve System are estimated at \$20 billion dollars each for the fiscal years 1944 and 1945.

<sup>3/</sup> Excludes float, Government deposits, and interbank deposits.

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### III. Liquid Holdings of Individuals and Businesses <sup>1/</sup>

(In billions of dollars)

	Dec. 1, 1930	June 30, 1943	June 30, 1944	June 30, 1945
Businesses (except insurance) - total	15	53	(71)	(90)
Demand deposits and currency	13	32		
Time deposits	1	1		
U. S. Government securities	1	20		
Individuals - total	44	86	(122)	(158)
Demand deposits and currency	10	28		
Time deposits	26	28		
U. S. Government securities	8	30		

### IV. Distribution of Liquid Holdings by Income Groups <sup>2/</sup>

(In billions of dollars)

	All groups	Estimated Range of Holdings by people with incomes of	
		under \$5,000	over \$5,000
Total individual holdings	86.0	33 - 47	39 - 53.0
Demand deposits	14.5	3 - 6	8.5 - 11.5
Currency	13.5	7 - 11	2.5 - 6.5
Government securities	30.0	8 - 10	20.0 - 22.0
Time deposits	28.0	(15 - 20)	(8.0 - 13.0)

Choosing \$38 billion as the estimated holdings by people with incomes under \$5,000, their share would amount to 43 per cent.

<sup>1/</sup> Estimates for 1944 and 1945 assume \$55 billion dollars borrowed each fiscal year from individuals, non-insurance businesses and banks. On the basis of the past year's experience, one-third of the resulting gross in liquid assets is allocated to businesses and two-thirds to individuals.

<sup>2/</sup> The estimates in this table are extremely speculative and should only be taken as an indication of the general magnitudes of holdings by people with incomes below and above \$5,000. With respect to time deposits, there are no indications at all upon which to base an estimate, so that the figures given in the table are not much more than a guess.

## POSTWAR MANPOWER

At the end of the war, we will have a total labor force of 66 million, 9 million more than in mid-1940.

The labor force increases normally by 700,000 a year, or over 1 per cent.

About 6 million of the <sup>war</sup> increase are extras not normally in the labor force. If these are forced back to school, kitchens, and retirement, we will have 60 million left.

Armed forces will be demobilized fast after Japan is defeated. Probably have about 2.0 in the services one year after victory.

About 20% million will be unemployed for frictional and seasonal reasons, even with full employment.

This leaves a minimum of 56 million jobs to be provided after the war, 8 million more than were employed in July 1940.

Output per manhour for all employed increases 2-3 per cent a year. War stimulus to productivity has been tremendous. Return to peace will find productivity about 20 per cent above 1940.

A return to 1940 production (\$97 billion gross national product) at 1940 hours of work (about 39 for nonagriculture as a whole) with a 20 per cent war stimulated increase in productivity, and 3 million normal increase in labor force would leave 20 million unemployed at end of war.

To obtain full employment, it would require a gross national product of around \$140 billion (at 1940 prices, \$165 billion at 1942 prices) at the end of the war.

The employment pattern indicates the great difficulty of providing full employment by increasing industrial jobs. Service jobs must increase.

	Prewar July 1940	End of War July 1945
	(In millions)	
Civil Employment	48	54
Agriculture	11	12
Industry	16	23
Manufacturing	10	17
Mining	1	1
Construction	2	1
Transportation & Public Utilities	3	4
Service	21	19
Government	4	6
Trade, Finance, Etc.	11	9
Self-Employed & Domestic	6	4



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Agriculture will end the war with a labor surplus. Manufacturing will have to decline substantially. (Automobiles will not employ as ~~much~~ as aircraft.) Mining will not increase. Transportation and public utilities are likely to contract. Construction is only industry which will increase materially.

Government will contract substantially; trade, finance, and service will increase and must. Self-employed and domestics will increase.

## POSTWAR BUSINESS AND FISCAL POLICY

### For the Duration of the War.

Present taxes are estimated to yield \$40 billion in the current fiscal year, as against \$104 billion of expenditures. Higher taxes are imperative in order to (1) assure continued success of the stabilization program (the excess of income payments after personal taxes over available consumer goods is estimated at \$40 billion for the present fiscal year), and (2) to assure a sound postwar economy (if present methods of finance continue, liquid assets in the hands of the public may amount to \$200 billion at the end of the present fiscal year and \$250 billion by June 1945).

Whereas Britain covers one-half of its expenditures by taxes, we cover only about one-third; while the United Kingdom and Canada respectively collect 42 per cent and 36 per cent of their national income in taxes, we are collecting but 32 per cent.

Most of the additional taxes must be collected where the bulk of the purchasing power is found, that is, from taxpayers with incomes of less than \$5,000, and much of it must be collected from taxpayers with incomes of under \$3,000. But this does not establish a case for a general sales tax. (Rather, a sales tax now would induce a tremendous pressure for wage increases.) On the contrary, equity in taxation becomes the more important the lower are the income groups which have to be reached. Exemptions, to be sure, should be lowered, but the principle of granting exemptions should not be discarded. Hence, the general approach must be along the line of the income tax, together with higher excises on non-essential products.

