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## COMPULSORY SAVINGS

There is a disturbing tendency in some quarters to underestimate the importance of strong fiscal action at this time. One reason would seem to be that, despite a serious and growing inflationary gap for more than a year, no inflationary torrent has yet gushed through it. The explanation of this fortunate but highly unreliable result is that individuals have refrained from spending the full amount of their incomes. They have done so on a scale that is entirely without precedent -- and as a result have immobilized for the time being a huge volume of funds that could have swamped the markets for goods.

This circumstance suggests a fact of crucial importance. The immobilization of those funds is not assured. It remains a matter of discretion with the public. And some day the public can and may well change the pace of its buying.

Considered from this approach, a strong and positive case can and should be made for compulsory savings.

The most common objection to compulsory savings is that voluntary investment by individuals in government securities would tend to be reduced.

The answer rests on the fact that tax increases operate in the same manner, and that voluntary lending is not the primary goal of a fiscal program.

The first aim of a fiscal program is to provide the Treasury with assured sources of revenue by compulsory means -- heretofore, taxes. If it were practicable to do the whole job this way, no one in authority would wish to rely on voluntary contributions. Since that is not practicable, compulsory measures are used in so far as the judgment of Congress and the technique of writing equity into tax legislation permit. Then these measures are supplemented by a sustained effort to absorb additional amounts of private funds through the sale of government securities on a voluntary basis (in order further to reduce the need for the Treasury to rely on bank credit).

Compulsory savings are proposed as part of the business of providing the Treasury with assured funds by compulsory means. By definition, they should take precedence over voluntary lending to the government.

This leads to the most important point, the fact that compulsory savings provide the Treasury with an opportunity to correct at least partially the trend toward the accumulation in private hands of an excessive volume of virtual demand obligations in the form of savings bonds (now about \$26 billion).

Compulsory savings can and should be restricted as to redemption so as to afford the Treasury some measure of discretion in timing repayments. So long as we are committed to the present form of savings bonds for voluntary purchasers, there would be a positive advantage in shifting substantial amounts of private savings into some form of compulsory savings -- thus restricted as to redemption. This point is of tremendous importance in connection with postwar problems.

Prevailing conditions require that a disproportionate amount of purchasing power be drawn away from the lower income brackets. In the face of this necessity, the requirements of equity will be better served if the burden on these groups is coupled with arrangements for repayments after the peak of wartime payrolls has been passed.

A corollary point is that compulsory savings could be arranged so that they could be made available at times when individuals and the economy of the country would be most benefitted.

The attitude of some people toward even the mention of compulsory savings suggests a feeling that there is something positively sinister about the idea. Doubtless, this stems from an instinctive reaction against any association between compulsion and the act of saving -- which some still regard as an entirely voluntary procedure. But the government's systems of unemployment and old age insurance are forms of compulsory savings -- and meet with general approval. Or put it this way: compulsory savings, like taxes, do interfere with the individual's program of voluntary savings -- but they do have the advantage from the taxpayer's point of view that he gets them back -- they are savings.

October 28, 1943.

## SALES TAX VERSUS INCOME TAX

It is agreed that a substantial amount of the additional tax revenue must be drawn from the lower income groups if taxes are to be an effective check to inflation. More specifically, a good part of the additional revenue should be drawn from taxpayers with incomes of \$2,000 or less. But this still leaves open the choice between taxing the low income groups through a sales tax or through an income tax.

### Political Aspects

The sales tax is much more likely to result in demands for higher wages and possibly farm prices. Should this be the case, a sales tax may well result in a net loss rather than gain in the fight for inflation control.

### Equity Aspects

Equity considerations remain important in tax legislation, even in times of war. They become particularly important if, as is the case now, taxes must be collected from the very low income groups. There is as much or more difference between the taxpaying ability of a family with a \$2,000 income and a family with a \$1,000 income than between a family with a \$10,000 income and a family with a \$5,000 income. In the low income groups, personal exemptions are the most important factor in obtaining a fair distribution of the tax burden (progression is more important for the higher income groups). On equity grounds, the income tax, however low the exemption, is thus greatly superior to the sales tax. The smaller a man's income, the heavier is the burden of the sales tax.

