BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 21, 1947

To Chairman Eccles

Subject: Taxes and prices

From Woodlief Thomas

The attached editorial from today's Washington Post seems to me to give about as clear and accurate a statement of the relation of tax reduction and inflation that can be given in so brief a space. It carefully analyzes the relationship of taxes to costs and prices.

The principal point that might be added to this statement on the subject is the one that you made the other day. It can be said that the payment of taxes adds to inflationary pressures under the following set of conditions:

(1) The Government spends the proceeds of taxes and does not use them for debt retirement and, if taxes were lower, would reduce expenditures. and

(2) The taxpayers (a) have to borrow from banks or draw on otherwise idle balances in order to pay the taxes, and (b) if taxes were lower, would either retire debt or hold increased idle balances.

In the present situation, the first requisite is certainly not satisfied because the Government is using its tax receipts to retire debt and, if taxes were lower, debt retirement rather than expenditures would be curtailed. Thus, even though taxpayers may need to borrow or draw upon idle cash balances to pay their taxes, the presumed inflationary effect of those transactions is offset by the deflationary effect of Government debt retirement. It is, moreover, not true that all of the increased taxes are being paid out of idle balances or borrowed. In the majority of cases the high taxes make it necessary for taxpayers to curtail their expenditures, and if taxes were lowered expenditures could be increased. Thus, the arguments that tax reduction would reduce inflationary pressures are altogether specious.

You may be interested also in the attached copy of a letter I have written Aubrey Lanston.

W.T.

Attachments

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