A good part of the additional taxes should be refundable. This is desirable (1) as a matter of equity (refunds should be applied particularly to the lower income groups), and (2) because refundable taxes (or compulsory savings) are much safer from the point of view of inflation control, particularly in the postwar period, than the bonds purchased under the voluntary plan. The latter point is very important. We must begin to place more emphasis on the postwar implications of current war finance. (See special statement on postwar liquidity.)

It goes without saying that the Government should make the utmost effort to avoid wasteful expenditures. At this point, however, it is better to have an all-out war effort, even though this may involve a billion or two of outlays not absolutely essential, than to cut war expenditures drastically and to operate on a, say, \$75 billion -- or 75%!-- war effort!

### The Transition Period.

The problem will depend altogether on how gradually the war terminates, that is, on the length of the Pacific war after Germany is defeated.

Demobilization of military personnel should be gradual if possible. But industrial reconversion to peace time production should be as rapid as possible. Contract cancellation should be speedy, and should be left in the hands of the contracting agencies.

Where necessary, financial assistance will have to be given to expedite reconversion, but by and large, the financial position of corporations will be strong. (See special statement.)

It will be to everyone's interest in the transition period to maintain wartime controls. For industry, a premature relaxation of controls and sharply rising prices would mean an enormous increase in reconversion costs. For labor, a rapid increase in living costs would be equally disastrous. However, industry should not attempt to break wage scales in this period; -- the active support of labor is needed to avoid postwar inflation and industry itself will need high wage rates after reconversion to be able to produce to capacity.

The role of fiscal policy in the transition period will be to cut expenditures rather than taxes. Every effort will have to be made to reduce the deficit to a minimum, so as not to aggravate the inflationary pressure.

#### Postwar Period.

In the postwar period, industry will be faced with a tremendous task. It will have to employ at least 56 million people, that is, 8 million more than were employed in July 1940. As a result of the enormous increase in productivity during the war years, this will mean a gross national product of at least \$160 billion at 1942 prices.

The future of private enterprise will depend on its success in meeting this goal. Policies will be required which in many respects will differ drastically from those accepted in the '20's and '30's:

(1) Industry must show an aggressive spirit of expansion. Individual savings at the indicated level of income are estimated at about \$20 billion, and corporate savings may amount to \$10 to \$12 billion. Depending upon the level of corporate savings, industry will thus have to make investments amounting to \$20 or \$30 billion per year -- a volume vastly in excess of anything experienced in previous peace years. Certainly, industry will not succeed in this task should it continue to retain large portions of its income. More reliance must be placed on equity financing and the bulk of funds not actually spent for investment must be distributed to the stockholders.

If full employment is to be achieved, there will also have to be a vast increase in consumption -- say, \$110 billion as against \$70 billion in 1939 -- much of which will be directed to the services, health, education, etc.

(2) Industry must be flexible and competitive. The technological advance which has been so enormous during the past years must be reflected promptly either in higher wages or lower prices. Vigorous competition must assure the expansion of our economic frontiers and the development of new products. Only if industry lives up to these basic mores of our economic system can it hope to succeed to provide full employment at a level of peacetime production of \$160 billion or more.

(3) The role of fiscal policy in the postwar period will be to encourage full employment under private enterprise.

(a) Taxes will have to be revised to encourage consumer spending and not to discourage enterprise. In particular, we shall have to cut consumption taxes and income taxes paid by the lower income groups which are the bulk of business' customers. We shall have to raise exemptions and again reduce the number of income taxpayers to a smaller group. The corporation income tax should be abolished (with the exception, perhaps, of a small franchise tax) and corporate income should be taxed to the owners of the corporation. However, provision should be made to make it impossible for stockholders to evade individual income taxes through non-distribution of corporate income.

(b) Public expenditures should be economical. If industry does the job of providing full employment, the Government should limit itself to essential expenditures which do not interfere with but strengthen the activity of enterprise. Even under these considerations, however, the Federal Budget in the postwar period may well approach \$20 billion.

(c) Economic freedom requires that no citizen should suffer unnecessary want. To assure this freedom, Social Security should be expanded greatly as proposed under the Wagner Bill. Also, an expansion of Social Security will make it possible for individuals to accumulate less savings and to consume more, thereby assuring a higher level of employment and income.

(d) If industry and government work hand in hand in the task of providing full employment under private

enterprise, they will jointly develop a flexible fiscal policy which in times of need will take up the temporary slack in business activity and at other times apply curbs against inflationary spirals. For such a policy to succeed, it is absolutely essential that the business community should participate and have full confidence in the formulation of fiscal policy.

International Trade.

To take its place in world commerce, the basic task confronting the United States is the maintenance of full employment and a high level of income at home. If this condition is met, Americans will be able to buy abroad, and American industry will be in a position to compete with other countries.