### Administrative Aspects

If the income tax approach is taken, it will be necessary to lower exemptions for families to \$1,000, or perhaps even \$800. This would add from 5 to 10 million taxpayers to the 40 million already covered, and would undoubtedly create an administrative burden. However, this burden should not be exaggerated:

1. As the Treasury emphasizes, the retail sales tax by itself creates a most serious administrative burden. It is altogether unlikely that a sales tax could be passed which is sufficiently high to permit a substantial increase in income tax exemptions and thereby offset the administrative burden.
2. The experience with the Victory Tax and with collection at the source has greatly improved our ability to deal with the direct taxation of low incomes. If the income tax applicable to lower income groups were simplified radically, the administrative task would be quite manageable. Surely, it

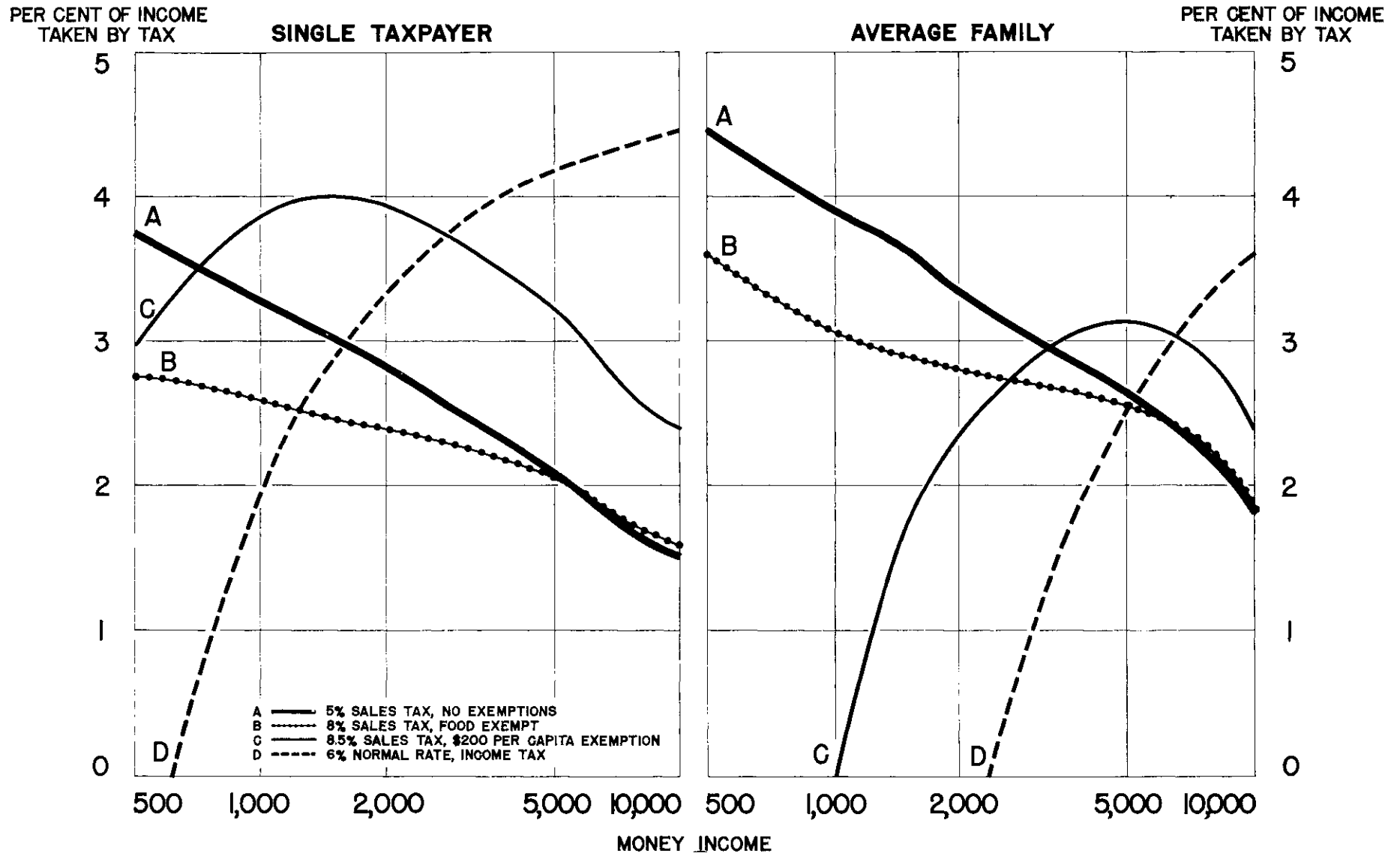
would be less than that of adding a general sales tax to the present income tax.

