

SUMMARY MEMORANDUM, BY M. S. ECCLES, FOR INFORMAL DISCUSSION OF
CURRENT AND POSTWAR PROBLEMS, OCTOBER 26, 1943.

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 necessary (1) to assure continued effectiveness 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 should 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 should be collected from taxpayers with incomes of under \$3,000. But this does not establish a case for a general sales tax. A general sales tax now would induce a tremendous pressure for wage increases. Equity in taxation becomes the more important the lower are the income groups which have to be reached. Exemptions should be lowered, but the principle of granting exemptions should not be discarded. Hence, the general approach should 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.

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 so drastically as to operate on a say, \$75 billion -- or 75% -- war effort.

The Transition Period.

The transition 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. But industrial reconversion to peacetime 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.

It will be to everyone's interest in the transition period to maintain inflation 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 ultimately need high wage rates after reconversion in order to maintain a market for its output.

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 the tremendous task of employing 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 should be placed on equity financing and the bulk of funds not actually spent for investment should 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 should be reflected promptly either in higher wages or lower prices. Vigorous competition should 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 succeed in providing 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 will probably be at least \$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. This will make for a higher level of employment and income than would otherwise be the case because individuals, released from fears of future want, will be disposed to consume more currently.

(d) If industry and government work hand in hand in the task of providing full employment under private enterprise, they can 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. Americans will then be better able to buy abroad, and American industry will accordingly be better able to sell abroad.