BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date June 23, 1944

To Chairman Eccles

Subject: Treasury Tax Meetings

From Richard A. Musgrave R.A.M.

Early in the week Mr. Shere sent over an outline of discussion topics for the tax group, asking for comments. For your information I am attaching the letter containing my suggestions. I do not think that you will find it necessary to study the outline yourself since it was a tentative draft only.

The first meeting of the group is scheduled for Monday.

June 22, 1944

Mr. Louis Shere,
Assistant Director of Tax Research,
Treasury Department,
Washington, D. C. 25

Dear Mr. Shere:

I enjoyed your outline of discussion topics for the study of postwar taxation and will let you have a few general comments for what they are worth.

There is some difference, of course, between the kind of outline which is most suitable for discussion purposes and the kind of outline most suitable for an eventual report on postwar taxation. I am not quite sure which of the two we have in mind. But in either case, it might be well to concentrate on the most important aspects at the cost, perhaps, of neglecting some of the less essential ones. I wonder whether your outline is not too comprehensive, thereby lacking emphasis on the most important points.

I think that it might be well to divide the study into two parts, Part I to deal with the more or less immediate transition period and Part II with the post-transition problem. This division seems desirable because the issues for these two periods are distinctly different, both with respect to the economic background and with respect to the specific needs of tax policy.

In Part I, dealing with the transition period, it would not be too difficult to set up several models showing how war expenditures and production might taper off from the peak and how the transition to peacetime production might be made. One of the models should allow for a distinctly deflationary situation, thus raising the question at what rate expenditures should be tapered off. On the basis of assumptions regarding the end of the German and Japanese wars, reasonable guesses should be possible for this period. I doubt whether very detailed assumptions with respect to the course of the transition, say by quarters, are necessary for discussing the transition tax problems. Agreement on the general degree of "gradualness" of the transition might suffice.

The main points to be discussed might be (1) the question of the excess profits tax, (2) possible tax adjustments with respect to dismissal wages, reconversion costs, etc., and (3) the timing of the initial reductions in other wartime taxes. Perhaps all of these points could be settled fairly briefly so as to permit main emphasis on the post-transition picture.

Part II of the study which would deal with the post-transition period would, as you suggest, have to be divided into two sections, the first one dealing with the economic background and the objectives of tax policy and the second with the structure of the postwar tax system.

In the first section, I think that it might be better to start out with a firm statement of some principles of postwar tax policy rather than with a forecast of postwar economic conditions. This would have two advantages. First, it would show that the main points with respect to tax revision can be made fairly independently of a precise employment and income forecast. Second, it would avoid basing the program on the validity of a rather speculative estimate. The usual method of postulating a, say, $20 billion budget and a $140 billion income level and then proceeding to set up a tax system which would balance the budget at that "full employment" level, is none too sound. In particular, it seems to imply that if a $140 billion level is reached, this level can be sustained under balanced budget conditions. It will be necessary, to be sure, to make some estimate with respect to expenditures and income and to give an indication of the yield significance of proposed changes. But it might be possible to do this in the second section, in connection with the actual proposals, and for this purpose one or two income models may be set up. In the first section, however, it might be better to emphasize some principles of tax, debt and budget policy. These would show what the policy should be under different sets of conditions, but would not be based on just one forecast of conditions.

In the second section, dealing with the postwar tax structure, I wonder whether it might not be well to concentrate on the two or three main problems leaving the minor ones for later discussion. Problem (1) might be the whole question of coordinating personal and corporate income taxation. Problem (2) might be the impact of taxation on investment, including the discussion of treatment of losses, depreciation and various types of incentive schemes. Problem (3) might be a discussion of the relative weights to be placed upon income versus excises and "high income" versus "low income" taxes, with some statistical analysis of the weight of different taxes upon consumption and savings. Having formulated a policy on these major points, it would then be relatively easy in a concluding part to summarize how the federal tax structure would look at various levels of income.

A study of this sort would imply clearly what kind of tax recommendations the Treasury would want to make depending upon economic developments. But it would not commit the Treasury to an altogether specific program, based upon estimated future developments which might well prove wrong. Since it appears that a statement is to be made well in advance of actual postwar tax legislation, a statement as here suggested might prove more useful than specific advance commitments as proposed in the Baruch report on War and Postwar Adjustment Policies.

Chairman Eccles has just returned to town and I hope to get his ideas in a day or two.

Sincerely yours,

Richard A. Musgrave,
Division of Research and Statistics.

RAM:vmr