3. To simplify the income tax, taxpayers with incomes up to perhaps \$2,500 or \$3,000 should be relieved from having to file returns. The tax should be collected on gross income after exemptions and the withholding tables used by the employer should set the final tax.

4. Rather than a general sales tax, we should have sharp increases in many existing excises as well as new excise taxes on broadly consumed but not really essential commodities.

# DISTRIBUTION OF BURDEN BY INCOME GROUPS UNDER ALTERNATE METHODS OF TAXATION

(YIELD: 3 BILLION DOLLARS)



Please substitute these two pages for the  
two pages of statistics on Liquidity which  
you previously received. (Some minor  
changes have been made.)

## POSTWAR LIQUIDITY

I. 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	14.0	19.5
Commercial Banks	20.1	52.1	65.3	74.8
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	49.7
Nonmarketable Securities	4.2	28.4	49.7	72.0

II. Total Money Supply <sup>1/</sup>

(In billions of dollars)

	June 30, 1941	June 30, 1943	June 30, 1944	June 30, 1945
<u>All Banks</u>				
Deposits				
Demand <sup>2/</sup>	37,317	55,952	( 68,000)	( 76,000)
Time	27,879	30,328	( 34,300)	( 37,300)
Total	65,196	86,280	(102,300)	(113,300)
Currency Outside Banks	8,204	15,800	( 19,800)	( 23,800)
Total Money Supply	73,400	102,080	(122,100)	(137,100)

<sup>1/</sup> Purchases of U. S. securities by the commercial banks and the Federal Reserve System are estimated at \$20 billion for the fiscal year 1944 and \$15 billion for 1945.

<sup>2/</sup> Excludes float, U. S. Government deposits, and interbank deposits.



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

(In billions of dollars)

	<u>Dec. 31,</u> <u>1930</u>	<u>June 30,</u> <u>1943</u>	<u>June 30,</u> <u>1944</u>	<u>June 30,</u> <u>1945</u>
Businesses (except insurance) - total	<u>15</u>	<u>53</u>	<u>(78)</u>	<u>(103)</u>
Demand deposits and currency	<u>13</u>	<u>32</u>		
Time deposits	<u>1</u>	<u>1</u>		
U. S. Government securities	<u>1</u>	<u>20</u>		
Individuals - total	<u>44</u>	<u>86</u>	<u>(117)</u>	<u>(147)</u>
Demand deposits and currency	<u>10</u>	<u>28</u>		
Time deposits	<u>26</u>	<u>28</u>		
U. S. Government securities	<u>8</u>	<u>30</u>		

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<sup>1/</sup> All figures are estimated. Businesses include both incorporated and unincorporated concerns. Estimates for 1944 and 1945 assume \$55 billion borrowed each fiscal year from individuals, non-insurance businesses and banks. The resulting gross in liquid assets is allocated to businesses and to individuals, roughly, on the basis of the past year's experience.

October 28, 1943

The Inventory Situation

Inventories, except perhaps in the manufacture of war products, declined somewhat in the last half of 1942 and the first half of 1943, but in recent months seem to have increased a little. Inventories are still large compared with prewar levels, but not large relative to the volume of sales.

Data on Inventory <sup>1/</sup>

(Billion dollars)

	<u>Dec. 1939</u>	<u>June 1942</u>	<u>Dec. 1942</u>	<u>June 1943</u>	<u>Aug. 1943</u>
Manufacturers' Total	10.7	17.2	17.7	17.2	17.6
1. Durable	5.1	9.0	9.7	9.8	9.9
Nondurable	5.6	8.2	8.0	7.4	7.7
2. Raw Materials	4.5	7.9	8.3	8.1	8.2
In process	1.9	4.3	4.8	4.8	4.9
Finished	4.3	5.0	4.6	4.3	4.4
Wholesale	3.5	4.6	4.0	3.9	3.9
Retail Total	5.1	7.5	6.4	5.7	6.1
Department Stores	0.7	1.4	1.0	1.0	0.9
Apparel	0.7	1.1	0.9	0.8	0.9
Other	3.7	5.0	4.5	3.9	4.3

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<sup>1/</sup> Department of Commerce, Bureau of Foreign and Domestic Commerce.

REQUESTS FOR ADDITIONAL TAXATION

Date	Treasury Request ( In billions of dollars )	Presidential Request	Yield of new Legislation	Date of new Legislation
April 1941	3.5		3.6	Sept. 1941
March 1942	7.6		7.0	Oct. 1942
Jan. 1943		16.0	3.0	June 1943
Sept. 1943	10.5		?	?

Figures on internal revenue collections show increases of almost \$6 billion from fiscal 1941 to fiscal 1942, and over \$9 billions from fiscal 1942 to fiscal 1943. Much of the increase was derived from a vastly broadened base of taxation rather than from the legislative increases in rates.

## THE INFLATIONARY GAP

The gross inflationary gap is the amount by which the income which people have left after taxes exceeds available goods and services at present prices. If this excess is saved, no net gap is left, and prices do not rise. Item 5 in Table A shows for the current fiscal year the excess of income that must be saved to avoid a price rise, that is, \$40 billion. Table B shows the forms which these savings might take.

If a part of the excess is not saved but spent, prices will rise to balance available goods with money demand.

Note that the whole "gap approach" refers only to the use of current income and leaves out possible spending from accumulated funds.

A. Use of Income Payments by Individuals \*  
(Billion Dollars)

	<u>Fiscal Year</u>		
	<u>1942</u>	<u>1943</u>	<u>1944</u>
1. <u>Income Payments to Individuals</u>	102.8	129.9	150.0
2. - <u>Personal Taxes</u>	5.7	9.9	20.0
3. <u>Disposable Income</u>	97.1	120.0	130.0
4. - <u>Payments to private industry</u>	80.7	85.9	90.0
5. <u>Personal Savings</u>	16.4	34.1	40.0
Savings as per cent of disposable income	16.9	28.4	30.8

B. Types of Personal Savings \*\*

(Billion Dollars)

Personal savings	16.4	34.1	40.0
A. <u>Applied Savings</u>			
7. Securities	6.2	11.0	(18.0)
8. Savings and Loan Associations	.3	.4	(.5)
9. Private Insurance	2.0	3.0	(3.1)
10. Liquidation of debt	1.1	2.0	(2.0)
Total	9.6	16.4	(23.6)
11. B. <u>Increase in currency and bank deposits held by individuals</u>	4.7	14.7	(13.0)
12. C. <u>Adjustment item</u>	2.1	3.0	(3.4)
Total	16.4	34.1	(40.0)

Table A. \*

Figures for 1942 and 1943 by U. S. Treasury Division of Research and Statistics. Figures for 1944 are estimated.

Item One equals national income plus transfer payments minus corporate savings and employment taxes. (National income equals gross national product minus depreciation reserves and business taxes).

Item Two equals income tax, Victory Tax, estate tax, gift tax, and certain excise taxes.

Item Four includes outlays on residential construction.

Table B. \*\*

Based on S.E.C. estimates for liquid savings. The estimates for 1944 are necessarily rough.

Item Seven includes purchases of United States Government, State and local governments, as well as private securities.

Item Eleven based on S.E.C. estimates and information obtained from Federal Reserve Deposit Survey.

Item Twelve. If the statistics used in Table A and B were entirely comparable, the total of applied savings and increase in currency and deposit holdings should equal total personal savings. The figures do not check completely, partly because of conceptual differences and partly because of differences in statistical sources.